Is Danger Lurking in Enerplus Corp’s 6.7% Dividend?

Description

Enerplus Corp (TSX: ERF)(NYSE: ERF) is a very compelling dividend stock. Dividend yields of 6.7% are rare in the marketplace. In fact, yields that high can often be a sign that danger is lurking and that the dividend is about to be cut. Let’s see if that’s the case at Enerplus by working through a dividend payout ratio analysis.

A look at the numbers

A dividend payout ratio analysis is a simple formula that tells investors how much of a company’s income it’s paying out in dividends. The ratio is earnings per share divided by dividends paid. In stating the obvious, we want to see a company pay out much less than its income with a dividend payout ratio above 50% typically being generous.

Here’s a look at Enerplus’ dividend payout ratio over the past two years.

Quarter	Earnings Per Share	Dividends Declared	Dividend Payout Rati
Q2 14	$ 0.20	$ 0.27	135%
Q1 14	$ 0.20	$ 0.27	135%
Q4 13	$ 0.15	$ 0.27	180%
Q3 13	$ 0.17	$ 0.27	159%
Q2 13	$ 0.19	$ 0.27	142%
Q1 13	$ (0.08)	$ 0.27	N/A
Q4 12	$ 0.17	$ 0.27	159%
Q3 12	$ (0.32)	$ 0.27	N/A

Source: Enerplus Corp press releases

What we see here is that over the past two years, Enerplus has paid out well over 100% of its net income to investors via dividends. That would be a clear warning sign that danger is lurking. However, before we label the company's dividend at risk, we need to take a closer look to see if there is a reason Enerplus is paying out well over 100% of its earnings each quarter.

Drilling down a bit deeper

One thing investors need to keep in mind is that reported net income and earnings per share of an oil and gas producer can be much different from the cash flow the company is pulling in each quarter. Energy companies take heavy non-cash depreciation charges. Further, hedging oil and gas production against exposure to volatile oil and natural gas prices can also eat into earnings but not impact cash flow. This is why we need to take a closer look at the actual fund flows generated by Enerplus.

Here's a look at fund flows and dividends over the past two years.

Quarter	Funds Flow	Cash and Stock Dividends	Payout Ratio
Q2 14	$ 213.2 million	$ 55.2 million	26%
Q1 14	$ 220.5 million	$ 54.9 million	25%
Q4 13	$ 180.7 million	$ 54.7 million	30%
Q3 13	$ 196.2 million	$ 54.4 million	28%
Q2 13	$ 204.7 million	$ 54.0 million	26%
Q1 13	$ 172.6 million	$ 53.8 million	31%

Q4 12	$ 200.4 million	$ 53.6 million	27%
Q3 12	$ 135.0 million	$ 53.4 million	40%

Source: Enerplus Corp press releases

What we see here is an entirely different payout ratio, as Enerplus' funds flow is well above the amount the company needed to pay dividends to investors. Further, up until September of this year Enerplus allowed its investors to be paid in stock instead of cash, which reduced the cash needed to pay the dividend. This is why the dividends actually paid went up over the past two years while the rate on a per share basis stayed the same.

Now, this doesn't mean Enerplus' dividend is completely safe; the company does spend a lot on capital expenses each quarter. In fact, in the second quarter, Enerplus spent $204.4 million in capex, so the company isn't currently funding its spending plan with funds flow but through debt issuance and asset sales. That's something that needs to be monitored, as we'd prefer the company to be at least cash-flow neutral in order to ensure dividend security. However, this isn't an uncommon practice in the energy industry, so it's not necessarily a big sign of danger.

Is there danger ahead?

There doesn't appear to be any danger lurking when it comes to Enerplus' dividend. It's currently paying out just a quarter of its funds flow, which is well within reason. There is, however, a warning sign, and that's the fact that it's still outspending its funds flow when we add in dividends and capex. It's an issue that could become a problem if oil and gas prices stay low for a long period of time, as it will eat into funds flow and possibly put the dividend at risk if the company doesn't make a big cut into its capex spending.

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2. Investing

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Date
2025/08/25
Date Created
2014/11/03
Author
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