# Is Whitecap Resources's (TSX:WCP) Monster 8% Yield Safe?

## Description

The energy patch has fallen into disfavour with investors and even the latest oil rally, which sees West Texas Intermediate (WTI) trading at over US$60 a barrel, has done little to lift Canadian energy stocks. One upstream intermediate producer that has been attracting considerable attention is **Whitecap Resources** (TSX:WCP). It has only gained a modest 3% since the start of 2019 compared to oil's 30%.



The driller, however, because its stock has failed to recover, is sporting a very juicy 8% dividend yield. The size of the yield has sparked considerable speculation among market pundits that the dividend is not sustainable and a cut may be looming. This is despite Whitecap hiking its monthly dividend by 5.6% at the end of the first quarter 2019.

Let's take a closer look at whether the dividend truly is under threat and whether Whitecap should trim the payment.

## Is the dividend sustainable?

A traditional measure of dividend sustainability is its payout ratio as a proportion of net income. When applying this measure, the payment has a trailing 12-month payout ratio of 640% on a diluted basis, indicating that it is clearly unsustainable, and that Whitecap should essentially eliminate the dividend.

However, this is not the only means to measure the sustainability of a dividend and may not be the most appropriate because of the capital-intensive nature of the oil industry.

A better means of testing sustainability is to find the payout ratio as a function of funds from operation (FFO). On a trailing 12-month and diluted-per-share basis, the dividend represents a mere 19% of Whitecap's FFO, illustrating that it is indeed sustainable.

If we turn to the driller's full-year 2019 guidance, where it predicts FFO of $1.66 per share diluted and allows for the recent dividend hike (the annual dividend is $0.342), the payout ratio should settle at around 21% of FFO. This is based on WTI averaging US$60 a barrel over the course of 2019 and illustrates that the dividend can be maintained. Should WTI weaken again and average US$55 a barrel, FFO will fall to $1.55 per share diluted, which equates to a payout ratio rising only slightly to a very sustainable 22%.

Whitecap has also established hedges to provide a price floor for 42% of its second-half 2019 production. Those hedges, along with considerable liquidity totalling $570 million and the ability to dial down capital spending as required, further enhances the sustainability of Whitecap's dividend.

## Why buy now?

What makes the driller an even more compelling buy is that its copious oil reserves totalling 423 million barrels net after royalties have an after-tax net asset value (NAV) of $9.98 per share, which is more than double its current market value. That underscores the considerable upside available to investors should oil rally for a sustained period, and when oil finally recovers, Whitecap could double or more in value. While they wait for that to occur, they will profit from Whitecap's sustainable dividend yielding a monster 8%, which is a more than adequate reward for the risk associated with investing in the upstream oil producer.

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