Dividends: Are They Safe?

How goes your "voluntary house arrest"? Like you, Jennifer and I are in our 3rd week of this voluntary lock-down. I am still very busy reviewing opportunities with cash we set aside for times like this. From discussions with clients, the number one question is; "are the dividends safe"? Before we address this further, if you have friends or family not receiving the advice they need from their financial adviser at this time, ask them to give me a call. So, let's get into it deeper and I will share my thoughts.

It Depends!

Great statement, huh! Well it does depend on who we are referring too. If we are talking about Crescent Point Energy, then their dividends have already been cut some -75%. Do I anticipate seeing more of the oil & gas, especially the E&P (Explorers and Producers) cut dividends...yes. Especially in Canada. Reminder Western Canadian Select (WCS crude) is massively discounted against US Crude prices. So, what your local news outlet quotes for crude in US$ is not what Canadian E&P companies receive. On April 1st, Western Canadian Select is running at around US$5.40 per barrel to US crude at US$25 per barrel. Why the discount? The big reason is transport costs. To get WCS to markets (in the US) costs a tremendous amount to transport. So yes, the E&P companies will cut capital spending (many already have) and possibly dividends.

That is one area to avoid and we always have. Now let's review Pipeline companies that transport this oil and natural gas. There may be some companies in this space that cut dividends (Inter Pipeline already has by -72%), however some are not showing signs to have to do this due to the following reasons. Many have contracts that are not exposed to the direct pricing of oil. Many have "use or pay" contracts (the E&P's pay the contract whether they use the pipeline or not). Many are very well capitalized and have strong balance sheets and are run by very competent management groups that run their businesses knowing challenges like the Covid-Correction can occur. So, at this time, within the selected pipeline companies we own, yes I do feel their dividends are safe.

What about the Banks?

As clients know, we have avoided any substantial investment in Europe for a decade. The ECB banks are being "voluntarily forced" to stop their dividend payments. US banks have already halted share buybacks under political pressure. Canadian banks have also received a similar request to halt share buybacks with the free flow of cheap capital, but not to stop dividends. They are requested to not increase their dividends beyond what they already pay, but not stop them. Could this political pressure change too "stop paying dividends"? Of course, anything is possible, but it is not realistic. And here is my argument why.

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Dividend policies by banks are not the same around the globe. ECB banks typically pay a dividend twice a year and it is based on profits and the period end capital position. So, there is no consistency to these dividends, unlike Canadian banks. The top 5 Canadian banks dividend payout target range is 40-50% on the forward profit outlook and this provides a strong cushion as we, like the banks, work through times like this. Reminder that approximately 80% of bank stock is owned by retail investors (you and me) and a large portion of these owners are retirees. One thing we do know, is retirees are a very vocal and large lobby group and there is likely no political desire to piss off this group, unless of course you wish to not get re-elected. Note; (RIF withdrawals can be reduced by -25% for 2020 already, to assist these same retirees).

Did they cut dividends in the 08'-09' Financial Crisis?

Many of you remember that the strong companies that make up our core list did not cut their dividend during that financial crisis. I do believe this is one of the strongest data points to be reviewed. For if the companies we own were great companies in '08-'09 and did not cut their dividends, and they are still great companies today, they will not cut them this go round. Absolutely I may get surprised by one of these great companies announcing a dividend cut, however I stand by my views at this time. It is also why we own multiple companies as we spread this risk around among these great firms and industries. Remember I am a big fan of infrastructure and utility companies...They are needed in good and bad times.

Clients stay tuned and be prepared to see communications from me on when I see further buying opportunities on a great company that fits my screening process. I cannot tell you when, however I do see this happening in days, weeks and months ahead. Stay well.

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