

Why a Dividend-Growth Stock Is Safer Than a Dividend Stock

Description

Dividend-growth stocks are stocks that have a history of increasing dividends. Dividends are powerful because they can be used to pay bills, buy food, or they can be reinvested for more shares and income.

Dividends are a way for businesses to return profits to shareholders, and typically only mature companies do this. These companies earn consistent earnings and cash flows to be able to continue paying dividends.

I emphasize *dividend-growth* stocks here because no matter which perspective you use to look at it, dividend-growth stocks are more powerful than dividend stocks. Why? Well, your income is not simply maintained. It grows! Plus, the safest dividend is the one that was just increased.

Why is a dividend-growth stock safer?

I would call **TransAlta Corporation** ([TSX:TA](#))([NYSE:TAC](#)) a dividend stock. It used to pay a quarterly dividend of 29 cents from 2009 to 2013. Now it only pays a quarterly dividend of 18 cents. So, shareholders have experienced a 38% cut in their income from their investment.

On the other hand, **Fortis Inc.** ([TSX:FTS](#)) has increased dividends for more than 40 years! In fact, it just increased its quarterly dividend by 10.3%—three times the rate of inflation.

Now you can see why TransAlta has a yield of 13.2%, while Fortis only has a yield of 4%. Obviously, the former is much riskier. The market requires it to have a higher yield to assume the higher risk.

Why did TransAlta perform so badly compared with Fortis?

From 2009 to 2014, TransAlta's earnings per share (EPS) went from 90 cents to 25 cents, a drop of 72%. At the start of January 2009 its shares traded around \$25. Today, it's at \$5.45, a drop of 78%.

In the same period, Fortis's EPS grew from \$1.51 to \$1.81, a rise of close to 20%. At the start of January 2009 Fortis's shares traded around \$25. Today, it's at \$38, a rise of 52%.

So, while an investment in TransAlta fell 38%, an equal investment in Fortis would have seen income rise by 44%. From 2009 to the present, Fortis's quarterly dividend increased from 26 cents to 37.5 cents per share.

Conclusion

Utilities are supposed to be very stable businesses because they provide needed products and services. However, Foolish investors should know that not all businesses are the same, even in the same sector or industry.

Going forward, Fortis will see an average 6% increase in the dividend per year through 2020. If I had to choose between TransAlta and Fortis today, I would not hesitate to choose Fortis.

Now, I'm not saying TransAlta is a bad investment, as it *could* very well be a potential turnaround investment, but I don't know that for certain.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:TAC (TransAlta Corporation)
2. TSX:FTS (Fortis Inc.)
3. TSX:TA (TransAlta Corporation)

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Date

2025/08/21

Date Created

2015/11/23

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