



Dividend Investors: Create Your Own 32.5% Yield With This Energy Giant

Description

There's a little-known way to generate income every dividend investor should be checking out.

Depending on the underlying stock used, this method allows investors to generate 10%, 15%, even 20%+ annual returns. No, those aren't typos. It really is that powerful.

The method used is writing covered calls. It seems complex, but it's really a simple strategy. Let's take a closer look at this powerful wealth-building tool, starring **Vermilion Energy Inc.** ([TSX:VET](#))([NYSE:VET](#)).

Why Vermilion Energy?

The truth is, you don't need a stock with a big dividend to successfully write a covered call strategy. You want one that's relatively stable, and Vermilion fits the bill. Yes, it does move up and down with the underlying price of oil, but unlike some of its peers the market doesn't view it as having a bankruptcy risk.

Vermilion has other things going for it as well. The company has diversified production in Canada, the United States, Europe, and Australia. While 60% of production is in North America, some 60% of free cash flow comes from the European assets. These fields benefit from getting Brent pricing, which has traded at a premium versus North American crude.

Vermilion's balance sheet is solid as well. It has just \$1.8 billion worth of debt versus \$6 billion in assets. And management focuses on capital expenditures with high immediate returns, meaning it can fully self-fund its current expansion program and afford to pay its generous dividend.

Turn Vermilion into an income generating machine

Let's take a closer look at how you can use Vermilion to generate eye-popping amounts of income.

The first step is as easy as buying the stock. Note that you must hold the underlying stock to write a

covered call.

The next part is where things get a little complicated. You must then go to the option market and sell a Vermilion Energy call option. What you're doing here is creating an obligation to sell the underlying stock if that stock hits a certain price on a particular day.

At this point it's easier to explain using a real-life example. Vermilion shares trade at \$32.48 each as I write this. The February 15, 2019 \$34 call option currently sells for \$0.55 per share. You'd sell that call option today and immediately pocket that \$0.55.

There are two things that can happen between now and February 15. Vermilion shares can either rise above \$34 or they stay below \$34.

The best result is if they stay below \$34 each. This way an investor gets to keep the \$0.55 option premium and their shares. The obligation to sell only comes into play if shares go higher than \$34. But remember, this isn't such a bad outcome. It means that you've locked in a profit of at least \$2.07 per share (\$1.52 in capital gains and \$0.55 in option premiums).

But wait. There's more. Vermilion pays a monthly dividend of \$0.23. It pays that distribution out to anyone who owns shares on January 30. An investor writing a covered call gets that premium no matter what happens.

Do it again... and again

If Vermilion shares cooperate and stay under \$34 each, it creates a powerful income machine.

Investors will receive \$0.55 per share in option premiums and \$0.23 per share in dividends, all without having to sell the underlying shares; \$0.88 per share each month works out to a 2.7% payout each month. Annualized, that's a 32.5% yield.

No, that's not a typo.

A covered call program also helps protect investors on the downside, too. Say Vermilion shares drop from \$32.48 to \$29. That's a loss of 10.7%. But if an investor writes covered calls on the original investment and generates \$0.88 per share in income, the loss decreases to just 8%.

The only negative aspect to this strategy is that it limits upside. If Vermilion shares skyrocketed to \$38, a covered call investor would lose out on approximately \$3 per share in profits. That stinks, but ultimately it's a small risk. It just isn't very often a stock will soar by over 15% in one month.

CATEGORY

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1. NYSE:VET (Vermilion Energy)
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