Dividend Investors: A Big Drop in Price Means This Dividend Is Now Yielding 8%!

Description

A dividend stock that drops in value presents an opportunity for investors to lock in a good yield before the share price recovers. Since a dividend yield is inversely related to the stock price, the more the share price drops, the higher the yield gets, and vice versa. The obvious danger is that the stock continues to fall and you end up using the dividend payment to help cover your losses. However, sometimes stocks can decline for a number of different reasons, and that is why it is important to assess whether the drop in the stock's value has to do with a problem with the business, or if it is out of the company's control.

I'll focus on one dividend stock that has seen a big drop in price recently that could be a great buy for dividend investors.

Alaris Royalty Corp. (TSX:AD) has seen its share price decline over 10% in the past three months. Its share price has been up and down during this time, and the last recovery happened back in early September when the company announced the redemption of shares that it owned of Sequel Youth and Family Services, LLC, which resulted in an 18% gain for Alaris on its investment. However, that was not enough to trigger more of a sustained rally in the stock's price.

Is the stock's valuation too high?

Since there has been no bad press about the stock lately to justify such a big drop in price, let's see if the valuation was too high to begin with.

Currently, the share price trades at over 12 times its earnings, and before the drop in price that multiple would have been over 13.5. That multiple is higher than the 11 times earnings that its peer, **Clairvest Group Inc.** (TSX:CVG), trades at. However, a look at its price history shows that Alaris traded at a price-to-earnings (P/E) ratio of over 14 just last year, and if we look further back, that multiple has only been higher. The company is certainly trading at the lower end of its historical P/E ratio, so there may be hope of a recovery yet.

Is the dividend sustainable?

It is important to analyze the payout ratio of the stock as well to assess if the company can continue to pay the dividend or if adverse conditions have made it unsustainable. A yield of 8% would make many investors skeptical about whether or not a dividend that high could be manageable, but a high yield on its own does not automatically imply it cannot continue.

The total dividends paid per share currently total $1.62, and with earnings per share in the past 12 months totaling $1.67, that means the company's payout ratio is just shy of 100% and would suggest it is not sustainable. However, because earnings include non-cash items, it is not always the best approach in assessing dividends.

If we look at the company's free cash flow, we see that last year, Alaris paid out 81% of its free cash, and in the past 12 months, that figure has dropped to 77%. Based on these figures, we would assess that although the payout ratio is high, it does not suggest a danger of it being cut in the near future.

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