Could This 10% Yield Be a Safe Dividend for Investors?

Description

Anytime a dividend starts yielding more than 5%, there's usually a temptation to look at the company's financials to see whether it's a stable payout or not. And the higher up the yield goes, the more concern there becomes about whether the dividend could be cut.

They're definitely very logical concerns, but sometimes a stock could be yielding a high amount simply because its share price has fallen sharply in value. That's why when dividend stocks drop in value, they can be very attractive buys, given investors can lock in a higher-than-normal payout.

If they recover and the dividend remains unchanged, you're earning the same payout as investors that bought at higher levels and thus earn a higher percentage on your initial investment.

One stock that fell hard this week was utility company **Just Energy** (TSX:JE)(NYSE:JE). The stock has had a high yield for some time, and with a 14% drop on Tuesday, its yield shot up to over 10%.

What was behind the significant drop in price?

The reason for the sell-off was because the company issued a press release essentially stating that the controls relating to its receivables were poor, and that it would likely incur a write-down that could wipe off $50 million from its books.

The company stated that there were many "customer enrollment and non-payment issues" in Texas during the last year that caused issues, which led to a change in how Just Energy estimates its receivables going forward.

However, the company's executive chair Rebecca MacDonald tried to downplay the issues: "The enrollment and non-payment issues have been remediated and management is confident in the business and operational controls currently in place. These issues will not have a continuing effect on future cash flows."

Is it a good time to buy the stock for its dividend?

As a result of the drop in price, Just Energy's dividend is around the 10% mark. It's not unusual territory for the stock, and it's even traded much lower than this during the past year. And although Just Energy has paid this dividend for multiple years now, there's definitely some risk for investors here.

Over three of the past five quarters, the company has finished in the red, and it's also seen negative free cash flow just as often. If these customer issues result in further costs for the company, that could mean its weak financial numbers could get even worse. Adding controls and more processes into the mix will likely result in more overhead and potentially more staff as well.

That extra oversight might make it more encouraging for the company to slash its payouts and free up cash flow.

Bottom line

There are a lot of red flags around Just Energy's financials that would make me very uneasy about investing in the company today. Relying on its dividend could be a very risky proposition, because it's not hard to see why it would make sense for Just Energy to at least reduce its payouts, and it may just be a matter of time before it does.

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