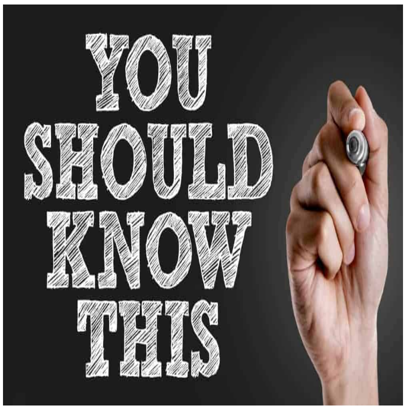

3 Dividend Facts Every Income Investor Should Know

Description

With bond yields at record lows, investing in dividend-yielding stocks seems logical. The recent market pullback has meant that forward yields are attractive for income investors. We know that forward yields and share prices move in opposition to each other.

For example, consider a company with a share price of $50 and a forward yield of 5%. If the stock falls to $40 per share, its yield will rise to 6.25%. Further, if a good-quality dividend stock has overcorrected, it'll give investors a chance to benefit from capital appreciation in a market rebound.

However, investors need to consider several factors while investing in dividend-paying companies.

The payout ratio is important

The payout ratio is one of the key ratios while investing in dividend stocks. The payout ratio is calculated by dividing the dividend per share with the company's earnings per share. A low payout ratio provides the company with the flexibility to increase dividends over time as well as reinvest in capital expenditures or reduce its debt balance.

It can also help the company sustain these payouts in case of an earnings slump due to macro conditions, such as the ongoing coronavirus crisis. Conversely, a dividend ratio close to 100% or over this multiple may indicate dividend payments are unsustainable.

Recently, energy giant **Suncor** (TSX:SU)(NYSE:SU) cut dividends by 55%. This means its attractive dividend yield of 8% has now fallen to 3.5%. In the first quarter of 2020, Suncor reported a net loss of $3.5 billion compared to a profit of $1.2 billion in the prior-year period.

It also had to cut capital-expenditure spending from $4.2 billion to $3.8 billion in 2020. Suncor was one of many energy companies to cut dividends. We have seen that the energy sector has been decimated due to low oil prices and oversupply. The COVID-19 pandemic has also meant lower-than-expected demand for oil producers. This has led to dividend cuts across energy companies.

This major dividend cut came as a shock to investors, as Suncor managed to maintain payouts even during the 2008 financial crisis. But these times are truly desperate, and Suncor will save approximately $800 million due to the lower payout and reduced capital expenditures.

Dividend payouts are not a guarantee

While Suncor reduced its dividend payout, there is a chance that companies can completely suspend dividends as well. Dividend payments are not guaranteed. In 2019, networking heavyweight **Nokia** stopped dividend payments, as it increased investments to build 5G infrastructure.

Nokia is part of a mature business with low-profit margins. It did not have a strong balance sheet to maintain payouts, and this led to the dividend withdrawal. Nokia's forward yield stood at 4% prior to its suspension.

Avoid the dividend yield trap

High payouts might be attractive. But you need to look closely at the company's financials. If a company has a strong history of dividend increases, you can safely bet on its ability to sustain these payouts.

Further, companies with high yields may also have been underperforming broader markets in terms of capital appreciation. **Chemtrade Logistics Income Fund** slashed its payout by 50% to $0.05 per share month. Despite the massive cut, the company's forward yield stands at 11%. However, the stock has lost close to 74% in market value in the last five years.

Forward yields cannot be viewed in isolation. Investors need to look at key metrics such as the company's payout ratio, debt levels, and earnings growth before making an investment decision.

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