McMurtry Investment Report – February 2024

Also available in PDF: McMurtry Investment Newsletter – February 2024

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Dividends, Dividends and More Dividends

Company	Div. Yield %	Dividend Payout % using Cash Flow	Financial Debt to TTM EBITDA	2024/2023 EBITDA % Ch yr /yr	2024/2023 EPS % change
V	0.75	20.22	0.866	15.69	13.08
CB	1.39	11.49	N/A		9.12
IFC	2.09	42.95	N/A	N/A	30.22
SLF	4.49	60.47	N/A	N/A	6.97
MFC	4.96	14.47	N/A	N/A	6.92
FRU	7.90	71.09	0.589	8.92	
CPG	4.76	26.76	1.464	13.03	
CVE	2.63	39.17	0.810	13.10	
CNQ	4.90	53.84	0.720	13.03	
ENB	7.70	81.76	6.062	5.06	
PPL	5.81	78.29	3.773	6.96	
TRP	7.07	-295.20	10.33	4.12	
STN	0.70	N/A	1.902	14.59	
CPKS	0.68	43.16	-29.31	15.75	
TIH	2.44	108.00	0.695	0.35	
EFN	2.10	-10.52	7.308		11.10
PH	1.16	26.00	2.652	12.48	
TFII	1.20	20.44	1.159	20.04	
CNR	1.98	54.82	1.903	7.75	
AFN	1.03	15.61	6.635	4.72	
GD	1.99	37.52	1.985	17.29	
MRE	1.40	14.84	1.707	8.49	
MG	3.25	111.40	1.523	14.81	
DOL	0.28	5.95	1.143	18.56	
QSR	2.75	80.71	6.285	8.76	
PBH	3.26	90.05	4.262	12.13	
JWEL	2.47	79.32	3.508	8.39	
L	1.32	16.72	1.301	4.03	9.24
LIN	1.25	48.07	1.478	9.81	
CCO	0.18	12.35	1.559	104.91	
CPX	6.61	135.30	2.594	-0.10	
ALA	4.28	-87.15	5.379	9.32	
FTS	4.38	-16.19	5.787	4.81	
BIP.UN	4.80	54.92	7.36	N/A	706.3

Company	Div Yield %	Dividend Payout % using cash flow	Financial Debt to TTM EBITDA	2024/2023 EBITDA % Ch yr/yr	2024/2023 EPS % change
ATD	0.74	16.10	1.045	8.76	
CAE	0.00	0.00	3.593	15.06	35.16
ELV	1.32	20.62	N/A	12.11	
LLY	0.78	N/A	2.276	71.89	
AAPL	0.51	14.11	0.827	5.12	6.97
META	0.44	0.00	0.254	27.49	34.54
MSFT	0.73	30.75	0.478	20.28	
OTEX	2.32	36.99	5.154	47.27	
CSH.UN	5.05	82.81	8.922	13.29	
BEI.UN	1.67	10.65	5.279	11.72	

You all know that there are many ways to select dividend stocks. Some mistakenly focus only on the highest dividend yielding securities, while others focus on other factors.

Before I discuss the factors, I use, I want to stress the importance of dividends in your overall total return from your investments. The importance is even more apparent when taking inflation into account. One of the main objectives of investors is to earn an income that keeps up with inflation, to make sure your standard of living is maintained. This is especially apparent in retirement, but also of significance for all investors, young, middle aged and seniors.

We have all experienced how a company's shares perform when their dividend is cut or eliminated. A company's dividend policy is something investors need to take into account in their stock selection process.

My focus on selecting dividend stocks for purchase or sale is the consistency of the dividend as well as the ability of a company to increase the dividend. I also look at red flags that indicate the company may cut their dividend.

A company's financial strength and the growth in their operating and free cash flow, EBITDA and earnings give me signs what a company will do with their dividend policy. Even companies that currently do not pay a dividend, but did in the past, are worthy of being included in the selection of dividend stocks.

Let's highlight CAE as a company that currently does not pay a dividend, but used to pay one. As you can see from the attached table, CAE's financial debt as a percentage of TTM EBITDA is a reasonable 3.6 times. Projected year over year EBITDA growth in 2024 is a healthy 15%. CAE has been a strong generator of EBITDA over the last year and as of the third quarter of last year generated free cash flow over the last twelve months of $116.60 million. A strong balance sheet in addition to strong projected growth are encouraging signs.

Meta (Facebook) just announced last week that it has decided to pay a dividend for the first time. This is quite significant and will bring many new investors who only purchase dividend paying securities into the stock.

As for the rest of the attached table, I have highlighted some companies that are currently in my model portfolios plus some others that are not. This analysis is to select dividend paying securities only. In no way does it diminish non dividend paying stocks that are suitable investments as well. For most of the companies I used projected growth in EBITDA rather than growth in EPS. However, for most financial companies EBITDA stats are not readily available. This is why I used projected EPS where appropriate. Banks also use Tier 1 Capital Ratios that determine how well capitalized they are and how much flexibility they have to change their dividend policy. I have not included their capital ratios in this report, but want to mention that the domestic and US banks I have in my model portfolios are well capitalized currently. But some of our domestic banks face ongoing headwinds from mortgage renewals over the next few years which may decrease the probability of material dividend increases over this time frame.

Secondly, for the Reit sector, I used funds from operations, not EBITDA, in order to calculate the dividend payout ratio. But for 2024 projections, I used EBITDA numbers as they are readily available.

The dividend payout ratio I am using is Ycharts definition which is as follows:

Proportion of free cash flow, after preferred dividends, that is paid out as dividends to common shareholders. The actual formula is:

Common Stock Dividends / (Cash Flow from Operations -Capital Expenditures-Preferred Dividends Paid)

Another important point is that if a company has one or two ratios that look like red flags, it does not automatically make me exclude the company from my model portfolios. But what it does is make me look more closely into a company's fundamentals. I will use Element Fleet Management (EFN) as an example. The company's cash dividend payout ratio is a minus number while its financial debt as a percentage of TTM EBITDA is an elevated 7.3 times. In this case I look at what industry the company is in and how the company is positioned against its competitors. The automobile fleet business is a growing business that only has a handful of national players. Their overall debt levels are higher than other industries. What matters are the company's track record plus its projected outlook for its sales, EBITDA and cash flow. In this regard, the company excels.

Several years ago, energy utility companies like Enbridge and TC Energy had very overleveraged balance sheets and their cash flows did not cover their dividends. In other words, they were borrowing to pay the dividend. This trend could not continue indefinitely. We have all seen how Enbridge's getting rid of non core assets to make their balance sheet much less levered. TC Energy has made the same announcements, but the numbers do not jibe with what the company is saying. TC Energy still has a strongly negative dividend payout and a much more levered balance sheet than Enbridge. It appears like Enbridge has seen the light, but am not sure that TC Energy has yet.

Conclusion

Never select a dividend stock based on its high yield only. Consistency and the ability to increase the dividend are far more important considerations than simply overall yield.

Pay careful consideration to the dividend payout ratio calculated using free cash flow or funds from operations in the case of Reits. A company with too high a payout ratio, especially the ones where the ratio is above one times, are susceptible to either a dividend cut or at the very least no dividend increases.

It is also important to o review a company's future growth prospects in terms of EBITDA, cash flow and earnings.

Lastly, always be on the lookout for a company that does not pay a dividend now, but has in the past. Even companies that have never paid a dividend may conceivably initiate one if their fundamentals are strong.

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