



## ALERT: High-Dividend Stocks Can Wind Up Being Dividend Traps

### Description

Novice investors should be on guard against dividend traps. Many investors often fall into these traps. The emphasis of every dividend investor is dividends. However, you should be wary of a falling stock with attractive yields.

As an example, when a stock is trading at \$100 and pays \$4 per share in dividends, the corresponding yield is 4%. Should the price drop by 50% to \$50, it doesn't follow that the dividend would increase to 8%. In cases of a sharp fall in price, a dividend cut or total elimination is likely.

### Assessing your prospect

**Husky Energy** (TSX:HSE), a \$9.35 billion integrated energy company, has been operating since 1938. The company derives revenue from two major segments — upstream and downstream.

In the upstream segment, Husky engages in the exploration for and development and production of crude oil, bitumen, natural gas, and natural gas liquids. It also markets its products as well as the products of other oil producers.

The operations are primarily in Western Canada, offshore East Coast of Canada, and offshore China and Indonesia. On the downstream side, Husky upgrades heavy crude oil feedstock into synthetic crude oil, refining crude oil, marketing refined and petroleum products such as gasoline, diesel, asphalt, and ancillary products.

Part of your due diligence as an investor is to determine whether the company can sustain its earning power. The energy sector is a complex and volatile market. Hence, earnings in the short term could be deceiving. You might have to look back at the stock's historical performance.

### Actual scenario

Husky was in the red in 2015, with a year-end price of \$14.31. The company rebounded in the next

three years and ended each one in positive territory. In 2018, net income grew by 80.9% from the previous year. The year-end price, however, was even lower at \$14.11.

As of this writing, Husky is down 34% year to date. The dividend yield is 5.62%, and the payout ratio is 35.97%. These are not favourable signs, which could lead to a dividend trap.

Net earnings are projected to be lower this year while overall production is slowing in Western Canada as well as in the Atlantic and the Asia Pacific regions. Lower oil prices are usually the reason why revenue and earnings are falling.

Unfortunately for Husky, other major players are not experiencing declining revenue and earnings growth.

Husky is in a precarious situation, although a boost in production is coming once the rebuilding of its Superior Refinery is complete. Unfortunately, the company would need to shell out \$400 million for the reconstruction. Recouping the huge expense might take time.

## Long recovery

If you go back further in time or 16 years ago, Husky was trading at \$21.38. It's a far cry from its current price of \$9.30. The energy company can still make a comeback, but it would take a longer period to regain lost ground.

The price is relatively low, and the dividend is tempting. However, you might be taking a risk. Instead of dividend growth, you might end up with a dividend cut.

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### Date

2025/08/17

### Date Created

2019/10/31

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