Is Torstar's 10% Dividend Yield Too Good to Be True?

Description

If you asked most investors to pick an underperforming sector, one of the first on many lists would be the newspaper industry. The internet has fundamentally changed the way we consume information. **Facebook** and **Twitter** can help breaking news travel faster than ever before. Non-stop news television can analyze and reanalyze the latest news story for hours before a newspaper even gets printed. Waiting until the next morning just feels like an outdated way to get informed.

Of course, newspapers have fought back. Their websites generally do a good job of providing content, and many Canadian papers have started charging users a monthly fee for unlimited access to the website. They've cut staff significantly, and cut benefits for those who remain.

This brings us to **Torstar** (TSX:TS.B), owner of the *Toronto Star*, Canada's largest daily newspaper. It even beats out the *Globe and Mail,* which is owned by **BCE** (TSX:BCE)(NYSE:BCE) — and the *Globe* is circulated nationally. Torstar also is the owner of the Harlequin-branded romance novels, familiar to most Canadian bibliophiles. The newspaper division accounts for about 70% of revenues and the book division accounts for the other 30%.

Like most newspaper companies, Torstar has struggled. Revenue slid from $1.54 billion in 2011 to $1.30 billion in 2013, a 15.5% haircut. Pressure is coming from all sides. Classified ad sales are way down, as people use free internet sites to sell their unwanted stuff. Website traffic has been decent, especially with the Rob Ford scandal dominating the headlines for the past few months, but revenue still continues to fall even after the company instituted a $10 per month paywall.

Even the Harlequin division is struggling, with revenue falling approximately 8% year over year. This is due to a couple of factors, mainly the success of the *Fifty Shades of Gray* series, as well as **Amazon's** Kindle marketplace making it easier for previously unpublished authors to compete against the established players.

Costs are coming down just as fast as revenues, and the company remains profitable with the exception of asset writedowns in the third quarter. The company recorded a 35 cent per share loss in 2013, but that would have been a 53 cent profit without the writedowns. Still, earnings aren't going in the right direction, falling from $2.72 in 2011 and $1.03 in 2012.

Even though earnings are falling quickly, the company still retains its 13 cent quarterly dividend, a yield of just under 10%. Torstar's cash flow in 2013 was enough to cover the dividend, but things aren't looking good long term. While total debt is going down, Torstar still has more than $175 million of it on its balance sheet. The balance sheet is also largely made up of goodwill and intangible assets, meaning investors can expect more writedowns in the future. It's not the type of balance sheet a value investor would get excited about.

Foolish bottom line

The market is sending a loud signal, as usually a double-digit yield is a warning sign of an impending dividend cut. While analysts expect the company to earn 92 cents per share in 2014 — easily covering the dividend — it's obvious investors don't share that confidence. While it looks as though Torstar can cover 2014's dividend, investors should be careful holding this stock long term.

On the other hand, for those looking for a contrarian play, Torstar trades at less than six times forward earnings, is at about half of book value, and pays a 10% dividend. There are problems with the newspaper business, but investors would get Torstar at a pretty cheap price.

CATEGORY

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