4 Dividend Champions With Growth Potential

Description

Companies that pay consistent and regular dividends (I call them “dividend champions”) can contribute significantly over time to complement investor income requirements. However, as equities generally carry a higher level of risk than government or investment-grade corporate bonds, investors should require a higher rate of return.

To achieve this objective, investors will be looking to invest in stocks that do not only have attractive current dividend yields but are also expected to maintain and grow their dividend over time. This will in all likelihood result in an attractive and growing income stream as well as capital gains in line with the growth in dividends.

My criteria for the selection of dividend champions are the following:

1. A track record of consistent and growing dividends
2. A rock-solid balance sheet
3. A moderate pay-out ratio

The **S&P Canadian Dividend Aristocrats Index** (^GSPTXDV) identifies companies that have increased or maintained their cash dividend payments for at least the past 5 years. Currently the index has 65 members. This list satisfies the first selection criterion above (although a 10-year record would better) and indicates at least a credible historical record of dividend payments. This establishes the dividend-paying pedigree of the company.

However, we are really interested in the future – will these companies be able to maintain and grow their dividends over the next 5 to 10 years? The second and third criteria provide some guidance in this regard: a solid balance sheet and modest pay-out ratio that leaves room for inevitable unfavourable business conditions will provide some flexibility for the company to maintain its dividend even in difficult times.

A quantitative screen applied to the 65 companies in the Dividend Aristocrats Index provides some interesting names for further consideration. Firstly, if all companies with a current dividend yield of less than the current yield on the 10-year Canadian Government Bond plus 0.5% (that is 2.75%) are removed, a group of 31 companies remain.

The challenge then is to apply an analytical framework to determine which of the companies will deliver reasonable growth over time. Based on the consensus forecasts of professional sell-side analysts, the top ranked stocks for dividend growth over the next three years, selected from the group that currently yields at least 2.75%, reduce to only seven stocks. From this group I also remove the companies that have too high level of debt or uncomfortably low dividend covers resulting in a final list, which is indicated in the table below.

Company	Current Dividend Yield	Dividend Growth per Year, Next 3 Years
Toronto Dominion Bank (TSX:TD)(NYSE:TD)	3.4%	11%
Telus Corporation (TSX:T)(NYSE:TU)	4.0%	10%
Suncor (TSX:SU)(NYSE:SU)	2.8%	21%
Canadian Utilities (TSX:CU)	2.8%	10%

The list only contains four names, which is somewhat disappointing from an investor perspective and perhaps indicative of an expensively priced group of stocks.

Dividend-based investment can produce great investment results. However, the key to success is to uncover those companies that will continue to grow their dividends ahead of the rate of inflation and to get an entry point with a relatively attractive initial yield. The list provided above will in all likelihood outperform an investment in fixed income instruments over the next few years.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. NYSE:TU (TELUS)
3. TSX:CU (Canadian Utilities Limited)
4. TSX:SU (Suncor Energy Inc.)
5. TSX:T (TELUS)
6. TSX:TD (The Toronto-Dominion Bank)

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