Pay Yourself First With This 5% Yield

Description

Are you familiar with the concept of paying yourself first?

Personal finance experts coined that expression, which simply means to take a percentage of every paycheque and put it toward your retirement savings before doing anything else with the money, including paying your rent.

If you do this already, well done, because not many people do.

However, there's another way of looking at paying yourself first — one that relates to the actual stocks you buy. Let me explain.

I recently moved to Halifax from Toronto. One of the first things I did was to open a hydro account with Nova Scotia Power, a utility that just happens to be owned by **Emera Inc.** (TSX:EMA).

Emera currently yields 5.4%, has a five-year dividend growth rate of 9.4%, and has lost 12% of its value since the beginning of January.

Rising interest rates

Emera's stock is down in large part because of rising interest rates. Utilities are especially sensitive to rising interest rates because the cost of capital to make acquisitions also goes up, making it harder to grow.

Last August, Fool.ca contributor Matt Smith did a good job of explaining why utilities stocks become less attractive when interest rates rise.

"After taking advantage of historically low-interest rates to finance a massive buying spree in recent years that saw it become a top 15 North American utility, **Fortis Inc.** (TSX:FTS)(NYSE:FTS) has amassed a colossal $46 million in debt and other contractual obligations," Smith wrote. "This leaves it susceptible to the impact of higher interest rates on the cost of capital, which becomes quite apparent when considering that for the first quarter of 2017, Fortis reported interest costs of $238 million, or almost $1 billion annualized."

Smith was talking about Fortis, not Emera, but the sentiment is the same.

In July 2016, Emera acquired TECO Energy, a Florida utility, for $13.7 billion. In 2015, Emera had just $3.8 billion in long-term debt. Today, that's up to $13.1 billion.

In 2017, Emera paid $698 million in interest on its debt. In 2015, the year before the TECO acquisition, it paid $212.6 million in interest. Over the course of two years, Emera's interest payments have increased by 228%, while its operating income increased by just 174%.

Considering TECO generates approximately 54% of Emera's operating earnings and has been a transformational acquisition, I wouldn't be overly concerned with the rate at which interest payments have increased over the last couple of years.

That said, it's something you might want to keep an eye on.

Emera plans to use excess its cash flow to pay down debt. Currently, the company's debt accounts for 61% of its capital structure; Emera plans to lower that figure to 55% by 2020.

That's good news for Emera shareholders who are concerned about rising interest rates.

Paying yourself first

If you live in Nova Scotia, you pay your monthly hydro bill to Emera. Depending on what you pay out each month, that's money you're not getting back unless you pay yourself first by buying Emera stock.

Let's say your annual hydro bill works out to $2,400.

Emera currently pays an annual dividend of $2.26 a share for a 5.4% yield. Over the past decade, the company has grown its dividend by 9% compounded annually. If it grows by the same 9% over the next 10 years, the dividend in 2028 will be $5.35 a share.

If you buy 1,000 shares of Emera (~ $41,000 investment), you'll receive $2,260 in annual dividends in the first year and $5,350 annually by 2028. Assuming average annual dividends of $3,805 over the next 10 years, you should be able to cover a decent portion of your hydro bill, although that depends on the rate at which hydro prices increase.

If you're from Ontario, you know that hydro rates can increase significantly.

The bottom line on Emera

Fool.ca contributor Haris Anwar recently recommended Emera stock over **Hydro One Ltd.** (TSX:H), reminding investors that Emera is currently trading at 14.2 times its estimated 2018 earnings — a valuation that’s very close to its historical low.

If I were to buy a utility stock, which is unlikely because I invest for capital appreciation and not income, I would pick Emera over Hydro One — if only to pay myself first.

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2. TSX:EMA (Emera Incorporated)
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washworth