Attention Investors: You Might Be Looking at Dividends All Wrong

Description

There's no denying the power of dividends.

From 1990 through 2010, the TSX Composite Index increased approximately 5.6% per year. That's enough to turn a $10,000 investment into one worth $40,177. That's not bad, but it could be more exciting.

The picture changes completely once we add dividends into the equation. The TSX Composite averaged a 2.5% yield during that time, giving it a total return of 8.1%. That turned a $10,000 investment made back in 1990 into one worth $64,124 by 2010. Now we're talking!

Investors don't just love dividends because they're cash money, although that is a big reason. Study after study has proven that dividend payers outperform stocks that don't pay a dividend. Dividend-paying stocks tend to be more stable organizations. And it sure is nice getting paid when the share price doesn't cooperate.

Dividends are great. But investors who only fixate on them are missing out on an important variable. Here's why focusing on shareholder yield is the better metric.

What's shareholder yield?

The concept is as simple as it is powerful. Shareholder yield looks at both ways a company can give back to its owners.

The missing part of the equation is share buybacks. Add that to the dividend yield, and we end up with shareholder yield.

Here's an example. Say a company is worth $100 million. It pays $4 million per year in dividends, giving it a 4% yield. It also decides to buy back $4 million worth of shares, which is the equivalent of paying out an 8% total yield.

There's just one problem. The average stock screener won't point out these companies for you. They'll look at the dividend yield and nothing else. You'll have to dig to find these opportunities.

Here are a few to get you started.

Magna International

Magna International Inc. (TSX:MG)(NYSE:MGA), the multi-national car parts giant with more than US$36 billion in revenue in 2016, isn't just incredibly cheap on a trailing price-to-earnings basis (8.1 times). It also has an attractive shareholder yield.

According to Google Finance, at the beginning of 2016, Magna had 402.3 million shares outstanding. It ended the year with 382.25 million shares outstanding, which is good enough for a 5% reduction. Add on the company's 2.6% yield, and we get a total shareholder yield of 7.6%. Not bad.

Magna has been consistently buying back shares for years now. At the end of 2013, the company had 442.3 million shares outstanding, which means it bought back more than 13% of its shares in just three years.

Aimia

If you thought Magna's 7.6% shareholder's yield was impressive, then **Aimia Inc.** (TSX:AIM) would like a word with you.

The owner of the popular Aeroplan rewards program didn't stand still when its shares sank to a cheap level in 2015. Management got extremely aggressive in buying back shares. At the end of 2014, the company had 172 million shares outstanding. Two years later, that number had fallen to 152.3 million shares for a net reduction of 11.5%.

Aimia also has one of the best dividends out there. It has a current yield of 8.9%. Add the two together, and the company has averaged a 14.7% shareholder yield in the last two years. That is simply remarkable.

Onex

Onex Corporation (TSX:ONEX) is often ignored by dividend investors who balk at the pitiful 0.3% current yield.

But the company's shareholder yield is much more attractive. Onex has consistently bought back approximately 3% of its shares outstanding over the last few years. At the end of 2013, the company had 111.5 million shares outstanding. That number was reduced to 102.9 million at the end of 2016.

Once we factor in these buybacks, Onex has a shareholder yield of approximately 3.3%. While that might not seem that exciting next to Aimia's 14.7% shareholder yield, it still shows the fallacy of only looking at the dividend yield.

The bottom line

Shareholder yield is a powerful concept overlooked by most income investors. A company that consistently buys back its stock is giving back to shareholders just as much as one that pays a juicy dividend. Remember this the next time you start looking for investment ideas.

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1. NYSE:MGA (Magna International Inc.)
2. TSX:AIM (Aimia Inc.)
3. TSX:MG (Magna International Inc.)
4. TSX:ONEX (Onex Corporation)

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