Are the 10%+ Dividends From Baytex Energy Corp. and Surge Energy Inc. Sustainable?

Description

When **Crescent Point Energy Corp.** cut its dividend last week, investors were not overly shocked. After all, oil prices have absolutely collapsed, and Crescent Point simply could not afford such a big payout.

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This brings about a very obvious question: who's next?

Well, two leading candidates are **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) and **Surge Energy Inc.** (TSX:SGY). Both companies' dividends yield well over 10%, so investors are clearly skeptical. We take a closer look below.

Baytex

Baytex has already cut its dividend in the past 12 months. In December the company slashed its monthly payout from $0.24 to $0.10. But with its shares trading below $9, even the smaller dividend yields a whopping 14%.

Yet investors should calm down before jumping on board—there is little chance this dividend surviving as is. To understand why, you just need to look at the company's second-quarter report.

In the quarter, Baytex earned roughly $60 million in free cash flow. And with 200 million shares outstanding, a $0.10 monthly dividend would cost about the same amount every three months.

But this free cash flow number was achieved with an average WTI oil price of US$57.94. That number has since sunk into the mid-US$40s. Making matters worse, Baytex has over $1.8 billion of monetary debt, a number that actually exceeds the company's market value. Thus, its balance sheet simply cannot handle such a dividend. You should expect a cut no later than when Baytex reports third-quarter earnings.

Surge

Like Baytex, Surge Energy has already slashed its dividend in the last 12 months. And also like Baytex, another cut is likely coming.

The second-quarter numbers once again tell the story. Surge's free cash flow totaled roughly $12 million during the quarter, and this number should be sharply lower in the next few quarters. Yet the dividend will cost Surge about $17 million every three months.

Furthermore, Surge recently doubled its capital budget, anticipating a modest rebound in oil prices during the second half of 2015. Of course, the opposite has happened. So, the capital budget will likely have to be cut as well. Clearly, there's very little room for the dividend.

Are there any better alternatives?

If you're looking for high-yielding stocks, the energy sector is the last place you'll want to look. With oil prices so low, many of these companies are on very shaky ground. You're much better off looking at the banks, the telcos, and the REITs.

On that note, the free report below is a great place to start.

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1. TSX:BTE (Baytex Energy Corp.)
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