Are These 3 Great Dividends at Risk?

Description

For a retiree looking for dependable income, there's nothing worse than the dreaded dividend cut.

Avoiding this is sort of like avoiding a flu that's going around. You can take steps to minimize your exposure, but there's nothing you can do to avoid it completely. There are just too many variables at play.

The beautiful part of dividend-growth investing is that you don't have to completely avoid risky dividends. A portfolio stuffed with great stocks that consistently hike their payouts will trump the odd dividend cut, especially if an investor makes risky stocks only a small part of their portfolio.

Still, it's always a good idea to avoid stocks that are clearly in danger of cutting their dividends. How do we tell that? A helpful hint is to look at free cash flow. If a company consistently doesn't generate enough cash to pay dividends, bad things could eventually happen.

Here are three Canadian stocks which are in danger of cutting their generous yields.

Student Transportation

Student Transportation Inc. (TSX:STB)(NASDAQ:STB) has, through a series of acquisitions, become one of North America's top school bus transportation providers. It operates some 13,500 vehicles.

There's just one problem: the company consistently doesn't generate enough free cash flow to cover its 7.3% yield.

In the company's fiscal 2016 — which ended on June 30, 2016 — it generated a mere US$1 million in free cash flow. It paid nearly US$38 million in dividends. The shortfall was covered by borrowing an additional US$70 million.

The previous year tells a similar story. Free cash flow was US$16 million; dividends were US$34 million. The shortfall was covered by selling US$63 million worth of shares.

In theory, this could go on for years. After all, Student Transportation has been a serial acquirer. It's one of the things investors like about the company. But what happens if the market is no longer willing to finance acquisitions? Can the dividend survive?

Corus Entertainment

Ever since **Corus Entertainment Inc.** (TSX:CJR.B) closed its huge media acquisition from **Shaw Communications**, investors have questioned its ability to cover the massive 9% dividend.

The company just released second-quarter 2017 results that were a little disappointing. Free cash flow for the first six months checked in at $130 million, or $0.65 per share. Meanwhile, the company's payout over the same period was $0.57 per share. It earns enough to cover the dividend, but that might change if TV advertising spending continues to shrink.

The good news is, the dividend is safe for at least a few more months. Shaw took approximately 71 million shares as partial payment for the media deal. These shares will remain in Corus's dividend-reinvestment plan until August 31. After that, Shaw has the right to start selling those shares to shareholders who will likely demand payment in cash.

Cominar

Cominar REIT (TSX:CUF.UN) currently has a 10.1% yield, which should immediately make dividend investors a little suspicious.

Upon further inspection, these feelings are confirmed. In 2016, Cominar earned $1.39 per unit in adjusted funds from operations. It paid $1.47 per share to investors in the form of distributions, giving it a payout ratio of 106%.

Fortunately for Cominar shareholders, things aren't quite as dire as they seem. Cominar gives investors a 3% discount if they use their dividends to buy new shares. Many investors are active participants in this program.

Cominar paid out $236 million in cash dividends in 2016, which works out to $1.29 per share. The payout ratio is still a little higher than most investors want to see, but it is sustainable. Barely.

The bottom line

There is no guarantee Student Transportation, Corus, or Cominar will cut their dividends. In fact, they're more likely to continue paying dividends. The last thing any of these management teams wants is to be remembered as the folks who cut the payout.

But at the same time, I think investors just shouldn't take the risk. There are safer dividends out there.

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