Tax-Free Riches: This Stock Pays You $2,180 a Year With a $20,000 TFSA

Description

TFSAs can help you build a passive-income machine. Because capital grows tax free and is also withdrawn tax free, you can meet your investing goals *years* faster.

When it comes to building a passive-income stream, dividend stocks should be your first choice. These companies produce more cash than they need for reinvestment and opt to distribute the excess capital directly to shareholders. Often, dividend stocks deliver annual yields between 3% and 5%. If you have $20,000 in your TFSA, that means you could generate between $600 and $1,000 in tax-free passive income per year.

But you don't have to settle for yields this low. One Canadian dividend all-star pays a 10.9% yield. It's maintained this payout for more than a decade. With $20,000, you could generate annual income of $2,180. With a TFSA, you keep 100% of this payout.

This stock delivers

Chemtrade Logistics Income Fund (TSX:CHE.UN) has figured out how to deliver sustainably high dividends to investors. It currently pays a $0.10 monthly dividend, which totals $1.20 per share on an annual basis. It's had the exact same payout since 2007, with zero interruptions, even throughout the 2008 financial crisis.

Previous to 2007, the company also paid market-leading dividends, but management opted for a variable approach. In 2006, it distributed $1.43 per share to investors. In 2005, it was $1.82. From 2002 to 2004, the annual payout averaged roughly $1.70.

Any way you slice it, Chemtrade has delivered a double-digit dividend yield for more than 15 years. It doesn't get more reliable than this. Investors often balk at the high payout with the misconception that it must not be sustainable. One look at the company's operating history dispels that notion.

If Chemtrade's dividend is so sustainable, why does the market still value the stock at a 10.8% yield? The most obvious answer is that the market isn't perfectly efficient. Mispricings occur all of the time, especially when it comes to small-cap stocks.

With a market cap of just $1 billion, few analysts cover Chemtrade. It’s virtually unknown among retail investors. Have you heard about the stock before this article? If so, are you familiar with what the company does? Likely not.

Chemtrade is a specialty chemicals distributor. It also has its own production facilities, meaning it can better control supply for some chemicals and ensure better pricing. When it comes to distribution, scale is king. Despite its small market cap, Chemtrade is one of the largest competitors in its industry.

Think of a waste collection business. If a company is servicing a certain area, it has to send an entire truck out to collect and transport the waste. Adding additional customers in that area is pretty cheap, considering the truck may only need to drive another few hundred feet to double or triple its revenue.

Chemicals distribution is similar. With a bigger network, Chemtrade has a structural cost advantage that its competitors don’t possess. It’s this advantage that’s allowed it to thrive for decades. Without a huge need for capital reinvestment, the company opts to redirect most of its cash flow back to investors.

In 2019, management reiterated several times that it has no plans to cut or suspend its dividend. The underlying financials support the payout, they argue, and the high yield is simply the market assigning an incorrect valuation to shares. You can use this mispricing to your advantage by building a TFSA cash flow machine.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:CHE.UN (Chemtrade Logistics Income Fund)

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