Is This Company a Safe Dividend Stock?

Description

For a long time, I was a pipeline investor. I always enjoyed receiving their steady dividends, as I watched the yields grow year after year. They were a core part of my dividend portfolio for many years. The yields were steady and growing over time, adding to their appeal.

The fall of 2020 has changed all that. For the first time in a decade, I am nervous about the dividends on the smaller pipeline companies. This fear was unfortunately realized when **Inter Pipeline** (TSX:IPL) cut its dividend a few days ago.

The move was not unexpected, as the company's shares tumbled to a low point of under $10 a share, where it still sits today. The yield is still substantial at around 6%, but that is a small comfort for investors who depended on the income.

Are all pipeline stocks at risk?

There was chatter that Inter Pipeline may cut its dividend, even when it sat up around $22 a share — a level that it had maintained for a few years. Its debt was high, but its future cash flow and the promise of the Heartland expansion coming online in a couple of years made it a promising risk. Besides, this was a company that had raised its dividend for years.

The fact that Inter Pipeline cut its dividend has put my faith in other mid-cap pipelines at risk. **Pembina Pipeline** (TSX:PPL)(NYSE:PBA), for one, was the higher quality of the two stocks, so it commanded a higher valuation. The dividend was smaller at 5% when the stock was around $50 a share, seemingly confirming the faith that I had in the company.

Unfortunately, that stock fell deeply as well, with the yield now at about 10%. This puts the payout into dividend purgatory, where it is neither absurdly high to warrant a very likely cut, nor too low, leading investors to believe the dividend is safe.

If it is true, possible oil production cuts announced by President Trump could be a positive factor for the pipelines. However, there is a massive lack of demand at the moment, which may counteract any possible cuts. Furthermore, the negative political environment facing western Canadian oil has not improved, adding more uncertainty to pipeline investment.

Who should buy these stocks?

A few months ago, I would have put pipeline stocks in the same category as other steady dividend payers such as telecoms and conventional utility stocks. Unfortunately, there is a real threat to revenues for pipelines due to a massive, never-before-seen global demand reduction combined with a supply shock.

This does not mean that pipelines are bad investments. For income-focused investors who depend on relatively safe, increasing dividends, they are simply far riskier in the current market environment than previously.

If you are looking to take a calculated risk on a very cheap stock with the possibility of a huge upside, you may want to check out stock like Pembina. It has not yet cut its dividend, implying that it may as yet be safe. Even before the issues facing oil companies were magnified by the OPEC supply shock, Pembina was considered a safer stock than Inter Pipeline.

It might be a smart move to wait for a turnaround while you are collecting a 10% dividend yield. You don’t have to look any further than the huge moves the stock recorded yesterday to determine how much it could move if oil prices turn.

The bottom line

At the moment, the smaller, pure energy pipelines such as Pembina are not for me. I want to take advantage of this pullback to buy shares of my core holdings. Telecoms, regulated utilities, and banks are more appealing currently than riskier oil plays. If you are looking for a huge upside swing, all the while collecting a large dividend, you might want to take a look at Pembina. Just understand the risks inherent to such a holding.

CATEGORY

1. Dividend Stocks
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3. Investing

TICKERS GLOBAL

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