3 Dividend Champions for Every Portfolio

Description

When constructing a dividend portfolio, investors should seek dividend-paying companies with a number of key characteristics. The dividends must be classified as eligible dividends with yields in excess of the risk-free rate, be growing at a greater pace than the rate of inflation, and be sustainable with a low payout ratio. It is also wise to seek out those companies with a solid economic moat or clear competitive advantage.

This will ensure that investors maximize the tax advantages associated with dividend investing, while building a sustainable, growing income stream that exceeds inflation while maximizing their risk/reward tradeoff. There is some debate as to what constitutes the risk-free rate, but for the purposes of this article I have chosen the yield on 10-year Canadian Treasury Bills, which at this time is around 2.4%.

So let's take a closer look at three companies I call dividend champions.

This top 5 bank has consistently paid a dividend for over 120 years
Investors shouldn't look past the **Bank of Nova Scotia** (TSX: BNS)(NYSE: BNS) when looking for a solid dividend payment history, with the bank having paid a dividend since 1892.

More impressively, not only is its dividend yield nudging 4% — well in excess of the risk-free rate — it has increased its dividend payment three times over the last year alone. In fact, for the last 10 years the bank's dividend has a compound annual growth rate in excess of 7%, which is significantly higher than Canada's average annual inflation rate of 1.83% over the same period.

When the low dividend payout ratio of 44.5% is considered in conjunction with this solid yield and growth rate it is clear why the Bank of Nova Scotia should be a cornerstone holding in any dividend portfolio.

But the good news doesn't stop there. Unlike its top 5 peers, which are struggling to boost marketshare in a saturated domestic financial services market, the bank has exposure to some of the world'sfastest-growing emerging economies. This includes Latin America, where it is the third largest bank inPeru and the fifth largest in Colombia, giving it a competitive advantage that over time can only boostits bottom line.

This utilities giant has an almost unassailable economic moat
The next cornerstone holding comes from the boring but reliable utilities industry. Canadian utilities giant **Fortis** (TSX: FTS) not only pays an eligible dividend with a yield of 4% (almost double the risk-free rate) with a payout ratio of 71%, but it also has hiked its annual dividend by an impressive 41 times since 1972.

These regular dividend hikes give Fortis' dividend an impressive 10-year annual compound growth rate of 10% or more than five times Canada's average annual inflation rate over the same period.

Even more compelling is that Fortis has an almost unassailable economic moat, which when coupled with the size and geographical diversity of its operations, gives it a clear competitive advantage. This is because the barriers of entry into the utilities industry are exceptionally high, thus limiting the number of competitors and giving Fortis greater market control.

Furthermore, the demand for electricity is relatively inelastic, as electricity is an essential element of our modern lives. This gives Fortis greater pricing power and shields it from the effects of changes in the business cycle. This makes Fortis an almost recession-proof dividend machine of epic proportions and our next dividend champion.

A long dividend history makes this Telco giant a compelling addition
Industry diversification is an important tool for mitigating risk when constructing a dividend-focused portfolio and so Canada's largest telecommunications provider, **BCE** (TSX: BCE)(NYSE: BCE), is my final pick. BCE has been paying a steadily growing dividend since 1949 and currently pays an eligible dividend with a yield in excess of 5%.

The 2013 payout ratio was a little high at 92%, but management expects this to fall to between 65% and 75% of free cash flow in 2014, indicating the dividend is sustainable. More importantly, BCE's dividend has a 10-year compound annual growth rate of almost 7%, which is more than triple the average annual inflation rate over that period.

Finally, despite operating in a highly competitive industry, BCE has been able to build a competitive advantage through its long history, size, and comprehensive suite of residential and business communication services.

Foolish bottom line
With dividends estimated by Standard and Poors to have made up over a third of the total returns generated by the S&P/TSX Composite Index since 1956, they form an important component of any investment portfolio. The key to successful dividend investing is to identify those companies providing a sustainable consistently growing dividend with a yield in excess of the risk free-rate just like the three companies here.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BCE (BCE Inc.)
2. NYSE:BNS (The Bank of Nova Scotia)
3. TSX:BCE (BCE Inc.)
4. TSX:BNS (Bank Of Nova Scotia)
5. TSX:FTS (Fortis Inc.)

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Date
2025/07/17
Date Created
2014/04/16
Author
mattdsmith