Oil Stocks: Expect More Dividend Cuts

Description

Oil stocks just can't catch a break. The news of a price war on oil has sent the price of the Brent and West Texas Intermediate crashing. Over the weekend, the price of crude touched a low of $27.34, losing more than 20% of its value. This is bad news for income investors, as it indicates that dividend cuts may soon be coming.

It's an unwelcome headwind for a sector that has been decimated. Oil stocks are trading at valuations not seen in over a decade. Last week, **Vermilion Energy** (TSX:VET)(NYSE:VET) announced a 50% cut to the dividend. Unfortunately, many investors were caught off guard despite the fact Vermilion was yielding around 16%.

Let this be a lesson to investors chasing yield — a yield that high is simply not good business practice. Bulls pointed to comments made by the CEO which supported the dividend. However, it proved to be nothing more than false promises. Just because the company says the dividend is safe, doesn't mean it is.

The dividend cut came before the current price war. Vermilion CEO cited COVID-19 as the main reason why the move was made. The coronavirus had pressured oil prices, giving Vermilion a way out.

On the day, Vermilion's stock price lost almost 10% of its value. As of writing, it was trading down 23.25% in pre-market on Monday.

Should the price of oil remain around $30 a barrel for a significant period, investors can expect another divided cut by Vermilion. They won't be alone. Most North American oil producers have cited $45 per barrel as a breaking point. That price is certain to lead to bankruptcies and cash conservation strategies for many oil stocks.

Two oil stocks to watch

With that in mind, investors should keep a close eye on **Arc Resources** (TSX:ARX). In late January, I estimated Arc's 8.4% dividend was relatively safe.

My conclusion was based on its low leverage, increased production and lower capital expenditure requirements for 2020. Since my article, Arc has lost another 22% and is trading at levels not witnessed since the late 90s.

Now yielding 9.90%, Arc Resources will be taking a closer look at making a dividend cut. A cut would not be uncharted territory for this mid-cap producer. The company also cut the dividend in 2016, when the price of natural gas hit record lows.

With this recent news, it is now facing a bearish market for both natural gas and crude oil. Natural gas and crude oil accounts for 74% and 21% of production. Can it sustain the dividend in a low price environment? Perhaps, but is it good business practice? Likely not.

Whitecap Resources (TSX:WCP) is another oil stock whose dividend yield doesn't look sustainable over the long term. As of writing, Whitecap currently yield's 9.02% and is likely to jump into the double digits given the price war.

Bulls will argue that Whitecap's dividend is well covered by free cash flow. Although true, it's dependent on current oil prices and the company's debt profile is far from stellar.

In fact, it has a poor current ratio of 0.83 and its interest coverage ratio is only 2.73, which means that the company's ability to service its debt is weak.

In a low price environment something will have to give; a more than 20% hit to the price of oil will impact the company's cash position and the dividend coverage ratio.

Given this, Whitecap would be best served making a dividend cut and paying down its more than $1.26 billion in debt.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

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

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred

4. Sharewise
5. Yahoo CA

Category

1. Dividend Stocks
2. Energy Stocks
3. Investing

Date
2025/06/30
Date Created
2020/03/10
Author
mlitalien