Penn West Petroleum Ltd. and Crescent Point Energy Corp.: Why You Shouldn't Buy a Stock Just for the Dividend

Description

All too often, I'll hear someone pitch a stock, and justify their pick by talking about the dividend. But let me make one thing clear: You should never buy a stock just because it has a big dividend. Instead, if you're looking for regular, reliable income, you should go with companies that generate steady cash flow.

Sure, a big dividend yield can look very tempting. But if you don't pay attention to the underlying business, then you can easily get burned. That is especially evident these days, thanks to the trouble that energy companies are going through.

So on that note, below we'll show you a real life example. Suppose you wanted to generate some income with $100,000 of your hard-earned dollars at the beginning of 2014. You looked around, and decided to invest half in **Crescent Point Energy Corp.** (TSX: CPG)(NYSE: CPG) and the other half in **Penn West Petroleum Ltd.** (TSX: PWT)(NYSE: PWE). Here's what would have happened.

Penn West: The problems continue

If you had bought $50,000 of Penn West stock on January 1, that would have earned you $789 in dividends per quarter, or $3,156 per year. Not a bad deal, right? By comparison, buying **Telus Corporation** would have netted less than $500 per quarter.

Unfortunately, Penn West has been facing numerous problems, which have only gotten worse this year. The company's production is declining, assets are being sold at bargain prices, and there was even a $400 million accounting restatement. The slide in oil prices is putting the company – and the dividend – under serious pressure.

Fast forward to today and your $50,000 investment is now worth just over $21,000. Your quarterly payout remains constant but almost certainly will be cut. Meanwhile, a Telus investment would now be worth over $59,000, and the dividend continues to rise.

I know it sounds like I'm Monday morning quarterbacking. But this mistake could have been avoided. If you're looking for reliable dividends, then you shouldn't bet on oil companies with a poor history. Further, companies with big dividends always draw lots of investor interest; there are always enough people tempted by the outsized yield. So these kinds of stocks are often overvalued.

What about Crescent Point?

Crescent Point also has a very tempting dividend. A $50,000 investment at the beginning of this year would have netted you nearly $300 every *month*. But fast forward to today, and your investment is now worth less than $35,000. Again, your monthly income hasn't changed, but thanks to low oil prices, a cut could be in the cards.

Of course, if you had better timing, the story would be different. But once again, when you're looking for steady income, are you really looking to make a bet on the oil industry? If the answer is yes, then a $100,000 nest egg can very quickly turn into $56,000, as we saw in this example.

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