



Does Whitecap Resources Inc. Need Higher Oil Prices to Survive?

Description

Nearly every Canadian energy producer is under pressure to lower costs in an attempt to mitigate losses from collapsing oil prices. Before the crash, shares of **Whitecap Resources Inc.** ([TSX:WCP](#)) were doing quite well and were up over 250% between early 2011 and late 2014. From its highs, however, shares have gone on to lose over 60% of its value. This week, Whitecap Resources was forced to slash its capital budget by more than half to only \$70 million. Still, earnings remain negative.

If oil prices remain depressed, many operators will find themselves incapable of survival, no matter how deep budgets are cut. Where does oil need to be for Whitecap Resources to survive?

Optimism abound

For its part, Whitecap Resources seems to be fairly bullish on oil prices. Its 2016 forecast, released this month, calls for gradually rising oil prices throughout the year. The company expects \$40 a barrel oil in the first quarter, \$45 by the second quarter, and \$50 in the second half of this year. With current prices below \$27 a barrel, this optimism may prove unfounded.

Fortunately, even without \$50 oil, Whitecap Resources can still break even this year. On a cash flow basis (not GAAP earnings), the company could actually survive all the way down to \$35 a barrel oil. At that price, Whitecap Resources would still generate positive free cash flow, even after \$70 million in capital expenditures and \$143 million in dividend payments. Still, oil would have to advance almost 30% to reach \$35 a barrel.

Room for more dividend cuts

While income investors may not welcome this move, Whitecap Resources has plenty of flexibility in lowering its outsized dividend. At an annualized rate of \$0.75 a share, investors are now getting a yield of nearly 11%. This month the company reaffirmed its payment. It said, however, that it “will reevaluate the dividend on a quarterly basis.”

If oil prices don't improve according to its optimistic forecast, a cut shouldn't be too far off. This would save the company over \$200 million a year at a time when the rest of the business is generating

losses. The simple fix of slashing the dividend will likely prove too tempting.

To survive is not to thrive

For now, it looks like Whitecap won't have a problem navigating low oil prices, even if they persist for another year or two. The company's asset base is fairly high quality, meaning it can continue production levels without too many added costs. Additionally, it has plenty of options—such as lowering its dividend—to create substantial financial flexibility.

While these positives ensure that Whitecap Resources will live to see 2017 and beyond, it doesn't mean the stock's slide will reverse any time soon. Shares are likely to feel additional pressure as its legacy hedges roll off and as management adjusts to even lower prices. If a dividend cut occurs (a high probability), income investors will most likely become sellers, adding even more pressure.

Unless you agree with management's estimates for \$50 oil this year, energy investors may be better off elsewhere.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

1. TSX:WCP (Whitecap Resources Inc.)

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