Can Investors Count On These 10%+ Dividends?

Description

For many investors, getting a 10% dividend is the Holy Grail. They want big income now, convinced a huge yield will make the rest of their problems go away.

There's just one problem. As the old expression goes, there's no such thing as a free lunch in the stock market. If a dividend is that high, there's one big reason why: it's perceived as risky by investors.

Many times, the market is correct on these huge dividends. A company might be able to maintain the payout for a year or two, but ultimately it'll get slashed. Select other times, the company is able to power through, maintaining or even improving its earnings power.

Let's take a closer look at a few huge dividends to see if they're safe.

Veresen

Veresen Inc. (TSX:VSN) is a pipeline operator, transporting liquid natural gas through two main pipelines. One is located in Alberta, while the other is in the western United States. The company also owns approximately 900 megawatts of power production, which is primarily gas fired. Finally, it has some $1 billion in development projects currently being completed, which mostly consist of natural gas processing plants.

Like many pipeline operators, Veresen has spent much of the last few years moving its revenue away from a commodity-based system to a fee-based system. This year will be the first year in the last five that the company isn't dependent on the price of natural gas.

Veresen currently pays a $0.083 per share monthly dividend, which is good enough for an 11.6% yield. For 2016, Veresen predicts it'll have distributable cash flow between $0.94 and $1.08 per share. At the mid-range of that guidance, the company will have a payout ratio of 98.6%. This indicates to me the dividend may be in danger.

The good news is, Veresen has a pretty solid balance sheet. It owes just $1.06 billion in net debt compared to $4.6 billion in fixed assets. The company could likely afford to borrow to maintain the dividend, but I'm just not sure it will happen, especially in the middle of a big expansion program.

Directcash

Directcash Payments Inc. (TSX:DCI) is Canada's largest owner of private-label bank machines. The company also has operations in Australia, New Zealand, and the United Kingdom.

On first glance, the company's 12.9% dividend looks to be unsustainable. It reported negative earnings over the last 12 months, and the technological threat facing ATMs are pretty obvious. Why use cash when it'll soon be easy to pay with your phone?

Free cash flow tells a much different story. Over the last year the company reported a free cash flow of $56 million while only paying out $25 million in dividends. That's a payout ratio of just 45%.

And nobody bothered to tell Directcash customers ATMs are about to go extinct. Both transactions per ATM and total ATMs outstanding went up over the last year.

Husky

After years as a dividend stalwart, **Husky Energy Inc.** (TSX:HSE) eliminated its $0.30 per share dividend for 2016. With crude oil so cheap, management simply couldn't afford to pay the generous payout.

Dividend investors do have another option if they want huge yield from Husky. They can buy the company's Series 1 preferred shares, which trade under the ticker symbol HSE.PR.A. These shares currently pay a dividend of $0.28 per share quarterly, good enough for a 12.4% yield.

But that yield won't last for long. These preferred shares are rate-reset preferreds, which means the dividend rate resets every five years. These preferred shares will soon start paying approximately $0.15 each quarter, good enough for a 6.7% yield.

That's not bad, but it's a far cry from 12.4%.

I view the new 6.7% yield as quite safe. Husky has a solid balance sheet, and eliminating the common-share dividend will save it some $1.2 billion per year. It certainly has the financial strength to make it through this crisis.

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Date
2025/07/07
Date Created
2016/03/09

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