3 Reasons to Avoid Enerplus Corp and its 10.4% Dividend

Description

This summer, everything was going right for **Enerplus Corp** (TSX: ERF)(NYSE: ERF). The company had achieved double-digit annual growth in production, reserves and cash flow over the previous two years. Over this time, its share price had more than doubled. And resource plays such as the Bakken and Marcellus were yielding better than expected results. CEO Ian Dundas was about to be named top turnaround CEO for 2014 by *Canadian Business*.

But since then, Enerplus has been a big victim of the oil rout. In fact, its shares have fallen by over 60% since early July, despite some nice gains on Tuesday. But even though the shares may appear cheap, this isn't a stock you should be jumping at. Below we highlight three reasons why.

1. A continued oil rout

No one can possibly know when – and at what price – oil will bottom out. But there is certainly a possibility that oil could fall a lot further. In a recent interview, Mr. Dundas even said that prices could fall to $40 before recovering. This would certainly hammer the fortunes, and stock prices, of energy companies such as Enerplus.

Interestingly, Mr. Dundas also said that the company can handle these really low oil prices. But that is what other producers are saying as well. It really makes you wonder just how much the industry will cut production as oil prices fall. I don't want to pay to find out.

2. A dubious dividend

After **Canadian Oil Sands** cut its dividend, Enerplus became the third highest yielding company on the **S&P/TSX 60**. Now I know what you're thinking: isn't a big dividend a good thing? Well, not really.

First of all, a dividend can be seriously constraining. For instance, Enerplus had to sell nearly $200 million worth of assets this year (through the first three quarters) in order to pay $143 million in cash dividends. Looking ahead, Mr. Dundas said that the dividend is important, but not as important as the company's financial stability.

And if Enerplus does cut its payout, the stock could easily get hammered. Just look at what happened when Canadian Oil Sands cut its payout – the stock fell more than 15% in response.

This is the real problem with these high dividend stocks. Numerous investors own the shares simply to collect the dividend (this is why the shares tank when the dividend is cut). As a result, there's usually plenty of demand for the shares, and as a result the shares are rarely undervalued. So if you're bargain hunting in the energy patch, these dividend payers may not be your best option.

3. Better alternatives

If you really believe in Enerplus and Mr. Dundas, and you're willing to assume the risks, then by all means you should hold the shares. Otherwise, there are some better alternatives.

If you're looking to bet on the oil sands, you should go with a proven performer, one with a low dividend and lots of financial flexibility. **Canadian Natural Resources Ltd.** and **Suncor Energy Inc.** fit the bill.

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