

## Are You Attracted to 6% Yields?

### Description

The market doesn't usually price a stock at a 6% yield for no reason. Investors in such stocks are likely taking on above-average risk and, in return, get a higher yield as compensation.

**Alaris Royalty Corp.** (TSX:AD) offers a yield greater than 6% today—two times greater than the yield of the Canadian market. Before investing you should ask, "What are the risks?"

### The business

Alaris offers capital to profitable, private businesses that wish to maintain the ownership in their companies. In exchange, Alaris receives monthly cash distributions from these partners.

### The problem

One of Alaris's partners, KMH, has stopped paying regular distributions to Alaris since November 2014. Since 2010 Alaris has spent \$54.8 million in preferred partnership units in KMH.

The latest negotiation with KMH could result in Alaris receiving an upfront cash payment of \$28 million. An impairment of \$7 million was recognized through earnings in the second quarter.

### The risk

Alaris aims to diversify its revenue stream to minimize the impact of each. However, as the KMH issue showed, there's an inherent risk in Alaris's business that any one of its partners could stop paying distributions to it.

### The pros

Alaris still earns revenue from 15 partners, which offer essential products or services in mature industries and have track records of generating free cash flow.

Additionally, Alaris earns 69% of its revenue from the U.S., which improves the safety of its dividend, which is paid out in the weaker Canadian currency.

### Conclusion

Management is working hard to resolve the KMH issue. In the meantime, Alaris's payout ratio is about 77% thanks to a stronger U.S. dollar. Alaris's dividend is sustainable as the payout ratio is based on the annualized expected revenue that excludes KMH.

Alaris's shares are still about 18% below the price it was before it announced its second-quarter results, so there's lower risk in investing in Alaris as one of the risks has already played out.

Something to cheer about is that Alaris seems to treat shareholders well by increasing its dividend when the business does well. Since 2010 Alaris has hiked its dividend per share at an average annual rate of almost 10%.

Although Alaris hasn't increased its dividend so far this year, it's probably a prudent move given the KMH issue. Alaris is better off solving the issue first and increasing its revenue stream before raising its dividend.

That's what being a stock investor is all about—you should choose the businesses that you're comfortable owning. You should know the underlying risks in a business and determine if the reward is big enough for you to take the risk.

In the case of Alaris, it offers an above-average yield with capital gains that are likely to occur when it fixes the KMH issue or adds new revenue streams.

Investors with an appetite for above-average risk can give some deep thought on whether or not to invest in Alaris at about \$24 for a 6.7% yield.

#### **CATEGORY**

1. Dividend Stocks
2. Investing

#### **POST TAG**

1. Editor's Choice

#### **TICKERS GLOBAL**

1. TSX:AD.UN (Alaris Equity Partners Income Trust)

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