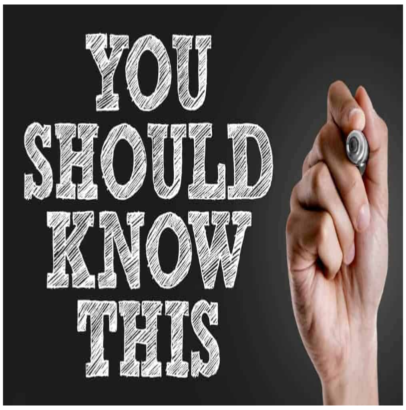


Warning: Don’t Buy These Dividend Stocks for Passive Income

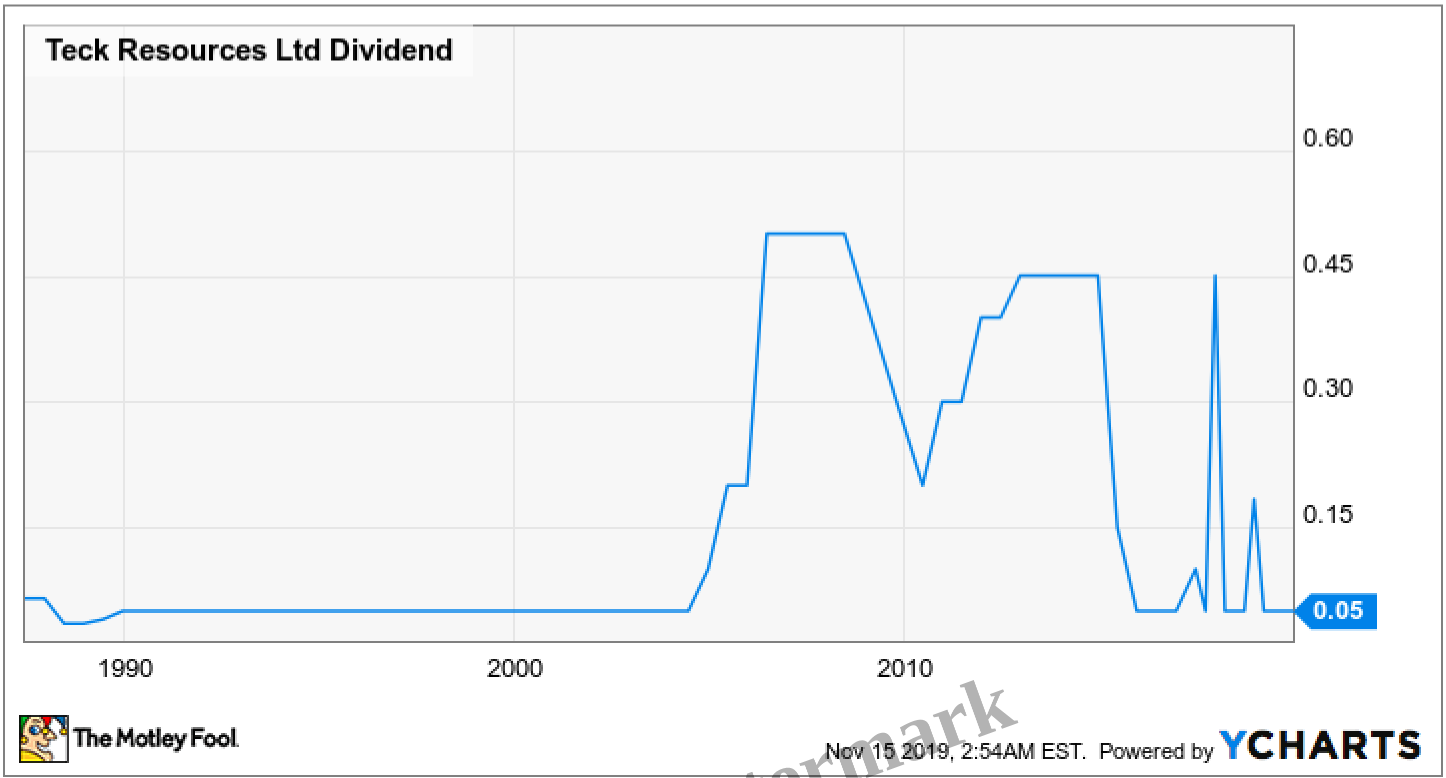
Description

If you’re attracted to dividend stocks for their passive income, be careful, because some dividend stocks require more attention than you think.

Passive income suggests that little to no work is required for the income to roll in. However, some dividend stocks require *a lot* of work. In fact, some can *cut* their dividends. Therefore, these dividend stocks require active management on the investor’s part. And it’s better to look at them as total-return investments instead of dividend investments.

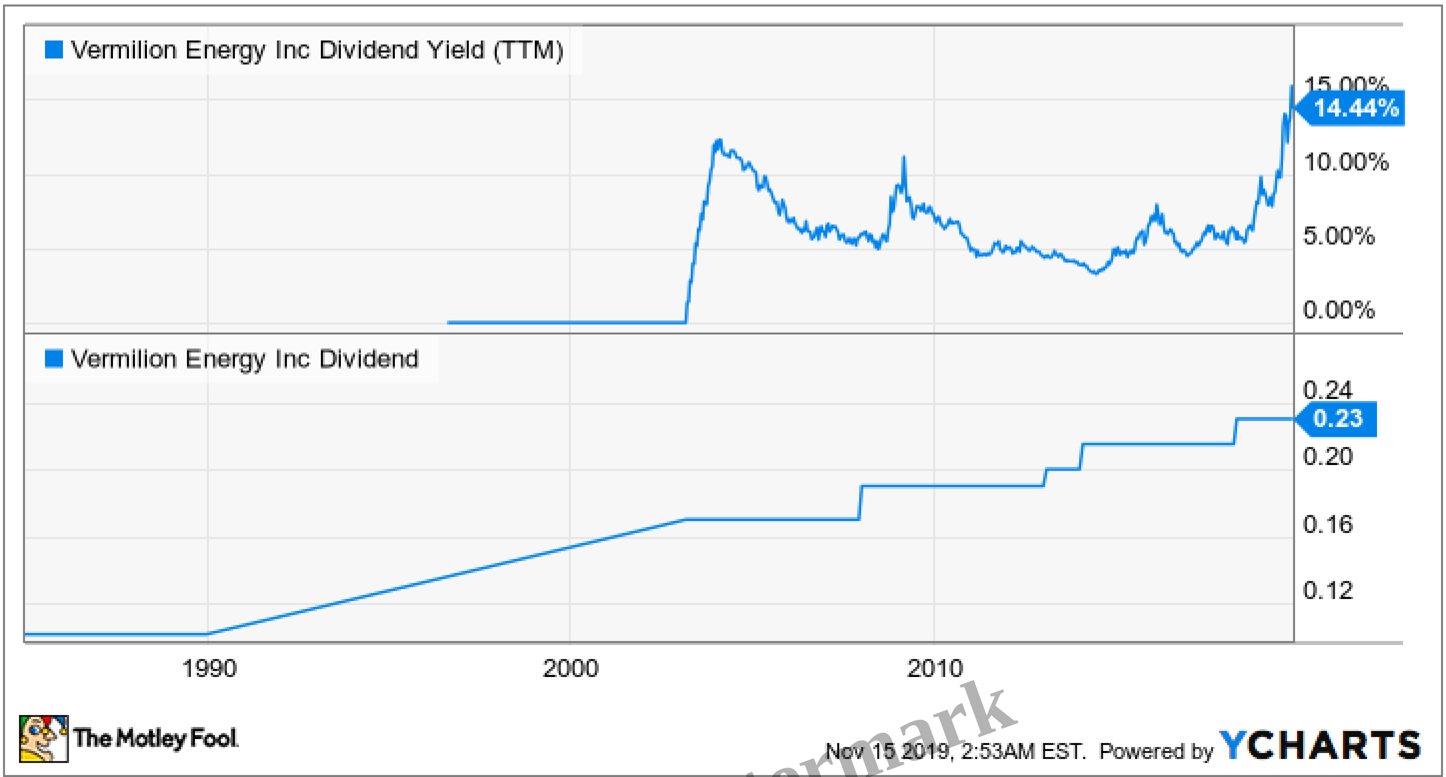
If you’re dealing with a lower-quality, cyclical, or commodity stock, be extra cautious!

Take a look at the dividend history of **Teck Resources** stock. The cyclical nature of its mining business makes its profitability highly unpredictable.



TECK.B Dividend data by YCharts. TECK.B's dividend history.

Other than mining stocks, oil and gas producers also tend to produce volatile profitability. So, it's very interesting that **Vermilion Energy** (TSX:VET)(NYSE:VET) has kept its dividend intact so far. Its +14% yield is begging for a dividend cut! At least, the market is expecting one.



VET Dividend Yield (TTM) data by YCharts. Vermilion's dividend and yield history.

On one hand, management is somewhat pressured to maintain the dividend because Vermilion has maintained or increased the monthly payout since 2003. On the other hand, it may be better off for the company to cut the dividend and use the capital to improve the balance sheet.

The company seems to be prioritizing the protection of its dividend over growth, which may be a good thing, because commodity prices are low. This year, it reduced the capital investment by $10 million to $520 million but still expects to increase production per share by 5%.

Next year, it's further reducing the capital investment to $450 million but expects to keep production levels stable at about 100,000 barrels of oil equivalent. By doing this, it projects sequential free cash flow growth in 2019 and 2020.

That said, Vermilion's year-to-date total payout ratio is 105%. So, don't bet the farm that it will maintain its dividend. Then again, since 2003, Vermilion had 12 years in which the payout ratio was over 100%, but it still maintained the dividend. So, whether Vermilion will or will not end up cutting its dividend depends on the management and macro environment.

Investor takeaway

Don't buy dividend stocks like Teck Resources or Vermilion Energy for their potential dividend income. Because their earnings and cash flows are highly unpredictable, there's a bigger chance for them to cut their dividends.

You’re better off examining them as total-return candidates. And if you do choose to invest in them, don’t bet the farm! If you want passive income, there are much better ideas out there.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing
4. Metals and Mining Stocks

TICKERS GLOBAL

1. NYSE:VET (Vermilion Energy)
2. TSX:VET (Vermilion Energy Inc.)

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