Dividend Stock: Is a 12% Yield Too Good to Be True?

Description

Editor's Note: An earlier version of this article referred to Labrador Iron Ore Royalty offering a $6 annual dividend, for a 15% dividend yield. However, Labrador Iron Ore Royalty offers a $4.60 dividend at a 11.9% yield at the time this article was published.

I'm not making this up. Motley Fool investors certainly have access to a 11.9% dividend yield, as of writing. And I won't beat around the bush. The dividend stock offering it is **Labrador Iron Ore Royalty** (TSX:LIF).

Labrador currently trades at about $39.25, offering a 12% dividend yield for its $4.60-per-share-per-year dividend. But is that 12% dividend yield something you should covet or be wary of? Let's look at whether this dividend stock is too good to be true.

What analysts say

Again, let's cut to the chase and see what analysts have been saying about this dividend stock lately. An analyst at **Raymond James** trimmed his target of the company from $41 to $30, reaffirming he expects the company to "market perform." This would put the company just higher than that target price, as of writing. **Scotiabank's** analyst also cut his target to $40 from $41 but believes the company will outperform.

Despite lower iron prices, overall the analysts believe Labrador is a strong dividend stock. This comes from its focus on being a royalty company. Labrador holds interest and royalties on Iron Ore Company of Canada, with a 15.1% stake. Further, it completely owns Hollinger-Hanna, receiving the funds through this company as well.

And yet, the company also has a very low jurisdictional risk, according to these analysts. Therefore, it can apparently continue to pay out this strong dividend yield, even in a low iron price environment.

Earnings past

Third-quarter results for Labrador came in above expectations but kept the company in line with market performance. The last quarter actually saw a benefit from higher iron ore prices, with royalty revenue increasing over $20 million to $74.2 million.

Furthermore, net income increased for the dividend stock to $1.64 per share, up 82% year over year. Free cash flow reached $1.99 per share, which was a whopping 333% higher than the same time in 2020. The company had no debt and continues to work with a positive net working capital. With a strong dividend coming from the Iron Ore Company of Canada, the company maintained an incredibly strong cash balance.

But be warned

This was a rosy picture that may not last for the dividend stock. The biggest risk to Labrador right now is China, where the majority of the world's steel production comes from at 70%. The country placed restrictions on steel production to curb growth, leading to lower iron ore prices.

This led to a lower guidance for production from the Iron Ore Company of Canada from 17.9 to 20.4 million tonnes down to between 16.2 to 17.9 million tonnes. Despite this, the company remains in a strong financial position after the strength of 2021.

So, what's in store for the future of this dividend stock? It pretty much relies on government action in terms of China's production output of steel. This would impact iron ore prices and, therefore, leaves a question mark for investors. While Labrador will still benefit from royalties and commission interests, it could be lower than the first quarters of 2021.

Bottom line

It looks like that 12% dividend yield is safe for now. But you cannot depend on another country's production output when considering a stock investment. It might be good to only consider a small interest in Labrador to see what happens across the Pacific. For now, the stock remains at fair value, but that 11.9% dividend yield is certainly one to consider.

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