14% Dividend Darling Stock – A Fairytale or Nightmare?

Description

In the news

Note holders slam Rickmers' proposal, Business News & Top Stories

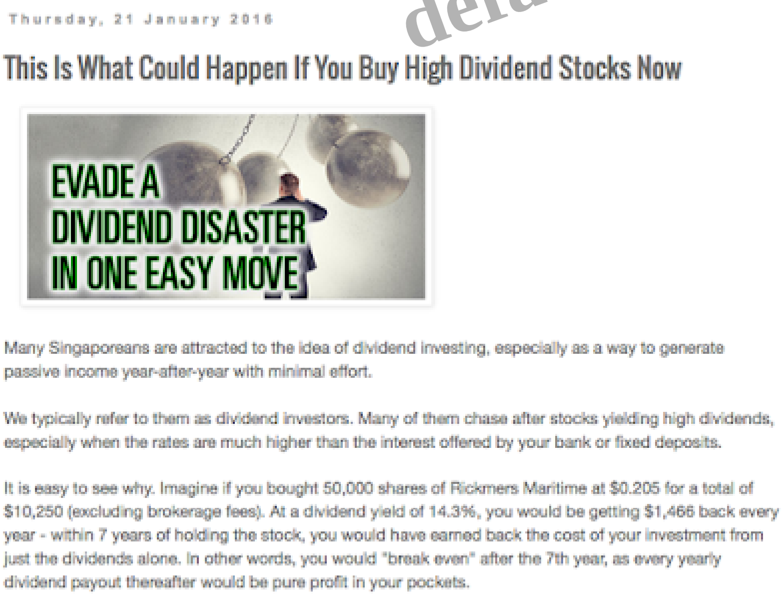
The Straits Times - 3 days ago

Investors holding **Rickmers Maritime** notes hit out yesterday after the trust's debt refinancing ...

Rickmers Maritime note holders are not happy with their latest debt refinancing proposal, but they don't really have much of a choice but to go along now, do they?

In January this year, a 14.3% high-yielding dividend stock caught my eye – Rickmers Maritime.

I was tempted to buy it, but decided not to after spending some time studying the company and its business. While the yield was indeed attractive, there were too many red flags that I didn't feel comfortable with. It then inspired me to write down my thoughts in this article, where I specifically explained why I decided to stay away from Rickmers (as well as other high-dividend yielding stocks). **Other than looking at dividend yield, we also need to question if the dividend yield is sustainable.** In the case of Rickmers, I highly doubted that they would have enough money to continue such payouts.



Thursday, 21 January 2016

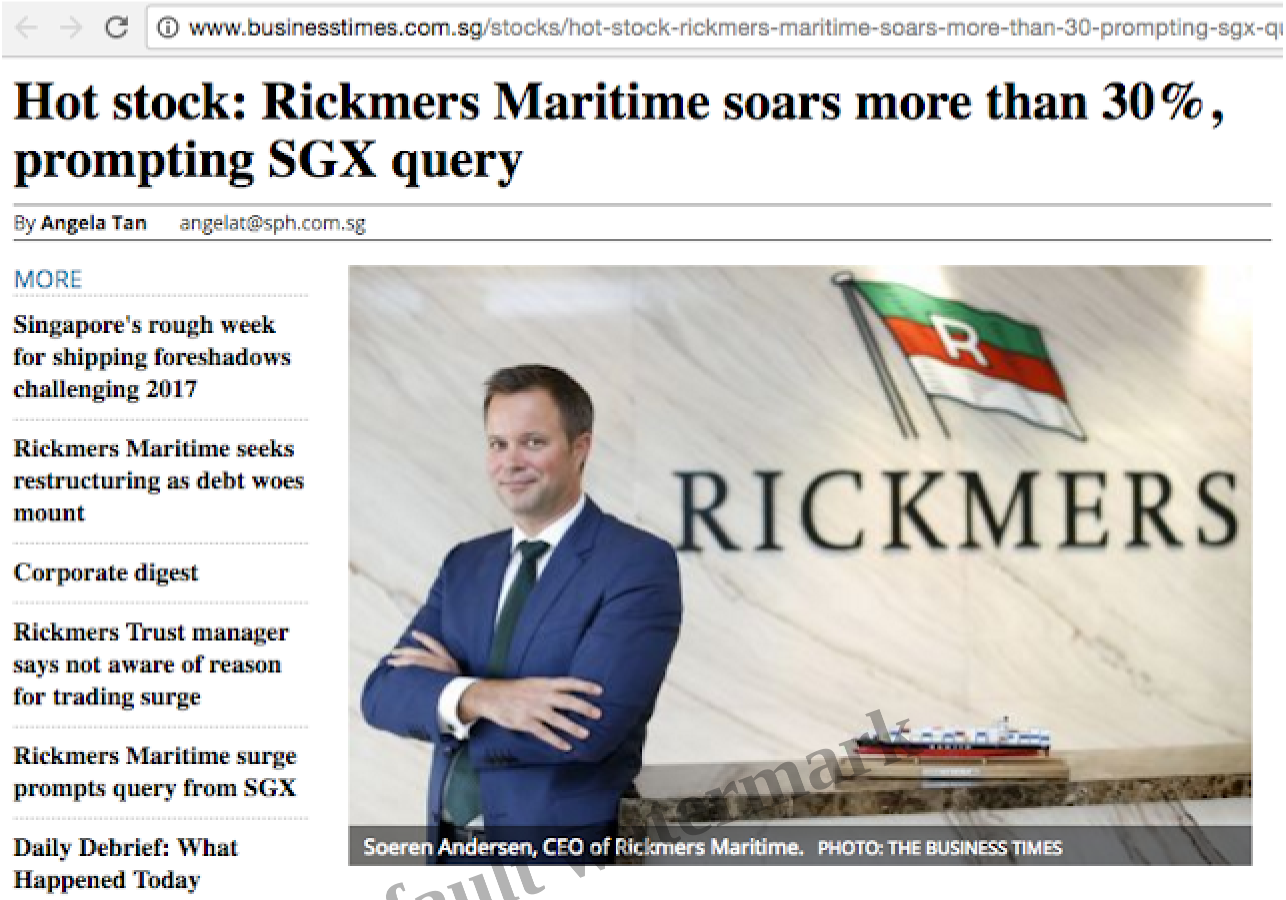
This Is What Could Happen If You Buy High Dividend Stocks Now

Many Singaporeans are attracted to the idea of dividend investing, especially as a way to generate passive income year-after-year with minimal effort.

We typically refer to them as dividend investors. Many of them chase after stocks yielding high dividends, especially when the rates are much higher than the interest offered by your bank or fixed deposits.

It is easy to see why. Imagine if you bought 50,000 shares of Rickmers Maritime at $0.205 for a total of $10,250 (excluding brokerage fees). At a dividend yield of 14.3%, you would be getting $1,466 back every year - within 7 years of holding the stock, you would have earned back the cost of your investment from just the dividends alone. In other words, you would "break even" after the 7th year, as every yearly dividend payout thereafter would be pure profit in your pockets.

Well, I was proven right when Rickmers suspended dividends shortly after. But in April this year, the stock rebounded spectacularly by 30%, prompting some traders to chase after the attractive profits.



www.businesstimes.com.sg/stocks/hot-stock-rickmers-maritime-soars-more-than-30-prompting-sgx-q

Hot stock: Rickmers Maritime soars more than 30%, prompting SGX query

By **Angela Tan** angelat@sph.com.sg

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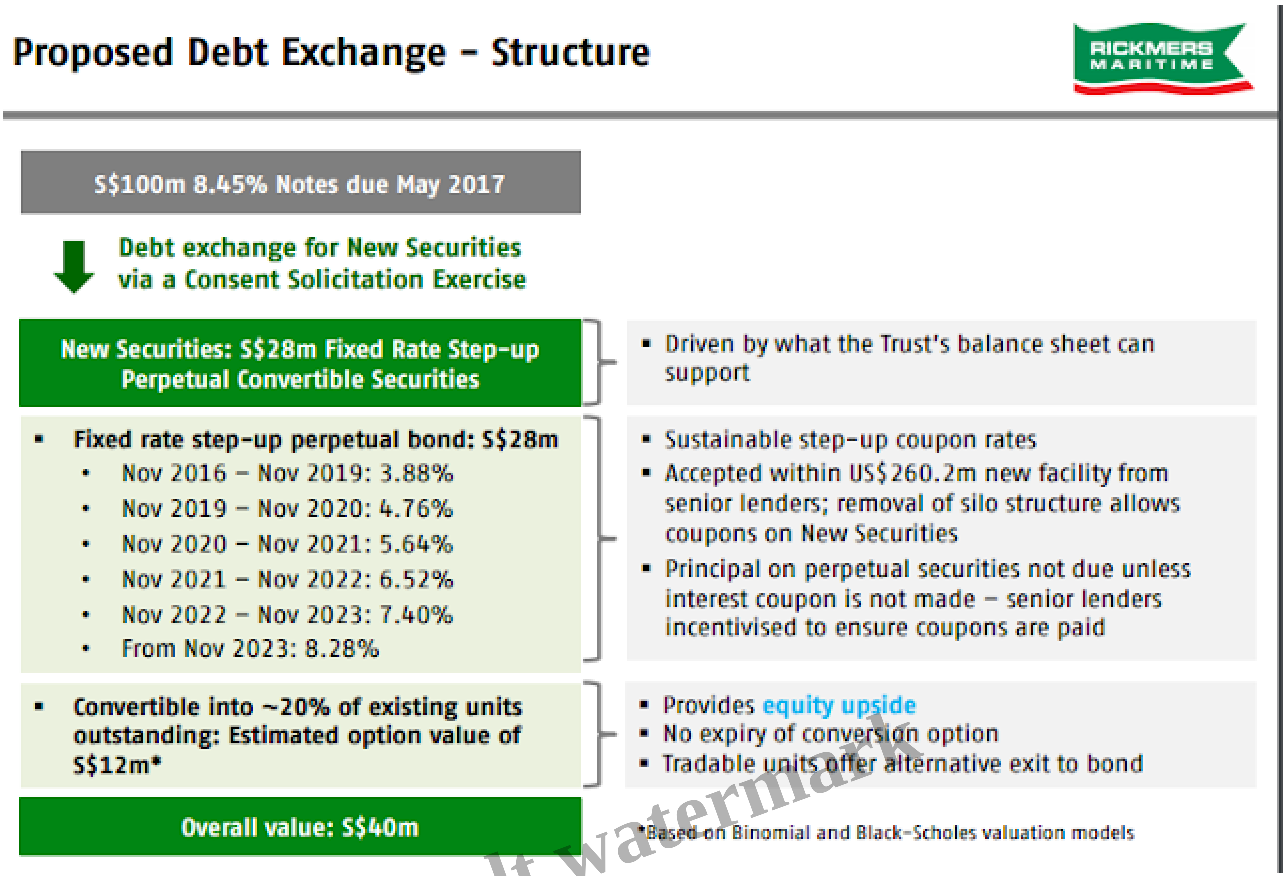
Soeren Andersen, CEO of Rickmers Maritime. PHOTO: THE BUSINESS TIMES

Those who weren't lucky enough to get out in time are sitting on 50% losses today.

Aside from the shares, there were investors who were similarly lured by high returns and bought Rickmers bonds. Unfortunately, Rickmers has just admitted that they are not able to pay the interest and principal on their US$179 million senior debt due March 2017. Management is now proposing an exchange of the existing principal amount of notes and interest with a NEW unsecured S$28 million fixed rate step-up perpetual convertible securities.

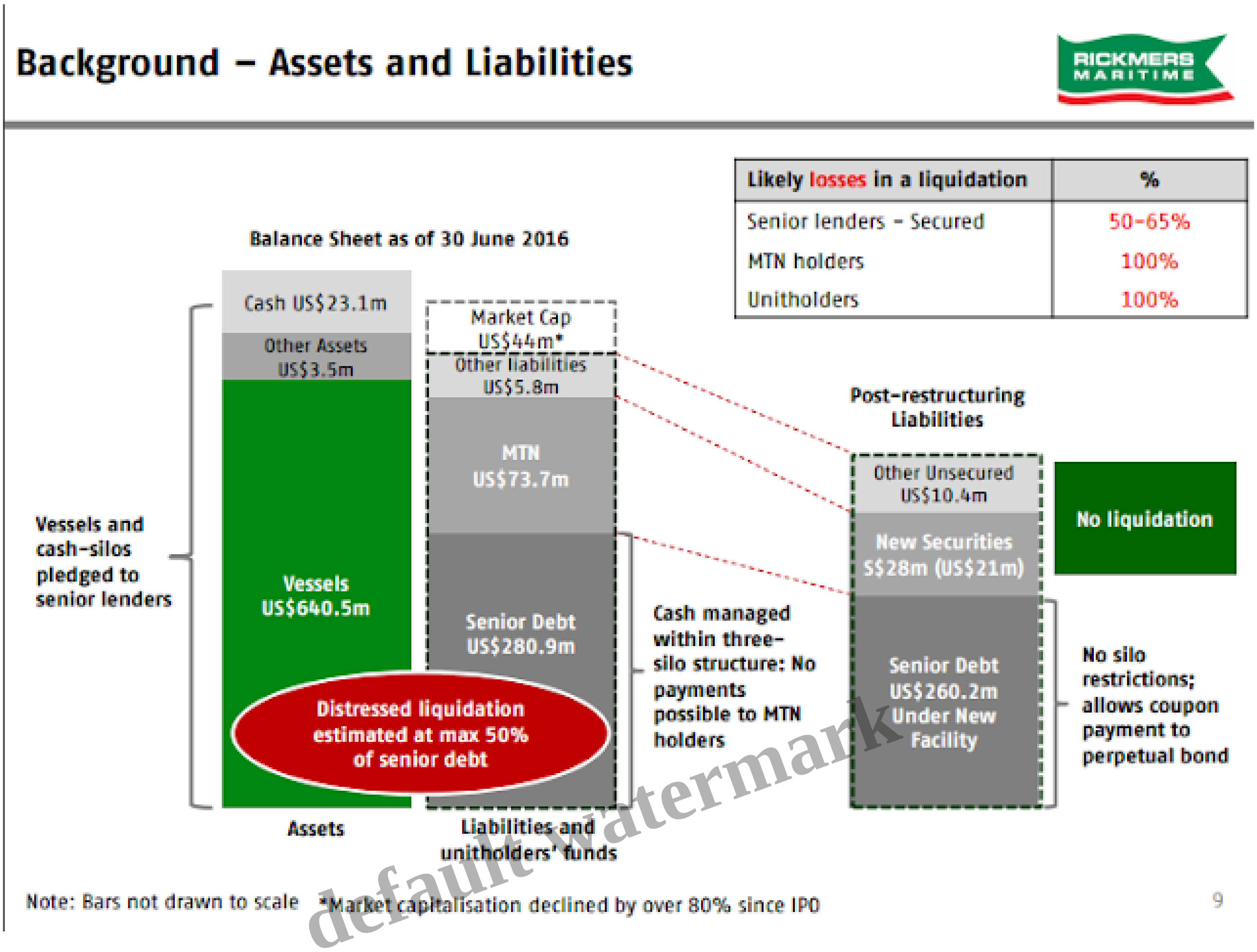
Don't worry if you didn't understand that. I didn't catch any ball either.



At a minimum of 3.88% and 8.28% returns, this new perpetual convertible securities is more attractive than most saving plans or investment options out there today. I'm waiting to see who else are going to buy into this.

Basically, when companies need to borrow money, most would first borrow from the banks. Other ways to raise more money is to issue new shares, bonds, perpetual bonds, convertible bonds, etc. What Rickmers is now proposing is a hybrid security of these.

If you're a bond holder, you have two options now – either accept the exchange, or not and watch the company potentially go into liquidation. If the latter happens, you're going to lose your entire capital. What would you choose?



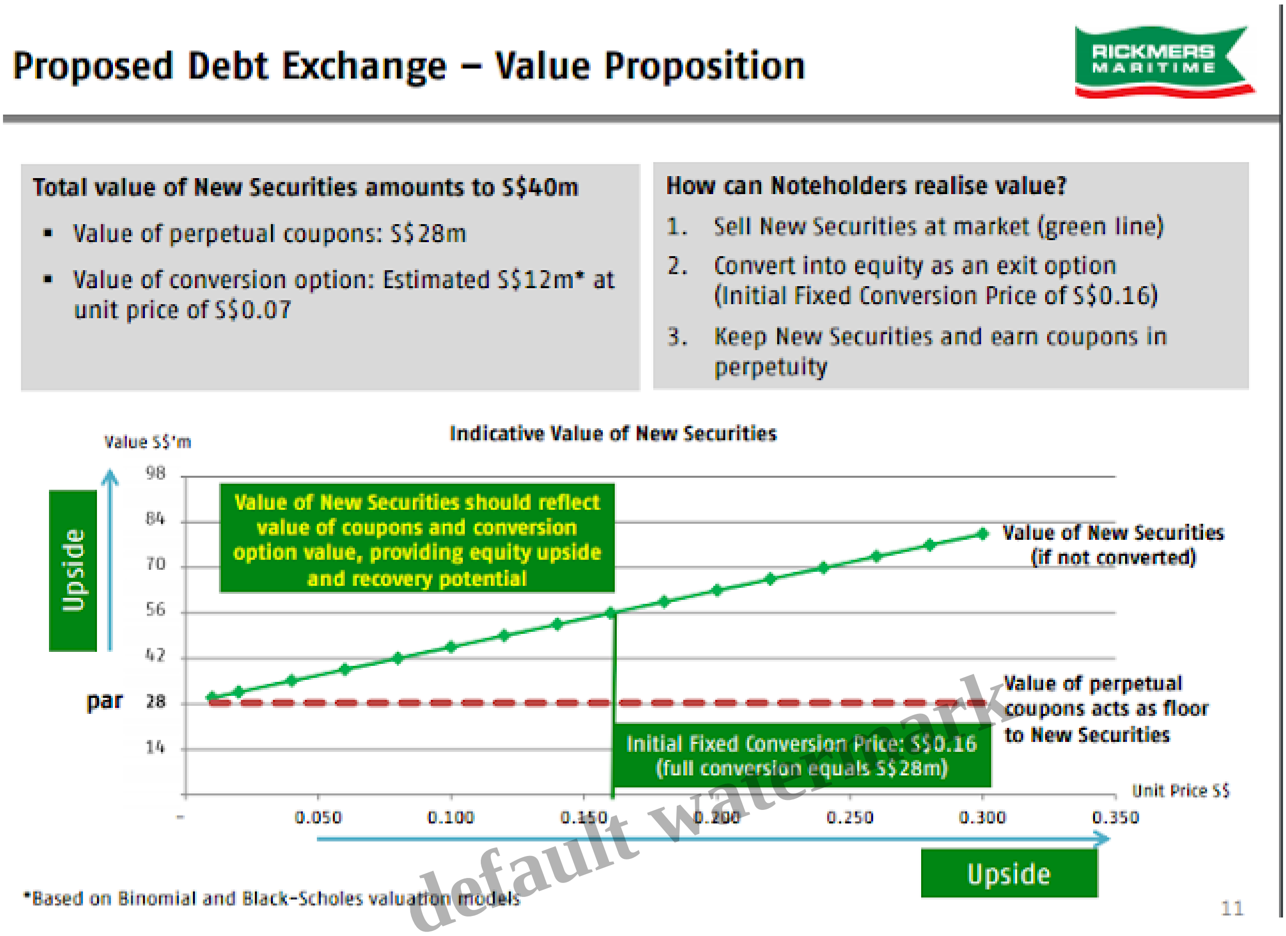
My friend Kyith explained that “in a liquidation, the senior lenders get their first dip on what is left, after selling their assets; then the junior lenders; then the preferential shares holders; then the equities holders”.

You basically don’t really have much of a choice, do you?

Now, going by book value, it does seem like Rickmers is under-valued at the moment, as their assets are gauged to be worth almost 10 times of the current stock price. **However, this provides a false sense of security. As investors, we need to look into whether these valuations are reliable.** Rickmers’ ships are valued at their purchase price (at 2006 highs) whereas the same ships are unlikely to fetch the same selling price today.

Remember that i**f you’re looking at book value, you should be evaluating based on what the company is worth if you sell off all its assets tomorrow**. Imagine if you had bought your condo at the property up-market at $1.5 million, but today in the down-market, buyers are only willing to pay a maximum of $1 million.

So should your condo be valued at $1.5 million still (your purchase price), or a more depressing $1 million (what you’ll fetch if you sell now)?



Rickmers is offering new buyers an option to escape – you can convert into shares as an exit option, and they use a target price of $0.16.

Today's share price is $0.056. I doubt it will jump by 300%, but I may be wrong. You have to decide for yourself if this target is realistic.

So why is Rickmers doing this? The answer is simple – they have no choice. Take a look at this.

Proposed Debt Exchange – Explanations

Why not raise equity?	▪ Markets are closed to us ▪ Needs going-concern status
Why only 20% conversion?	▪ Approved at April 2016's AGM (supported by Rickmers Holding; would not have passed otherwise); Over 20% conversion would require an EGM, outcome of which is uncertain ▪ Unitholders have lost 95% of their investment since IPO
Why no sponsor support?	▪ Rickmers Holding is a shipping company and is also affected by market conditions ▪ Their unsecured debt trades at a significant discount to par
Why conversion? Why step-up coupon?	▪ Both features attempt to deliver maximum value to Noteholders ▪ Aligns all stakeholders' interests
Why not paying coupon on MTNs in Nov 2016?	▪ Limited cash ▪ Several vessels unemployed and underemployed, resulting in cash burn
Why perpetual?	▪ Recognises inability of the Trust to repay unsecured debt going forward ▪ Increases value of income stream together with option feature (green line in slide 11) ▪ Allows exit at any time through market sale
Have you considered all options?	▪ Yes, with PricewaterhouseCoopers and Morgan Lewis Stamford ▪ Best solution in context of senior bank debt package and market conditions ▪ Delivers most upside to Noteholders and avoids liquidation

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Read my friend Kyith's takeaway on this here as well. Some of the images here have been reproduced from his original screenshots with permission.

I don't know about you, but I'm sure glad I stayed away from this stock, and will continue to stay away for now. But it'll be interesting to monitor this case moving forward to see what other new lessons we might learn without getting burnt.

With love,
Budget Babe

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