Create Your Own 15.6% Yield With Altagas Ltd. (TSX:ALA)

Description

Many dividend investors crowded into **Altagas Ltd.** (TSX:ALA) stock over the past couple of years, enticed by the fantastic dividend.

Alas, it was not to be. After paying what analysts agree was too much to acquire WGL Holdings, a Washington D.C.-based natural gas utility, Altagas' management team was forced to take drastic cuts to improve the company's bloated balance sheet. This included spinning out some of the best Canadian assets into a different company, selling different non-core assets, and slashing the dividend to something a little less generous. Shares currently pay $0.08 per month or $0.96 annually, good enough for a 5.7% yield.

There are now thousands of Altagas shareholders who are left with a company that is in financial difficulties paying a decreased dividend. These folks don't want to sell because then they'd be forced to take a loss on their shares.

I can't do anything about the stock price, but I can show these investors how to use a special trick to really juice their income from this stock. Here's how you can generate a 15.6% income on distressed Altagas shares.

Covered calls

We're going to use something called a covered call strategy, which is far less complicated than it would first appear.

First, an investor has to own the underlying stock. This is because a covered call strategy creates an obligation to sell the underlying stock if the trade doesn't quite go to plan.

The next step is to go into the options market and sell a call option, which generates income immediately in exchange for agreeing to sell at an agreed-upon price.

Let's look at a real-life example. Altagas shares currently trade at $17.75 each. If we go into the option market and sell the April 15 $19 call options, we'd generate income of $0.15 per share. That premium is compensation for agreeing to sell shares at the $19 level during the middle of April.

This trade can end in two ways, neither of which is the end of the world. If shares stay under $19 each, then the investor gets to keep the $0.15 per share option premium without having to sell their underlying stock. This is the ideal outcome.

If shares rise above $19 each, then the investor must sell their shares at the agreed upon price. But they've immediately booked a capital gain of 7%, plus the income generated by the option strategy. And since Altagas pays a monthly dividend, they'd also receive that. In total, it would be close to an 8.5% gain in just over a month, which is a nice result.

Earn 15.6% annually

Ideally, at least for this strategy, is Altagas shares rising very slowly over the course of the month. This allows an investor to get solid gains without triggering the forced sale.

In total, a covered call strategy for Altagas would generate the following, guaranteed: $0.15 per share for the option premium, and $0.08 per share for the monthly dividend, which works out to $0.23 per month for each share. Repeat this strategy 12 times a year and you're looking at $2.76 per share in income, which works out to an eye-popping 15.6% yield.

In fact, this strategy would generate even more income than an investment in the stock before the dividend cut.

The bottom line

With the **TSX Composite Index** up 12.5% thus far in 2019, many investors feel like the rest of the year might turn out to be a little lackluster. This is exactly the time to implement a covered call strategy on some of your holdings. As you can see with today's Altagas example, it's a very lucrative income generation tool.

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