



Attention Dividend Investors: Is Canadian Oil Sands Ltd.'s 17.7% Yield Safe?

Description

If you own **Canadian Oil Sands Ltd** (TSX:COS) and count on the company's dividend income, then this might be the most important article you'll ever read.

Here's why: the company's dividend program may now longer be sustainable, and investors who rely on Canadian Oil Sands for income could see their dividend stream dry up.

If you own Canadian Oil Sands, you have to see what this analyst just said

Income investors have long adored Canadian Oil Sands.

The company is the largest partner in Syncrude, one of the biggest energy projects in Canada. Because the firm has no expansion ambitions, almost all of the company's cash flows can be paid out to shareholders. The result: a consistently high single-digit yield.

Success hinged on expensive oil. The Alberta oil sands are the most costly place in the world to extract crude. But as long as oil prices stayed high, the company would always be able to generate enough cash flow to reward shareholders.

At least, that was the theory. The model worked well when oil was above US\$75 per barrel. However, at current prices, the company's payout is no longer sustainable.

That's why last month management cut the dividend. Citing the impact of falling crude prices, the company slashed its quarterly payout by 42% to 20 cents per share. That sent shareholders fleeing.

This cut should not have come as a surprise. In the face of lower oil prices, energy producers need to conserve cash. The scary part is, another dividend cut could be looming.

Last month, **National Bank** issued a warning to investors. In its report, it compiled a list of energy producers that are most likely to cut their dividends. The top concern: Canadian Oil Sands.

"We have already seen one company cut the dividend so far," wrote analyst Kyle Preston in the report,

“but believe there could be more to follow assuming oil prices remain at current levels for an extended period of time.”

In spite of management’s best efforts, the company’s math no longer works. Assuming oil prices at around US\$75 per barrel, Canadian Oil Sands is expected to generate \$0.35 per share in free cash flow next year. However, even after the recent cut, the firm has pledged to pay investors \$0.80 per share in dividends annually.

If that wasn’t bad enough, business continues to get worse. Oil prices show no signs of bottoming, trading at around US\$48 per barrel at the time of this writing. And last month, the company announced an outage at the Syncrude sour water treater. Management now expects oil output will come in well below their original guidance for the year.

How safe is your income from a dividend cut?

All of this means the business will be generating much less cash than expected. The bottom line, if energy prices don’t rebound soon, Canadian Oil Sands will be forced to cut its dividend once again. That could send the company’s income-focused shareholders running for the exits.

That is, if they haven’t bailed already.

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