Is a Dividend Cut Looming for This Energy Stock Yielding 7%?

Description

Whitecap Resources (TSX:WCP) was one of the few Canadian upstream oil producers to continue paying a dividend after oil collapsed in 2015. While it has cut its dividend since the slump began, it is still yielding a very juicy 7%. It is this yield combined with the ongoing headwinds and uncertainty facing crude which has sparked considerable conjecture that a dividend cut will occur.

Softer oil and a weaker bottom line

The reason for this becomes clear when it is considered that Whitecap's dividend has a payout ratio of over 670% of its trailing 12-month net income. In fact, Whitecap has reported a net loss for four out of the last eight quarters, which can be attributed to sharply weaker crude. That does not provide a great deal of assurance that the dividend is sustainable at current levels, particularly if oil weakens further.

Nonetheless, the dividend-payout ratio as a function of 12-month trailing funds from operations (FFO) comes to a very low 20%, indicating that the dividend is sustainable.

A further indication that the dividend can be maintained is in Whitecap's 2019 guidance. At an assumed average price for WTI of US$63 per barrel, the driller expects to generate FFO of $726 million with a total payout ratio of 81%, after accounting for development capital and dividends. If WTI weakens further and only averages US$53 a barrel during 2019, Whitecap will produce FFO of $622 million with a total payout ratio of 95%.

In both scenarios, Whitecap expects to be free funds flow positive, generating $137 million and $33 million, respectively. This indicates that the dividend is secure, even if WTI does weaken further, which is likely because of trade war fears and the potential for supply to expand.

Even when WTI slid under US$50 a barrel in 2016 and 2017, Whitecap maintained its dividend.

Furthermore, debt by the end of 2019 is projected to be between 1.3 times and 1.9 times FFO, respectively. That is very manageable, highlighting the strength of Whitecap's balance sheet and that it possesses considerable financial flexibility, further indicating that the dividend can be maintained.

If oil collapses once again and WTI plunges below US$50 a barrel, Whitecap can boost FFO by cutting capital spending, which — along with Whitecap's sound balance sheet — provides it with further short-term financial flexibility.

Whitecap has also established a hedging strategy to mitigate the impact of weaker crude on its financial performance. For 2019, 45% of the driller's production is hedged with an average floor price of $71.70, whereas for 2020, 12% is hedged with an average floor price of $68.92. This essentially protects a portion of Whitecap's funds flow, bolstering the dividend's short-term sustainability.

Putting it together for investors

Whitecap's high-quality assets, solid netbacks (which, for the first quarter, were $29.32 per barrel), and financial flexibility make it an attractive means of playing higher crude. While the company's weak bottom line coupled with softer oil make it appear that its dividend — yielding a juicy 7% — is under threat, robust FFO and Whitecap's oil hedges will protect it for at least the foreseeable future. For these reasons, Whitecap is an attractive bet on higher crude.

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Date
2025/08/20
Date Created
2019/06/03
Author
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