Is a 10% Yield Ever Safe?

Description

When you're looking for dividend income, the temptation is often there to go with a high yield, but while that may be appealing, it's often not sustainable. A yield of around 5% is what I'd consider to normally be the cutoff before investors should start taking a closer look at why a payout is yielding such a high return.

While some companies will certainly compensate their investors more, perhaps due to risk or other factors, it's important to, at the very least, do some analysis to see whether or not the stock can afford a high yield before taking it as a given.

The three stocks listed below are paying 10% or more in dividends, which, at first glance, would certainly be too good to be true, but let's take a closer look at why that may not be the case.

Pizza Pizza Royalty (TSX:PZA) pays investors a yield of around 10%, although with payouts not increasing since 2016, the higher rate is due to the stock sliding this past year. Over the past 12 months, Pizza Pizza's stock has been cut in half, pushing an otherwise normal yield of about 5% to nearly double that amount.

Because dividend yield is a calculation that factors in both the dividend and share price, a decrease in price will have an inverse impact on its yield, which is what has happened here. The company is in as good a position as it was before to make its payouts, so there are no alarms going off that should be scaring away investors.

AltaGas (TSX:ALA) is another example of where a tumbling stock has sent its yield into the stars. The company has also lost about half of its value in the past year, and its dividend was even higher than Pizza Pizza's was before its decline started.

As a result, AltaGas is now yielding more than 14% for investors. It's an obscene amount that's hard to believe, but it too is technically not in a position where it needs to cut its dividend.

While a higher yield certainly can certainly give these companies a justification to reduce their dividends, that doesn't mean that it will happen. After all, if the stocks bounce back in price, these yields could easily get cut in half, but if investors buy in now, they effectively lock in the higher payout.

Just Energy (TSX:JE)(NYSE:JE) currently pays its shareholders a dividend of more than 11%, and while it hasn't seen as significant a drop off in price as the other stocks on this list have, it has declined more than 35% during the same time period.

The utility company might be more at risk of reducing its dividend, however, as two of its past four quarters have finished in the red and it has not been generating enough free cash flow to cover its dividend payments.

The company is set to release earnings later this week, and how it does in its latest quarter could determine whether or not we see an adjustment in its dividend payments.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:ALA (AltaGas Ltd.)
2. TSX:PZA (Pizza Pizza Royalty Corp.)

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