Why Dividends Are Good for Both the Company and Its Investors

Description

There are obvious reasons why dividends are good for investors. However, paying dividends is good for companies, too.

Why dividends are good for investors

When investors buy a stock that pays out dividends like clockwork, they get regular returns from the dividend income — no matter what the stock price does. Investors don't ever have to sell any shares to get a return on their investment.

Investors who buy stocks that don't pay dividends will need to sell some shares at some point to get a return. However, we all know that share prices are out of our control, especially during market corrections or crashes.

Fortis (TSX:FTS)(NYSE:FTS) is one of the companies with the longest dividend-growth streak on the **Toronto Stock Exchange**. By just holding on to its stock, Fortis shareholders would have gotten 44 consecutive years of dividend hikes. In other words, eventually, you can get your original investment back from dividends alone!

Fortis's dividend income will only keep coming. It recently just extended its dividend growth guidance, aiming for 6% average annual dividend growth through 2023.

Why dividends are good for companies

Healthy dividends come from a portion of earnings or operating cash flow. Paying out dividends forces companies to be more stringent on their use of capital. The dividends force management to be more disciplined in their capital allocation. For example, management will be more critical on their acquisitions, making sure they're fitting assets, accretive, and a good value for the buck.

Fortis began acquiring U.S. utilities in 2013, when the U.S. dollar and the Canadian dollar were close to parity. Between 2013 and 2016, the regulated utility acquired Central Hudson, UNS Energy, and ITC Holdings, which were all quality businesses. This shows that Fortis management is patient and made acquisitions at opportune times.

Final thoughts

Companies that consistently increase their dividend per share over time has a more stable investor base, which makes their stocks less volatile. According to Yahoo Finance, Fortis has a recent beta of -0.06, which means it actually moved in the opposite direction of the market, while the market was having a correction. However, that could just be a coincidence, as Fortis stock was depressed to an attractive valuation from the fears of impacts from increasing interest rates.

Now that Fortis is trading at about $46 per share (a price-to-earnings multiple of about 18), the stock is close to being fully valued. So buyers today should not expect another 11% price appreciation in the next month like last month.

Fortis' dividend reinvestment plan (DRIP) also helps keep the stock stable, as long-term investors turn on the DRIP to build their positions. The company offers a 2% discount on the purchase of common stock, issued from treasury, with the reinvested dividends, which is a good way to reward its loyal shareholders.

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Date
2025/08/18
Date Created
2018/11/24
Author

kayng