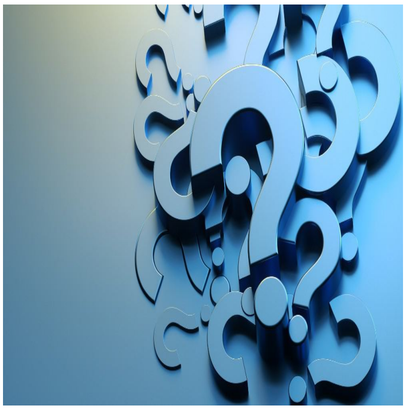

Is This 14% Dividend Stock Too Good to Be True?

Description

Chemtrade Logistics (TSX:CHE.UN) has long paid a hefty dividend. Since 2007 the company has paid a $0.10 monthly dividend with zero interruptions. Even the financial crisis of 2008 didn't reduce the payout. Although the yield often surpassed 10%, management didn't flinch.

The coronavirus has changed everything, however. With global economies starting to shut down, industrial businesses are expecting a big impact. That's a problem for Chemtrade, which supplies these customers with chemical inputs.

On March 11, management took unprecedented action, slashing the dividend by 50%. The payout was reduced to $0.05 per share per month, resulting in a yield of 7.9%.

The very next day, the stock market imploded, posting the biggest single-day loss in more than a decade. As a small-cap stock with little analyst coverage, Chemtrade shares were slammed. The stock now yields 14.3%. That's *after* the latest dividend cut.

Management teams like Chemtrade don't take a dividend cut lightly, especially since there hasn't been a decrease for 13 consecutive years. When they reset the payment level, they make sure it will be sustainable for months, if not years to come.

The 50% dividend slash was just 48 hours ago! And now the stock is yielding more than 14%. Is the dividend too good to be true?

What executives say

When Chemtrade slashed its dividend, company executives shared their thinking.

“Given the current uncertainty in the global economy and reduced visibility into the future, Chemtrade believes that it is prudent to reduce its monthly distributions by 50%,” the company said. “To date, the current economic conditions have not had a material impact on Chemtrade’s business, nor on the assumptions underpinning Chemtrade’s 2020 earnings guidance, which was issued in January 2020.”

So it appears as if the dividend was cut *in advance* of any trouble. That’s smart. Many companies wait until they’re forced to conserve cash, although Chemtrade’s elevated debt levels may have influenced the decision.

“While we continue to believe that our distribution is sustainable in normal times, these are not normal times,” noted CEO Mark Davis. “In times like these, financial prudence is essential.”

Looking to the future

At its core, Chemtrade is a strong business. The company distributes specialty chemicals to industrial users across North America. In this business, scale is king.

The bigger you are, the cheaper you can service your clients. Chemtrade has number one or number two market positions across its portfolio, entrenching it as an industry leader.

This business isn’t going away, and its structural advantages are clear, yet its debt levels are concerning. Long-term debt currently stands at $1.4 billion. After the stock price decline, Chemtrade only has a market cap of $400 million. Cash levels are only $13 million — a disaster waiting to happen.

If you’re looking to scoop up dividend deals, stay away from Chemtrade. The company’s long dividend history and current yield will likely tempt some value investors, yet the math doesn’t add up.

Interest expense last quarter totaled $25 million. The new dividend rate will cost around $15 million per quarter. That’s more than the company’s total cash balance!

Chemtrade will almost certainly need to access the credit markets again this year. Whether credit will be available is all but certain. While this may be a good long-term value play, I don’t have any confidence in the dividend’s sustainability.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:CHE.UN (Chemtrade Logistics Income Fund)

PARTNER-FEEDS

1. Business Insider
2. Msn
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