Is This 13% Yield a Safe Bet?

Description

In anticipation of a long pause in interest rate hikes or even a rate cut, investors need to begin looking once again for yield in the stock market. Hopefully, positive data will come about again and yields will once more start rising from their all-time lows. But if rates continue to be lower for longer (think of Japan and its two-decade struggle to raise rates), then investors will be on the hunt for high yield, which may come with high risk.

Chemtrade Logistics Income Fund (TSX:CHE.UN) definitely has a yield that will draw some looks from investors. The company's stock currently sports a yield of 13.23% — a juicy payout by anyone's reckoning. But is the income safe and will it continue to be for the foreseeable future?

The company has an interesting business, providing industrial chemicals to global customers. Chemtrade is one of North America's largest suppliers of various chemicals, like sulfuric acid and sodium hydrosulfite. The company has three business segments: Sulphur Products & Performance Chemicals, Water Solutions & Specialty Chemicals, and Electrochemicals. The company uses long-term, negotiated contracts in an attempt to mitigate issues commonly associated with commodity companies.

The company's 13% distribution is paid out on a monthly basis, definitely a plus for income-seeking investors. The positive news is the fact that Chemtrade has paid this distribution for a long time, providing some assurance that the distribution will remain intact. Its currently monthly payout of $0.10 a share has not changed since 2008, so I wouldn't expect an increase anytime soon. Nevertheless, the fact that it has such a long history might be enough to convince investors of its staying power.

As seems to frequently be the case in a number of companies these days, Chemtrade's debt levels are quite high. The company has just under $700 million in long-term debt and another almost $500 million in convertible unsecured subordinated debentures. This is compared to the $13 million it has in cash and total current assets of $367 million. The good news is that there is no debt due for the next few years, giving the company some room to breathe.

The year-end earnings were not stellar, adding to concerns that the distribution may not be safe. While revenues were slightly higher due to increases from its Water Solutions & Specialty Products segment, earnings were not positive. In the fourth quarter, Chemtrade suffered a net loss of $97.2 million, although this did include a one-time impairment of goodwill charge. Cash flow from operating activities increased by 28% as compared to the fourth quarter of 2018, however, which does underscore some operational strength.

The bottom line

Chemtrade's long history of distributions does provide some confidence that the 13% distribution will remain in place for the foreseeable future. The biggest question mark is the large amount of debt the company maintains on its balance sheet with a relatively small amount of cash and other current assets to offset it. The debt, combined with the poor earnings reported at year-end 2018, makes this a riskier income play than I am comfortable with, although the company's strategy of using long-term contracts to stabilize profits could support its cash flow.

If you have a higher tolerance for risk than I do, there is a good chance that you will collect the monthly yield for years to come. Additionally, the stock has already sold off significantly, so you may enjoy some capital gains as well. This stock is a riskier income play, but aggressive income investors may be provided with potential rewards as you wait for interest rates to rise once again.

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