Whose Dividend Is Safer: Penn West Petroleum Ltd. or Talisman Energy Inc.?

Description

This year has not been a kind one to shareholders of **Penn West Petroleum Ltd.** (TSX: PWT)(NYSE: PWE) or **Talisman Energy Inc.** (TSX: TLM)(NYSE: TLM).

Both companies have suffered from similar problems. They have overstretched balance sheets, a legacy of overambitious expansion at the wrong time. Each has had to face collapsing oil prices. And each has a big dividend that could easily be cut.

So that leads to an obvious question: Are either of these dividends safe? Below we take a closer look.

Penn West Petroleum Ltd.

Penn West's dividend now yields nearly 12% (as of this writing), which ranks first among all companies in the **S&P/TSX 60** index. This can only mean one thing: Investors are convinced that the dividend will get cut. Such a move would not be unprecedented – last year, the company's payout was cut by nearly 50%.

When looking at the numbers, it appears that the current dividend is unsustainable. To illustrate, the company earned roughly $180 million through the first six months of 2014, or $0.36 per share. This was just barely enough to cover the dividend of $0.28 per share.

But that was when oil was trading for $100 in the United States. Now it is trading for less than $80. And the company's production has consistently declined in recent years. So at this point, the company will likely have to issue a lot of shares to pay for the dividend. And with the stock down 43% so far this year, that strategy doesn't seem helpful.

In any case, we'll find out soon. Penn West is due to report earnings, as well as its 2015 capital budget, tomorrow.

Talisman Energy Inc.

Talisman's situation is not much better. The company has a wide range of assets all over the world, but in recent months these assets have seemed more like liabilities. The biggest problems lie in the North Sea, where Talisman is facing declining production, big capital commitments, and expensive abandonment obligations.

Management is actually trying to sell the company, but unfortunately Talisman is too complex for any buyer's liking. There was reportedly interest earlier this year from Spanish giant Repsol, but that story quickly fizzled out.

Regarding the dividend, Talisman has a much lower payout than Penn West; its dividend yields only 4.25%. But Talisman has negative free cash flow this year, and has been funding the dividend from selling off assets. In fact the company has raised $1.5 billion so far this year from asset sales, which has funded $200 million in cash dividends.

But at this point, Talisman's dividend appears much safer. The company has plenty of assets that can be sold off to raise cash, and this can be done for a while. But eventually, the company will have to start generating some free cash flow. At today's oil prices, that looks unlikely.

There's another energy stock with a much safer dividend, and it's also The Motley Fool's top stock pick for 2014. It's featured in the free report below.

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