



## Can Premium Brands Sustain Its Premium Dividend?

### Description

In its earnings release last week, **Premium Brands Holding Corporation** ([TSX: PBH](#)) announced that it had raised its quarterly dividend by 6.3%, pushing the total annual yield on the dividend to 6.5%. While Canadian investors are used to seeing lucrative dividend checks from the energy industry and the likes of **Canadian Oil Sands** (TSX: COS), which currently yields 6.8%, food industry corporations which offer robust dividends remain a rarity. **Loblaws** ([TSX: L](#)), for example, returns a very decent if representative 2% per year.

Premium Brands invests in manufacturers and distributors of specialty foods across a broad swath of Canada, and in Nevada and Washington State. The company increased revenues by more than 22% in 2012, to \$968 million, and has more than doubled revenues since 2009, with acquisitions playing a significant role in this growth. Yet the company has struggled to post appreciable profits: net income as a percent of sales has declined over the same period, from 4% in 2009 to 1.5% in 2012.

Premium Brand's 2012 net income amounted to \$15.2 million. During the year, the company paid out \$24.0 million in dividends. Issuing dividends in excess of earnings has been a trend at Premium Brands for several years. This is possible because the company's net income reflects significant portions of non-cash items. As an acquirer of businesses, it incurs amortization expense of goodwill booked to those acquisitions. Also, depreciation tends to be a significant non-cash expense as the company owns asset-heavy manufacturing and distribution operations. The company's actual operating cash flow last year was \$50.8 million.

### Debt is an issue

If we could stop the story here, all would be well. But Premium Brands has used quite a bit of debt to help fund its numerous priorities in recent years. These priorities include business acquisitions, capital expenditures, and maintaining the attractive dividend. As of June 29th, 2013, the company had utilized \$327.6 million of \$379.5 million of various credit facilities available; that's 86% of available credit utilized.

In addition, due to long-term and short-term debt incurred, and the lack of adequate balance sheet

resources at hand, the company is a little too close for comfort on some of its debt covenants with its lenders. For example, the company is required by its lenders to maintain a current ratio (ratio of current assets to current liabilities) of 1.30. Premium Brands just passes muster here, with a current ratio of 1.37 as of June 29th, 2013.

The company will likely focus on reducing its debt load in the next two years, as well as refinancing or otherwise extending some maturities of debt, including \$108 million of scheduled principal repayments in 2014. Managing the debt with available cash flow, as well as continuing to invest in property, plant, and equipment, clouds the dividend picture over the next two to three years. For example, while Premium Brands generated \$50.8 million in operating cash flow last year as mentioned above, it used \$32.0 million in investing activities, primarily in capital expenditures, and it used \$19.6 million in financing activities, which included paying \$24.1 million in dividends to shareholders (the end number is lower than the dividend due to a net issuance of new debt). So the company essentially used all the operating cash it generated, plus another \$800,000 during the year.

### Proceeding with caution

To maintain its dividend going forward, Premium Brands must continue to increase revenues and earnings, and there's little room for error. While the dividend certainly seems safe for this year, investors should carefully evaluate quarterly results into 2014. Any miss-steps in the form of lower earnings in the near future may result in Premium Brands having to shave off some of that enticing, premium dividend it supplies to its investors.

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*Fool contributor Asit Sharma does not own shares in any of the companies mentioned at this time. The Motley Fool does not own shares in any of the companies mentioned at this time.*

### CATEGORY

1. Investing

### TICKERS GLOBAL

1. TSX:PBH (Premium Brands Holdings Corporation)

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