Income Investors: Get a 17.2% Yield From Suncor Energy Inc.

Description

Two years ago, many Canadian investors held oil stocks primarily for their terrific dividends.

One of the most popular choices was Canadian Oil Sands. For years the company had maintained its generous dividend of $0.35 per quarter, which was a yield of approximately 6-7%, depending on the share price. Since its operations didn't carry any supply risk–there's an awful lot of oil left in the oil sands, after all–dividend investors seemed to view it as being a little safer than the rest.

And then oil fell, and you know the rest of the story.

As a response, many investors fled to the perceived safe energy stocks. **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) has been by far the most popular, attracting investors because of its downstream operations, its strong balance sheet, and because Warren Buffett owns approximately 30 million shares.

Suncor has it all, with one notable exception. Its dividend is a somewhat paltry 3.3%. Sure, that looks pretty good when compared to fixed-income alternatives like GICs or government bonds, but it pales in comparison to other asset classes like REITs.

Fortunately for income-starved investors, there's a better way. Here's how you can really supercharge your income from this energy giant.

Using options

Puts and calls serve many different purposes in today's market.

Primarily, they're used by investors to speculate on the direction of a stock without putting too much of their own money to work. If the bet pays off, the investor does well. If it doesn't, the loss is minimized.

As an example, investors can buy a $40 call option (which gives them the right to buy Suncor shares at $40) for September 16th for just $0.36 per share. For just $36, an investor can take a stake in securities worth $4,000. If Suncor shares are worth $41 by then, the return based on the original amount invested is spectacular.

This type of speculation should be of little interest to buy-and-hold investors. But these types of investors can still use options to their advantage using covered calls.

Here's how they work. An existing Suncor shareholder would sell a call option, which means they would create an obligation to sell their shares at a certain date for a certain price. In exchange for this, the shareholder would immediately collect the option premium from the person buying the call.

Let's look at a real-life example. Suncor shares currently trade hands for $34.50 each. A shareholder would sell a $36 call which expires on June 17th, collecting a $0.40 per share premium for doing so.

Two things can happen by June 17th. If Suncor shares are below $36 each, an investor gets to keep the premium and their shares, while the option expires worthless. The other scenario is if shares close above $36, which would mean the investor would be forced to close out their position. The good news in that scenario is a profit of $1.90 per share would be made, which is a pretty decent return annualized.

How much income?

Here's the beauty of this strategy. Suncor has monthly options, which means investors can use covered calls to goose their income each month of the year. Assuming a similar premium price going forward, investors can get a 13.9% annual return using just this strategy.

And remember, you'd still be getting the dividend income from Suncor, which works out to a 3.3% yield.

Put the two sources of income together, and investors are looking at an eye-popping 17.2% annual income yield from being a little creative with their Suncor shares. Or, to put it another way, an investor who buys 300 Suncor shares today–an investment worth $10,350–could generate $1,780 in income each year.

That kind of income spread out over a whole portfolio could be a huge help to a retiree. They owe it to themselves to at least check out this strategy.

CATEGORY

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