How to Avoid Dividend Cuts

Description

In the past year (and the past few years for some companies), certain companies cut their dividends and others even eliminated them. **Baytex Energy Corp.** eliminated its dividend. Since 2012 **Teck Resources Ltd.** has slashed its annual payout from $0.90 to $0.10 per share, and **Barrick Gold Corp.** has slashed its annual payout from US$0.80 to less than US$0.12 per share.

Most recently, **ConocoPhillips** cut its dividend by 66%, and **Potash Corporation of Saskatchewan Inc.** cut its dividend by 34%.

How can dividend investors be safe?

All the companies mentioned above that cut their dividends have something else in common: their profitability is more or less related to commodity prices. So, one simple way to avoid dividend cuts is to avoid companies whose profitability is dependent on commodity prices in any way.

After all, if you're investing for dividends, you want them to be reliable. You can find much more reliable dividends in businesses that generate stable earnings and cash flows that aren't cyclical. The Canadian banks and utilities are good industries to invest in for reliable dividends.

Canadian banks

The better-valued banks include **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), which has a 4.9% yield at $56.80 per share, and **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), which has a 5.1% yield at $89.60 per share.

Bank of Nova Scotia is priced at under 10 times its earnings, while Canadian Imperial Bank of Commerce is priced at 9.5 times its earnings. Both banks have payout ratios under 50%, making their dividends rock solid.

For a deeper-valued bank, investors can consider **Canadian Western Bank** (TSX:CWB), which has a 4% yield at $23 per share. It's priced at only 8.7 times its earnings because almost half of its loans are in Alberta. However, I think the bank understands that it's riskier, and so its payout ratio is maintained at under 35% thus far, so its dividend has a larger margin of safety than the Big Five banks.

Utilities

The top dividend-growth companies in Canada are utilities, including **Fortis Inc.** (TSX:FTS) and **Canadian Utilities Limited** (TSX:CU), which have increased their dividends every year for over four decades. **ATCO Ltd.** (TSX:ACO.X) has over two decades of dividend-growth history, and it owns 53% of Canadian Utilities. At close on Friday, Fortis and Canadian Utilities yielded 3.6% and ATCO yielded 2.9%.

Fortis is usually expensive with a multiple of 18-20. However, I find that it's uncommon for it to reach a high yield of 4%. When it does I will consider buying its shares for a solid 4% yield. The company targets a 6% growth rate in the foreseeable future.

Canadian Utilities also looks expensive with a multiple of 18.6. I find that it’s uncommon for it to reach a high yield of 3.8%. When it does I will consider buying its shares for a 3.8% yield. The utility has increased its dividend at a compound annual growth rate (CAGR) of 10.3% in the last three years. In the near term, it still has the ability to increase its dividend at a 10% rate.

ATCO looks cheap with a multiple of 15. Although it only yields 2.9%, it has the ability to increase its dividend at a faster rate than Fortis and Canadian Utilities because it has the lowest payout ratio of the three. ATCO has increased its dividend at a CAGR of 14.9% in the last three years. In the near term it still has the ability to increase its dividend at a 15% rate.

Conclusion

To avoid dividend cuts, don’t invest in commodity-related stocks. Instead, invest in the top companies of stable industries such as the Canadian banks and utilities. Top ideas from those industries include Bank of Nova Scotia and Canadian Imperial Bank of Commerce, which have paid dividends for over a century, and ATCO, which should experience higher dividend growth than Fortis and Canadian Utilities.

I’m not saying that you never invest in commodity-related stocks because they could be lucrative investments. I’m just saying that their dividends are not reliable when commodity prices fall lower and stay low as they have done in the recent past.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

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1. Editor's Choice

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. NYSE:CM (Canadian Imperial Bank of Commerce)
3. TSX:ACO.X (ATCO Ltd.)
4. TSX:BNS (Bank Of Nova Scotia)
5. TSX:CM (Canadian Imperial Bank of Commerce)
6. TSX:CU (Canadian Utilities Limited)
7. TSX:CWB (Canadian Western Bank)
8. TSX:FTS (Fortis Inc.)

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