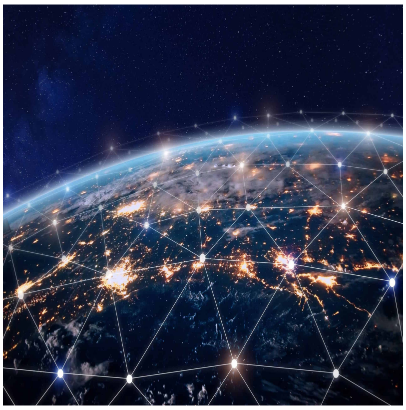

TSX Stocks: Are Dividend Cuts Always Bad?

Description

Dividend investing is one of the best long-term investing strategies. There's almost nothing better than compounding passive income and using it to make investments in new **TSX** stocks.

Whether it's a high-yield dividend stock providing you a significant return on your money, or whether it's a dividend growth stock that continues to grow in value over the course of your investment, dividend investing can be extremely rewarding.

However, sometimes it doesn't always go as we would have planned. And when stocks that pay a dividend have issues, it could lead to a dividend cut.

There are a whole host of reasons why a TSX stock may cut its dividend. Profitability could be declining. The company could face a major expense. Then there are debt issues that could force a company to trim the dividend.

Essentially, whenever a company faces a cash flow issue, the dividend is one of the best tools management has to save the business cash.

Obviously, from a shareholder's point of view, none of this is ideal, but are dividend cuts always a bad thing?

Dividend cuts

When TSX stocks run into trouble, like almost every business is today, management has to act swiftly and decisively. That said, impulse decisions must be avoided.

A potential dividend cut is rarely an instant thing when a company runs into trouble. In the meantime, the stock is going to sell off, and investors will speculate about the fate of the company.

This is when you'll start to hear rumours of a dividend cut.

By this point, the negative issues are already priced into the stock. So sometimes the dividend can give the shares a boost if investors believe that the cut is what's best for the company long term.

Peyto Exploration and Development Corp (TSX:PEY) is a perfect example of exactly that scenario.

TSX energy stock

Peyto is a natural gas stock, and one of the lowest-cost producers on the TSX. The company has a significant debt load that is manageable when commodity prices are trading naturally.

Unfortunately, when commodity prices crash, so too does Peyto's earnings power. Most of the debt ratios are calculated using earnings or cash flow, so when prices affect the company's earnings, the debt ratios tend to increase substantially.

This is precisely what happened to Peyto. So although it's a low-cost producer, the debt ratios were becoming too big, and the company had to step in to ease liquidity strains.

I even warned investors that there was a good chance Peyto would cut its dividend in my article back on March 28.

It's far better for TSX stocks to suspend or trim a dividend for six months and use that cash to stabilize the business, rather than continue to pay the dividend and risk far more significant issues with the business long term.

When Peyto cut its dividend on April 15, the stock exploded over the next few days. The next five trading days saw the stock gain roughly 80%, as investors saw the new potential for a company with lower liquidity issues.

In fact, the stock rallied so much that many analysts have come out and said this would be a great time to reduce your investment in Peyto, as the stock is above its target price.

Bottom line

While Peyto may not be a buy today, it's a perfect example of how dividend cuts aren't always a negative.

Not only can they make the shares of **TSX** stocks rally, but they can also provide significant liquidity to a company as it battles short-term headwinds.

The next time one of your stocks runs into trouble and you think there may be a cut to the dividend, don't rush to sell your stock. It could end up being better for your investment in the long run.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

1. TSX:PEY (Peyto Exploration & Development Corp)

PARTNER-FEEDS

1. Business Insider
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Date
2025/08/16
Date Created
2020/04/27
Author
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