Avoid These 3 Dividend Traps

Description

Dividend investing can be a very tricky game to play, because there are always so many trade-offs. Is it better to go with a high dividend or a growing dividend? Is it OK to buy shares in a company you don't like, just because it pays a nice dividend? Or is it better to buy a company with a great business model but no payout?

If this didn't make dividend investing hard enough, some companies pay out a really nice dividend, but should still be avoided by income investors. These can be referred to as "dividend traps" — three of them are highlighted below.

1. Crescent Point Energy

There are few companies in Canada that yield as much as **Crescent Point Energy** (TSX: CPG)(NYSE: CPG). Based on Wednesday's closing price, the shares yield 6.3%. But there's a catch.

Crescent Point's net income is not sufficient to meet the payout. So how does the company afford to pay such a high dividend? Quite simply, it offers an incentive for investors to take additional stock instead of cash. So if you hold the shares and elect to take a cash dividend, you must effectively subsidize the investors that take additional shares. This is not a good long term investing strategy.

2. Labrador Iron Ore Royalty Corp

Labrador Iron Ore Royalty Corporation (TSX: LIF) makes all of its money off of the Iron Ore Company of Canada, which mines iron ore in Labrador. LIORC pays a nice dividend, yielding 3.4%, but there are two problems.

One is that over time, the company pays out all of its cash flow as dividends. So there's not very much prospect for that dividend growing. Secondly, iron ore is a very scary business to be in. The commodity is very exposed to a potential slowdown in building activity in China, and there are also plenty of prospects for increased supply. It's best just to stay clear of this company.

3. AGF

Whenever a company pays a high dividend, there's always a lot of pressure to maintain the payout, even if the company itself is struggling. **AGF** (TSX: AGF.B) is a perfect example.

Poor fund performance, departing employees, and shrinking assets have all hurt the company – net income has declined each of the past three years. But the dividend was never cut; last year the company paid out $1.08 per share in dividends despite only earning $0.25 in income. This cannot last forever, and you're better off staying on the sidelines.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:VRN (Veren)
2. TSX:AGF.B (AGF Management Limited)
3. TSX:LIF (Labrador Iron Ore Royalty Corporation)
4. TSX:VRN (Veren Inc.)

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