Investors: Be Wary of These Great Dividends

Description

We've all been warned about the dangers of chasing yield.

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As the old expression goes, there's no such thing as a free lunch. In a world where GICs yield 2%, it's naive for investors to believe dividends of 7%, 8%, or even 10% are as safe as the guaranteed payout offered by banks.

Sure, there are dozens of stocks that pay high dividends and have maintained those payouts for years. That kind of history is nice to see, but it's pretty much meaningless going forward. Dividends are paid from cash flow. If cash flow is hurt, dividends will feel the pain. It's that simple.

Investors looking at these kinds of stocks must do a little analysis, ensuring free cash flow is up to snuff.

Here are three stocks with great dividends that are looking a little uncertain going forward.

Dream Global REIT

Dream Global REIT (TSX:DRG.UN) owns 197 office buildings in Germany, focusing on the seven largest markets in the country.

When Dream Global first became publicly traded in 2011, approximately 85% of its rental income came from Deutsche Post. Thanks to a series of acquisitions and a serious diversification effort, Germany's post office only accounts for 22% of total revenue.

There's a lot to like about investing in Germany. It has a strong economy and low unemployment. Interest rates are also very low in Europe, allowing Dream Global to borrow at attractive rates.

There's just one problem. Through the first six months of 2016, Dream Global earned $0.40 per share in funds from operations. It paid out the same amount. That's not sustainable over the long term.

One saving grace might be the company's dividend-reinvestment plan. About 14% of shareholders take their dividends in the form of more shares, which reduces the cash payout ratio to 86%. But that's only a short-term fix, since the constant dilution of shares will mean greater dividend obligations going forward.

DH Corp.

Last week was bad for **DH Corp.** (TSX:DH) shareholders. Shares of the cheque-printing-turned-software company plummeted nearly 40% because of quarterly results that missed expectations.

There were two main issues. The first was the payment-processing business, which includes printing cheques. Revenue from this part of the company is now projected to fall by double digits this year versus previous projections of single-digit declines.

The other issue is with the Canadian housing market. Mortgage volumes are expected to fall as new, tighter rules limit what borrowers can qualify for. Software to do these applications and process payments is a big part of DH’s business. A downturn in housing will impact it.

DH also owes a lot of money with a current debt load surpassing $1.5 billion. It’ll be difficult for the company to continue paying its attractive 7.3% as well as having enough cash flow to really make a dent in the debt, especially if it experiences any additional weakness.

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Veresen

It’s been a tough few days for **Veresen Inc.** (TSX:VSN) shareholders. Shares of the pipeline company are down more than 11% in the past five trading days alone.

The company consists of two major parts: natural gas pipelines (and storage) and power plants. Veresen recently announced the power division was up for sale, freeing the company up to focus on the natural gas business.

Veresen has approximately $1.4 billion in capital projects on the go, and selling the power plants would go a long way to paying for those projects as well as eliminating some debt.

But that move would lead to lower profits in the short term. Veresen currently earns enough in distributable cash to cover the dividend–albeit barely–and investors are concerned a drop in earnings from selling the power division could put the payout in danger.

Management is telling a different story, however. By 2018, new assets will add to the bottom line, leading to a sustainable dividend even without cash flow from the power assets.

The company might be right, but investors interested in Veresen’s 8.3% dividend should still be careful.

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