Like Recurring Revenue? This Small-Cap Stock Is for You!

Description

Do you rent your apartment or home? Do you pay your own utilities? Do you live in Ontario?

If you said yes to all three questions, it's highly likely that **Enercare Inc.** (TSX:ECI) is making approximately $25.40 a month from you. I know that because I used to live in Ontario, and the monthly $25 charge at the end of my gas bill used to drive me crazy.

Everyone in Ontario talks about ridiculously high electricity bills, but the growth in the gas bill over the last few years by **Enbridge Inc.** was equally disturbing to the point where you forgot about Enercare's cut.

Based on a water heater lasting an average of 15 years, Enercare's generating about $4,500 in revenue on one water heater over its useful life that might cost $1,200 if you were to buy it.

From a landlord's perspective, it's a no-brainer. Why pay out $1,200 when you can get the tenant to pay for it? Not to mention, if it ever breaks down, Enercare will be on the hook.

Enercare's recurring revenue

The company's water heater rental program is part of its Enercare Home Services segment. The segment generated 42% of the company's overall revenue in the first quarter of 2018 with the rental of water heaters and HVAC units just one of the unit's four revenue streams. The others being protection plans; HVAC sales; and services such as duct cleaning, etc.

Although Enercare's Home Services business only generates 42% of the company's revenue, it delivers 62% of its gross profits, with the rental business accounting for a lion's share of the revenue and gross profits.

Interestingly, while I've chosen to focus on the water heater rentals, it's the HVAC rentals that really deliver for Enercare. According to its Q1 2018 report, the HVAC rentals generate 3-5 times more revenue than do the water heaters, which makes sense given that HVAC systems are much more expensive.

But holy recurring revenue.

When interest rates have been low over the past decade, it has cost the company next to nothing to finance the installation of rental water heaters and HVAC units, thereby generating a ton of cash flow in the process.

By comparison, Service Experts, Enercare's HVAC repair business in both the U.S. and Canada, accounts for 54% of its overall revenue, but only 32% of its gross profits. Not only that, but the repairs aren't nearly as recurring in nature as that of the monthly rental contracts.

Think about it

The company borrows $1,200 at the prime rate of 3.7%. That's $44 simple interest annually. The company receives $300 annually in monthly rental payments. It takes Enercare less than five years of a 15-year lifespan to pay off the cost of the water heater, including interest.

The company is left with as much as $3,000 in cash flow over the next decade, excluding potential maintenance issues. It's a big reason that **Royal Bank of Canada** recently called it one of the 20 best small-cap stocks to own over the next year.

If you're an income investor, as Fool contributor Kay Ng recently pointed out, you've got to like its juicy 5.5% dividend yield; that's especially true given that it has upped its annual payout by an average of 5% every year since 2011.

The odds of Enercare not being able to pay a dividend are about as low as **Bombardier Inc.** delivering TTC streetcars on time.

So, if there's a lock on a 5%-plus yield, Enercare is it.

One downside

The big downside I can see with Enercare is that its rental business does come with its share of PR nightmares. Google the words "Enercare complaints" and you'll find stories about water heater rental situations gone awry.

Like owning cigarette stocks, if you can handle the optics of it, you'll do just fine on the investment.

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