Will This Natural Gas Driller Cut its Dividend Yielding a Monster 9%?

Description

Upstream oil and natural gas producer **ARC Resources** (TSX:ARX) has seen its market value plunged by a whopping 23% since the start of 2019, leaving it with a very juicy dividend yield of 9%. This has sparked fears that the dividend is not sustainable, particularly in the current difficult operating environment where the long-term outlook for natural gas remains poor.

Poor outlook for natural gas

The fossil fuel has rallied over the last two weeks to only be down by 6% since the start of 2019, generating considerable optimism that natural gas will recover over coming months as we head into winter.

Nonetheless, this is shaping to be the usual seasonal spike, driven by greater demand for heating, leading to higher consumption of the fuel, and it will do little to drive natural gas higher over the long term regardless of growing consumption. This is because global natural gas supplies are growing at a furious clip.

The U.S. alone has seen its output expand exponentially over the last decade, seeing it overtake Russia to be the world's largest natural gas producer. This was driven by the shale oil boom, which, because of ever-improving technology and drilling techniques, saw the U.S. oil industry capable of exploiting the country's considerable unconventional hydrocarbon potential. Global natural gas production continues to soar at a rate that has seen supply overtake demand growth, which is weighing heavily on natural gas prices and the long-term outlook for the fuel.

There is considerable concern that this will weigh on the financial performance of many natural gas producers, including ARC, forcing them to cut their dividends.

Solid results

ARC is focused on natural gas exploration and production in the Montney, where it has 770,000 net acres. The driller reported some solid second-quarter 2019 results, including net income of $94 million compared to a loss of $55 million for the previous quarter and $46 million a year earlier.

That can be attributed to ARC's oil and natural gas output growing by 6% year over year, including a notable expansion of higher-value condensate production. That — along with ARC generating strong funds from operations, despite the difficult operating environment — bodes well for the sustainability of the driller's dividend.

A traditional measure for determining whether a dividend is sustainable is a company's dividend-payout ratio. This is calculated by determining what proportion of net income is paid out to investors. ARC's trailing 12-month dividend is equivalent to 86% of its earnings per share, indicating that the payment can be maintained.

Typically, when considering dividend sustainability for an energy stock, the payout ratio as a function of funds from operations (FFO) is a superior measure. This is because net income includes a range of non-cash deductions, meaning that FFO is a more accurate representation of the amount of cash flow a driller can generate. When using this methodology, ARC's payout ratio falls to a very conservative and sustainable 38%.

Foolish takeaway

Natural gas's latest rally coupled with firmer oil and ARC's focus on boosting higher value condensate production will boost earnings and FFO, further ensuring that it can maintain its dividend for the foreseeable future. This makes now the time to buy and lock in a juicy yield of 9%.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

1. TSX:ARX (ARC Resources Ltd.)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Dividend Stocks
2. Energy Stocks
3. Investing

Date

2025/08/21
Date Created
2019/11/10
Author
mattdsmith