



2 Factors That Could Drive Canadian Oil Sands Ltd.'s Dividend Higher

Description

Canadian Oil Sands Ltd. (TSX:COS) shareholders have been recently dealing a quarterly dividend of \$0.05 per share—the lowest quarterly dividend in the company's history. At \$0.20 per share annually, the dividend produces a yield of only 2%, which also happens to represent the lowest yield in the company's history.

Currently, Canadian Oil Sands only pays out approximately 24% of its estimated 2015 cash flow, which is significantly lower than usual; the company typically pays out around 50%. All these factors point to a dividend that could potentially increase, and for Canadian Oil Sands shareholders, this is a key concern given the fact that the company's high dividend was a key draw for investors and a means of offsetting some of the risk associated with its high correlation to oil prices.

Of course, it is important to not forget why the dividend was cut to begin with—the plunge in oil prices resulted in the previous \$679 million annual dividend exceeding cash flow. Since January, however, conditions have been improving for Canadian Oil Sands, which could have a positive effect on the dividend.

1. Oil pricing is improving

Ultimately, the key driver behind Canadian Oil Sands's dividend is the price of oil. The company's cash flows are incredibly tied to oil prices, and the company estimates that a \$10 change in WTI prices would lead to a 70% increase in cash flow. While WTI prices were around US\$47 per barrel when Canadian Oil Sands slashed their dividend 75%, they are now \$10 higher at about US\$57 per barrel.

Canadian Oil Sands is anticipating \$407 million in cash flow for 2015, and this based off a 2015 price of US\$55 per barrel. With prices hovering between \$55 and \$61 since mid-April, Canadian Oil Sands can expect higher cash flows if prices maintain.

Even more important than WTI prices are synthetic crude prices. Canadian Oil Sands sells synthetic crude produced from its upgraders, and receives payment in Canadian dollars. Synthetic crude has been trading at a fairly large discount to WTI, but this gap has been steadily closing, with synthetic crude even trading at a premium to WTI earlier in the year thanks to increasing pipeline access to gulf

coast and mid-west refineries.

The end result is that while Canadian Oil Sands is estimating a \$4 discount to WTI in their 2015 guidance, the current discount is only \$0.50. With WTI prices higher than estimated, the WTI-synthetic crude discount smaller than anticipated, and the Canadian dollar weaker than estimated by the guidance report (\$0.79 CAD:USD exchange rate as opposed to \$0.82 in the guidance report), Canadian Oil Sands should see much more cash flow than planned if things don't change.

At current levels Canadian Oil Sands would receive \$701 million of cash flow from operations as opposed to the \$407 million estimated in the guidance report. This would give the company's \$100 million annual dividend plenty of room to increase.

2. Canadian Oil Sands is reducing costs.

Falling operating and capital expenditures should reduce total expenses and free up even more cash flow for the company to use to fund its dividend. The company recently completed its four major capital projects, including the major Mildred Lake Mine train replacement project. The company is now only expecting \$429 million in capital expenses for 2015, down from \$1 billion in 2014.

In addition, the company should see operating costs fall as well. All four of the company's major projects were geared towards improving reliability and reducing maintenance costs. The company recently posted extremely low operating costs per barrel of \$35.71 per barrel, significantly lower than the \$39.48 being estimated for 2015 by the guidance report.

These reductions are due to lower maintenance costs, lower natural gas prices, and also to higher production thanks to better reliability. Lower costs should free up even more cash flow to potentially boost the dividend.

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