Dividend Investors: Get a 5.3% Yield From Loblaw Companies Limited

Description

There are a bunch of reasons to be bullish on **Loblaw Companies Limited** (TSX:L).

The biggest one, at least in my mind, is the massive opportunity coming in the pharmacy business. Thanks to its acquisition of Shoppers Drug Mart in 2014, Loblaw is now the largest pharmacy in Canada, with more than 1,800 drug dispensaries located in 2,300 stores. With 9.2 million baby boomers ready to start popping pills in a big way over the next 10-15 years, I can think of worse businesses to be in.

Plus, the acquisition of Shoppers also gives Loblaw access to a whole new style of store — much smaller locations mostly in urban areas. These stores are attractive to everyone from millenials picking up a few things on the way home from work to seniors who value the convenience of picking up staples at the small store where they also get prescriptions.

But the market is also pretty bullish on Loblaw too. Shares currently trade hands for almost $64 each, which is close to a 10-year high. The current P/E ratio is more than 460, but that's expected to drop down to a much more reasonable 18 times earnings by the end of 2015, as earnings stabilize after being thrown askew by acquisition costs.

Still, without another major acquisition, it's hard to imagine the company growing earnings by more than mid-to-high single digits over the long-term. And if interest rates go up in a meaningful way, investors might not be very excited about a low-growth grocer trading at 18 times earnings, which could cause shares to drift lower.

Plus, Loblaw pays a pretty anemic dividend, currently just 1.5%. Sure, there's potential to further grow that dividend, but it's still not great choice for investors who are looking to get paid generously now, like retirees.

Here's how investors can get a 5.3% yield while owning this stable grocer.

Prefer the preferred shares

Preferred shares are essentially a mix of equity and debt. They pay a fixed dividend, and will often move in reaction to what interest rates are doing. But they'll also move up or down based on company-specific news as well.

Recently, Loblaw's management made the decision to retire all of its existing preferred shares and replace them with a new issue that yields 5.3%. These new shares have only traded on the TSX for a few days, under the ticker symbol L.PR.B.

Unlike many preferred share issues that are currently out there, the Loblaw issue is what's called a perpetual preferred. That means the company has committed itself to paying an annual dividend of $1.325 per share for as long as they're outstanding.

In a world where GICs, government bonds, and other sources of income only pay 1-2% annually, these preferred shares represent a pretty attractive option. Sure, they could go down in value if interest rates rise, but as long as investors don't get spooked and sell, they won't see any interruption in their dividends.

The other thing investors have to factor in is the stability of the dividend. Generally, a company will continue to pay preferred shareholders before they pay common shareholders, like **Bombardier** did earlier this year when it eliminated the dividend to common shares.

Since this will be Loblaw's only preferred share offering, this means that investors shouldn't have to worry about whether it can make the dividend payments. Remember, the total amount of dividends paid to these shares will come out to a little more than $10 million annually, or just 2.4 cents per common share.

For investors who are all about the income, these preferred shares look to be a pretty good bet. They won't offer investors the same upside potential as the common shares, but also come with a much lower risk of downside. For folks who are near retirement age or are just looking for steady income, this sounds like a pretty good combination.

CATEGORY

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2. Investing

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1. TSX:L (Loblaw Companies Limited)

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