These 3 Stocks Have Massive Dividend-Growth Potential

Description

Many dividend-growth investors follow a relatively simple formula. They load up on companies with histories of increasing the payout, knowing the management team wants to keep that streak alive at all costs.

It's almost a perpetual-motion machine. Management hikes the dividend. Investors like it, so they start buying. Management appreciates the encouragement, so they raise the distribution again. And so on.

But I'm not sure this is the best formula to embrace when looking for the next generation of dividend growers. Companies in Canada that have raised their dividend annually for a decade or more–excluding the Great Recession: a period when many companies wisely paused dividend growth–are generally pretty mature. They're still growing, but it's obvious their best days of growth are behind them.

Thus, investors are resigning themselves to dividend raises of between 3% and 6% annually over time. That's certainly not bad, but I think we can do better, especially younger investors who don't need to live on dividends.

Here are three Canadian stocks with huge potential to increase their payouts.

Waste Connections

On May 31, Progressive Waste Solutions and **Waste Connections Inc.** (TSX:WCN)(NYSE:WCN) officially merged. The combined company now has a market cap of $17.3 billion with 15,000 employees and operations across Canada and the United States. Approximately 83% of revenue comes from the U.S.

The new company generates a decent amount of free cash flow, yet pays a fairly anemic dividend. According to estimates provided to investors at the time of the merger, free cash flow per share was projected to hit US$3.01 per share in 2016. That number will likely increase over time as well, as the newly combined company squeezes out additional synergies.

Waste Connections just increased its dividend substantially, hiking it from US$0.1445 to US$0.18 per share–an increase of 24.1%. Even after that increase, investors are looking at a payout ratio of just 24% of free cash flow.

As Waste Connections further pays down its debt and increases rates to customers, look for dividend hikes like the one we just saw become more and more frequent.

Canadian Tire

Canadian Tire Corporation Limited (TSX:CTC.A) has quietly become one of Canada's premier retailers. Besides its namesake brand, it also owns Mark's, Sport Chek, Atmosphere Sports, and PartSource. Sales were strong across all company brands in the most recent quarter with revenue increasing 2.9%. This helped the company post $2.46 per share in earnings–an increase of 14.5% versus last year.

Analysts are projecting earnings to hit $9.08 per share this year, and then $9.77 per share in 2017. That's impressive growth potential for a company only trading at 14.6 times trailing earnings.

It also bodes well for dividend growth, which has already been outstanding in the last five years. The payout is currently $2.28 per share, which is good enough for a 1.75% yield and a payout ratio of 25.3%. It's easy to see the potential for big dividend increases if management decides they're serious about it.

Saputo

Saputo Inc. (TSX:SAP) is a growth-by-acquisition machine. After conquering the milk and dairy sector in Canada, it moved to the United States, then Argentina, and finally Australia. It's been a little while since the company did a big acquisition, which means it's probably about due to make another splash somewhere.

Saputo has raised its dividend annually for years now, and it's still had ample ability to finance its many acquisitions. It just recently announced an 11% increase from $0.135 to $0.15 per share each quarter.

Even after that latest dividend hike, the payout ratio still only comes to 37% of trailing earnings and 32% of forward earnings expectations. That's the kind of payout ratio long-term holders should like to see.

The bottom line

If you're looking for the next generation of dividend-growth studs, the best place to look is among growth stocks with low payout ratios. Saputo, Canadian Tire, and Waste Connections all fit the bill.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:WCN (Waste Connections)
2. TSX:CTC.A (Canadian Tire Corporation, Limited)
3. TSX:SAP (Saputo Inc.)

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Date
2025/09/11
Date Created
2016/10/28
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