Is This 12% Dividend Yield Safe?

Description

When you see a dividend yield as high as 12%, you must ask yourself, “Why is it so high?”

In today’s market, normal stocks pay dividends in the range of 3-4%. When you see stocks paying as high as 9%, or even 10%, there is something wrong with them.

One simple reason behind these ballooning yields is that companies have missed earnings or have lost major customers. When that happens, investors usually demand a steep discount to the share price because they expect a dividend cut is around the corner.

The case I’m pointing out today is **Cominar REIT** (TSX:CUF.UN). Its ~12% dividend yield looks very exciting, and this could be a great income stock for your portfolio. But here’s why I think investors are better off to let this opportunity go.

Disappointing earnings

Cominar is a perfect example of those danger signs. Last week, the company announced a 22% cut in its dividend after failing to improve many of its business metrics.

Cominar is the third-largest diversified real estate investment trust (REIT) in Canada and currently remains the largest commercial property owners in Quebec. The REIT owns a real estate portfolio of 525 properties in three different market segments: office properties, retail properties, and industrial and mixed-use properties.

But its second-quarter earnings suggest that it’s struggling to generate enough cash to justify its high payout in dividends.

Adjusted funds from operations (AFFO) — a key performance metrics for REITs — fell to $56.3 million in the second quarter from $62.9 million a year ago, showing that the company has failed to arrest the declining trend in 2017 after a similar dismal performance last year.

One biggest factor pressuring the company’s cash flows is its static occupancy rate. During the first half of 2017, it was 92.4% by June 30 — unchanged from what it had by the end of last year.

After the last week's cut in its dividend, Cominar now pays $0.095 per unit per month, down from $.1225. According to the management, that substantial reduction has given back Cominar all the flexibility in its operations and growth by reducing its payout ratio below 90%.

On the surface, this looks like good news because this reduction has brought the company's payout ratio from over 100% to a more manageable point.

But, unfortunately, management hasn't yet shown a clear path to growth or how it's going to improve its occupancy ratio in its key market, Quebec.

Cominar sold $115 million worth of property last year, and it wants to dispose of $143 million more in 2017. Investors are right to question how the company will improve its earnings when it's reducing its income-producing assets.

The bottom line

Cominar shares, trading at $12.41 at the time of writing, are down 8% in the past month. Trading at the price-to-earnings multiple of 9.62, its valuations look attractive when compared to other REITs in this pace.

But without a clear growth plan and a visible recovery in the Quebec commercial real estate market, I'm staying away from this name. There are so many other opportunities available in the Canadian REIT space.

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Date
2025/07/06
Date Created
2017/08/10
Author
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