Why Dividend Stocks Win in a Downturn

Description

Oil and gas producer stocks are a perfect example for this discussion because they have above-average volatility. Their shares swing more or less in relation to the ups and downs of changing commodity prices. Other factors can also cause huge price movements, such as when the companies push out equity or debt, make an acquisition, or release surprising earnings results.

However, there's a big difference between buying a stock that offers a dividend and one that doesn't, though both will experience price volatility.

Given that two stocks in the same industry that are affected by the same economic environment, the one that offers a decent dividend will outperform. After all, dividend income is a part of the total returns equation.

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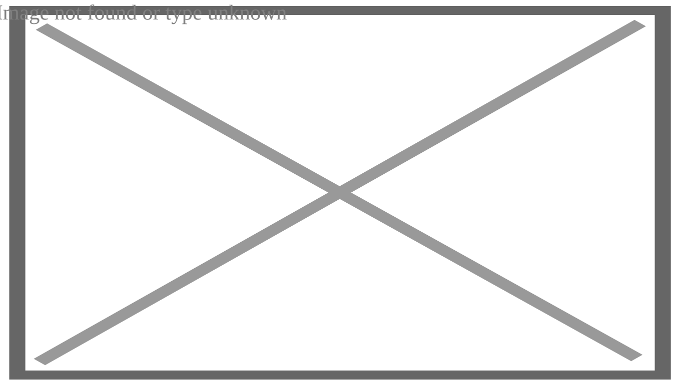

Since before the last recession, **Vermilion Energy** (TSX:VET)(NYSE:VET) stock has delivered annualized returns of 5.1%. If you think that's bad, take a look at **Baytex Energy** (TSX:BTE)(NYSE:BTE) stock, which delivered 0.7% in the period. Baytex also no longer pays a dividend. In fact, a big reason for its underperformance is that it eliminated its dividend, which used to be very generous at a normal yield of 4-6%.

If a stock with a decent dividend yield is to win in a downturn (by offering positive returns from the dividend), the key is that the dividend must be sustained. Hopefully, it's sustained by cash flow and not through borrowing or with the help of a dividend reinvestment plan.

Vermilion has maintained or increased its dividend since 2003. That is, it has paid a solid dividend through the last recession and market crash, and through the oil price collapse in 2014 until now. So, its dividend is relatively safe compared to oil and gas producers, which have cut their dividends.

Vermilion's payout ratio is estimated to be about 90% this year after accounting for its 2018 capital spending. And the payout ratio is positioned to improve next year.

The stock offers a yield of exactly 8% at $34.52 per share as of writing. Should the stock price continue to fall, buyers today will at least get an 8% return from the dividend. However, I believe that eventually, the stock will trade much higher than current levels, such that investors can get a nice monthly income along the way and price appreciation some time down the road.

Assuming Vermilion stock recovers to a more normalized level, buyers today are looking at +50% upside potential.

Investor takeaway

In a downturn, the stocks of both Vermilion and Baytex will decline, but Vermilion should act more defensively given the support from its dividend. Moreover, its dividend yield, which is currently very generous at 8%, offers immediate returns as dividend income while investors wait for its share price to recover.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:VET (Vermilion Energy)
2. TSX:BTE (Baytex Energy Corp.)
3. TSX:VET (Vermilion Energy Inc.)

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