Income Lovers: Use This Weird Trick to Collect a 10.9% Dividend From AltaGas (TSX:ALA)

Description

After years as one of Canada's top dividend stocks, **AltaGas** (TSX:ALA) did the unthinkable in December and cut its generous payout. The distribution was slashed from $0.1825 per share each month to today's level of $0.08 per share on a monthly basis.

Outraged investors dumped their shares aggressively, creating a huge buying opportunity for those of us who were brave enough to take the plunge when the future looked darkest.

Even though shares have rallied nicely from those lows set in the early part of 2019, I think the stock is still a good long-term buy. Management has done a nice job shedding debt and securing the balance sheet. Non-core assets have been sold for good prices. And the main utility business is still a good one that should deliver plenty of predictable cash flow.

Perhaps most importantly, the stock is still very cheap. Guidance for 2019 remains at approximately $900 million in funds from operations (FFO), while the company's market cap is just over $5 billion. That gives the stock a price-to-FFO ratio of just above five times, which is incredibly cheap.

Perhaps the only problem with an AltaGas investment at this point is the dividend yield. Shares still yield a generous 5.1%, but investors used to higher payouts might not like today's yield so much.

The good news is by using a simple trick you can more than double your income from AltaGas. Let's take a closer look.

Use covered calls

Astute investors use a covered call strategy to really juice their income. In fact, there are funds that use the strategy to consistently spin off double-digit yields.

Here's how it works.

First you need to own the underlying stock. Next, you'll go into the options market and write a covered call option. You do this by selling a call option, which creates an obligation to sell a stock at a certain price on a certain day. In exchange for creating this obligation, an investor receives the market price for the call.

It's easier if we look at a real-life example. The AltaGas September 20th $20 call option currently has a price of $0.09 per share. If an investor sells that call option, they'd immediately pocket the premium.

The trade would then have one of two outcomes. If AltaGas shares — which currently trade at $18.72 as I write this — end up below $20 at the end of the trading day next Friday, then the option expires worthless and you'd keep the $0.09 per share premium. If AltaGas shares rally between now and then, you'd be forced to sell at $20. This rule applies no matter the price; it would apply even if the stock somehow hit $30 in the next week and a half.

Even if the stock rises to above $20 by the deadline, it's not really the worst thing in the world. You'd still lock in a profit of $1.28 per share on the sale of the stock and an extra $0.09 per share from the covered call premium. That's a profit of 7.3% in just over a week.

A fantastic annualized yield

A covered call strategy works really well if a stock stays in a tight trading range for a while. It can produce some eye-popping annualized yields.

This AltaGas trading strategy would generate $0.17 per share in monthly income on a stock trading for under $19 per share. Annualized, that works out to a 10.9% yield. That's quite exciting, especially in today's interest rate environment.

Or, to put it another way, this strategy could create more than $1,000 in annual income from an investment of just 500 AltaGas shares.

The bottom line

A covered call strategy isn't for everyone. It does require a little work, and investors are trading some upside potential for income today.

But for retirees who crave more income, I can think of few more effective ways to really juice your yields. If you're in that boat, this strategy is for you.

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1. Dividend Stocks
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TICKERS GLOBAL

1. TSX:ALA (AltaGas Ltd.)

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