Is This Massive 8% Monthly Dividend Yield Safe for Income Investors?

Description

If a history offers any lesson, stocks that support dividend yields much higher than the market average will, at some point, won't be able to sustain that payout.

High yields, that look quite attractive for income generation, are an indication that there is something wrong with the company's financial health. With their high yields, investors seek a discount to own the share of the company.

In Canada, there are many recent examples that support this theory. More recently, we saw the Calgary-based **AltaGas Ltd.** (TSX:ALA) announcing a 56% cut in its dividend from what it paid in 2018 as the utility ran out of options to cut its debt and generate more cash.

Today, I have picked another Calgar-based stock, **Inter Pipeline Ltd**. (TSX:IPL) to try to find out if the company's 8% yield is sustainable.

IPL's business

IPL runs a diversified business in the energy infrastructure space. The company operates four business segments in Western Canada and Europe. Its pipeline systems span over 7,800 kilometres in length and transport approximately 1.4 million barrels per day.

In Europe, IPL operates 16 strategically located petroleum and petrochemical storage terminals, which have a combined storage capacity of approximately 27 million barrels. Its NGL business is one of the largest in Canada, processing an average of 2.8 bcf/d in 2017 with the capacity to produce over 240,000 b/d of NGL.

Risks to IPL dividend

The biggest risk to IPL's $1.71 annual payout is the company's high payout ratio, which is currently 108%, suggesting that IPL is paying more in dividends than it's earning. That's generally a bad sign for a company in the energy space where cash flows are very volatile.

In Canada, many energy producing companies are under pressure due to shortage of pipeline capacity that's restricting their ability to move their products. That challenge, which is unlikely to be resolved in the short-run, is scaring investors away from Canada's energy stocks, including IPL.

The other risk to this extremely attractive dividend yield is IPL's aggressive expansion plan. In Canada, IPL is in the middle of building a $3.5-billion petrochemical complex near Edmonton to convert propane into polypropylene plastic. In late October, IPL announced a $354-million deal to buy European storage terminals from Texas-based **NuStar Energy**.

But the market doesn't like it when companies borrow too much to fund their expansion, especially when their earnings are volatile. The same is true for IPL, which missed analysts' earnings expectations in three of the past four quarters.

Should you buy IPL stock?

In my view, IPL's diversified revenue stream, its wide-economic moat in the storage business, and its development plan are strong positive factors that separate it from other risky dividend payers. If your risk appetite is higher and you can tolerate the energy market's volatility, then IPL is a good bet to earn a higher yield. That said, it's not a stock for conservative investors who want to preserve their capital and earn only modest income.

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