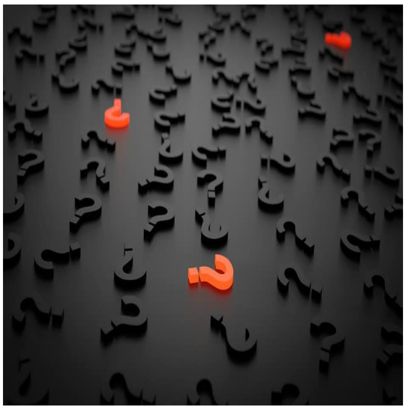

Is Owning a Stock With a 13% Yield Ever a Good Idea?

Description

The short answer to the question in the headline is no.

It's never a good idea for regular investors to own a stock yielding 13%, and it's especially to be avoided if you depend on dividend income for your survival.

So, if you're thinking of buying **Corus Entertainment Inc.** (TSX:CJR.B) stock because of its juicy, double-digit yield — don't. And if you already own its stock, I'd sell. Here's why.

Thinking of buying

A stock like Corus typically yields 13% for several reasons, and none of them are good.

The first reason is a falling stock price. A $10 stock paying an annual dividend of 50 cents yields 5%. If the stock drops in half to $5, it yields 10%.

In the case of Corus, it's seen its stock drop by more than 22% in the last week on weak Q1 2018 earnings, a topic Fool contributor Joseph Solitro covered in his January 10th article.

A quick glance at Corus's earnings doesn't show anything that's devastating to its business — revenues and adjusted earnings per share were down 2.3% and 7.3%, respectively, over the same period a year earlier, while free cash flow and operating cash flow were up 283.4% and 145.4%, respectively, from a year earlier — but when you go in for a closer look, there are a few clues that all is not well at the television broadcaster.

The second reason a stock might be yielding 13% is that the company's financial situation is dire enough that it needs to make a bigger dividend payment to keep shareholders happy. In the case of Corus stock, it's a very legitimate point.

A $10,000 investment in Corus stock a decade ago is worth $8,000 today. By comparison, the **S&P/TSX Composite Index** is worth a little over $15,000, while the **S&P 500** is worth $23,000 today, or almost three times Corus's value.

It's at this point where I'd lose interest in Corus stock, but my colleague, who thinks it's a buy, obviously sees a diamond in the rough, whereas I only see a lump of coal.

The final reason it's yielding 13% is that it has enough free cash flow to make those dividend payments — what I would call bribes — but that can't go on forever.

In the trailing 12 months ended November 30, 2017, Corus generated free cash flow of $204 million, paying out just $129 million in dividends — a payout ratio of just 63%.

All's good, right? Wrong.

A couple of things should jump out at you at this point.

First, Corus hasn't increased its dividend payment since January 2015. The failure to grow its dividend over the last three years is indicative of a company whose earnings are declining. Always look for dividend growth rather than dividend yield; the former points to corresponding growth in earnings, which is what drives share prices higher.

Second, Corus has $2 billion in debt — $200 million more than its entire market cap. That debt is never going to get paid down if it continues to pay $1.14 per share in annual dividends. Look at its debt levels over the past five years, and you'll see that they haven't budged, and neither has the value of its assets.

The speculative play

Is Corus a stock I'd want to own for the next 10 years? Absolutely not. It's a powder keg operating in an industry whose best days are behind it.

That said, if the company suspends its dividend, Corus will have additional funds to pay down debt and, in the process, give it more time to figure out a way to grow.

Speculative investors should take advantage of the correction, which appears slightly overdone, because any news to suspend the dividend will likely give Corus stock a welcome boost.

For income investors, Corus is a prime example of why you don't chase yields in double digits. You go for the 3% yield and 6% dividend growth.

Steady as she goes always wins the race.

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