Profit From Higher Oil With This Driller Yielding 6%

Description

Tensions in the Middle East, most notably between Iran and the U.S. continue to rise in the wake of recent U.S. airstrikes. This has sparked yet another oil rally that saw the international benchmark Brent briefly hit US$70 per barrel for the first time since May 2019, breathing renewed hope into Canada's beaten-down energy patch.

While Brent has gained a whopping 21% over the last year, many energy stocks have failed to keep pace.

One stock, which I have been bullish on despite the market marking it down heavily, is **Whitecap Resources** (TSX:WCP). The company has rallied significantly to see it up by almost 20% over the last year, and there is still considerable upside ahead. Even after that solid rally, Whitecap still sports a 6% dividend yield, thereby enhancing its attractiveness as a play on higher crude.

Quality assets

The driller's strengths lie in its high-quality light and medium oil acreage, which has relatively low decline rates, thus reducing the amount of investment in development drilling required to sustain production.

That acreage gives Whitecap proven and probable oil reserves of 489 million barrels, which, before-tax and after the application of a 10% discount rate, have been determined to have a net present value (NPV) of $6.7 billion.

After deducting taxes, long-term debt and leases, decommissioning liabilities and deferred tax obligations Whitecap has a net asset value (NAV) of $6.94 per share, almost 24% greater than its current market price.

This indicates that there is considerable upside ahead for shareholders, particularly given that development drilling conducted during 2019 will see the volume of Whitecap's oil reserves expand.

While higher oil certainly bodes well for Whitecap's outlook, its focus on strengthening its balance sheet and preserving cash flows during 2019 has enhanced its financial flexibility. This means that it can endure a pullback in oil prices, which could occur once the latest round of Middle East tensions ease, and sustain its dividend.

Dividend sustainability

Contrary to the claims of some pundits, Whitecap's dividend is sustainable. The driller projected that it will have a total payout ratio of 76% and free cash flow of $305 million for 2020 if the North American benchmark West Texas Intermediate (WTI) averages US$57 per barrel, which is around 10% lower than the current spot price.

Even if oil falls sharply once geopolitical tensions ease, with some industry analysts predicting another price collapse in 2020, the dividend is covered even if WTI falls to as low as US$45 per barrel.

Foolish takeaway

Whitecap is one of the top plays on higher oil in Canada's energy patch. Its focus on light and medium oil production — which means it isn't impacted by the discount applied to Canadian heavy crude, stronger balance sheet and firmer oil — will drive earnings higher over the course of 2020.

That will ultimately cause Whitecap's stock to appreciate. While patient investors wait for that to occur, they will be rewarded by its sustainable dividend yielding a very juicy 6%.

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