3 High-Yield Stocks Whose Dividend Is Well Covered by Cash Flow

Description

One of the most common mistakes made by dividend investors is relying solely on yield and payout ratio to determine the safety of the dividend. A high dividend yield and payout ratio might signify that the dividend is unsustainable and that a dividend cut is inevitable.

Not so fast. A company's payout ratio is typically measured against a company's earnings. Earnings often include many one-time and non-cash items that have no bearing on the company's ability to pay a dividend. Likewise, a high yield doesn't mean anything without context.

This is why I also look at a company's dividend in relation to cash flow. This provides investors with a more accurate picture on the safety of the dividend. With that in mind, here are three stocks with above-average yields whose dividend are well covered by cash flow.

A top industrial stock

Aecon Group (TSX:ARE) is one of my favourite in the space. After the failed takeover attempt by China Construction, the company has flown under the radar. This is a company that is firing on all cylinders.

In 2018, the company achieved record revenue, up 16% over the full year 2017. It booked $5.8 billion in new contracts, a 107% increase over the $2.8 billion in booked in 2017. Now that the takeover overhang is behind it, the company is well positioned to move forward.

The company yields 3.27% and its dividend as a percentage of free cash flow is only 11%. It also raised dividends by 14.5% along with fourth-quarter results.

A hidden technology stock

Pason Systems (TSX:PSI) is a technology company buried in the oil and gas industry. Year to date, Pason's stock is up 9% and has returned approximately 14% in the past year.

Pason currently yields 3.65%; however, it has a payout ratio near 95%. Is this reason for concern? Not at all. The company has no debt, and its dividend accounts for only 57% of cash flow.

It is also important to note that this is a company expected to grow earnings by double digits over the next couple of years.

An unloved consumer cyclical

Down 14% year to date, **Transcontinental** (TSX:TCL.A) has struggled over the past couple of years. As a result, the yield has jumped and it is now at levels not seen in almost a decade (5.27%).

Is the dividend safe? It sure looks that way. The payout ratio as a percentage of earnings is a reasonable 40% and it drops to 21% when compared to operational cash flow.

The company certainly has its challenges, but it is still expected to achieve low single-digit earnings growth over the next few years. Transcontinental is a Canadian Dividend Aristocrat with a 17-year streak of raising dividends. Even with slowing earnings growth, it has ample flexibility to grow its dividend.

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2. TSX:PSI (Pason Systems Inc.)
3. TSX:TCL.A (Transcontinental Inc.)

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Date
2025/08/18
Date Created
2019/03/28

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