Why Investors Are Often Better off With Dividends Than Share Buybacks

Description

There's often a debate around whether investors are better off receiving dividends or benefiting from share buybacks made by a company. Essentially, investors end up benefiting either way as a dividend can provide a cash payment while a buyback helps lift the stock in price and allows investors to sell it at a higher value.

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Admittedly, there's often not a clear winner as to which option is better, but generally speaking, I'd go with dividend stocks, and here's why.

Share buybacks can be sporadic

Neither share buybacks nor dividend payments are guarantees and investors have no assurances that they will continue into the future. However, share buybacks are even worse when it comes to predictability as dividends normally follow a consistent schedule.

A company like **Enbridge Inc** (TSX:ENB)(NYSE:ENB) that always pays quarterly will likely continue doing so unless it decides to halt its payments entirely. However, as long as the company continues making payments, investors at least have an idea of when they'll receive them.

For investors seeking consistency, dividends are certainly a more reliable and predictable option. And unless something drastic happens that leaves the company believing that it can't continue making payments, there's a good chance they'll continue. That's especially true for a company like Enbridge that not only has a track record of paying dividends, but increasing the payments as well.

Enbridge won't want to break that streak, as it's an easy way to sell investors on the stock by saying that the company has made dividend payments for however many years in a row.

Buybacks can be suboptimal

Share prices can often be very volatile and when a company makes a repurchase of its own stock can have a significant impact on cash flow. In Enbridge's case, the stock has traded between $39 and $51 over the past 52 weeks. Currently, it trades at around 1.5 times its book value at writing and closer to the high end of that range.

Warren Buffett loves buybacks, but his policy in the past stipulated that they should be made when shares were at least 1.2 times book value or less, which makes sense and also ensures that a company isn't wasting money buying the shares at a premium. For Enbridge, that means he'd likely wait until there's a price drop to purchase stock, and if that doesn't happen then buying back shares might not be the best option for a company to make.

Ultimately, buybacks are much more discretionary than dividends, which is why they can be less than ideal. While some investors may for tax purposes prefer capital gains to dividend income, there's not a whole lot more reason that buybacks are better options.

It can also distort a company's performance, as buybacks have the effect of improving a company's earnings per share, as the denominator in the equation, the shares outstanding, will be reduced. For investors, a company that buys back a lot of its shares can also do so in order to make its numbers look a whole lot better.

It's a matter of personal preference in the end, but unless there are significant tax benefits for individual investors to be gained, I'd prefer to collect Enbridge's growing dividend on a consistent basis rather than trusting and relying that a company buying back its shares does so at the right time and for the right reasons.

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