Alaris Royalty Corp.’s +7% Drop: Should You Buy, Hold, or Fold?

Description

Alaris Royalty Corp. (TSX:AD) stock has been in a downward trend for the last five years. Big drops such as the one experienced on Wednesday is not all that uncommon for Alaris. Investors need to be aware of what type of stock Alaris is.

Alaris isn’t the typical financial services stock. That’s why its big yield now pushes above 10%, which should be a signal that it’s a higher-risk stock than the likes of, say, **Royal Bank of Canada**.

An overview of the business

Alaris offers capital to private businesses that want to maintain the ownership in their companies but can’t get the capital they need from traditional means. In return, Alaris gets big cash distributions from them monthly. Alaris gets a different yield from each of its partners, but for most (11 out of 15 of its partners), it receives humongous distribution yields of 15% or higher.

Although Alaris looks for partners that generate strong cash flow, there’s obviously high risk involved given the handsome yields that it gets. Indeed, the risk has played out, as the company booked a significant reserve against notes from KMH and Group SM, which resulted in a loss in the first quarter. Moreover, two of Alaris’s current 15 revenue streams give Alaris fewer distributions than originally intended. That’s why the stock hasn’t done well. Those two streams currently contribute 4% to Alaris’s annualized revenue.

First-quarter results

Compared to the first quarter in 2017, Alaris's revenue per share increased 14%, and its normalized earnings before interest, taxes, depreciation, and amortization increased 10% on a per-share basis.

Notably, the company posted a loss of $0.09 diluted earnings per share due to the note write-offs for KMH and Group SM. However, president and CEO of Alaris Steve King stated that "The focus should be on the 15 very healthy partners in our portfolio and the robust market for deployment that we have in front of us. No investor ever wants negative outcomes but receiving positive returns on 23 of 26 partnerships over 14 years is a track record that we are very proud of and will work diligently to maintain and improve."

On a positive note, Alaris got a rate of return of 25% (based on the Canadian currency) on Agility Health by selling it to a third party as well as receiving U.S. dollar-denominated distributions while it held the investment.

Is the dividend safe?

The company estimates its payout ratio to be ~90% this year. Its partners' earnings coverage looks stable. So, Alaris should be able to maintain its dividend. At ~$15.30, Alaris offers a high yield of nearly 10.6%.

Investor takeaway

At its normalized multiple, Alaris can trade above $20 per share. However, it could take more than a few quarters for the company to prove that its revenue is stable and regain investor confidence. New board member Jay Ripley may be a positive change for the company.

Alaris is not an investment for the faint of heart. However, those who seek high income might consider a small position in the stock for a 10.6% yield and as a potential turnaround investment.

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Date
2025/08/22
Date Created
2018/05/10
Author
kayng