Why a Dividend Cut Isn't Always a Bad Thing

Description

One of the riskiest things about owning a dividend stock is the possibility that its payout could be slashed or even eliminated entirely. However, it's not always a bad thing for a stock, and sometimes share price can even increase as a result of the move.

How could a dividend cut possibly be good for a stock?

Cutting a dividend is usually not a sign that things are going well, unless of course the company is going to invest in some big venture that will require a lot of cash.

However, for stocks that have been struggling and where their yields have reached astronomical levels, investors may know that it's only a matter of time before a cut is around the corner.

In those cases, it may be perceived that the company is trying to cling on to a dividend that's no longer feasible and that it's not exercising good financial management of its assets.

When a dividend reduction happens, sometimes share prices get a boost as investors breathe a sigh of relief that the company is freeing up some much-needed cash.

In the end, whether a company pays dividends or it produces a strong return through capital appreciation, the difference ultimately comes down to taxes, and preferences there will vary by individual investor.

It was a year ago that **Cameco Corp** (TSX:CCO)(NYSE:CCJ) announced that it was slashing its dividend, and during the past 12 months the stock has climbed 18%. With a low price of uranium and the stock struggling, it seemed inevitable that a cut to the dividend would take place.

The risk with investing in stocks that are dependent on commodity prices means that factors outside the company's control can severely impact its share price. That's what happened with Cameco, as a weak commodity price was more than enough to sink the stock.

Fast forward to today, and uranium prices have improved and there could be a lot of promise for the future if this trend continues. Although Cameco posted a profit in its most recent quarter, in three of the past five periods, it has finished in the red.

Although Cameco is a bit of a risky buy today, at just 1.3 times its book value, the stock could have a lot of upside left.

Most recently, **Altagas Ltd** (TSX:ALA) opted to slash its dividend, which was yielding as much as 16% after a steep drop in price. The stock has been struggling for much of the year, and with a very high payout ratio, it appeared to be overdue for some sort of an adjustment.

Even with the reduction in dividend, Altagas is still paying a very attractive 7% per year. The stock got a big jump upon announcing the cut, and it gives it some valuable cash in the process that it can use to fund more growth and to pay down its debt.

It's a good move for Altagas because it doesn't burden the company with a big monthly payout anymore and investors will benefit more from a company that has strong financials rather than one that has an unsustainable dividend.

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Date
2025/08/17
Date Created
2018/12/22
Author
djagielski