Are These 3 Dividend Machines a Good Buy?

Description

If you're looking for big dividend yields, the energy patch has numerous options for you. Many energy producers yield well above 5% (by comparison, none of the big five banks do). But should you invest in any of these companies? Below we take a look at three of them.

1. Crescent Point

Crescent Point Energy (TSX: CPG)(NYSE: CPG) offers one of the most attractive dividends in the energy sector — the company pays out $0.23 per share per month, good for a 6.3% yield. But in 2013, Crescent Point made only $0.37 per share in net income, and only $0.58 per share in free cash flow. So what's going on? How can the company afford such a dividend payment?

Crescent Point uses a tactic very common in the energy patch: a dividend reinvestment plan (DRIP). The DRIP incentivizes shareholders to take their dividend in shares, rather than cash, by offering a 5% discount. As a result, the company only had to pay out 39% of its dividends in cash last year.

Unfortunately, the DRIP comes with an unwanted consequence — share dilution. In 2012, the average shares outstanding increased by 19%, and last year increased by another 17%. And it's the shareholders taking their dividend in cash, the ones not getting that 5% discount, who are getting burned the most by this dilution. Your best bet is to stay away.

2. Penn West

Like Crescent Point, **Penn West Petroleum** (TSX: PWT)(NYSE: PWE) offers a very attractive dividend, currently yielding 5.9%. But also like Crescent Point, this dividend is higher than the company's net income or free cash flow.

To illustrate, last year Penn West made $0.46 per share in free cash flow, and actually lost money on a net income basis. But the company still pays out a $0.14 per share dividend every quarter. And this was after cutting the dividend by nearly 50% in June 2013.

Penn West funded its dividend mainly by selling off assets last year, a strategy that is unsustainable.

And even though the dividend is more manageable now, the company will still be stretched to meet this obligation. You're probably better off leaving this company alone.

3. Twin Butte

If you think 6% is a strong dividend, how does 11.5% sound? Because that's what you get with shares of **Twin Butte Energy** (TSX: TBE). Part of the reason for the high yield is a falling stock price; the shares are down by more than a third since peaking in April.

But you should be very careful before buying Twin Butte shares. The company is in growth mode, and as a result has negative free cash flow. To pay for the dividend, Twin Butte has been issuing shares ferociously – like Crescent Point, Twin Butte has a DRIP with a 5% discount for those who take their dividend in cash.

As a result, the share count increased by 98% from 2011 to 2013. Your best bet is to steer clear.

CATEGORY

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bensinclair