3 More Dividend Champions for Every Portfolio

Description

I recently analyzed three dividend champions that I feel should form the cornerstone of any income-focused share portfolio. In this article we will take a closer look at three more dividend champions, which income investors should also consider as core holdings.

But first, let's quickly recap the key characteristics investors should look for in a dividend champion. The dividend must be classified as an eligible dividend, have a yield exceeding the risk-free rate, be sustainable with a low payout ratio and paid by a company with a solid economic moat or clear competitive advantage.

There are a number of ways of determining the risk-free rate; for the purposes of this article, I have used the yield on 10-year Canadian Government Treasury Bills, which is around 2.5%.

So let's take a closer look at three companies whose dividends fit these criteria.

This quiet achiever in the patch continues to deliver value for investors
Canada's third largest pipeline and midstream (oil transportation, storage and wholesale marketing) company **Pembina Pipeline Corp.** (TSX: PPL)(NYSE: PBA) continues to create value for investors. Not only does it pay a dividend with a tasty yield of just under 4%, which is significantly higher than the risk-free rate, but the dividend is paid monthly, providing investors with a smoother income stream than quarterly dividends.

Even more impressively, Pembina has been paying a steadily growing monthly dividend since 1998, which has a compound annual growth rate of just under 4% over that period. This is higher than Canada's average annual inflation rate of 2% for the same period.

At first glance the dividend doesn't appear sustainable, with a payout ratio of 147%, which represents the portion of net income paid out as dividends. But substitute operating cash flow for net income and the payout ratio falls to a sustainable 78%.

This is a superior method for determining whether the dividend of a midstream company is sustainable, because cash flow is king in this industry due to the capital-intensive nature of the business. It is also more accurate, because the formula for calculating net income includes a number of non-cash items, which may impact the bottom line but not a company's ability to pay its dividend.

Finally Pembina continues to maintain an economic moat because the midstream industry has a number of significant barriers to entry, primarily created by the need to invest considerable capital and regulatory requirements. Those challenges limit the number of competitors and give Pembina greater market control.

Firmer oil prices and a solid dividend yield make this oil sands play a compelling investment
Higher crude prices have created renewed investor interest in the patch and seen the profitability of many of the patches major players grow. This has left many of the major players well positioned to continue rewarding investors through dividend payments and share buybacks. One player in the patch that stands out because of its tasty dividend yield of almost 6% is **Canadian Oil Sands** (TSX: COS).

Not only does it have a solid dividend payment history having consistently paid a quarterly dividend since 2002, it has a payout ratio of 81% when calculated using net income, which falls to a very sustainable 50% when operating cash flow is substituted for net income.

The high development costs associated with oil sands production and particularly the refining of synthetic crude create significant barriers to entry and give Canadian Oil Sands a competitive advantage.

Furthermore, synthetic crude, unlike Canadian heavy crude, typically trades at a premium to the benchmark price of West Texas Intermediate and in 2013 Canadian Oil Sands' syncrude averaged a 1.1% price premium to WTI. This allows Canadian Oil Sands to generate a superior profit margin per barrel of crude produced compared to its heavy crude producing peers.

This top 5 bank is a dividend growth machine
Like its top five peers, **Toronto Dominion Bank** (TSX: TD)(NYSE: TD) is a dividend machine, having increased its quarterly dividend four times over the last year alone. It has also paid a steadily appreciating quarterly dividend since 1970, with an impressive compound annual growth rate of over 15% since then. More importantly, Toronto Dominion's dividend has a conservative payout ratio of just under 45%. In conjunction with its long dividend payment history and ability to consistently grow cash flow, that indicates the dividend is sustainable.

But what makes Toronto Dominion standout from many of its peers is the bank's growth potential in a saturated Canadian financial services market, with limited growth opportunities. Toronto Dominion has built a strong presence in the Canadian and U.S. wealth management industries and embarked on growing a strong retail banking in the U.S., giving it access to the world's largest single banking market. This gives it a competitive advantage over the majority of its competitors.

Foolish bottom line
Each of these companies pays an eligible dividend with a solid yield that exceeds the risk-free rate, and is coupled with consistent dividend payment histories and low payout ratios. Investors in these companies can generate a tax-effective and sustainable income stream, making each company an important addition to any dividend-focused portfolio.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:PBA (Pembina Pipeline Corporation)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:PPL (Pembina Pipeline Corporation)
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