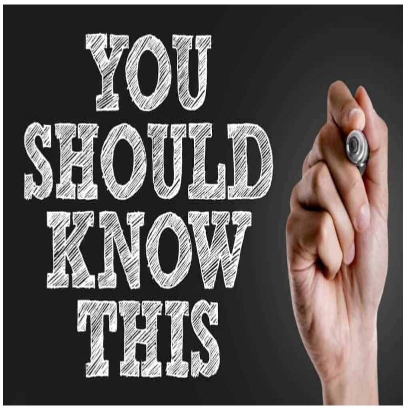

This Dividend Just Hit 10%: Is it Sustainable?

Description

Over the past 12 months, shares of **Dorel Industries** (TSX:DII.B) have fallen by 50%, pushing its once reliable dividend yield up to nearly 10%. Income investors have been starting to take notice, particularly since the company hasn't missed a payment in nearly five years.

Last quarter, management confirmed the $0.30 quarterly payout per share.

On March 14, the company is set to release its fourth-quarter results. I suspect management will weigh in on the dividend's future during the company's conference call with investors. This discussion should have a heavy impact on the stock's trading price.

Is Dorel's 10% dividend sustainable or will it inevitably be cut this week?

Consumers control Dorel's future

Dorel has three operating segments: home, sports, and juvenile.

Dorel home produces a range of home furnishings (e.g., furniture). Dorel sports mainly manufactures bicycle equipment, including popular brands like Cannondale, Mongoose, and Schwinn. Dorel juvenile makes products for small children (e.g., car seats) under brand names like Maxi-Cosi, Tiny Love, and Infanti.

In total, think of Dorel as a consumer company selling a mix of mostly discretionary products. If consumer spending rises, the company will likely benefit. If the economy is pressured, Dorel will follow suit.

Can profits support this dividend?

In the first three quarters of 2018, Dorel produced a cumulative net income of roughly $0. That's despite sales of around $650 million per quarter. In 2015 and 2017, for comparison, the company produced annual profits of around $26 million.

Why have Dorel's profits eroded in 2018? In one word: *competition.*

In the second quarter of 2018, the company took a $24.2 charge related to the value of its customer relationships and trademarks. For example, sales to wholesale customers in Chile plummeted as retailers removed juvenile products from stores. Other major retailers are also pressuring profits. Management specifically noted issues with financially troubled customers, including Toys "R" Us, Kmart, and Sears.

The rest of the company's brands aren't nearly as valuable as their book values suggest. Last year, Dorel sold its Sugoi and Sombrio brands to Louis Garneau for a $11.2 million loss.

Currently, Dorel is paying $9.7 million per quarter to service its dividend. With breakeven profit levels and declining asset values, the dividend is being paid with cash on hand. As of last quarter, the company ended with just $31 million in cash assets, meaning debt may have to be used to support the payment this year.

Don't be fooled

A few months ago, I wrote that investors should "expect a dividend cut as early as next quarter." Even if the payout is maintained, it would likely just accelerate Dorel's demise.

There are few reasons to believe in a quick turnaround for this stock. While some income investors may be tempted to buy this 10% dividend yield, it has the makings of a classic dividend trap. This week, we should know for sure.

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