What You Need to Know Before Buying Crescent Point Energy Corp. or Penn West Petroleum Ltd.

Description

In Canada's energy sector, there are plenty of companies that pay out a big dividend yield. Two of them are **Crescent Point Energy Corp.** (TSX: CPG)(NYSE: CPG) and **Penn West Petroleum Ltd.** (TSX: PWT)(NYSE: PWE), whose dividends yield 7.7% and 12.0%, respectively.

Unfortunately, these dividends come with a catch: They exceed what the companies actually make in net income. To allow for this, each company offers shareholders an incentive to take their dividends in shares. Below we show you how this works, and look at how you can benefit.

Crescent Point: Take advantage of the discount

Crescent Point pays a dividend of $0.23 every month, not bad for a $35 stock. Unfortunately, the company has only made $0.94 per share so far this year in income. To compensate for this, the company offers a 5% discount to anyone willing to take their dividend in shares rather than cash.

Surprisingly, a minority of shareholders actually take advantage of this offer. Through the first three quarters of 2014, Crescent Point has paid out 71% of its dividends in cash. It seems that most shareholders are looking for the monthly income.

But this offer is too good to pass up. To illustrate, let's say you invest $10,000 in Crescent Point shares today. Every month, you use the discount to accumulate more shares. Over the course of a year, assuming the share price stays constant, the discount is worth more than $70. So instead of your dividend yielding 7.7%, now it yields 8.5%. That may not sound like a lot, but this is essentially free money. You should take advantage of the offer.

Little faith in Penn West

Penn West also pays out a big dividend, higher than what the company can actually afford. And like Crescent Point, it offers a 5% discount if you're willing to take your dividend in shares.

Oddly, 79% of dividends are paid out in cash. This makes no sense. After all, if you're willing to buy the shares at full price, why not accept more stock at a discount? If you go against the grain, and take advantage of the discount, the dividend yield goes from 12.0% to 13.2%. So that's an extra $120 per year on a $10,000 investment. Again, this adds up.

Buying a stock just for the dividend

It's a shame that so many people don't take advantage of this offer. In fact it seems that most shareholders own these stocks just for the dividend.

This is a dangerous game to play. After all, if you buy a stock just for the dividend, and ignore the underlying fundamentals, then you're exposing yourself to a dividend cut. In fact, that's what happened to Penn West shareholders in 2013, when the company cut its payout by nearly 50%.

So if you really believe in these companies, you should take advantage of the discount. But if you're looking for cash dividends, you should go with a proven, reliable performer. Three such companies are featured in the free report below.

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Date
2025/09/10
Date Created
2014/11/06
Author
bensinclair