Warning: These 3 Great Dividends Are in Danger

### Description

Despite warnings from seemingly every expert investor and pundit, many Canadian savers are still committing a big investing sin.



They continue to stretch for yield.

The tricky part about this dire warning is there are dozens of high-yield stocks in Canada that pay sustainable dividends. Although in general, a higher yield is always more risky than a lower one, that doesn't necessarily make the whole sector something to be avoided. Investors just need to be careful, that's all.

Unfortunately, the same mistakes are usually made. Greedy investors focus on the highest yields. Some don't look at the underlying financials — documents that are usually filled with warning signals — and many focus on crummy businesses without much pricing power, organizations that are at an even higher risk of cutting their payouts.

Let's take a look at three of the most dangerous high-yield stocks in Canada — names that dividend investors shouldn't touch with a 10-foot pole.

## Vermilion Energy

You shouldn't be surprised that an oil producer with a 15.5% dividend tops this list.

**Vermilion Energy** (TSX:VET)(NYSE:VET) is a medium-sized energy producer with assets around the world. It has production in Canada, the United States, various nations in Europe, and Australia.

Management has focused on high netback light oil production, and the company gets an additional boost from its foreign operations getting the benefit of Brent crude pricing.

If crude lingers around the US$55 per barrel mark, Vermilion can just barely afford its dividend. But thanks to decreased projected energy demand from China, the North American benchmark price for crude has recently dipped to around US$50 per barrel.

There's also a strategic argument for Vermilion switching its dividend policy. Its shares are hardly expensive here. It would make sense for the company to slash the dividend and then use the cash to repurchase those cheap shares.

The company could slash dividends by 66% and still pay a 5%-ish yield, as well as having plenty of excess cash for share repurchases.

## Melcor REIT

**Melcor REIT** (TSX:MR.UN) is a small-cap real estate company that primarily owns assets in Alberta. Its portfolio includes 38 office, retail, and industrial buildings in Alberta, Saskatchewan, and British Columbia, with around 90% of net operating income coming from Alberta.

Unfortunately, the Alberta economy continues to struggle. Crude oil is the big culprit for Alberta's woes, of course, but some investors argue the province isn't doing itself any favours with talk of separation or when it actively antagonizes the federal government. This could potentially lead to more political uncertainty — something that would impact investment in the province.



Getting back to Melcor more specifically, the company has a current payout ratio of around 100% of adjusted funds from operations. It can barely afford the dividend today. Additionally, Melcor's debt-to-assets ratio is a little high, checking in at 55.8%. Most REIT investors like to see that ratio in the 50% range, or ideally even lower.

Melcor shares also trade at a large discount to book value. It would be a prudent move to cut the 8.2% dividend and use the savings to gobble up undervalued shares.

## IGM Financial

**IGM Financial** (TSX:IGM), the parent company of Investors Group, is in a tricky spot today.

The company is trying to pivot away from its traditional business, which is selling overpriced mutual funds to retail investors. To management's credit, the company can see the writing on the wall and wants to focus on lower-priced funds and, increasingly, high net worth clients.

There are a few problems with this strategy, however. Competition is fierce in wealth management, especially toward wealthier clients. And with competitors offering basic portfolio management for 0.50% annually — or even cheaper if investors go a do-it-yourself route — I see a future where IGM's earnings crater.

To the company's credit, however, pundits have been predicting its death for years now, and it keeps on chugging along. The 5.8% dividend is also well covered by earnings today, although the payout ratio could turn ugly quickly if we get a big bear market.

## The bottom line

There's no guarantee any of these dividends get cut, of course. But they sure look risky to this writer. I'd avoid all three in favour of payouts that are much safer.

**CATEGORY**

1. Dividend Stocks
2. Energy Stocks
3. Investing

**TICKERS GLOBAL**

1. NYSE:VET (Vermilion Energy)
2. TSX:IGM (IGM Financial Inc.)
3. TSX:MR.UN (Melcor Real Estate Investment Trust)
4. TSX:VET (Vermilion Energy Inc.)

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