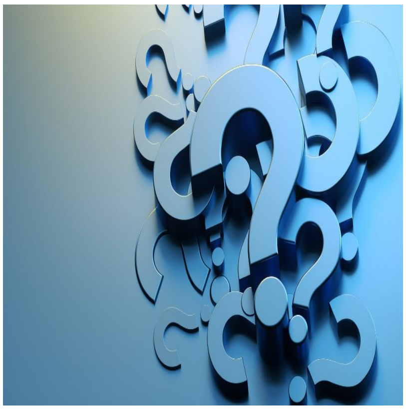

Is This 19%-Yield Stock Worth Your Money?

Description

At writing, **Alaris Royalty** (TSX:AD) stock provides a yield of 19.25%. This is an indicator that the market thinks its dividend is sustainable. The financial stock has experienced severe selling pressure in the last month or so.

However, the stock can still be a lucrative total returns investment for high-risk investors with a long-term investment horizon.

Let’s review its business to see how Alaris Royalty generates cash flow.

The business

Alaris lends money to U.S. and Canadian private businesses mostly in the form of non-voting preferred equity. It targets business owners who want to remain fully in charge of their businesses but can’t get capital from other means.

In return, Alaris gets huge monthly cash distributions from the preferred equity investments, which ensures Alaris gets a return on its investments periodically without having to rely on an exit event, such as the private businesses buying back the preferred equity.

Alaris last reported generating revenue streams from 16 businesses. Its top three streams contribute about 43% of its revenue, while the top five streams contribute about 60%.

Alaris’s dividend isn’t safe: Here’s how much it can cut its dividend…

Alaris receives monthly cash distributions that are typically about 14% of its investments but ranges from about 9% to 16%. With that high a yield, you can imagine that there exists corresponding risks.

In fact, about three of its streams are either not paying distributions or paying only about half of their original cash distributions right now.

As the coronavirus situation has escalated in North America, the businesses that Alaris partners with are likely to be negatively impacted. In fact, the company has changed from a monthly dividend to a quarterly one.

When it declares its next dividend in June (payable in July), investors will have better clarity on its cash flow and dividend coverage.

Aside from the coronavirus situation, Alaris's run-rate dividend payout ratio of approximately 94% in early March wasn't reassuring at all. It is a high payout ratio.

Alaris's dividend isn't safe, particularly in today's economic environment. In the last recession, Alaris cut its dividend by about 36%. However, importantly, in subsequent years, it was able to increase the dividend to greater than pre-recession levels.

This time around, investors should be ready for a dividend cut that's in the 30-40% range. Assuming a cut of roughly 40%, Alaris's forward annualized payout would be $0.99, and its forward yield would be approximately 11.5% based on the recent quotation of $8.57 per share.

The Foolish bottom line

Of the 15 businesses that Alaris exited, four led to huge losses, while the rest delivered double-digit rates of returns. Overall, the average total returns was 63%.

This means that shareholders simply have to accept that a meaningful percentage of Alaris's investments will result in losses. However, total returns should still be positive.

Shareholders should keep in mind that a large portion of the returns come from the monthly cash distributions that Alaris receives (and pay out a big portion as dividends).

Investors, who are considering Alaris as an investment today should expect a dividend cut from the stock in June. However, a purchase at current levels should still result in above-average income. Currently, I estimate a forward yield of 11.5%.

Moreover, when the economy recovers, Alaris will likely steadily restore its dividend to pre-cut levels and lead to strong price appreciation of roughly 86% (assuming a long-term price target of, say, $16).

If Alaris isn't your kind of investment, here's a safer option.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:AD.UN (Alaris Equity Partners Income Trust)

PARTNER-FEEDS

1. Business Insider
2. Msn
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4. Sharewise
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Category

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