Should You Buy This Stock After the Dividend Cut?

Description

For a long time, I have been pretty excited about buying stocks like **Alaris Royalty** (TSX:AD). The great monthly dividend and steady dividend growth made holding the stock a winning proposition. Even though the stock price was depressed for a while, I was willing to hang on in order to collect the income while I waited for the stock price to recover.

Over the past couple of months, the stock has changed its monthly distribution to quarterly. While that in and of itself is not a big deal, it was a disruption to the regular income I was expecting. The biggest blow, though, was when it cut its distribution. This is the latest in a long line of dividend cuts brought on by the economic fallout from the pandemic-induced lockdown.

After all the dividends dropping like flies, I started to wonder if it was ever worth buying stocks with large dividend yields.

A rare moment in history

Let's face it; as much as we have gotten used to the "new normal," this is a very rare time in human history. Looking back over the centuries, situations such as the one we are currently facing are exceedingly rare. In fact, this has not happened within the span of many lifetimes.

Dividends like those offered by Alaris Royalty, with yields over 7% even a year earlier, were very rare occurrences. A high yield signals an increased risk that makes a dividend cut a real possibility. If you are willing to take the risk, high-dividend stocks can provide you with an excellent income stream. For approximately a decade, Alaris did exactly that. In fact, if you had owned Alaris for a decade, you would already have your original principal back from the dividend alone.

Should you own this high-yield stock?

I think the first thing you should consider before you buy a stock is whether or not you want to own the business. Stocks are not bond equivalents, and they certainly are not GICs. When you own a stock, you should be certain you want to own the business first and foremost. You also need to determine whether the stock can sustain the yield with income from its business.

Previously, Alaris was able to maintain its high payout. Income from its royalty streams was and still is very diversified. It prefers to invest in old economy businesses with track records of free cash flow and low debt levels. Most of its investments are in the United States, with about 20% located in Canada. As a result, Alaris has benefited from the high U.S. dollar in recent years.

Why the dividend cut?

Its investments are spread across a number of sectors. Approximately 40% of its income comes from industrials, though, which explains why it might face some pandemic-related pressure. The 30% dividend reduction will help the company ride out pandemic-related issues that might arise in the short term.

Another reason for the cut was likely related to preserving capital. Alaris stated that it has about $189 million available to invest in any opportunities that might come its way during the pandemic. In the long run, the dividend cut may result in a stronger company than before, as these investment opportunities come to fruition.

The bottom line

I have a general rule of thumb. When a company cuts its dividend, I cut bait and run. I believe that a good company should be able to pay its dividend and grow it continuously over time. I may, on occasion, take a small contrarian stance if I expect a certain stock to make a turnaround based on a potential change in fundamentals.

There are so many turnaround stories at the moment that I would not invest in a high-risk stock like Alaris as an income play. Invest as a contrarian turnaround play if you want, and simply count the dividend as a bonus. The dividend cut was probably the best move for the company given the market conditions and its strategy, but it is disappointing for income investors.

CATEGORY

1. Coronavirus
2. Dividend Stocks
3. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

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

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Coronavirus
2. Dividend Stocks
3. Investing

Tags

1. Editor's Choice

Date
2025/08/24
Date Created
2020/05/25
Author
krisknutson