



The Bottom Line

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Can You Count on Dividends?

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In the U.S., the answer is certainly no. Over the course of the past year or so, dividends of U.S. companies—particularly financial corporations—have been slashed as payout ratios rose sharply and many turned to the government for help. Even the most reliable blue chip companies have shown signs of potential dividend cuts for the first time in their history.

The *Financial Times* reports that for the first time since 1912, Dow Chemical Company is hinting that it may have to cut its dividend and Moody's has placed GE's sacrosanct triple-A rating on credit watch. GE's chairman and CEO, Jeff Immelt, insists that the company warrants its blockbuster rating and will not need to cut its dividend, which at today's stock price, yields 10%; this will force GE to spend more than \$13 billion in cash during 2009. GE's payout ratio is currently over 69%.

TABLE 1

PREVIOUS DIVIDEND SCREEN

(ranked in order of market cap : as of January 2008)

Symbol	Company name	Market cap (\$ blns)	Sector	Dividend yield (%)	5-yr div. growth (%)	Payout ratio	Beta
S&P/TSX							
RY	Royal Bank of Canada	59	Financial	4.4	31.0	48.0	0.87
MFC	Manulife Financial	53	Financial	2.7	24.0	31.4	0.82
TD	TD Bank	44	Financial	3.7	14.5	37.6	0.81
BNS	Bank of Nova Scotia	43	Financial	4.3	18.7	47.0	0.80
HSE	Husky Energy	33	Energy	3.4	49.2	27.0	0.92
GWO	Great-West Life	28	Financial	3.5	17.5	54.0	0.54
IGM	IGM Financial	11	Financial	4.3	15.6	55.7	0.60
RET/A	Reitmans	1	Consumer Disc.	4.6	45.9	41.1	0.55
S&P 500							
JNJ	Johnson & Johnson	184	Health Care	2.7	15.8	38.6	0.34
BAC	Bank of America	167	Financial	6.9	14.9	45.7	0.67
HD	Home Depot Inc	48	Consumer Disc.	3.2	31.8	24.2	0.81
BUD	Anheuser-Busch Companies Inc	36	Consumer Stpl	2.7	10.4	44.4	0.57
ALL	Allstate Corp	28	Financial	3.1	13.0	17.7	0.87
HSY	Hershey Ord Shs	8	Consumer Stpl	3.3	12.1	42.1	0.42
VFC	VF Corp	8	Consumer Disc.	3.2	15.8	40.4	0.63
CINF	Cincinnati Financial Corp	6	Financial	4.0	12.0	24.9	0.75
ZION	Zions Bancorp Ord Shs	5	Financial	4.0	12.9	27.1	0.68

Criteria: Must be a member of TSX 300 or S&P 500 index; dividend yield greater than 2.5%; 5-year dividend growth greater than 10%; payout ratio less than 60%; beta less than 1 (for a risk measure); positive trend in pre-tax profit margin.

TABLE 2
DIVIDEND STOCK SCREEN

(ranked in order of yield : as of January 29, 2009)

Symbol	Company name	Market cap (\$ blns)	Sector	Dividend yield (%)	5-yr div. growth (%)	Payout ratio	Beta
S&P/TSX							
NA	National Bank	6	Financial	6.8	16.6	53.0	0.83
RET/A*	Reitmans	1	Consumer Disc.	6.4	45.6	40.8	0.71
RY*	Royal Bank of Canada	44	Financial	6.3	17.6	58.9	0.97
IGM*	Investors Group	9	Financial	6.3	15.1	53.4	0.79
TD*	TD Bank	36	Financial	5.8	14.9	49.1	0.86
T	Telus	11	Telecom	5.5	24.9	41.4	0.80
POW	Power Corp.	10	Financial	5.3	18.8	28.6	0.98
IAG	Industrial Alliance	2	Financial	4.8	21.8	25.1	0.90
FTT	Finning International	2	Industrials	3.4	19.0	23.0	0.79
RCI/B	Rogers Communications	22	Telecom	2.9	82.1	41.6	0.78
SAP	Saputo Inc.	4	Consumer Stpl.	2.9	18.8	32.8	0.56
CP	Canadian Pacific Rail	6	Industrials	2.6	14.2	24.6	0.90
Former members (screened in January 2008; current data shown)							
GWO	Great-West Life	17	Financial	6.7	16.4	51.1	1.07
HSE	Husky Energy	26	Energy	6.6	20.2	35.1	1.06
BNS	Bank of Nova Scotia	31	Financial	6.4	16.9	62.5	0.94
MFC	Manulife Financial	33	Financial	5.0	20.7	31.9	1.08
S&P 500							
KMB	Kimberly-Clark	22	Consumer Stpl.	4.4	11.3	57.2	0.74
KO	The Coca-Cola Company	101	Consumer Stpl.	3.5	11.6	52.7	0.73
WMI	Waste Management Inc.	16	Industrials	3.5	155.1	42.6	0.85
MCD	McDonalds	66	Consumer Disc.	3.4	32.4	43.2	0.76
PEP	Pepsico	81	Consumer Stpl.	3.3	21.2	40.8	0.69
JNJ*	Johnson & Johnson	162	Health Care	3.1	14.2	39.3	0.69
UTX	United Technologies	47	Industrials	3.0	18.8	26.8	0.94
MSFT	Microsoft	160	Info. Tech.	2.9	13.9	23.1	0.82
CB	Chubb Group	16	Financial	2.9	12.9	16.3	0.99
PG	Procter & Gamble	174	Consumer Stpl.	2.8	12.5	37.5	0.69
LMT	Lockheed Martin	32	Industrials	2.8	25.8	22.9	0.83
TXN	Texas Instruments	20	Info. Tech.	2.8	37.6	27.9	0.89
Former members (screened in January 2008; current data shown)							
ALL	Allstate Corp	13	Financial	6.9	12.0	19.4	1.21
CINF	Cincinnati Financial Corp	4	Financial	6.6	11.5	28.2	1.13
VFC	VF Corp	6	Consumer Disc.	4.1	18.2	40.2	1.01
HD	Home Depot Inc	38	Consumer Disc.	4.0	28.2	40.6	1.14
HSY	Hershey Ord Shs	8	Consumer Stpl	3.2	10.5	117.8	0.78
ZION	Zions Bancorp Ord Shs	2	Financial	1.0	9.6	37.8	1.36
BAC	Bank of America	44	Financial	0.6	9.2	402.4	1.75
BUD	Anheuser-Busch Companies Inc	36	Consumer Stpl	— Acquired 11/18/2008 —			

Criteria: Must be a member of TSX 300 or S&P 500 index; dividend yield greater than 2.5%; 5-year dividend growth greater than 10%; payout ratio less than 60%; beta less than 1 (for a risk measure); positive trend in pre-tax profit margin.

* d denotes stocks also on screen last year.

In January 2008, we ran a dividend stock screen to find shares that met the following criteria:

- Must be a member of TSX 300 or S&P 500 index
- Dividend yield greater than 2.5%
- 5-year dividend growth greater than 10%
- Payout ratio less than 60%
- Beta less than 1 (for a risk measure)
- Positive trend in pre-tax profit margin

Table 1 shows the stocks on both indices that met these requirements. Notice that one year ago, Bank of America was on the list. *Table 2* shows the results of the stock screen run this week (January 29, 2009)—what a difference. Bank of America dropped off the screen because dividends plunged while its payout ratio skyrocketed to over 402% (despite a dramatic cut in dividends) and its beta surged from 0.67 to 1.75 in just one year. Hershey's payout ratio is now also too high and the other displaced stocks suffer from huge increases in their betas. Only one financial services company remains on the S&P stock screen, Chubb Group, with a dividend yield of 2.9%. New members on the list include consumer staples companies Kimberly-Clark, Coca-Cola, Pepsico, and Procter & Gamble, showing that consumer staples are indeed defensive stocks in a recession. Also new to the list are three industrial stocks—Waste Management Inc., United Technologies and Lockheed Martin—two infotech companies—Microsoft and Texas Instruments, and finally McDonalds, a consumer discretionary stock. Only Johnson & Johnson remains from the first to the second screens.

For Canada, the story is different as the stock screen is still dominated by financials. Also notice that dividend yields are significantly higher in Canada for companies that qualify. Canada has never had a culture of dividend reduction at the banks. Aside from the National Bank, none of the other five Canadian banks have cut their dividend since the Great Depression.

Three financial stocks remain on the list—Royal Bank, TD Bank and Investors Group—and several were added—National Bank, Investors Group, Power Corp., and Industrial Alliance. Also remaining is Reitmans. Falling off the list are Great-West Life, Bank of Nova Scotia, Manulife Financial and Husky Energy. BNS has too large a payout ratio (62.5%) and the others have betas in excess of 1. Payout ratios have also been too high for BMO and CIBC to make the list for either period. Also new on the TSX list are industrials Finning International and Canadian Pacific Rail, telecoms Telus and Rogers Communications and consumer staples company Saputo Inc.

The Bottom Line: Dividends are higher and more reliable in Canada than the U.S. in general, but especially in the financial services industry. All of the Canadian banks have historically high dividends, yet all have refrained from cutting distributions even with payout ratios above target norms. In the past, banks have been very reluctant to cut their dividends, even in very hard times (think early-'80s and early-'90s recessions).

All of the Canadian banks have high tier one capital ratios—much higher than virtually all U.S. or European banks—and all have waded only up to their ankles (more or less) in the toxic gunk that is drowning many U.S. banks. Nevertheless, the Canadian bank share prices have fallen between 44% and 54% from their peaks; but that is far better than the declines in many U.S. bank share prices.

Banking is a cyclical industry and we are at the point in the cycle when reserves against potential loan losses rise; many of those loans will be worked out and recovered in the next few years, but some will be realized losses. The problem is that this downturn is likely to be the worst in decades (at least for the U.S.) and it began with a banking crisis in the U.S. caused broadly by over-leveraging and under-pricing risk.

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