Is This 8.3% Dividend a Safe Stock to Hold in Your TFSA?

Description

A TFSA is a great place to hold dividend stocks, since any income earned on the investments, whether it's capital appreciation or dividend income, will not be taxable. While investors want to maximize that income, it can be dangerous to hold very high yields, because it could leave you vulnerable to a possible dividend cut. And if a cut happens, not only could you see less dividend income, but the stock could also plummet in value, hitting your portfolio on multiple fronts.

One stock that I'll look at today that could be in that boat is **Gamehost** (TSX:GH). Currently, the Alberta-based company is paying its shareholders a very attractive 8.3% yield. Let's take a look at some of the reasons why the stock is a bit of a risk and whether or not investors should stay away from it.

The company has already cut its dividend before

A few years ago, Gamehost was paying a monthly dividend of $0.073 and reduced it to $0.058, an amount that it has been paying since mid-2016. This is an important consideration for investors because for stocks that have a history of raising dividend payments, it can be a big deterrent to suddenly cut them, as it could stop their streak and make them less attractive to dividend investors.

Gamehost doesn't have a reputation for dividend growth, nor is it a stock that hasn't reduced a dividend, either. Those factors would make it easier for the company to look to slash its dividends again should it need to do so. There would certainly be more resistance from management were Gamehost a Dividend Aristocrat. But with that not being the case, the path to a cut is much easier for the company to take.

Gamehost's margins and free cash may not be strong enough to justify keeping the dividend

Over the past four quarters, the company has generated free cash flow of $18.2 million. That's well in excess of the $16.8 million in dividends that it paid out during that time, but whether that's enough of a buffer for the company is questionable. During that period, Gamehost spent just $600K on capital expenditures. If the company is looking to spend more on growth, the gap between free cash flow and dividends could begin to shrink in a hurry.

While the hospitality and gaming company has a very healthy profit margin of 23% over the past four quarters, the company's payout ratio has still been more than 100%. If that high of a ratio persists, management could feel the need to cut its dividend as that is often a key indicator of whether payouts have become unsustainable. A payout ratio of more than 90% could be a big risk, let alone 100%.

Is Gamehost's dividend too risky?

As of now, the Albertan economy still looks to be a big question mark, and it's one that I wouldn't be comfortable be investing in just yet. Unless we see more traction in that province, and that includes a stronger oil and gas industry, TFSA holders may be taking on too much risk, as there's definitely a strong case to make as to why Gamehost could slash its dividends again. A bad quarter or two could put pressure on management to free up some cash flow, and with a dividend of 8.3%, the company's high payouts could be an easy area for them to target.

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