Income Investors Beware: These 3 Dividends Are Ripe to Get Cut

Description

[*Editor's Note: This article has been updated to correct an error.*]

So far, 2015 hasn't been a terribly good year for income investors, at least for those who loaded up on beaten-down energy companies. The sector is now littered with former dividend greats that have cut their payouts to almost zero, barely holding on to their dividend status.

That just goes to show the dangers of depending on strong commodity prices for your dividends. When the price of these commodities tanks—which inevitably happens every few years—the cash flow from selling them goes quickly, too. Since costs for these companies are often inelastic, things like dividends and capital expenditures are often the first things to get cut. Thus, it's easy to make the argument that commodity stocks are not the place investors should go for dividends.

Investors have to be careful while searching for yield, that's for sure. With that in mind, here are three stocks that I think have very weak dividends: payouts that could be cut at any time.

Husky

I think there's a case to be made for buying shares of **Husky Energy Inc.** (TSX:HSE) at these levels. At $23 per share, the company barely trades above book value, even though it has a solid balance sheet, downstream assets like refineries and its network of service stations, and natural gas operations in Asia, which are much less affected by North America's weak gas market.

But at the same time, it's obvious Husky's dividend is at risk with crude hovering around US$40 per barrel. Through the first six months of 2015, the company earned $1.76 billion from operations, while investing $1.56 billion in capital expenditures. That's on pace to match the company's projection of approximately $3 billion in capital expenditures it plans to spend in 2015.

While $200 million in free cash flow is a much better number than most of Husky's peers have posted, unfortunately, it's not enough to pay the dividends, which came in at $600 million through the first half of the year. That's a projected shortfall of $800 million through all of 2015.

Husky does have the ability to borrow the cash to make up the dividends. It owes approximately $7 billion (including preferred shares) compared to assets of $38.5 billion. But I'm not sold on why the company should worsen its balance sheet just to pay a 5.3% yield, especially since most of its peers have already cut their payouts.

Student Transportation

Although **Student Transportation Inc.** (TSX:STB(NASDAQ:STB) has a long history of consistent dividends, it's obvious the market isn't a believer in the sustainability of its 9.9% payout, as evidenced by the yield.

On the surface, it would seem that Student Transportation would be the ideal dividend payer. There aren't many businesses more steady or recession-proof than transporting kids to school. Government budgets are getting stretched tighter and tighter, making outsourcing things like student transport attractive.

But Student Transportation hasn't generated enough in free cash flow to pay its dividend in years. Through the first nine months of the company's fiscal 2015, it generated $35 million in cash from operations, if you ignore changes in working capital. Add in $31 million in capital expenditures—buses do need to be repaired, after all—and you're left with just $4 million in free cash flow. Meanwhile, the dividend has cost nearly $25 million during the same period.

IGM Financial

Although the financials for **IGM Financial Inc**. (TSX:IGM) don't look as bad as the previous two companies, there's still a danger that the parent of Investors Group may cut its generous 6.2% dividend.

IGM's main business is selling expensive actively managed mutual funds, which looks to be under threat by ETFs and new rules coming into place in 2016 that say funds have to disclose the total dollar cost of owning them and not just a percentage.

Plus, the company's balance sheet has deteriorated severely over the past few years, and it now owes nearly $7 billion in net debt. The nearly $600 million it pays annually in dividends would come in handy to help pay that off, especially if an exodus of customers fleeing its expensive funds force the company to cut fees, and, in turn, profits with them.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. TSX:IGM (IGM Financial Inc.)

Category

1. Energy Stocks
2. Investing

Tags

1. Editor's Choice

Date
2025/07/08
Date Created
2015/08/21
Author
nelsonpsmith