Dividend Stocks: Is This 7.3% Yielding Stock a Buy?

Description

Like it or not, a stock that's yielding above 7% always comes with an elevated risk profile. Our job as investors is to find out if this elevated risk profile is an accurate evaluation of risk. Let's take **Extendicare Inc**. (TSX:EXE) as an example. Is Extendicare's 7.3% dividend yield a signal that it's a great opportunity or a high-risk trap?

Let's consider this question and ultimately determine if this is a dividend stock to buy or to stay away from.

The aging population is one of the strongest secular trends today

Extendicare is a leading provider of long-term care in Canada. It's the owner and operator of these facilities, as well as home health care services. Clearly, Extendicare has a strong position in caring for Canada's aging population.

However, while the demand for Extendicare's real estate and services is skyrocketing, clear problems are affecting the company's ability to meet it. These problems are not specific to Extendicare. Rather, they are problems within the healthcare sector and economy. Thus, we have an industry that's failing to adequately meet the needs of seniors.

Staff shortages, the COVID-19 pandemic, and general cost of inflation have all wreaked havoc on Extendicare's business. In response, the government has laid out plans to address staff shortages. These plans include more spaces in college for training new healthcare professionals. Also, the government is increasing targeted immigration levels. Lastly, they're working on changing existing credential requirements for potential new healthcare workers.

While all of this is great news for the industry in the long run, it does take time to see the effects of these efforts. In the meantime, Extendicare must survive – and the system must take care of our seniors.

At the mercy of government funding

Extendicare relies heavily on government funding. While this highlights the extent to which Extendicare's business is valued and essential, it also brings with it many problems. For example, oftentimes, government funding takes a while to catch up to inflationary pressures. This is what's currently taking place. While revenue increased 8.7% in Extendicare's most recent quarter, its net operating income fell 19%. Essentially, funding rate increases have lagged inflation and this has dragged margins down.

How does this dividend stock stack up?

At this time, Extendicare is paying out much more than its net income in dividends, which is not a good payout ratio, nor a sustainable one. Furthermore, its debt load is quite high, at 75% of total market capitalization. At least its interest coverage ratio has been acceptable, at roughly two times. However, in the latest quarter, elevated costs and delayed government funding really destroyed Extendicare's ability to generate income. Thus, all of these metrics deteriorated sharply.

Undoubtedly, the risk level of Extendicare stock is elevated. It's an industry that's going through major cost increases and staff shortages, as well as a pandemic that's been with us for three years. This has all dealt a huge blow to the business and everything related to it. There are no easy fixes.

In the end, it comes down to two things for me. The first is simple – the ugly truth is that things are ugly. Extendicare is having a hard time making the business work, and much more distressingly, a hard time providing the exceptional standard of care that we should expect in the Canadian healthcare system. The second point is that Extendicare must work. I think that the government must and will find a way to support this company that's been so essential in taking care of our senior population. In fact, as discussed previously, they are already working on it.

Therefore, while I wouldn't expect exceptional growth to come any time soon, I do expect that Extendicare will survive these struggles intact. While its dividend payout is unsustainable, it has been at this level since 2013. The company is hesitant to cut it and taking steps to increase its net income. Proceed with caution, but for those willing to take some risk, this 7.3% yielding dividend stock could be a great opportunity.

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