3 Reasons Dividend Investors Should Prefer Canadian Natural Resources Limited Over Penn West Petroleum Ltd

Description

When searching for dividend stocks, it can be tempting to go for the highest yield. But that's not always, or even often, a good idea.

The best examples are in Canada's energy patch, where some companies offer extraordinarily high yields, while others pay no dividend at all. Yet the latter group often features better companies, which make for lower-risk investments.

To illustrate the difference between these two groups, below we take a look at two companies. One is **Canadian Natural Resources Limited** (TSX: CNQ)(NYSE: CNQ) and its 1.9% yield. The other one yields an enticing 6.9%: **Penn West Petroleum Ltd** (TSX: PWT)(NYSE: PWE).

So without further ado, here are three reasons to prefer CNRL's dividend, even though it has a far lower yield.

1. A better track record

This should go without saying. But CNRL has done a far better job creating shareholder value than Penn West. The former has earned a fantastic reputation for disciplined capital allocation and ferocious cost control. As a result, CNRL has been able to grow production very efficiently.

Meanwhile, Penn West has made all the wrong moves, from expanding too quickly, to selling assets too cheaply, to accounting mishaps. Over the past three years, its stock is down 54% (meanwhile CNRL's is up 39%). So Penn West clearly has plenty to prove, which means its shares are very risky. This is not something that should be appealing to a dividend investor.

2. A more stable company

Fast forward to today, and Penn West is still somewhat boxed into a corner by its balance sheet. As of the end of last quarter, the company's total debt stood at over $2.3 billion, more than double its annual cash flow from operations. But the real picture is even worse, because the company has been selling assets to pay down this debt, hardly something that can be sustained over the long term.

CNRL's debt/cash flow ratio is closer to 1.5, and given how efficiently the company is operating, its debt level is perfectly under control. In fact, CNRL's position has recently allowed it to be a buyer in a buyer's market. So all of its shareholders, including those that like dividends, should feel at ease.

3. A more affordable dividend

Finally, CNRL pays out a small portion of its cash flow as dividends, which is why the yield is so low. To illustrate, the company's dividend currently works out to $0.90 per share per year. Last year, the company made over $2 per share in net income, and much more than that in cash flow. So as the company grows, the dividend can only really move in one direction.

Meanwhile, Penn West pays out $0.56 per year, far above what it makes either in income or free cash flow. To compensate, the company raised over $500 million last year by selling assets, and also increased the share count by 10 million. This is not a sustainable long-term strategy. So dividend investors should stay away, despite the high yield.

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