Could This REIT See Another Cut to its Dividend?

Description

Dividend stocks are great while the payouts last, but if payments are cut or eliminated, investors may be stuck with an investment that no longer has any appeal. Typically, stocks that have had to cut their payouts have done so due to adverse conditions, and a cut usually means that the company hasn't been performing well. So, when a dividend is cut an investor could be left with a lower dividend (or none at all), along with a poor-performing stock.

This is why, before buying a dividend stock, investors should first evaluate the ability of the company to continue its payout and take note of any warning signs that may already be evident.

Cominar REIT (TSX:CUF.UN) already cut its dividend once this year by a whopping 22%; I'll determine if more cuts could be on the way. Monthly payments of $0.1225 were reduced in September to $0.095, as the company wanted to keep its cash payout ratio to under 90%.

Oftentimes, companies have their own methodology for calculating cash flow, and in Cominar's case, the company uses recurring adjusted cash flows from operations. I'm going to have a look at the payout ratio using two more conventional calculations.

Payout ratio based on earnings

A monthly dividend at $0.095 would total $1.14 annually per share, which is right at 90% of the company's earnings per share (EPS) in the trailing 12 months. Although 90% might seem high at first glance, REITs typically have higher payout ratios than other dividend stocks.

For example, **Canadian REIT** (TSX:REF.UN) currently pays out 89% of its EPS.

Payout ratio based on free cash flow

Using earnings to calculate a payout ratio is not always optimal, since net income includes non-cash items that will have no impact on a company's ability to pay dividends. This is one reason that companies sometimes formulate their own metric for basing the payout ratio on.

However, free cash flow is usually a good base since it represents cash from operations less capital expenditures. Using the free cash flow approach actually puts Cominar in a worse position than using earnings, as in two of the past four years the company has had negative free cash, while in the other two years its dividend payments were more than double the company's available cash.

If we look at Canadian REIT as a comparison, in two of the past four years its dividend payments also outpaced free cash flow, although to a much lesser extent. However, in the other two years payouts averaged just 55% of free cash flow.

What this means for investors

Cominar's 8% yield presents a lot of uncertainty, and investors are best to look at other dividend stocks for a more reliable stream of income. Although Cominar's new payout ratio was comparable to Canadian REIT when looking at EPS, the free cash flow approach told a much different story.

In Cominar's second-quarter results, the company mentioned that the closing of Sears locations could have an impact on the company's ability to keep its payouts below 90%. However, since that earnings release, Sears has announced that it would be liquidating even more stores, which might force Cominar to make an even deeper cut to its already fragile dividend.

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Date
2025/09/01
Date Created
2017/10/26
Author
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