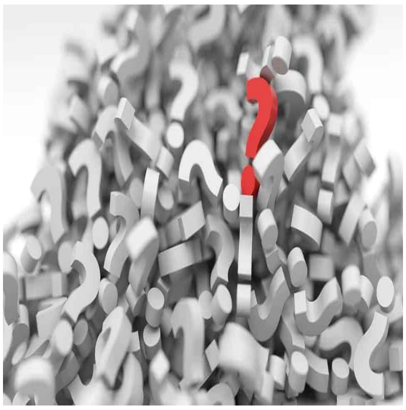

Why Are You Buying This Specific Dividend Stock?

Description

If you want income, how do you choose one dividend stock over another? Investors must be sure to pay reasonable valuations for a stock to generate reasonable returns.

For some stocks, it makes sense to require a larger margin of safety before buying them. For other stocks, investors should accept a lower expected return for taking less risk.

It may be confusing at this point, but it should make more sense with the following examples.

RioCan Real Estate Investment Trust (TSX:REI.UN) is A favourite holdings of retirees, particularly for its safe, above-average income.

At $24.50 per share, the largest Canadian retail real estate investment trust (REIT) offers a yield of nearly 5.8%. The REIT has a sustainable payout ratio of about 83% and has an investment-grade S&P credit rating of BBB.

Currently, one analyst thinks RioCan can grow its funds from operations per share by about 3% per year for the next three to five years. If so, it'll keep pace with inflation.

So, don't expect much growth from the stock unless you buy it at an undervalued price. Luckily, like most retail-related stocks, RioCan shares have been under pressure, but the REIT's fundamentals are holding their ground.

The shares have about 10% upside before reaching its normal multiple, which would imply a near-term 12-month return of about 16%.

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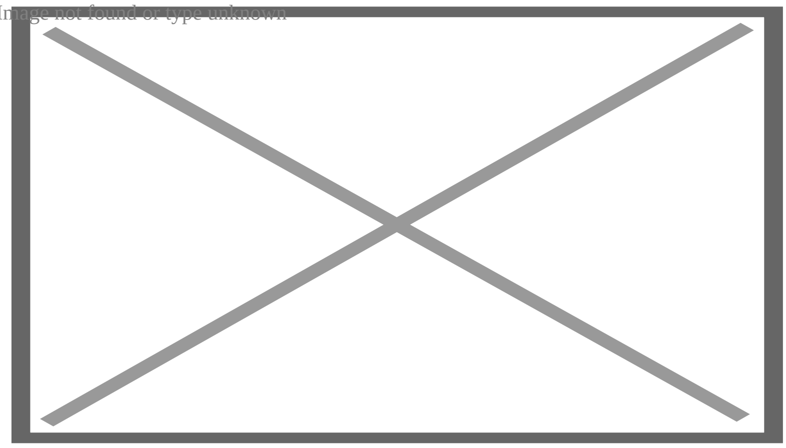

Fortis Inc. (TSX:FTS)(NYSE:FTS) offers a smaller yield of 3.6%. With its 43 consecutive years of dividend growth and a sustainable payout ratio of about 66%, you can count on the regulated utility to continue growing its dividend.

In fact, management aims to grow its dividend by 6% per year for the next few years.

Because Fortis has higher growth than RioCan, you can expect that an investment in Fortis will eventually outperform the same investment in RioCan in the long run. But you're giving up some yield for higher growth.

Vermilion Energy Inc. (TSX:VET)(NYSE:VET) also offers a dividend — a high yield of 6.5%. However, this dividend stock is very different from RioCan and Fortis.

Vermilion is an international oil and gas producer. Management is committed to its dividend; the company has at least maintained the same payout since 2003.

However, if you look at its long-term price chart, you'll see that it is much more volatile than RioCan and Fortis. Additionally, the company's cash flow generation will be affected by the prices of the underlying commodities.

So, Vermilion's high yield is meant to compensate for the above-average volatile and uncertainty in the business. Who knows where the energy prices will be next year?

Investor takeaway

No dividend is the same. Each time you buy a stock with the expectation of generating income from its dividend, you should know what kind of business you're buying.

Shares of stable businesses such as RioCan and Fortis tend to have low volatility, and if you buy them at the right valuations, you can generate above-average income. Fortis, which has growth that beats inflation, can deliver market-outperforming returns if you buy at the right valuations.

Vermilion's business does well when commodity prices are high. Unfortunately, it can't control the commodity prices. So, it makes sense to require a bigger margin of safety before considering the shares of such businesses.

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

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2. NYSE:VET (Vermilion Energy)
3. TSX:FTS (Fortis Inc.)
4. TSX:REI.UN (RioCan Real Estate Investment Trust)
5. TSX:VET (Vermilion Energy Inc.)

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