Why Cuts Are Good

Description

In early 2016, **Dream Office Real Estate Investment Trst** (TSX:D.UN) announced a dividend cut, which led to a share price increase from ~$16 to ~$20 in less than one month. In July of this year, the same thing happened, as shares were trading around the $19 mark. The result has been a rally to ~$22.50 per share, as the company retains a greater portion of its cash flows in the form of shareholders' equity.

For investors fearing a dividend cut, the truth is that it can sometimes be the best thing to ever happen.

Throughout 2017, **Home Capital Group Inc.** (TSX:HCG) was the biggest name to cut the dividend to zero, as the company experienced a run on deposits amid a nightmare that saw many c-suite executives leave the company. Although dividend investors jumped ship due to the significant headwinds, those who were willing to double down along the way have experienced significant returns in their investments. After cutting the dividend, the company saw shares rise from a 52-week low of $5.06 to a current price of more than $17 per share. The decision to cut the dividend may have changed the outcome of the company over the long term.

As every company has many financial obligations, there are many instances in which a cut is the best opportunity for investors. Just this week, **Teva Pharmaceuticals Industries Ltd (ADR)** (NYSE:TEVA) announced plans to cut 14,000 jobs and suspend its dividend until further notice. What amounts to terrible news to many employees right before the Christmas season was welcomed by investors.

The result of this announcement was a share price that increased by slightly more than 10% for the day. Given that the company would have struggled by having too many expensive commitments to fulfill, the perception by those seeking for value in their investments is that the long-term gains from this restructuring will far outweigh the costs of undertaking them.

Translation: Teva is doing more with less.

Over a long period of time, many companies that fall on to hard times will often face this fate. As we have learned over the past year, however, not every company will see a higher share price when the announcement comes. Shares of **General Electric Company** (NYSE:GE) have now declined by close to 45% for the year and trade at no more than US$17.75. Clearly, investors have lost faith that the company can use the additional cash flows to turn things around.

Over the next year, the name that may benefit the most from a reduction in the dividend (or potentially job cuts) is **Restaurant Brands International Inc.** (TSX:QSR)(NYSE:QSR), which, at a price of $78 per share, will eventually need to squeeze its operations and franchisees even further. Barring that, the company may have to deal with many more challenges down the road.

As history has proven time and time again, when company management ignores what is so obvious, the outcome can be extremely bad. Sometimes ripping the band-aid off is the best alternative.

CATEGORY

1. Dividend Stocks
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2. NYSE:QSR (Restaurant Brands International Inc.)
3. NYSE:TEVA (Teva Pharmaceutical Industries Limited)
4. TSX:D.UN (Dream Office Real Estate Investment Trust)
5. TSX:HCG (Home Capital Group)
6. TSX:QSR (Restaurant Brands International Inc.)

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