Alaris Royalty Corp.: Don’t Miss Out on This Misunderstood Stock

Description

If I told you about a stock that increased revenues and earnings by 22.1% and 15%, respectively, over the past year, you would assume that it would be having a banner year in the markets.

You would be wrong.

Alaris Royalty Corp. (TSX:AD) just announced its fourth-quarter and year-end results that, for the most part, were another home run; yet its stock lingers around $21.

The quasi-private equity firm lends money to middle-market businesses in return for non-voting preferred share equity which provides monthly distributions to the company.

In business for 13 years, Alaris sets the rate of distributions its 16 partners pay annually based on top-line metrics, such as gross revenues or same-store sales. It’s a business model that creates a true partnership between lender and borrower that’s designed to keep Alaris’s partner companies cash flow positive at all times.

The last thing Alaris wants to do is to have a business making significant interest payments in a year in which revenues and, by extension, earnings, declined.

This past year, Alaris has had some fires to put out with four of its partner companies, whose businesses have suffered setbacks, causing investors to question the viability of its business model and the safety of the monthly dividend which currently yields 7.5%.

At the moment, Alaris expects to receive approximately US$102 million from the four partners for its preferred units on an original investment of US$149.1 million. The partners have either stopped paying distributions or have previous unpaid distributions but have resumed payments while they work out solutions to their cash flow problems.

If you back out the distributions that have already been paid by the four partners, along with permanent impairments on these investments, Alaris likely would get back to breakeven or fairly close, although that’s just conjecture on my part; I haven’t gathered the exact distributions previously paid to Alaris.

So, despite these four hot potatoes, Alaris’s core business is remarkably sound.

In 2016, it deployed US$70 million into three new businesses and US$10.8 million into two existing businesses. The new businesses are as follows:

1) Sandbox: Marketing and advertising solutions for life sciences, financial services, and other specialized industries.

2) Providence Industries: Sourcing and production of apparel for other companies.

3) Matisia LLC: Management consulting for Fortune 1000 companies.

Also, during the year, Alaris exited three partnerships, generating internal rates of return (IRR) between 17% and 53%; the 53% IRR was from its US$13.3 million investment in Mid-Atlantic Healthcare, a Pennsylvania operator of geriatric care facilities.

As for the safety of Alaris's dividend, its payout ratio is currently at 80.2% of the company's $73.3 million in net cash from operating activities in 2016. Given that its net cash from operating activities increased 23.2% from a year earlier and it will likely deliver a decent-sized increase in 2017, you can rest assured that the dividend is safe and that Alaris might actually increase the monthly payout slightly.

I can see why some investors might misunderstand Alaris's business model, but if you look closely at the people behind its business and what the results actually mean, its stock should be closer to $30.

Will it get to $30? That's for the markets to decide.

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