5 Must-Haves Before Buying Any Passive Income Stock

Description

New investors looking for passive income continue to flock to dividend stocks. Right now, there are quite a few stocks out there with high dividend yields. But what can seem great on the surface usually requires some investigating.

That's why today, I'm going to look at five factors every investor should consider if they're purchasing passive income stocks. If each of these items is checked off the list, you should be good to go.

A stable sector

First off, is the company you're investing in part of a stable sector? Passive income stocks are just like any other. They can be great when the economy is thriving, and bad when things take a turn for the worse. A company that provides you with a soaring dividend yield may eventually cut that yield if its revenue starts falling short.

That's why utility stocks, bank stocks, infrastructure stocks, and real estate stocks are some of the best to look at when you start your search. While not every stock in these sectors is an optimal choice, these sectors are a great jumping off point to find passive income stocks.

Historical performance

Next up, let's look at how long these stable passive income stocks have been around. And just as important, how long have they been paying and *increasing* their dividend. Consider reviewing a list of Dividend Aristocrats. These are dividend providers that have increased their dividends each year for over 25 years.

Keep in mind that a long track record of dividend hikes doesn't guarantee these hikes will continue into the future. Oil and gas stocks, for example, had Dividend Aristocrat status and then fell back. But combined with a stable sector, the status can be another sign that you've chosen great passive income stocks.

A high dividend, but not *too* high

A high dividend yield can look great, but how sustainable is it? Is it only high because the share price has fallen back so drastically? These are important points to consider when choosing passive income stocks. While dividends are great, you don't want your initial investment to suffer in the meantime.

Look back at the history of the company's dividend yield and see how stable it's been. You should also review the share performance itself, and make sure there haven't been major drops that didn't quite recover. If there have been, what was the cause? Get to know the company before you invest in it.

Cheap? Or worthless?

Another way to gauge how sustainable the dividend will be is by looking at the company's fundamentals. There are two factors in particular I would consider when looking at passive income stocks, and that's the total debt to equity ratio (D/E) and price-to-earnings ratio (P/E).

If the D/E is under 1, the company has enough equity to cover all its debts. If the P/E is under 15, that's a good sign the company is of value as well. If these numbers fall in line, then you're getting the stock for a good price.

Is growth there?

I've already mentioned share growth, but how much is the dividend growing for these passive income stocks? There are online calculators that allow you to figure out the compound annual growth rate (CAGR). This tells you how much the stock and the dividend have grown on average over a select period of time.

A company that checks all of these boxes is **Canadian Utilities** (TSX:CU). It's the only Dividend King on the **TSX**, with over 50 years of dividend increases. While its D/E is at 1.4, that's a reasonable amount. It trades at 19.68 times earnings, which is fairly valued if not cheap. It offers an attractive 4.39% dividend yield, has grown steadily for decades, and is in the stable utilities sector.

As for its dividend, it's grown at a CAGR of 7.2% over the last decade. That's a strong increase year after year, despite having 50 years behind it and coping with a volatile market. So, it's certainly a great contender among passive income stocks.

Bottom line

While some of the items here are flexible, others are not. When it comes down to it, passive income stocks should pay you to hold them. And that means these payments should continue no matter how long you own the stock.

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