



## 2 Must-Have Dividend Champions for Your RRSP

### Description

In an earlier article fellow Fool Chris Lau [highlighted three ways](#) to make the most of your RRSP. Of these, one of the most important strategies is investing in stocks that pay eligible dividends, because they are tax-free when held in an RRSP. But when selecting dividend stocks for an RRSP it is important to ensure they meet a range of criteria in order to reduce risk while maximizing returns.

#### Key characteristics of dividend stocks for an RRSP

In order to meet these requirements, there are three key attributes that I focus on when selecting dividend stocks, especially if they are to be held in an RRSP.

First, I look for those companies with a dividend payment ratio of less than 60%. This ratio is essentially a quick and dirty measure of dividend sustainability, measuring how much of a company's net income is paid out as dividends. A ratio of over 100% indicates the dividend may not be sustainable. A lower ratio of 60% or less indicates the dividend is sustainable with plenty of fat to absorb any fall in net income.

Second, I want a company that has historically grown its dividend at a rate higher than inflation. This ensures the real return — the yield less inflation — remains positive maximizing the reward investors receive for the risk undertaken.

Typically, I measure this by the dividend's compound annual growth rate over the last five years. And with Canada's annual inflation rate since 2009 averaging 1.5%, I want a higher compound annual growth rate for the dividend.

Finally, I also want the dividend yield to exceed the yield on 10-year Canadian government bonds, which is essentially treated as the risk-free rate. When investing in equities investors should be seeking a reward that exceeds the risk-free rate in order to compensate them for the greater risk they are taking.

At the time of writing the Canadian government 10-year bond yield is 2.15%, so I have focused on companies paying a dividend with a higher yield.

I also suggest that investors consider diversifying their dividend stock investments across both industries and sectors as a means of reducing risk. After considering all of these factors, let's take a closer look at two dividend-paying stocks that meet all of the criteria discussed.

### **This top five bank has solid growth prospects**

One of my preferred dividend stocks is the **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)). The bank's dividend clearly meets all of the criteria, with an annual yield of 3.9%, a payout ratio of 45% and a five-year compound annual growth rate of 4%.

But the Bank of Nova Scotia also possess solid growth prospects, with it now having a significant footprint in a number of emerging markets including two of Latin America's fastest growing economies, Peru and Colombia.

It is now the third largest commercial bank in Peru and controls the fifth largest commercial bank in Colombia, Banco Colpatria. Both Peru and Colombia have projected GDP growth rates for 2014 that are significantly higher than the 206% forecast for Canada, of 6% and 4% respectively.

This emerging market strategy is particularly important because it will provide the bank with the opportunity to continue growing revenues despite the Canadian credit market now approaching saturation point.

### **You can't ignore this Canadian integrated energy giant**

Another standout company for inclusion is Canadian integrated energy major **Suncor Energy** ([TSX:SU](#))([NYSE:SU](#)). It currently pays an eligible dividend with a yield of 2.5%, but it is not the moderate yield that makes it stand out.

Rather it is the conservative payout ratio of 29% coupled with a consistently growing dividend, which for the last five years has a compound annual growth rate of a whopping 19%. And with such a conservative payout ratio there is certainly room for further dividend increases.

The company is also focused on making its operations more cost efficient, while boosting production which will see revenue, cash flow and the bottom line continue to grow through 2014. This has already seen 2013 net earnings jump by a healthy 43% in comparison to 2012 and higher margin crude make up a greater proportion of its production for 2013.

Suncor will also see its 2014 revenue boosted by the narrowing differential between West Canadian Select heavy oil and West Texas Intermediate, which forms the benchmark price. All of which indicates Suncor will continue to perform strongly and with management showing a proven history of increasing dividends I would expect further future increases.

### **Foolish bottom line**

The importance of selecting a dividend stock that meets the three criteria while diversifying your portfolio can't be stressed enough. Not only does it allow you to build a consistently growing, tax-effective income stream, but it also helps reduce risk. All of which will allow you to maximize your RRSP's balance when it comes time to retire.

## **CATEGORY**

1. Investing

## **TICKERS GLOBAL**

1. NYSE:BNS (The Bank of Nova Scotia)
2. NYSE:SU (Suncor Energy Inc.)
3. TSX:BNS (Bank Of Nova Scotia)
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