Are These 3 Succulent Energy Dividends Safe?

Description

It hasn't been a good three months for Canada's energy sector.

On May 1, the **iShares S&P/TSX Capped Energy Index ETF** was narrowly above $10 per share. By August 1, the value of Canada's largest energy ETF had fallen all the way to $8.40 per share, which is just a hair above its 52-week low. That's a decline of more than 15% in just one quarter.

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So what happened? Much of the recent weakness in Canadian oil stocks has to do with the price of the commodity. WTI Crude, the North American benchmark price, is down approximately 10% over the last three months.

Western Canadian Select, the benchmark price for Canadian heavy oil, has done a little better, falling just 6% during the same period.

Pipeline issues haven't helped either. Yes, the path has been cleared to start construction on the Trans Mountain Pipeline expansion, but other pipeline proposals are being delayed. Alberta's crude isn't much use if it can't be transported around the country.

With this in mind, let's take a closer look at some of Canada's top dividend-paying energy stocks and see if they can afford their generous dividends going forward.

Vermilion Energy

Just a few weeks ago, **Vermilion Energy Inc.'s** (TSX:VET)(NYSE:VET) CEO went on *Business News Network* and declared his company's dividend safe.

The market doesn't seem to agree; shares are down significantly since Anthony Marino made his appearance, pushing the yield up to 11.7%.

The good news is that Vermilion generates around half of its earnings from operations in Europe and Australia — areas with better fundamentals than North America. These are long life assets that don't require much spending to slowly grow production.

North American operations are a different story, however. Vermilion plans to spend $530 million in capital expenditures in 2019; $353 million will be spent expanding operations in North America.

While operations in Canada and the United States are good assets, they're the most vulnerable to weaker crude prices.

Vermilion still estimates that it will generate $400 million in free cash flow in 2019. Unfortunately, its dividend is also approximately $400 million, which gives it a payout ratio of 100%, which is never really sustainable over the long term.

Whitecap Resources

I recently highlighted **Whitecap Resources Inc.** (TSX:WCP) as a company that's at risk of cutting its dividend.

The company disagrees with my assessment, pointing out to investors it has high-quality assets that offer solid net backs, a hedging program that has locked in good prices for 40% of 2019's remaining production, and a strong balance sheet.

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The company has no major debt coming due until 2023, giving it plenty of time to weather this current storm.

Another good sign for the dividend is that the company has raised the payout for three years in a row. The current payout is $0.0285 per share each month, which is good enough for an 8.1% yield.

If crude remains at US$55 per barrel, Whitecap will generate $753 million in funds flow in 2019. Subtract $400 million in maintenance capital expenditures and we get free cash flow of $353 million. The dividend is a mere $141 million, giving us — at least on the surface — a low payout ratio.

But investors must remember growth capex. Once we add in that number, the payout ratio jumps to above 80%. That's still sustainable, but that puts it into risky territory.

Husky Energy

Husky Energy Inc. (TSX:HSE) has quietly turned into a free cash flow monster, and nobody seems to be paying attention.

The company has had nice success bringing costs from its oil sands operations down, as well as improving its balance sheet.

Management told investors during a recent presentation that the company is forecast to generate approximately $800 million in free cash flow in 2019, with that number increasing to $1 billion in 2020.

Husky pays out a 4.8% dividend, which works out to approximately $500 million annually going out the door. This gives the company a payout ratio in the 60% range, which is much more sustainable thanthe other two dividends on this list.

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1. NYSE:VET (Vermilion Energy)
2. TSX:VET (Vermilion Energy Inc.)
3. TSX:WCP (Whitecap Resources Inc.)

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