Dividend Investors: Get a Rock-Solid 5.8% Yield From George Weston Limited

Description

It’s simple in theory, yet difficult in practice. Setting up a retirement portfolio that throws off predictable dividends is much harder than it sounds.

The issue isn’t so much with dividends themselves. Let’s look at an extreme example. Say you invested in a company that earned $100 per share, yet paid out only a $1 per-share dividend. I think we can agree that a 1% payout ratio seems very sustainable.

But a stock that earns $100 per share would likely trade between $1,000 and $1,500 per share. At the midpoint of that range, it works out to a 0.08% dividend. At that rate it’ll take 12.5 centuries to get paid your principal back in dividends.

Investors are constantly having to balance between sustainable dividends and attractive payouts. A 10% dividend isn’t worth much if it isn’t supported by earnings. A 1% yield isn’t very valuable either, at least for most retirees.

Dividends between 3% and 6% strike a good balance, at least in my view. But once you start getting a yield above 5%, pundits chime in, declaring dividends with that kind of yield aren’t safe in today’s low interest rate environment.

Nothing could be further from the truth. Yes, some of these high-yield stocks are paying unsustainable dividends. Others are paying terrific yields that are easily covered by earnings.

First, find a great business

George Weston Limited (TSX:WN) is one of those stocks that a retiree might want to own, but they avoid it because the dividend just isn’t high enough.

George Weston is an attractive business. Its largest asset is a 187.8 million share stake in **Loblaw Companies Limited** (TSX:L), and 21.7 million units of **Choice Properties Real Est Invstmnt Trst** (TSX:CHP.UN). Together, those two assets are worth $12.65 billion, while George Weston has amarket cap of $13.7 billion.

Essentially, investors are getting George Weston's bakery business for $1 billion. This is a business that generated $300 million in EBITDA in 2014. That's a cheap price to pay one of Canada's largest bakeries.

If George Weston's bakery business traded at the same valuation as some of its publicly traded counterparts, shares of the conglomerate would trade at levels closer to $130. That's a nice upside potential compared to today's price of $107.20.

Investors are also getting indirect exposure to Loblaw's transformational 2014 Shoppers Drug Mart acquisition. As the biggest retailer in Canada, expect the company to be able to hammer suppliers on price as well as creating additional synergies.

Really, the only reason why retirees shouldn't look at adding George Weston to their portfolio is the meager yield. The dividend is only 1.6%, and with growth of only 19.4% over the past five years, dividend growth is a little lacking as well.

Supercharge your yield

There's an easy solution for investors who want exposure to George Weston and a generous dividend. Buy the preferred shares.

The Series I preferred shares (ticker symbol WN.PR.A) currently yield 5.8% and trade at approximately $25 per share. They pay $0.3625 per share on a quarterly basis.

The preferred shares are a really easy way to nearly quadruple the yield you'd get from the common shares. And since there are only 9.4 million Series I preferred shares outstanding, the dividend adds up to a commitment of just $13.6 million per year. That's nothing for a company that earned $540 million over the last 12 months.

One disadvantage to preferred shares is the lack of principal appreciation. The par value of George Weston's preferred shares is $25. When the Series I shares eventually get bought back by the company at par value, there's no gain.

Investors can buy the Series V preferred shares for their potential capital appreciation. These shares (under the ticker symbol WN.PR.E) currently trade hands at $21, a full 16% under their par value. The dividend is slightly lower at 5.6%, but these shares can be bought back by the company at $25 at any time.

There are currently eight million Series V preferred shares outstanding, meaning it would cost the company $200 million to buy them all back. George Weston currently has $2.7 billion worth of cash on its balance sheet. It can easily afford to buy them back.

George Weston is a great company with interesting assets. It just doesn't pay a great dividend. The preferred shares let income investors get their dividends.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:CHP.UN (Choice Properties Real Estate Investment Trust)
2. TSX:L (Loblaw Companies Limited)
3. TSX:WN (George Weston Limited)

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