Is Crescent Point Energy Corp.’s 9.2% Yield Safe?

Description

A few weeks ago, I heard from a friend who had purchased shares of **Penn West Petroleum Ltd**.

He figured the firm—one of the largest energy producers in the country—would be a great long-term investment. He backed up the truck and bought the stock in March “for the yield,” which at the time was about 18%.

The huge payout didn’t scare him, but it should have. What happened next highlights the most important rule of income investing: big yields often come with big risk.

On March 12th, citing the impact of low crude prices, Penn West cut its quarterly dividend 93% to one cent per share. That announcement sent investors fleeing.

This is not the first time people have been seduced by a big yield. Like college students to a free lunch, the huge payouts on **Trilogy Energy** and **Canadian Oil Sands** attracted scores of income-hungry investors. Unfortunately, both companies have been forced to slash their dividends in recent months.

However, these cuts should not have shocked anyone. Low oil prices have crimped the profits of energy producers. To conserve cash, many have been forced to slash their distributions. The scary part is that more dividend reductions could be looming. Case in point: **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG).

As you can see in the chart below, shares of the shale driller have plunged over the past few months. Today the stock yields 9.2%. But whenever a payout gets this high, it’s prudent to ask about the dividend’s sustainability.

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Source: Yahoo! Finance

For a long time, there was little reason to fret about the stock’s distribution. Before the turmoil started in the energy patch last summer, Crescent Point had hedged most of its exposure to oil prices. The company had locked in the rate for two-thirds of its production through the remainder of 2015.

That meant Crescent Point could stomach a temporary drop in energy prices. However, the key word here is temporary. As the doldrums in the oil patch roll on, the company's distribution is starting to look expensive.

Most of Crescent Point's hedges are starting to roll over, which means the price the company receives for its production is dropping. Assuming oil prices at about US$55 per barrel, the firm is expected to generate only US$1.8 billion per year in cash flow. Needless to say, that's not enough to fund both US$1.5 billion in capital expenditures *and* US$1.2 billion in annual dividend payments.

The bottom line is if oil prices don't rebound soon, dividend investors should be prepared to see their income stream cut.

CATEGORY

1. Investing

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