Does Royal Bank of Canada or TransCanada Corporation Have the Better 4% Dividend?

Description

If you're looking to generate some income from your savings, a 4% yield is about what you should be shooting for. If you go for a higher yield, you'll likely have to settle for little growth, or worse still, a potential dividend cut. And with bonds yielding next to nothing, 4% should be considered very attractive.

As it turns out, two of Canada's top dividend stocks yield roughly 4%: **Royal Bank of Canada** (TSX:RY)(NYSE:RY) and **TransCanada Corporation** (TSX:TRP)(NYSE:TRP). But which is the better pick?

The case for RBC

If you're looking for a great dividend stock, the Big Five Canadian banks are a great place to start. Thanks to limited competition, they are able to generate big profits, while still acting responsibly. None of them have cut their dividend since World War II. And today they are some of the world's best-capitalized financial institutions.

RBC is a perfect example. The bank has a Common Equity Tier 1 (CET1) ratio of 10.0%, well above the 8.0% minimum for Canada's big banks.

Analysts are worried about the Canadian economy, but this hasn't had much of an effect on RBC. In the first two quarters of this year RBC's adjusted earnings grew by 12% and 9%, respectively.

Here's the best part: RBC pays out less than half of its earnings to shareholders. To illustrate, the bank has earned $6.50 per share over the last 12 months. And even after the company raised its dividend by 3% in February, the dividend works out to only $3.08 per share per year. By comparison, TransCanada is paying out 84% of its trailing 12 months' income.

The case for TransCanada

Like RBC, TransCanada is a very reliable dividend payer—since 2000 the company has raised its dividend by an average of 7% per year. Even more amazingly, TransCanada has raised its dividend every year during that stretch, something that not even RBC can claim.

Unlike RBC, TransCanada has a very stable business model. The company's pipelines are generally secured by long-term contracts, and come with practically no exposure to commodity prices.

Also unlike RBC, TransCanada has a wealth of growth opportunities, with over $40 billion of commercially secured projects in its pipeline (no pun intended). Pipelines remain in strong demand thanks to rising oil production, and crude by rail is a far more expensive (and dangerous) alternative.

The verdict

At this point, I'm going to give the slight nod to TransCanada. The company has a clear plan to grow its dividend for the next few years (the goal is 8% per year through to 2017), while RBC is more exposed to the shaky Canadian economy.

That said, RBC is still a very solid dividend stock, so owning both is a perfectly legitimate option.

CATEGORY

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