Do Dividend Track Records Matter?

Description

Assessing future dividends has always been an art, rather than a science. In other words, there is still no definitive means of predicting how a company's future dividend will grow. While looking at the track record of dividend growth can be useful in providing a rough guide on how future dividends may increase or decrease, the approach also has its limitations.

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Changing circumstances

Most companies would like to raise dividends at a steady pace, year-in and year-out over a long period. This could provide their shares with a premium valuation, since investors tend to be willing to pay more for a lower-risk stock and more reliable income opportunity. However, the reality is that the performance of any business is constantly evolving due to a changing environment. As such, even if a company has the best intentions of raising dividends each year, there may be times when it is simply not possible to do so.

For example, a company may have a sound strategy and a well-diversified business model. It may have been hugely successful in the past and been able to record above-average dividend growth for a long period. However, if there is an external event which impacts on its profitability, it may be forced to cut dividends. This could be in the form of a recession, regulatory change within an industry, or even changes among consumer tastes. Such changes can be foreseen to some extent, but ultimately a company's profitability and dividends can be hit by unexpected events.

Strategy change

Another reason why focusing on a company's dividend track record is of limited use is that its strategy inevitably changes. This is often prompted by a new management team which seeks to take the company in a different direction.

For example, a company may be relatively mature and its management team may be comfortable in paying out a high proportion of earnings as dividends. However, a new management team may replace them and decide that a much larger proportion of profit is required for investment in order to pursue a major growth strategy. This could lead to a bigger and more profitable company in the long run, but it may also mean a cut in shareholder payouts over the short run.

Therefore, for income investors it can be prudent to focus on a company's strategy – especially when it changes, since it can have a direct impact upon the affordability of dividends.

Takeaway

Clearly, there is some merit in checking a company's dividend track record. Unless there is an event which affects the company's future outlook, the historic trend in dividends is likely to continue. However, the fact is that events occur which change either the profit growth outlook for a business, or its strategy. Both of these changes can impact positively or negatively on the payment of dividends.

Therefore, buying companies simply because they have grown shareholder payouts at a brisk pace for a period of time may not always lead to sustained dividend growth in future.

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