Is it Just a Matter of Time Before This 13.8% Yield Gets Cut?

Description

High-yielding dividend stocks can produce some attractive returns for investors. But when the yields become too high, it may just be a matter of time before a company makes an adjustment, either by reducing or completely eliminating its dividend.

In some cases, a high yield may only last for a short period of time, especially if the stock only falls in value for a short time. But if the drop in price proves to be more than temporary, investors may want to think long and hard before buying shares of what could be a risky dividend stock.

One example is **Vermilion Energy Inc** (TSX:VET)(NYSE:VET). As of the end of last week, the stock had tumbled nearly 40% since the beginning of the year. Underwhelming quarterly results, as well as general bearishness in the oil and gas industry, have hurt Vermilion's stock. Many oil and gas stocks have struggled not just this year but since the downturn in the industry began five years ago.

The steep drop in price has had a big impact on Vermilion's dividend.

To put into perspective just how high its dividend payments are, consider that if the company paid shareholders $0.23 every quarter, the stock would be yielding a very impressive 4.6% per year. Many dividend stocks don't even come close to such a yield. And yet, Vermilion doesn't pay $0.23 quarterly. Instead, it makes those payments on a monthly basis. It's yield is considerably higher, coming in at around 13.8%.

Could the recent election results change the company's outlook?

While Vermilion's management didn't suggest a cut to the dividend was on the horizon anytime soon, things have gotten even worse for the industry. The recent election results did not go the way the oil and gas industry wanted, and could lead to even tougher times ahead in the oil patch, which could be more bad news for companies and employees that have already been devastated.

As much as investors may want to believe that the dividend will remain intact because management says so, it's a risk that they can't afford to ignore. If an announcement comes that the payouts will be adjusted, they will come without warning and the impact will be immediate. That being said, freeing up cash could actually be welcome news for investors.

But relying on the dividend to stay intact in light of some very challenging conditions is definitely a risky proposition for investors.

Bottom line

If you're thinking of investing in a good dividend stock, you don't want to neglect the importance of stability. Lower-yielding stocks may pay you less, but they'll also likely be a lot safer as well.

If I had confidence that Vermilion's dividend would remain intact, I'd definitely buy shares, especially with the stock being a fairly cheap buy, trading at little more than its book value. And while Vermilion may continue paying its dividend for the foreseeable future, there's a lot of uncertainty surrounding the stock and it's not a risk I'd be willing to take.

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