2 Stocks Whose Dividends Could Be in Danger

Description

If your primary purpose of buying dividend stocks is for dividend income, then you need to beware of factors that could result in dividend cuts. Dividend stocks with the following characteristics may have dividends that are in danger.

Dividend stocks with volatile earnings

Dividend stocks with highly volatile earnings are ones you need to watch for. Potential TSX stocks in this bucket are commodity stocks like energy stocks and mining stocks. Energy stocks like **Whitecap Resources** (TSX:WCP) can do very well for investors, including increasing their dividends and providing amazing price appreciation when oil prices cooperate or are rising — especially if the company is leveraged.

For example, WCP stock has more than doubled investors' money in the last three years while significantly improving its financial position. However, when the operating environment is challenging and oil prices are depressed, it does poorly and is likely cut its dividend, as it did in 2016 and 2020.

Currently, the oil stock is still in a position to pay a healthy dividend. At $9.85 per share at writing, it yields 4.5%. Additionally, analysts estimate substantial price appreciation potential of about 52% over the next 12 months.

Stocks with high debt levels

Stocks with high debt levels are especially penalized in today's rising interest rate environment. For example, **Algonquin Power & Utilities** (TSX:AQN) currently has an investment-grade S&P credit rating of BBB. However, its debt-to-equity ratio has risen from 1.6 times in 2019 to two times in the last reported quarter.

One analyst also pointed out that Algonquin is impacted by variable interest rates on some debt that requires refinancing within the next couple of years. Essentially, the utility is getting a double whammy from its relatively high debt levels and lower credit rating versus its larger regulated utility peers and from having an extend payout ratio.

Stocks with high/extended payout ratios

Based on the midpoint of Algonquin's most recent adjusted earnings per share estimate, its payout ratio would be extended at about 107% this year. Given that inflation is still relatively high at about 7%, interest rates would at least stay elevated for some time (if not rising some more).

Currently, Algonquin stock yields 10%. Algonquin's acquisition of Kentucky Power would increase its regulated-utility rate base but if the transaction doesn't close as anticipated this year, the stock could cut its dividend next year. On the positive side, stocks that cut their dividends could experience a rally, because the savings could be used to pay down debt. In any case, at the present time, investors should view AQN as a potential total-return investment instead of a safe dividend stock.

The Foolish investor takeaway

Juicy dividend yields could be too good to be true. Know that you're taking greater risk when a dividend stock offers a big yield. The greater risk could come in the form of slower earnings growth or be a potential dividend cut down the road if the macro environment isn't doing well or management makes a misstep. Limit the allocation of these riskier stocks in your portfolio to better protect your principal.

Whitecap Resources currently appears to have strong coverage for its dividend. Although Algonquin's dividend could be in danger, it could make a comeback over the next few years as a turnaround investment or contrarian play.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:AQN (Algonquin Power & Utilities Corp.)
2. TSX:WCP (Whitecap Resources Inc.)

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