Is This 7% Yield Too Good to Be True?

Description

Over the past five years, no form of investing has gained popularity as much as dividend investing. The main reason for this is record-low interest rates, which have pushed down bond yields, making dividend-paying companies an enticing substitute. As the baby boomers enter retirement, and need a steady stream of income from their savings, so-called dividend stocks will likely remain popular for a long time.

There is one stock in particular whose 7% yield has become very popular among dividend investors: **Crescent Point Energy** (TSX:CPG)(NYSE:CPG). In today's environment, where a high yield is so hard to come by, it would be natural to assume there must be some catch. And that reaction would be spot on.

It is normal for a company to have a dividend reinvestment plan (DRIP), in which an investor can choose to automatically use his dividend to buy more shares of the company. But Crescent Point takes that a step further – investors can use their dividend to buy shares at a 5% discount to the market price. In other words, if you're willing to take more shares rather than cash, you get a 5% bonus from the company.

Crescent Point's most recent filing tells the story. In the first three quarters of 2013, the company declared over $800 million in dividends ($0.23 per share per month). But less than a third of that amount was actually paid out in cash. Crescent Point is not trying to hide this at all; the company has dedicated a section of its investor relations website to explain the DRIP in great detail. After all, the more investors enroll in the DRIP, the less cash the company has to pay to shareholders, which frees up cash to expand production.

The investors who elect to receive shares are getting a great deal. But who pays for such a benefit? Quite simply, it's the shareholders who elect to receive their dividend in cash. While they do get to enjoy their cash dividend, their share of the company slowly dwindles.

Crescent Point is not the only company that does this. **Penn West's** (TSX:PWT)(NYSE:PWE) DRIP also comes with a 5% discount on new shares. Last year, **Encana Corp** (TSX:ECA)(NYSE:ECA) amended its DRIP, putting in a 2% discount for shareholders that opt in. But Crescent Point, with its 7% yield, takes the concept to a new level.

Crescent Point is aggressively expanding production, particularly in the Bakken region (North Dakota and Southeastern Saskatchewan), and has had a lot of success recently. People who believe in the company's strategy, and think the shares are underpriced, should definitely become investors. But if they do, they should also enroll in the DRIP and take advantage of the 5% discount.

Dividend investors looking for a steady stream of income should probably look elsewhere.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:VRN (Veren)
2. TSX:VRN (Veren Inc.)

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Date
2025/07/27
Date Created
2014/02/13
Author
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