Why Canadian Oil Sands Ltd.’s Dividend Is at Risk; 1 Stock to Buy Instead

Description

For high-dividend yield seekers, **Canadian Oil Sands Ltd.** (TSX:COS) is a very appealing investment, with a 7.91% annual dividend yield. The high yield alone is very attractive, but a further analysis combined with the recent slump in oil prices raise the possibility that Canadian Oil Sands may have to decrease its dividend to maintain its financial position.

High payout ratio

The first metric to analyze to determine if a dividend is sustainable is the payout ratio. In the case of Canadian Oil Sands, the payout ratio is 97% (using second-quarter earnings data), well above the 75% deemed as the cut-off line for what is a sustainable dividend payment. Analyzing the dividend one step further by comparing operating cash flow and dividend payments in the most recent quarter and we find that Canadian Oil Sands puts 70% of its operating cash flow into paying dividends, a very high rate that does not give much wiggle room if the company’s operating cash flow were to decline.

Oil market concerns

A high payout ratio alone is not enough of a reason o determine if a company’s dividend is unsustainable. Perhaps the company has some fundamental reason why it can justify paying out large dividends relative cash flow. It could have a very solid financial position, or maybe it has some new product or line of business on the horizon that will dramatically improve its business.

Unfortunately, for Canadian Oil Sands this is not the case. In fact, the company has a relatively high debt burden and in the first half of the year its operating expenses increased while its production declined. This was even before oil prices really took a dive.

Caution on the horizon

Canadian Oil Sands dividend payout ratio already looks unsustainable through the first half of the year and that was before oil prices really took a dive. If the company sees its cash flow decrease thanks to the lower oil prices, then there is a good chance it will have to reduce its dividend payments or could risk going into debt to pay dividends.

1 stock to consider

If you are looking for the highest dividend yield possible despite the risk, then Canadian Oil Sands could be a good investment for you. But if you would rather invest in a company with a stable dividend, then one of my top picks is **Goldcorp Inc.** (TSX:G)(NYSE:GG). Goldcorp's annual dividend yield is a much more modest 2.70%, but this is actually a high dividend payment for a gold miner, and the dividend is very stable. Goldcorp's current dividend payout ratio is 69.8%, below the key 75% payout ratio level. It puts about 18% of its operating income into funding dividends payments, a very low level, which means that a decline in operating income is not likely to impact dividend payments. In addition, Goldcorp's fundamentals are stellar. The company has a managed to continue to expand production without acquiring much debt, and is well known as *the* low-cost gold producer.

Goldcorp's business is not immune to the recent slump in commodities prices, but the company is in a far better position to weather the storm than Canadian Oil Sands. If I were looking to add a new dividend payer to my portfolio, I would choose Goldcorp over Canadian Oil Sands.

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lklingel