Alaris Royalty Corp. Has a Smoking-Hot 7.75% Dividend Yield, but Is it Safe?

Description

Shares of **Alaris Royalty Corp.** (TSX:AD) are still down ~43% from the all-time high reached in 2013. The company now offers an artificially high yield of 7.75%, which has probably captured the attention of income investors who are looking to give themselves a raise.

When you're considering owning shares of a stock with a yield this high, you've got to do your homework to ensure that the probability of a dividend cut is low for the medium term. That means taking a glimpse at the financials and asking yourself if the company has a plan to get back its share price back on the high road.

What is Alaris involved in?

For those who are unfamiliar with the company, it's a private equity firm that provides capital to private companies in the form of either long-term licences or royalty arrangements. The company has about 16 revenue streams at the time of this writing. The revenue stream is quite diverse, and it's small enough that the management team can keep an eye on the businesses to ensure everything is running smoothly.

What about valuation?

Shares of AD currently trade at a 12.53 price-to-earnings multiple, a 1.2 price-to-book multiple, a 8.2 price-to-sales multiple, and a 10 price-to-cash flow multiple, all of which are significantly lower than the company's five-year historical average multiples of 22.3, 1.9, 14.4, and 18.2, respectively.

Based on traditional valuation metrics, the stock is dirt-cheap, but that doesn't mean there's a huge margin of safety at current levels! The success of Alaris ultimately depends on the health of the companies that it invests in. If a partner finds itself in financial trouble, Alaris could see its payments be delayed. If a partner goes belly up, then Alaris could take a major hit on the chin.

Dividend safety

The dividend, although artificially high, still appears sustainable since it's covered by free cash flow.

The payout ratio is in the high 90% range, but I do not believe that's anything to be worried about, especially when you consider the payout ratio has been much higher in the past. Despite the stock's sub-par performance over the past few years, the dividend has remained intact and has grown by a fair amount on a consistent basis.

Bottom line

Just because the dividend appears to be sustainable for now doesn't mean you should be loading up on shares today. The stock has been ridiculously volatile, and if you don't have a stomach of steel, you could find yourself monitoring your shares of Alaris as much as Alaris monitors its revenue streams!

Personally, I'm on the sidelines because the roller-coaster ride is too much, even if the dividend is sustainable. I'm also not convinced that the company has a meaningful long-term plan to get out of the hole it's in. So, as fellow Fool contributor Will Ashworth noted, Alaris may continue to be a bouncing ball, and I'm in no mood to be chasing it!

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