Why This 9.7% Yield Could Be a Bargain Buy!

Description

Typically, when a stock's dividend yield hits above 5%, questions arise as to how sustainable it is. However, when a dividend stock declines in price, its yield will go up as a result. That's why when dividend stocks go on sale, it can be a very attractive time to buy since investors can lock in higher-than-normal payouts.

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One stock that has struggled mightily this year that has a high yield is **Pizza Pizza Royalty** (TSX:PZA), which is down around 50% since January. Despite the drop, its monthly dividend payments have stayed the same, and investors that buy today can earn a yield of 9.7%.

Is the yield safe?

Anyone would be skeptical of a yield of around 10%, and rightfully so. However, there are ways we can look at whether it is safe and sustainable.

The first method involves looking at the company's earnings. In the trailing 12 months, Pizza Pizza has generated per-share earnings of $0.86, which is nearly equal to its dividend payments per share, which total $0.856. Using this analysis, we can say that the company pays out nearly 100% of its earnings.

That's a very high payout to be sure, but given that the royalty company doesn't require funds for capital investments, it's not as big of a red flag as it would be for other types of companies.

Another method of assessing a dividend involves looking at a company's cash flow, which takes out a lot of the noise that comes with earnings and non-cash items. Over the past four quarters, Pizza Pizza has paid out $28 million in dividends, and during that time it has generated free cash flow of $28 million as well, which, once again, means its payout ratio is 100%.

Both of these methods suggest that the company's payouts are at their maximum, and whether the dividend will be able to stay at this rate is uncertain. In the short term, it's very possible that Pizza Pizza can continue its dividend payments, but if over the long term some adversity were to hit the company, then that could all change.

Should you buy Pizza Pizza stock?

Ultimately, the decision of whether you should buy the stock or not shouldn't rest solely on the dividend itself. After all, if the dividend is cut or eliminated, you could be left with a stock you don't really want. It's important to look at performance and the future outlook for the company as well.

In its most recent quarter, the company's sales were down slightly from a year ago, as were profits. The disappointing results sent the stock into an even further decline. However, if Pizza Pizza can bounce back, then the stock could recover very quickly and the high yield could shrink in no time.

I see a lot of upside for the stock given that it's currently trading near its book value and at a price-to-earnings multiple of just 10. The share price hasn't been this low since 2011, and with the brand still appearing to be strong, it could be a terrific time for investors to buy.

CATEGORY

1. Dividend Stocks
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TICKERS GLOBAL

1. TSX:PZA (Pizza Pizza Royalty Corp.)

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