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What 2 of Canada’s Top Dividend Stocks Have in Common (and Why You Should Buy)

Description

Some recent studies revealed some shocking statistics that every long-term investor needs to know — not only did stocks that grow dividend payments outperform their stable-dividend and no-dividend peers over the past 40 years (10.1% versus 7.6% and 2.1% respectively), they also did so with much less volatility.

For income-focused investors, research by Manulife Asset Management found that investors should focus on dividend growth, rather than yield, since a 3% yielding stock with a 12% annual growth rate would provide 3X more income than a 5% yielding stock with no growth.

Dividend growth matters, and stable dividend growth requires predictable earnings growth. This is harder to come by today in Canada, especially since some of Canada’s largest industries (energy/materials sector and the financial sector) are suffering from downturns.

As a result, M&A has become more central for some of Canada’s key dividend payers, and a successful history and strategy of acquisitions have allowed some of Canada’s top dividend names to diversify geographically, take advantage of deals brought on by economic weakness, and extend organic growth. Here are how two of Canada’s top dividend names are using smart acquisitions to fuel future dividend growth.

1) Royal Bank of Canada

Royal Bank of Canada (TSX:RY)(NYSE:RY) has been of Canada’s most solid dividend payers. The stock consistently pays out between 40 and 50% of its earnings, and has been one of the most steady dividend growers in the country.

Since 2010 the company has grown its dividend by an average of over 10% CAGR, and since 2000 has grown its dividend every year except for 2009 and 2010, which was due to the financial crisis (even then, it didn’t cut its dividend). All told, it’s dividend has grown by 500% since 2000.

The oil downturn in Canada and an overleveraged Canadian consumer have been major headwinds for RBC’s earnings growth recently, but the bank recently made a smart move into the United States with its $5.5 billion November purchase of City National Bank.

This should provide a significant tailwind to RBC’s earnings going forward. City National is a California-based private and commercial bank which is focused largely on high net worth individuals in California and New York. This will likely provide extensive growth opportunities to RBC — the GDP of City National’s core markets in New York, and California is 1.7x greater than Canada’s, and these markets have a high net worth market that is 5x greater than all of Canada.

The high net worth market in the U.S. is rapidly growing, and City National will be able to exceed the

11.4% earnings CAGR it has seen since 2011 through synergies with RBC and interest rate hikes in the U.S. RBC expects to see City National double its earnings by 2020, contributing $1 billion annually to net income.

This is good news for dividend investors in Royal Bank, and will support strong continued growth in the dividend.

2) Agrium Inc.

Agricultural retailer and whole-sale fertilizer producer **Agrium Inc.** (TSX:AGU)(NYSE:AGU) has recently become a top dividend growth name thanks to the stability of its retail business, as well as major recent capital expenditures on its potash and nitrogen production facilities winding down. The end result is Agrium seeing a sharp and sustainable increase in free cash flow, growing from US$4.34 per share in 2013, to US$8.59 last year, with an expected move up to $10 by the end of 2017 being in the cards.

Going forward, acquisitions in the retail segment, combined with an improvement in crop prices will drive this growth. Agrium has had a steady track record of making tuck-in acquisitions for its retail segment, acquiring 33 facilities this year alone, and 305 since 2010. These will add US$25 to US$30 million of EBITDA annually plus the additional 1-3% annual growth contribution from the new facilities each year.

Earlier in July, Agrium announced the acquisition of 158 retail facilities from Cargill, which is in addition to the 33 acquired so far this year. These acquisitions will help fuel rapid growth in Agrium's current US$3.50 dividend as free cash flow expands.

CATEGORY

1. Dividend Stocks
2. Investing

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