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How to choose the best dividend paying companies by Isol

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Finding and investing in a dividend paying company is quite a bit easier than finding a company to tradition invests in. By learning and studying the dividend itself, a dividend investor will be able to gain a better view of a company and can add it to their tool belt on how to invest.

First of all, what is the difference between trading and investing? With trading you are buying an equity or option and then planning to sell it within a several days or weeks later. Traditionally they follow technical analysis and studying charts and look to get out of a trade after gaining a target profit level.

An investor is focused around buying partial ownership of a company and as the company does well, profit from it. They follow fundamental analysis techniques to figure out which company will grow and the investor makes their money as the stock price rises.

A dividend investor is focused primarily on the dividend payment by a company. They are interested in becoming part owner in the company and seek to profit primarily by obtaining regular cash payouts (though the rise in equityâ€™s price is also a welcome bonus).

Now I want to give an overview and general method of how to appraise a company and its dividend to get you started. There are many in-depth books that can explain it more precisely.

What exactly is a dividend?

A dividend is a cash payment made to the owners of a company, the shareholders of the company's shares of stock. Here are some examples on why a company would pay out a dividend payment. Expansion and growth becomes pricey. Employee stock options; itâ€™s in their best interest to have the company pay a cash payment as they too will get a payment Stockholder anticipations. A company exists to make a profit. It cannot put 100% of its profits into growing the company or there would be no reason in going into business if there is no enjoyment of the profits.

Fundamental Analysis of a Dividend itself

Fundamental analysis is a way of analyzing a company's results. By reviewing how they make and spend their money, their debt, and their performance; an investor is able to determine the strength of a company.

Going further, an investor can analyze and review a company's dividend to determine the strength of the underlying company.

Continual Years of Increased Payments:

The count of continual years that a company has increased it's dividend is a very important aspects to consider for dividend investing. Are they consistent? Are they regular? If equity is able to keep paying year after year it shows strength of the board of directors in being able to survive recessions and drop in business. If they can raise the rate each year it tells the investor that they are growing the company.

There are also special names and types of companies that reach certain milestones. When equity has raised its dividend 15 years straight then they are known as a Dividend Achiever. When a company has lifted their dividend 25 years in a row then they are known as Dividend Aristocrat. Some companies have been paying for over 50 years straight. That overcomes the worst economic conditions.

Dividend Payout Ratio:

This measures how much of the left over profit a company pays. If its too small like a 10% or 20% it shows the company is keeping most of the money for itself and is not serious about a strong dividend. Alternatively if the payment is over 80% and it won't be able to mail its dividend check out to the investors for very long. A dividend with too high of a payout ratio means the next payments are smaller as inflation sets in year after year. The worst thing is if the payout ratio is over 100%. This means the company is throwing away future payments to pay you now. A 40%-60% payout range is a safe balance.

Dividend Growth:

The dividend growth shows how much the dividend increases each year. A profitable company should be growing and then passes on the growth to its shareholders. A high dividend yield and little to no growth means that in the future your dividend payment will become smaller and smaller each year due to inflation. You expect a raise each year at your job and your dividend should get one too.

Frequency of Payment:

One overlooked but still important element is how frequent a company pays out a dividend. When you receive a dividend you can elect to get paid in supplemental shares which then will earn their own dividends at the next payment, this is called a DRIP program. It acts like a compounding effect similar to credit card debt or a loan, but in this case itâ€™s in your favor. Do you want you dividend income to compound monthly, quarterly, semi-annually, or just once per year? If you are retired and are living off your dividends are you able to save for 12 months in between payments? Lastly, if a company is having difficulties and wants to cut or stop its dividend you can at least get part of a payment before the cut happens as compared to a yearly dividend.

Dividend Yield:

The yield is the average % that a dividend will pay back each year. This gives a quick and easy way to compare the stock to other investments like bonds, savings accounts, and certificates of deposit. Sticking to a long term average of a dividend yield is a good way for succeeding at long term investing or retirement income. A high yield can be a great thing as it makes for a large dividend payment but be mindful of it getting to big.

A large yield might mean that the stock price of a share has dropped and the dividend is about to follow on down to match. A $100 stock giving out $4 a year gives a nice 4% yield. If it drops in half then it will be an 8% yield and look like a better return. Equity will fall in price for a reason so in depth research should be done to find out the source of the price drop. I view a strong stock to have a 2-3% yield to try to keep up with inflation. Anything over 5% can be a caution flag for a regular company.

Do not neglect alternate evaluation models

Some basic and important ways to evaluate a dividend are covered here. The different techniques can be combined with more complex or alternative ways to evaluate a company's strengths and weaknesses.

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