Investors Beware: These 3 Dividends Might Be Too Good to Be True

Description

In 2015, it's tough to get consistent yield that's more than 3%.

For investors looking for total return, or retirees with a large amount of capital, this isn't a big deal. Total return investors just reinvest dividends anyway, and a big nest eggs make it really easy to be content with a 3% yield. A ton of savings allows an investor to be conservative.

But what about those investors who need to maximize current yield? Naturally, they check out other types of assets, like no-growth stocks with plenty of yield, REITs, or even preferred shares. Often, these investors will commit one sin that just about every dividend investor is guilty of at some point—stretching for yield.

Once you get a yield past about 6%, alarm bells should be going off. I'm not saying that a company with a yield greater than 6% is an automatic sell, but you should just be careful with it. There usually isn't a lot of wiggle room with companies like that. The good news is there's usually plenty of warning; you just have to see it among the good news.

Let's take a closer look at three different companies on the TSX that could be in danger of cutting dividends soon.

Manitoba Telecom Services

For value investors, I think **Manitoba Telecom Services Inc** (TSX:MBT) is a solid choice. It has an underrated moat, and has done a great job defending market share in its home province. It also trades at a much lower P/E ratio than its peers, and has a lower debt-to-equity ratio to boot. There's also the potential for one of its rivals to buy it, which would send shares soaring.

Then why the heck is it on this list?

The dividend currently yields a meaty 7.2%, more than 40% higher than other Canadian telecoms. There's also a deficit in the company's pension plan and not a whole lot of excess cash to throw at it with the dividend at current levels. Plus, when asked, new CEO Jay Forbes was pretty noncommittal when it came to the payout.

In the long term, I think this company could turn it around. But in the short term, investors should expect a cut in the dividend to yield around 4%.

ARC Resources

There are quite a few oil companies I think should just slash their dividends and use the proceeds to shore up their balance sheets. **ARC Resources Ltd.** (TSX:ARX) is one of them.

This isn't to take anything away from the company's results. It has good assets and one of the best management teams in the business. It also hedged production during the good times, so approximately half of its natural gas production has a selling price of at least $3.94 per MMcf locked in.

But in 2014, the company only generated a free cash flow of just $73 million, while paying out more than $228 million in dividends. That shortfall will only get worse in 2015, considering lower commodity prices and a higher share count from raising capital earlier in the year. There is credit available to cover the dividend, but borrowing to pay dividends is never a good long-term option.

Teck Resources

The management team over at **Teck Resources Ltd** (TSX:TCK.B)(NYSE:TCK) has done a nice job keeping costs under control as metallurgical coal prices continue to decline. Plus, the company's copper and zinc mines also managed to eke out profits. Low oil prices also help with fuel costs.

But the company is still on the hook for $3 billion for its share of the Fort Hills oil sands project, which is forging ahead even though $90 per barrel is needed to make the project viable. The company does have more than $2 billion in cash, but it paid out nearly all of its free cash from 2014 in dividends. At some point, it'll either have to borrow more cash or cut the dividend. Without a big improvement in coal prices, lenders are likely to insist on the company slashing its 5.2% yield as a condition of financing.

CATEGORY

1. Dividend Stocks
2. Investing

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1. Editor's Choice

TICKERS GLOBAL

1. NYSE:TECK (Teck Resources Limited)
2. TSX:ARX (ARC Resources Ltd.)
3. TSX:TECK.B (Teck Resources Limited)

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