Why This 15% Dividend Yield Could Be Safe (for Now)

**Description**

Dividends can be a great way for investors to accumulate plenty of cash flow. However, when yields become too high it can raise alarm bells as to whether the payouts are sustainable.

While percentage alone isn't the sole criteria you should consider when doing this assessment, you shouldn't ignore it either, as it could help flag problematic dividend stocks.



## Dividend yields shouldn't normally be in double digits

A yield of 5% is usually what I'd consider to be the upper limit for a reasonable dividend that investors don't have to worry too much about. At 4.8%, that's right around how much **Bank of Nova Scotia** ( TSX:BNS)(NYSE:BNS) is paying its investors today.

It's a relatively high dividend for a bank stock, albeit still a very manageable dividend for the company. Scotiabank is currently paying about half of its income out in dividends, with a payout ratio of over 51%.

That's an important percentage, as it tells us just how much room there is in the company's earnings. If that number were to be over 100%, it would indicate that Scotiabank is paying out over and above what it's generating in profit, which could be a big warning sign that the dividend isn't sustainable.

However, a dividend yield alone won't tell us that as Scotiabank could be paying 7% or 8%, potentially because the stock price has fallen significantly.

Yield is calculated by taking the annual dividend payments and dividing them by the current share price, meaning that the higher the price goes, the lower the dividend becomes, and vice versa.

That's definitely been the case for Scotiabank, as the bank stock has fallen 7% over the past two years. With dividend payments rising over that time, it's put upward pressure on its yield.

Generally, when there's a big drop in the share price, it's usually because things haven't been going well for the company, and profits have likely been falling. And while Scotiabank's shares have declined, they haven't exactly been crashing, which is why its yield hasn't become astronomical.

In contrast, an extremely high yield of 10% or more could suggest that a company might be in trouble and investors would be well advised to take a closer look at whether the dividend is able to continue.

## There's usually a (bad) reason why a dividend is over 10%

Anytime you see a dividend of 10% or more, you should be doing a careful analysis of whether it's a safe buy. Consider **Medical Facilities Corporation** (TSX:DR), which is currently yielding more than 15% in dividends.

If it were sustainable, it would be the hottest dividend on the **TSX**. Dividend investors would be buying up the stock and it would be sure to rise in value, making the dividend yield shrink.

That hasn't been happening, however; the stock hasn't seen any big rally. Instead, over the past three months, it has declined by close to 40%. The catalyst behind the big fall was due to the company's earnings, which were released back in August.

Not only did the company see its revenues fall in the most recent quarter, but Medical Facilities also incurred an impairment charge of US$29.5 million, sending its financials into an operating loss. A year ago, the company posted a healthy operating profit of US$17.9 million.



However, even without the impairment charge, it still would have been a smaller profit overall compared to a year ago.

Another concerning item was that the company also announced that its payout ratio for the past quarter was a whopping 179%, up significantly from the same time last year when it was just 74%. And over the past 12 months, it has averaged 91.9%. Clearly, there are some concerns here that investors should take into account.

The saving grace is that the company has generated strong, positive free cash flow over the past 12 months of US$62.3 million, which is well in excess of the US$26.4 million it has paid out in dividends during that time.

For now, the dividend still looks to be saving from a cash flow perspective, but investors will still want to keep a close eye on the company's earnings because if the situation gets worse, a cut could be inevitable.

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3. TSX:DR (Medical Facilities Corporation)

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