Long-Term Investors: This 4.2% Dividend Is Worth Buying

Description

Last May, **Finning International Inc.** (TSX:FTT) upped its dividend to $0.73 a year, which was then a 2.8% yield. With most analysts very concerned over crumbling global demand for commodities, it seemed odd that the world's largest dealer of **Caterpillar** parts and vehicles would be paying out even more money to shareholders. Since the latest raise, Finning's stock has fallen by over 25%, pushing the yield up to 4.2%.

While you may be skeptical, Finning's dividend actually looks surprisingly safe. Plus, there are a few other moves management is making to position the business for the long term. While the next year or two may present some unique headwinds, investors with a five- to 10-year time frame should take note.

Still pumping out free cash flow

Despite the market's obsession with GAAP accounting earnings, free cash flow is what pays the bills, including the dividend. Despite significantly weaker market conditions in Canada, the company posted free cash flow this quarter of $347 million compared to $385 million in the fourth quarter of 2014. EBITDA (excluding one-time items) was also strong at $139 million, a 9.1% margin. So while the business will no doubt see a tough 2016, the underlying financials underpin the stability of its dividend.

Downsizing is only beginning

Finning has plenty of opportunity to scale its business alongside falling demand. Recently, it announced that it will cut 400-500 jobs from its global operations this year on top of 1,900 that were announced in 2015.

While the CEO mentioned that Finning is "not immune to the challenges facing our customers across our key markets and geographies," he was sure to point out the company's ability to generate relatively consistent earnings and cash flow by adjusting to the conditions, enabling it to maintain its dividend.

Buying when others are fearful

Most share buybacks occur when times are good and are paid for by record profits and cash flows.

Unfortunately, studies show that a significant portion of stock repurchases destroy shareholder value as they are typically put in place when company shares are expensive. It's rare to find a company willing to institute a massive buyback when investors are dumping shares.

Last May, Finning announced a share-repurchase program that will buy back 10% of the outstanding shares. It's taking the process slowly, however, buying shares as investors are more willing to sell at depressed prices.

By the end of 2015, it had only spent $91 million to repurchase 4.4 million shares at an average price of $20.60. As this only represents 2.5% of all shares, Finning has plenty of firepower left to ramp up repurchases if the stock price weakens further. This may be counter-intuitive during weak market conditions, but buying while others are fearful is a time-tested formula to creating wealth for patient investors.

While you wait, collecting a 4.2% dividend is a great reminder that Finning's business remains viable even during industry downturns.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:FTT (Finning International Inc.)

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