3 Monster Dividend Yields From the Patch

Description

Income-hungry investors needn't look any further than Canada's oil patch for monster dividend yields in excess of 7%. But despite these compelling and very attractive yields, dividend investors need to dig deeper to determine whether they are truly sustainable. So let's take a closer look at three big dividend yields from the patch to determine whether they are a worthy addition to any income-focused portfolio.

This junior oil explorer and producer continues to surge ahead
Small-cap oil producer **Surge Energy's** (TSX: SGY) share price continues to rocket ahead, up by a massive 123% over the last year alone. But even more intriguing is the company's monster 8% dividend yield.

On first impressions this dividend appears unsustainable when the dividend payout ratio is calculated using the traditional methodology of annual dividend paid divided by net income. This is because for the full year 2013, Surge reported a net loss of $9.9 million. But when operational cash flow is substituted for net income, the payout ratio becomes a very sustainable 17%.

Even more reassuring for investors is that there are a number of catalysts which will boost Surge's performance for the foreseeable future. The key is strong production growth, which for 2014 alone is expected to jump a whopping 42% in comparison to 2013, in an environment where crude prices remain above $100 per barrel. This augurs well for further cash flow growth and underpins the sustainability of this tasty yield.

Management also indicated they are confident the monthly dividend is sustainable, recently boosting it by almost 4% for all dividends paid from March 2014 onwards, based on their positive expectations of the company's future performance.

Another small-cap oil explorer and producer with a monster yield
Oil explorer and producer **Twin Butte Energy** (TSX: TBE) is focused exclusively on heavy oil production in the Lloydminster region and medium oil in the Provost region in Canada. Like Surge it pays a monthly dividend with a tasty yield of just over 8% and has been doing so since January 2012.

Furthermore like Surge on initial appearances its dividend appears unsustainable, with the company reporting a full-year 2013 net loss of $115.6 million. But when operating cash flow replaces net income when calculating the payout ratio, it becomes a sustainable 38%.

Twin Butte is focused on boosting oil production and in 2014 expects it to grow a healthy 28% in comparison to 2013. The company also anticipates cash flow for the same period will shoot up by at least 68% in comparison to 2013 to $210 million. In conjunction with net debt of only $361.6 million, that leaves Twin Butte well positioned to continue meeting dividend payments while financing its $145 million 2014 capital program.

A troubled intermediate oil producer which continues to pay a colossal yield
It wasn't long ago that troubled intermediate oil explorer and producer **Lightstream Resources** (TSX: LTS) slashed its monthly dividend by 50% to $0.04 per share as part of its plan to reduce cash outflows and bolster a weakening balance sheet.

This forms a key plank of the company's turnaround strategy as it seeks to pay down debt and reduce leverage to below 2.5 times operational cash flow. Even after such a massive dividend cut, Lightstream still pays a dividend with a yield in excess of 7.5%, making it on face value a compelling investment for income hungry investors.

But like Surge and Twin Butte, Lightstream reported a 2013 full-year loss, indicating the dividend is not sustainable, but after substituting operating cash flow for net income, the payout ratio becomes a sustainable of 27% for 2013.

Furthermore, this payout ratio will continue to fall, with the 50% cut only applied to its December 2013 dividend payment. With management expecting 2014 oil production and cash flow to remain stable in comparison to 2013, the payout ratio should continue to fall as the 50% cut is applied to all dividends paid throughout the year.

But unlike Surge or Twin Butte, Lightstream's future performance is dependent upon the successful completion of its turnaround program, a key part of which is divesting itself of non-core assets. This may be difficult to successfully complete with the market awash with Canadian oil and gas assets. Any failure to complete the targeted assets sales may see Lightstream move to further cut its dividend or halt it altogether until the program is complete.

Foolish bottom line
The patch offers investors some particularly tasty dividend yields, but many should be treated with caution, as they being paid by small-cap companies with limited financial resources. However, for income hungry investors with an appetite for high risk high reward investments, both Surge and Twin Butte offer considerable potential.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:SGY (Surge Energy Inc.)

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