Income Investors: The Time Is Right to Buy These 3 Dividend Studs

Description

With stock markets in North America making new highs, investors everywhere are struggling with one pesky factor–valuation.

The bull case goes something like this.

Investors should be happy to pay 20 times earnings, 25 times earnings, or even more for high-quality companies. With interest rates so low and little possibility that they'll go much higher anytime soon, getting a 5% earnings yield versus a 1% fixed-income yield is a nice premium.

The bear case is much more sinister. These folks tend to agree about interest rates, but they believe some sort of unforeseen event will catch investors by surprise, whacking the price of stocks around the world. You can guess what would happen to some of these so-called safe stocks in such a scenario.

Perhaps investors nervous about the overall stock market should take a different approach. Instead of buying expensive, high-quality stocks, investors should be a little more selective and buy companies that have high-class operations and low valuations.

You might think such stocks don't exist in today's market, but they do. Here are three to get you started.

National Bank

National Bank of Canada (TSX:NA) posts results that are consistently as strong as its five larger peers, pays a dividend of 4.8%, yet persistently trades at a lower valuation than the rest of the sector. Shares currently trade hands for less than 10 times projected 2017 earnings.

Why doesn't it get any love?

The big reason is the bank's dependence on Canada. Sure, it has a smattering of foreign assets, including the ownership 90% of a bank in Cambodia. But those investments are only worth about $350 million–a pittance for a company with a $15.5 billion market cap. Until it can really make a splash with a big foreign acquisition, it'll likely trade at a discount price.

Investors looking to take advantage of this potential catalyst should buy now. Management has been vocal in saying they're looking to make acquisitions, and the new recently announced mortgage rules should benefit companies like National Bank that get the majority of their funding through deposits.

Extendicare

Extendicare Inc. (TSX:EXE) is a way to play a massive upcoming trend, while not paying too much for the opportunity. We're all getting older, and there's a lot of money to be made providing retirement homes for the more than nine million Canadian baby boomers.

Extendicare recently exited the United States, and used the cash from the sale of those assets to further bolster its home health division. It also acquired new homes and plans to fix up some old ones. All of these changes should boost earnings, further solidifying the company's 5.1% yield.

Even after a weak first quarter, Extendicare is on pace to post $0.71 per share in adjusted funds from operations, which is a key measure of its profitability. That puts shares at just 13.25 times earnings, which is not only quite reasonable in today's expensive market, but also puts it at a discount to peers, which trade closer to 20 times adjusted funds from operations.

Magna International

It isn't often investors can pick up a leader in its sector for under 10 times earnings. Such an opportunity exists with **Magna International Inc.** (TSX:MG)(NYSE:MGA) with shares trading at 8.8 times trailing earnings.

The manufacturer of everything from car seats to engines is well positioned to do well as cars transition from gas engines to electric models. The company recently made an acquisition to expand its technology portfolio, and it's already been tapped by **Ford** to make the drivetrain for its new Focus electric vehicle.

Rumours are also swirling around Magna's possible role in making the much-awaited **Apple** Car with some believing the tech company could outsource the whole process to the parts maker, like it does with its mobile phones.

In the meantime, investors are getting paid a 2.2% dividend to wait. With a payout ratio of just 19.6% of earnings, look for the company to continue hiking that payout.

The bottom line

It's not impossible for investors to find reasonably priced dividend-paying stocks. National Bank, Extendicare, and Magna all pay nice dividends (with the strong possibility of dividend growth) and offer capital-gain potential when valuations return to normal.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:MGA (Magna International Inc.)
2. TSX:EXE (Extendicare Inc.)
3. TSX:MG (Magna International Inc.)
4. TSX:NA (National Bank of Canada)

Category

1. Bank Stocks
2. Dividend Stocks
3. Investing

Date
2025/08/26
Date Created
2016/10/05
Author
nelsonpsmith