1 Undervalued Stock Yielding 8% to Add Passive Income to Your Portfolio

Description

With the stock market at an all-time uncertainty, it is wise for your portfolio to shift to a more defensive strategy. Without taking on too much risk at a good price, a stock that is offering high returns in this environment is **Chesswood Group** (TSX:CHW). Today, I'll analyze Chesswood and provide a brief overview on the prospects of this company.

Background

Founded in 1982, Chesswood has operated in almost every interest rate environment possible. Most prime to subprime equipment financiers were out of business by January 2009, but Chesswood was able to survive due to its strong market position and disciplined approach in the years prior to the crisis.

The financial services company specializes in small- to medium-ticket equipment financing. When a specialty business with large capital expenditures needs to buy new equipment, Chesswood can provide the financing required to do it. The company operates two wholly owned subsidiaries — two equipment financiers for small- to medium-sized businesses in the U.S. and Canada.

The U.S. Equipment Financing segment ("Pawnee") has approximately 600 independent operators across 48 U.S. states, while the Canada ("Blue Chip") segment has about 50 independent operators. These independent operators are diversified from various different industries, thus providing even more diversification, even on industry types!

Cash dividends

Chesswood is a very popular stock for its dividend, which is currently at 8.33% as of this writing. Most companies pay cash dividends from its earnings of the year. Chesswood, in particular, pays out about 74% of its earnings to shareholders. Investors can then reinvest these dividends into the stock and continue a virtuous cycle.

A payout ratio of 70-75% is a standard figure for most companies and especially sustainable for

Chesswood. This is because it is a financing company, with no expected major capital expenditures in the near future.

Dividend cuts and swings may provide interesting opportunities for strategic investors, but they may not be of interest to the average income-oriented investors. Chesswood has a track record of stability. For the past decade, its cash dividends have been growing at 11% per annum. Earnings, however, are growing at 3.6% per annum. This means that dividend growth is limited, until it can find a way to increase the growth rate of its earnings.

Valuation: Is Chesswood a cheap stock?

Relatively speaking, Chesswood is a cheap stock. With a forward P/E of about 8.4, it is trading at the lowest price that it has been in five years. **Element Fleet Management** and **goeasy** have been trading at forward P/Es of 11.4 and 9.1, respectively. These two companies also have extremely low dividend yields, both at about 2%.

Using a very conservative dividend discounted model, which assumes 4% dividend growth until the year 2029 and 2% growth afterwards, the stock is undervalued at about $11.95. This is good news for value investors, as the stock currently trades at $10.09 as of this writing. It is a modest margin of safety, but one nonetheless. It also provides passive income for your portfolio. Chesswood is not a spectacular stock that will make you rich, but it should be a conservative pick for income-savvy investors.

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