Warning: These 3 Stocks Could Cut Their Dividends in 2019

Description

It's every income investor's worst nightmare. Yes, I'm talking about the dreaded dividend cut.

Some investors try to avoid this fate by steering clear of high-yield stocks altogether, but limiting your investing universe to companies yielding 5% or less can really impact the total income generated by the portfolio. Besides, Canada has dozens of safe and dependable income sources paying anywhere from 5% to 10% annually.

The secret is taking a look underneath the hood rather than just kicking the tires. Companies that cut their payouts will usually give investors many warning signs. Unfortunately, optimistic investors don't want to hear about a impending dividend cut, so these red flags get ignored.

Here are three stocks in danger of cutting their generous payouts in 2019.

Diversified Royalty

Diversified Royalty (TSX:DIV) owns the kind of assets many investors like. It acquires top-line royalties from asset-lite companies in exchange for a one-time fee. Deals so far include well-known brands like Mr. Lube, Air Miles, and Sutton Real Estate. The company then pays out virtually all earnings back to shareholders and borrows the cash each time it acquires a new royalty stream.

Unfortunately, the Air Miles acquisition has been a bit of a dud thus far. Air Miles reported growth in miles issued over its last two quarters, but that came after six consecutive quarters of declines.

When Diversified acquired Air Miles a little over a year ago, management made the decision to raise enough cash to cover more potential deals. This pushed the payout ratio to over 100%. Unfortunately, another deal hasn't happened yet.

The payout ratio currently sits at approximately 116%, which is never something you want to see. On the other hand, there's plenty of cash just sitting idle on the balance sheet, easily enough to cover the shortfall for a long time. Still, investors should be a little cautious here.

Slate Office

Slate Office REIT's (TSX:SOT.UN) dividend immediately looks too good to be true. The yield just passed 12%.

The company has been on an acquisition tear in 2018, picking up some $500 million worth of property. This includes an expansion outside Canada for the first time, entering the Chicago office market.

One problem with all these deals is they've left the balance sheet in weak shape. Slate's debt-to-assets ratio is approaching 55%; most REIT analysts like to see that number below 50%. You do not want to have too much debt in a rising interest rate environment.

Slate has also been paying out more than it earns on an adjusted funds from operations (AFFO) basis for months now. In its most recent quarter, it earned $0.17 per share in AFFO. Distributions totaled $0.1825 in the period for a 110% payout ratio. That isn't good.

American Hotel

American Hotel Income Properties (TSX:HOT.UN) also pays a massive dividend. Its monthly payout is US$0.054, which translates into a 13.6% yield.

Shares have been battered lately because the company released tepid quarterly numbers. It also has a debt problem, with its debt-to-assets ratio surpassing 60%. Other red flags include the company replacing the outgoing CEO with his brother and the long-term problem of more travelers choosing options like AirBnb over traditional hotel rooms.

2018's payout ratio is expected to be approximately 100%. Management projects the payout ratio will drop to around 95% in 2019 as recently renovated rooms start earning again. It's obvious the market doesn't share the company's optimism.

The bottom line

I'd rank American Hotel Properties and Slate Office REIT as having a high chance of cutting the dividend in 2019, while Diversified Royalty's payout is a little more secure. Still, the fact remains; investors putting their cash in companies that pay more than 100% of earnings back to shareholders are taking a major risk.

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