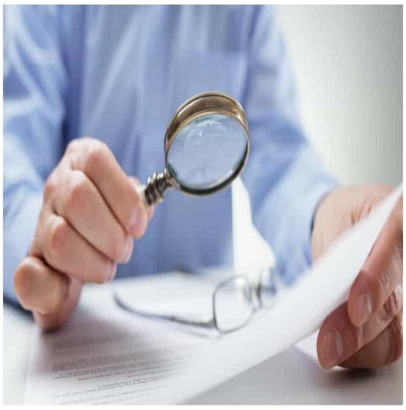

Why You Should Wait on This Big-Dividend Stock

Description

Chorus Aviation (TSX:CHR) offers a big yield of about 6.5%. Is the dividend a safe bet? What about the growth of the stock?

First, here's an overview of the business.

A business overview

Chorus Aviation operates in three sectors of the regional aviation industry: aircraft leasing, contract flying operations, and maintenance, repair, and overhaul, including part sales.

Good news

Early this month, Chorus Aviation strengthened its partnership with **Air Canada** by extending its capacity purchase agreement (CPA) with the company by an additional 10 years to the end of 2035.

As a part of the agreement, Air Canada bought $97.26 million of Chorus Aviation stock, which equated to nearly 10% of Chorus Aviation's issued and outstanding Class A and Class B shares.

This was a win-win deal between the two companies. It's a cost-effective way for Air Canada to compete in the regional market segment, while it provides long-term stability for Chorus Aviation.

Specifically, the 17-year contract will provide Chorus Aviation minimum contracted revenues of $2.5 billion, including 65% that will be generated from aircraft leasing revenue.

Profitability and dividend safety

Chorus Aviation is profitable. In the last four reported quarters, Chorus Aviation generated more than $1.4 billion of revenue and net income of more than $84 million. This resulted in a net margin of 5.8%.

The company generated more than $205 million of operating cash flow in the period. However, after accounting for capital spending, Chorus Aviation was free cash flow negative.

Taking out the cash flow generation and capital spending of the Q4 2017 quarter and only looking at the first three quarters of 2018, the company generated free cash flow of nearly $27 million. This wasn't enough to cover for the nearly $41 million paid in dividends in the period.

So, Chorus Aviation's dividend doesn't look bulletproof. Moreover, in the past decade, the company has cut its dividend three times. Therefore, it would be prudent to observe how the contracted revenue of Air Canada will translate to cash flow over the next few quarters before making a decision to buy the company for income.

Investor takeaway

The newly amended and extended contract with Air Canada is positive for Chorus Aviation. Perhaps that's why analysts from **Thomson Reuters** have a mean 12-month target of $9.44 per share on Chorus Aviation, which represents almost 28% near-term upside potential.

The stock gapped up from about $6.25 per share early in the year. For a bigger margin of safety, Interested investors should see if the stock will retreat to $6.50 per share or lower before buying shares.

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