Gibson Energy Inc.'s 7.4% Dividend: Is it Safe?

Description

Dividends are a great way to collect recurring income, but the danger is sometimes the rate may seem too good to be true. Generally, anytime you see a dividend over 5%, you should look into the company's financials to assess the likelihood of the payout continuing.

In some cases, the stock may have declined in price, which is inversely related to the dividend yield (assuming it remains unchanged). However, if the company's stock price has dropped, and it is because profits are decreasing or a result of other issues that could impact future profitability, then it might be a sign that a dividend cut might not be too far away.

Gibson Energy Inc. (TSX:GEI) doesn't have a long history of paying dividends and has only been listed on the TSX since 2011. During that time, the company has increased its dividend often and has yet to cut it. However, sales in the past two years have declined by 46%, and the company's bottom line has been in the negative the past two years as well, accumulating over $440 million in losses during that time.

If we look at profitability, there are some serious concerns for the oil and gas service provider, and perhaps that should be no surprise given how the price of oil has declined in the past few years. However, the tide may be turning. In its most recent quarter, the company saw revenues rise by 35%, while profits, although still in the red, have improved significantly and are near breakeven.

The problem with looking at net income is that it includes many non-cash items that could make the company's potential to pay its dividend look worse than it really is. Another way to assess Gibson's ability to maintain its dividend is by looking at its cash flow, and that's where it really counts.

Cash flow issues

In the past 12 months, the company has paid $187 million in dividends, and with just $206 million in cash flows from operations, Gibson would have enough for its payouts if it had no capital expenditures or other cash needs. Unfortunately, that is rarely the case, and the company's free cash flow was only $19 million in the last 12 months. In the previous fiscal year, free cash flow was in the negative, and so there are real concerns the company is not bringing in enough cash to be able to continue to pay its dividend at this rate.

Gibson evaluates its dividend payouts as a percentage of the company's distributable cash flow from continuing operations, where it backs out line items such as non-recurring expenses, interest, and capital replacements and upgrades from its cash flow from continuing operations. The company calculated its distributable cash for the past 12 months as being $162 million, which is still short of the dividends the company paid during that time. However, the company has made no mention of any cut to its dividend — yet.

Bottom line

Gibson is clearly running into issues, and the company's cash has dropped almost 80% in just one year. If the situation does not improve quickly for Gibson, it won't be a matter of if a dividend cut will happen — only when. If you are looking for quality dividend stocks in oil and gas, you might be better off looking at **Enbridge Inc.** or **Inter Pipeline Ltd**.

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