Are These 3 +9% Yields Safe?

Description

The tricky thing about high-yield investing is and will always be the security of the payout.

In theory, it should be as easy as analyzing the underlying cash flow and making sure it's enough to cover the dividend. If the ratio works, then the yield should be safe.

The problem is doing this doesn't look forward. If a company pays out most of its earnings back to shareholders, then just a small hit to the bottom line can put a dividend in danger. Sometimes this deterioration is easily spotted before it happens, but often it isn't. And sometimes the market is convinced it's coming, only to have it be a false alarm.

With this caveat in mind, let's take a closer look at three Canadian stocks that have massive 9%+ yields and see if they can afford their payouts over the long term.

Just Energy

Just Energy Group Inc. (TSX:JE)(NYSE:JE) is a polarizing stock. Some investors appreciate the business of reselling energy to both residential and commercial customers. The latter has been traditionally more important to the company's bottom line because they can offer cost certainty (although that appears to be changing) while others look at the company's complaint record and immediately deem it uninvestable.

Just Energy does have some good things going for it. It's moving away from door-to-door sales, much to the delight of customers tired of being interrupted during dinner. Operations have expanded into other markets like the UK, Ireland, and Germany. The company also has a newfound focus on using technology to both help customers save money as well as helping them be more environmentally conscious.

Just Energy has cut its dividend three times in the last decade. The current payout of $0.50 per share annually — good enough for a 10.3% current yield — doesn't inspire a lot of confidence. Neither does the company's erratic earnings per share history. The company also earned approximately $90 million in funds from operations in 2018 (after maintenance capital expenditures) while paying out some $100 million in dividends.

Pizza Pizza

2018 was not a good year for **Pizza Pizza Royalty Corp** (TSX:PZA). The parent company of some 650 Pizza Pizza and 110 Pizza 73 locations was hit by minimum wage increases in its two largest markets, tepid sales caused by increased competition, and a somewhat lackluster Canadian economy. As a result, shares cratered from a high of $18 each in mid-2017 to today's levels just over $9.

The company is working on some improvements to help operations turn the corner. Certain restaurants are being renovated and it will continue to expand into markets outside of Ontario and Alberta. But same-store sales continue to be stubbornly weak, falling 1.4% through the first three quarters of 2018.

This gives us a payout ratio of slightly over 100%, which isn't a good thing, even for a stock with a 9.2% yield today. But the company does have cash reserves to pay for this overage, and it targets close to a 100% payout ratio normally, so at this point the dividend looks solid.

Gluskin Sheff

Gluskin Sheff and Associates (TSX:GS) is a private wealth manager specializing in high-net worth clients, institutional investors, and pension plans. This has traditionally been a very good business with high margins, and the company's insiders own 17% of the company.

Long-term growth has been nothing short of spectacular. The company started in 1984 with just $26 in assets under management. That number has grown to $9.1 billion today, representing an 18% annual growth rate.

At this point, the 9.4% dividend looks sound. The company earned $1.24 per share in its most recent fiscal year; the payout is $1 per share. That's a payout ratio of just over 80%. Additionally, Gluskin Sheff regularly pays special dividends, including $0.60 per share in June, 2018 and $0.85 per share in October, 2017.

This dividend looks about as secure as you can get for a stock yielding 9.4%.

The bottom line

Figuring out whether a high-yield stock will cut its dividend is never easy. Many find ways to maintain the payout even if it exceeds 100% of cash flow, while others are more conservative and will cut even if it's not absolutely necessary.

That said, I'd rank Just Energy's payout as the most likely to be cut, but that's certainly not a guarantee. Pizza Pizza and Gluskin Sheff's distributions look more secure.

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

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