5 Tips for Solid Dividend Investing

Description

Dividend investing is a defensive investing strategy because when the market turns on you, you'll still receive positive returns from the dividends. Dividend investing is a great strategy if you're investing for the long term. Here are five tips for solid dividend investing.

1. Choose companies with reliable business models

You want companies that have reliable business models. These are businesses that make money in good times and bad. Perhaps they generate recurring revenues from repeat sales. Perhaps their earnings and cash flows are very predictable because of the nature of their business.

For example, utilities such as **Fortis Inc.** (TSX:FTS) generate stable earnings because everyone uses electricity and gas. Another example is real estate investment trusts, which earn rent from the many properties they own and manage. For instance, **Canadian Apartment Properties REIT** (TSX:CAR.UN) owns interests in over 41,000 residential units.

2. Choose companies that are difficult to bankrupt

A company with no debt cannot go bankrupt. However, it's not necessarily bad to have some debt. With the low interest rate environment, debt is a cheap way for companies to finance their projects.

Investors can compare a company's debt levels with its peers' debt levels to see if the one you're interested in has too much debt. For example, Fortis, **Canadian Utilities Limited** (TSX:CU), and **Emera Inc.** (TSX:EMA) have debt-to-cap from 46% to 54% with the median at 50%. So, if a fourth utility has debt levels at 70%, then it may be better to avoid that one.

3. Choose companies with a sustainable payout ratio

The payout ratio is the proportion of earnings paid out as dividends. For example, Fortis has a payout ratio of 60%, which means that it retained 40% of its earnings. The retained earnings can be used to pay down debt or to grow the business.

The lower the payout ratio, the safer the dividend. Once again, Foolish investors can compare the payout ratio of a company with its peers' payout ratio because different industries tend to have different ranges for their payout ratios.

4. Choose companies with strong earnings growth

Businesses that have a long-term trend of growing earnings are businesses that become more profitable and valuable over time. Sure, dividends can pay us while we hold on to the shares of the business, but capital growth of the shares is nice to see over time as well. And price appreciation is spurred by consistent earnings growth. More importantly, though, as mentioned in tip three, dividends come from earnings. So, earnings growth implies a safer dividend.

5. Choose companies with a history of dividend growth

So, we want to invest in companies that tend to grow their earnings, but it doesn't make sense for dividend investors if the company doesn't increase its dividend. After all, the safest dividend is the one that was just raised. So, it benefits dividend investors to look for companies that have a history of growing dividends.

If it's already ingrained in the culture of the company to increase dividends each year, they're likely to continue doing so. The utilities mentioned in tip two have increased dividends for at least eight years, with Fortis's and Canadian Utilities's dividend-growth records going back at least 40 years!

In conclusion

Dividend investing is simple to do if you choose companies by following the five tips above. The hard part is being patient and calm enough to hold on to the shares through the inevitable market swings. After all, you need to hold the shares to receive the dividends.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:CAR.UN (Canadian Apartment Properties Real Estate Investment Trust)
2. TSX:CU (Canadian Utilities Limited)
3. TSX:EMA (Emera Incorporated)
4. TSX:FTS (Fortis Inc.)

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Author
kayng