Don’t Be Tempted by This Company’s Huge 9.3% Dividend Yield

Description

The rule of thumb used to be that a dividend yield in the double digits was a huge red flag. By sending shares so low (which increases the dividend yield correspondingly), the market is sending investors a signal that the dividend is unlikely to be maintained over the long-term.

In today’s environment of anemic interest rates, I’d argue the red flag cutoff is more like an 8% dividend yield. Most high-yield-low-growth stocks pay dividends in the 6-7% range, with some of the riskier names creeping up to 8%. Anything I’ve looked at above that level has some huge question marks involved, at least from a dividend perspective.

There are certainly question marks surrounding **AGF Management Limited** (TSX: AGF.B), which manages money for institutional and retail investors. Ever since shares hit a high of nearly $40 on the strength of its mortgage business in 2007, the company has been a terrible investment. Shares are currently at $11.45, which is near a five-year low.

One of the things AGF’s management has done in an attempt to support the share price is offer a very generous dividend. The company pays out a dividend of $0.27 per share each quarter, good for a 9.3% yield. And it’s been consistently paying dividends for nearly two decades. Considering the company’s history, why is the dividend at a risk of getting cut?

It can all be traced back to three letters — ETF.

Investors have been exiting mutual funds en masse, creating a huge problem for the wealth management industry. Since AGF’s assets under management peaked at more than $53 billion in 2007, it’s seen investors of all sizes leave for the greener pastures of ETFs and their lower management fees. Assets under management as of March 31 were just $34.4 billion, which is especially bad considering stock markets were bumping up against record highs.

One of AGF's main competitors is **IGM Financial Inc**. (TSX: IGM), the parent of Investor's Group. Unlike AGF, IGM has an army of its own agents dedicated to selling the company's mutual funds.Sure, all the big wealth managers offer AGF funds to their clients, but in a challenging environment,you better believe a company like Investor's Group will push its own product before a competitor's.

As a result of this weakness, AGF hasn't earned enough to cover its dividend in years. The company's earnings have dropped from $0.80 per share in 2011 to $0.29 per share in 2012, and then again to $0.25 per share in 2013. So far the company has earned $0.37 per share over the first two quarters of 2014, but it also paid out $0.54 per share in dividends. Revenue has also dwindled, falling from $586 million in 2011 to just $484 million in 2013.

That's not what long-term income investors want to see.

In 2012, AGF sold its mortgage business to **Laurentian Bank of Canada** (TSX: LB) for $415 million. That windfall has served as a dividend buffer ever since. The company didn't earn enough to cover the dividend, but that was okay. It had plenty of money in the bank to cover it.

But now the cash pile has dwindled to just over $255 million, and the company still owes more than $300 million in long-term debt. And, management is on record saying that they will review the dividend, considering factors like coverage ratio, and the performance of its assets under management.

I'm no expert in management speak, but that doesn't sound like a ringing endorsement to me.

It's obvious the trend is not your friend with AGF. There's no reason to think it's anywhere close to bankruptcy, but it's obvious the overly generous dividend isn't going to be around a whole lot longer. Investors should avoid the name, because the stock will almost certainly take a haircut when the fateful dividend cut happens.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:AGF.B (AGF Management Limited)
2. TSX:IGM (IGM Financial Inc.)
3. TSX:LB (Laurentian Bank of Canada)

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