Caution: Dividend Stocks Can Behave Very Differently

Description

Stocks that pay dividends are generally more stable than stocks that don't. However, investors should be aware that one dividend stock can behave very differently from another, even though both of their dividends may be safe. After all, each stock is driven by its underlying business, which is unique.

I'll use **BCE Inc.** (TSX:BCE)(NYSE:BCE) and **Exco Technologies Limited** (TSX:XTC) as examples.

A stable cash cow

BCE is Canada's biggest communications company. It offers wireless and wireline services as well as television programming services. At the end of June, BCE had 8.9 million wireless subscribers, 3.7 million high-speed internet subscribers, and 2.8 million TV subscribers; these services had healthy growth of 7.5%, 8.8%, and 2.7%, respectively, year over year.

Essentially, BCE is a cash cow. It generates steady cash flows year in, year out, which allows the company to be a stable dividend stock. The telecom has increased its dividend for eight consecutive years.

The company's five-year dividend-growth rate is 5.9%, and its dividend per share is 5.1% higher than it was a year ago. Its payout ratio is estimated to be 85% this year. At ~$58.30 per share, it offers a yield of 4.9%.

BCE is a low-beta stock which experiences below-average volatility. It also trades in a narrow range. Its 52-week range is a difference of only ~10%. For its stability and stable dividend, the market currently commands a premium multiple of ~17.1 on the stock.

Small-cap, high dividend-growth stock with higher risk

Exco's Automotive Solutions business designs, develops, and manufactures automotive interior trim components and assemblies primarily for passenger and light truck vehicles.

Its Casting and Extrusion business primarily designs, develops, and manufactures die-casting and extrusion tooling and equipment for the automotive and industrial markets. Year to date, they contributed about 70% and 30%, respectively, to sales.

In the last 12 months, the stock has declined about 20%, despite having a safe, fast-growing dividend. The market may be worried about peak auto sales and the shift to electric vehicles. After a meaningful dip, Exco now offers a yield of nearly 3.4%, which is on the high end for the company.

At ~$9.50 per share, Exco trades at a seemingly cheap multiple of ~8.7. However, it actually aligns with the multiples its bigger peers trade at. Both **Magna** and **Linamar** trade at a multiple of ~8.8.

The management have been decent capital allocators: the company's return on equity has been at least 11.8% since fiscal 2011, and the company has increased its dividend for 11 consecutive years with a three-year dividend-growth rate of 15.9%.

In the first three fiscal quarters, which ended in June, Exco generated $40.2 million of free cash flow. About 24% was used to pay its quarterly dividends, and most of the remainder was directed towards reducing debt.

Exco's dividend per share is 14.3% higher than it was a year ago. Its payout ratio is estimated to be about 30% this year.

Investor takeaway

Although BCE and Exco both offer safe dividends, and I expect both to continue to increase their dividends going forward, they are very different investments.

BCE should be a smoother ride for investors. It also trades at a premium to the market for its stability.

Exco trades at a low multiple, which is the norm in its industry. That said, if the Exco management continues to put capital to good use, as it has done since 2011, the stock can still head higher overtime without any multiples expansion.

For investors who have a bigger appetite for risk, they can consider Exco, which has the potential to deliver higher returns and more income than BCE down the road.

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Date
2025/08/27
Date Created
2017/09/21
Author
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