Should You Risk Your Money in High-Yield Stocks?

Description

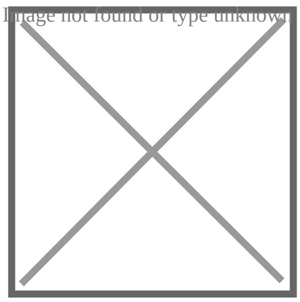
Alaris Royalty Corp. (TSX:AD) stock has popped about 8% in the past two trading days after it reported its second-quarter results.

Before reviewing its quarterly results, let's first take a look at its business and why the stock has been in a downward trend in the last year.

The business

Alaris offers capital to private companies that want to maintain the ownership in their businesses but cannot get the capital they need from traditional means. In return, Alaris gets big cash distributions from them monthly.

These preferred distributions are based on sales performance and are paid in priority to other equity. If the underlying businesses do well, Alaris's cash flow generation will improve.



Diversification of revenue stream

In July, Alaris generated cash distributions from 14 revenue streams or private businesses. The top three businesses currently contribute just more than half of Alaris's distribution with each contributing 16.1-17.3%.

Alaris monitors these private businesses closely every month. In the second quarter, they all generated enough earnings to at least cover Alaris's distributions, interest and principal payments to lenders, and capital spending.

However, it's important to note that two of Alaris's revenue streams, SCR and Kimco, which currently contribute a total of 3.9% of Alaris's distribution, have cut their distributions to Alaris because they have experienced problems with their businesses. That's also why Alaris stock has been down in the last year.

Second-quarter results

Here are some key metrics compared to the same period in 2017:

	Q2 fiscal 2017	Q2 fiscal 2018	Change
Revenue per share	$0.62	$0.78	25.8%
Normalized EBITDA per share	$0.52	$0.56	7.7%
Net cash from operating activities per share	$0.41	$0.62	51.2%
Diluted earnings per share	$0.38	$0.73	92.1%
Normalized earnings per share	$0.39	$0.47	20.5%

Alaris's revenue-per-share increase was helped by a number of items, including distributions of $4.3 million, which were not recognized previously, from Labstat. Excluding this one-time item, Alaris's revenue per share would only have increased almost 6.8%.

Alaris's investments

Labstat was previously one of Alaris's revenue streams. Labstat sold its business, and as a result Alaris exited the six-year investment with an annualized return of about 19% in June.

Over the years, Alaris's investments have either been wildly successful or huge failures. Thankfully, most were successful. Across the 13 investments that it exited, three were failures with negative rates of returns of 18-95%, and the rest delivered annualized returns of 17-47% (mostly about 20-30%). As noted previously, two of its current streams have been problematic but look stable now.

Going forward, it really depends on management's ability to deploy capital and invest in the right businesses. Perhaps it's logical to expect a small percentage of the streams will be problematic based on the history we've seen in the niche of private capital markets that Alaris operates in.

Is Alaris's 9.2% yield safe?

At the recent quotation of about $17.50 per share, Alaris offers a yield of roughly 9.2%. Its run-rate payout ratio is about 98%, which is really cutting it close.

That said, Alaris markets itself with a long-term goal of creating the optimal dividend stream for investors. Moreover, insiders own about 10% of the stock. So, management should try their best to maintain the dividend.

Investor takeaway

It wouldn't be right to categorize Alaris as a safe dividend stock given its high payout ratio. However, Alaris is trading at one of its cheapest levels since inception. Risk takers can take a small bite at these low levels and wait for a potential turnaround.

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