# Dividend Growth – A Proven  Strategy For Above Average Returns

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## Tim Plaehn

- Lead investment research analyst for income and dividend investing at Investors Alley.
- Air Force Academy Graduate –1979– with a degree in mathematics.
- Nine years as an Air Force pilot and instructor pilot.
- Post Air Force a stint as a registered securities rep, and Certified Financial Planner.
- Launched Dividend Hunter service in June 2014.

## The Problem

- We live in a era when it is harder than ever to earn a decent investment return.
- At the same time, traditional pensions are fading away, and more and more individuals are and will be dependent on their retirement savings to fund their lifestyles after they stop working.
- For many nearing retirement, the amount they have accumulated is not enough and they are into the investment markets with the goal of growing their savings totals.
- I focus on developing dividend centric strategies that will work to build and sustain a portfolio for decades of retirement.

## The Problem: Part II

- Losing money in the market is easy – investing for a good total return over time is very hard!
- 10-year Treasury yields 2.5%
- CD's yield 3.0% max
- Two major market crashes since 2000 and four market corrections since late 2015 show that market timing to produce steady gains will most likely not work.
- Expert after expert continues to point out that from here returns are likely to be well below the 9% per year long term average.
- A different strategy is required.

- I teach and make stock recommendations using a higher-yield dividend stock strategy.
- The focus is on building a growing income stream.
- Share prices are a secondary concern, however the strategies naturally lead investors to buy low and sell high.
- The goal is to have an investment system that works through the market cycles.

There are two approaches to dividend investing:

- Dividend Growth
- High Yield

## Traditional Dividend Growth Strategy

- Buying shares in blue chip or near blue chip stocks with long histories of annual dividend increases.
- "Dividend Aristocrats" and "Dividend Achievers“
- Companies have decades long dividend increase histories. Boards of directors don’t want to break the growth streaks.
- Typical yields are 2% to 4%
- The strategy will build wealth, but it can take a long time, as in decades

## Typical High Yield Investor Strategy

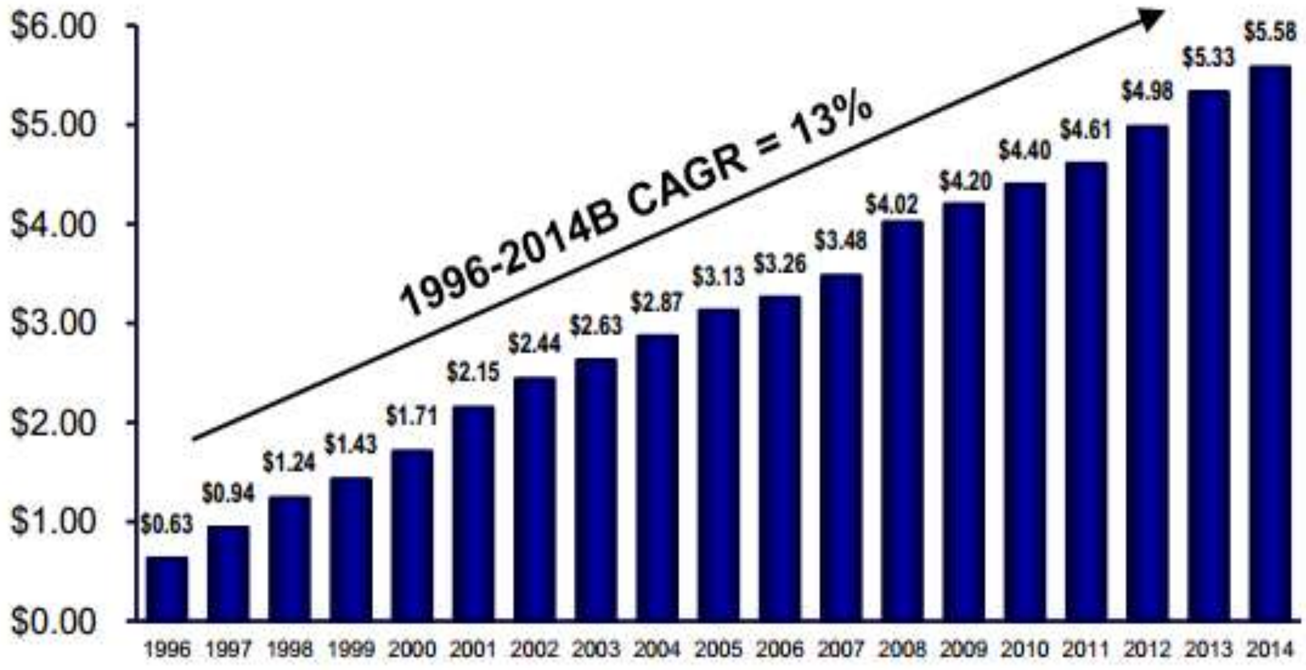
- Buy companies with pass-through tax structures – REITs, MLPs, BDCs.
- Wide range of yields: 2% to over 20%.
- Most investors go for the higher yield choices.
- High cash flow rate to investors can be used for current income or in a reinvestment strategy.
- A portfolio can be built with attractive current yield and growing dividends.

## Problems With High Yield Strategy

- Pass through structures require large portion of net profits/cash flow to be paid as dividends.
- Growth oriented companies need access to debt and equity markets at reasonable rates.
- Results more varied on a company by company basis.
- Investors may focus too much on yield, and not on underlying business and cash flow.
- Potential for dividend cuts and big share price drops are higher.
- Traditional stock metrics typically do not work.

- I have developed a hybrid strategy based on a simple math idea.
- The total return from an income stock over time will be the average yield plus the average annual dividend growth rate.
- Dividend earnings growth is the key to sustainable total returns through market up.
- My strategies combine manufactured dividend growth with organic growth.
- Here are some examples of great returns from organic growth:

# Kinder Morgan Partners

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## Kinder Morgan Partners

- KMP IPO Feb 1997 at $10.62 per unit
- Initial annual dividend rate was $0.94
- The dividend grew at a 13% annual compound growth rate for 18 straight years
- The company was bought out in November 2014 at $103 per share
- Final dividend rate: $5.58
- Total dividends earned in 17 ½ years: $58.66 per share
- 1,000 shares purchased at IPO for $10,062 returned $58,660 in dividends and $103,000 in share value.
- Average annual return: 16.9%

## Simon Property Group Inc. (SPG)

- Nine years ago, SPG had a $2.40 annual dividend and a $70 share price.
- The dividend has been increased 21 times since 2010. Now at $8.20 annual rate
- The shares are now at $180, but still off a 2016 high of $227.
- 12.7% five year averaged dividend growth rate. 9.9% 10-year average dividend growth.
- 240% dividend growth. 160% share price appreciation

## Balance Dividend Growth Income Stocks with High-Yield

- Higher yield stock typically don’t have much dividend growth.
- You can manufacture dividend income growth using dividend reinvestment.
- Compound growth becomes a powerful force as dividend yields increase.
- Different income focuses strategies diversify risk in your portfolio.

I have two services for dividend focused investors:

- **Dividend Hunter** provides a recommendations list of high yield stocks, ranked by risk factors. I include a lot of educational material to subscribers. Dividend Hunter has something for beginner stock market investors through the most experienced. More at www.thedividendhunter.com

- **Automatic Income Machine** uses a dividend growth on steroids strategy to help subscribers build wealth. Complete portfolio tools including number of shares to own and buy/sell trades. More at www.incomewithtim.com

You can also ask any of my colleagues in the room.

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## Compound Growth Illustrated (Dividend Hunter)

- The low interest rate environment of the past decade has pushed compounding income for growth out of the investing publics mindset.

- My Dividend Hunter recommended stocks list has a average yield of over 8%.

- A $100,000 portfolio of high yield stocks will grow to $147k in five years and $216k in 10 years at 8% compounded.

- More importantly and predictably, portfolio income would grow from $8k to 17k in ten years.

## Total Return Potential (Automatic Income Machine)

- High yield should be balanced by dividend growth holdings.
- Sustained dividend growth of 8% to 10% is attainable. Add in 4% to 6% yields, and you have long-term mid-teens compounding total returns.
- That will give a double in roughly five-years. Reinvestment and taking partial profits will enhance return potential.
- This approach can build total portfolio value towards a retirement 5 to 10 years in the future.

## Risks of High Yield

- Individual stocks have high yields to price in market expectations of a dividend reduction.

- Two potential outcomes: The market is right and the dividend will be reduced, or the market is wrong and investors will reap an above average yield.

- Most of these companies most or choose to pay out a high (90% or more) percentage of free cash flow as dividends.

- If cash flow per share is not sustained, dividends won’t be either.

## Risks of High Yield - continued

- Many of these companies need to access the capital markets – equity and/or debt – to raise capital for growth or even to sustain revenue and cash flow

- Dividend yield is the cost of equity capital, so a share price crash can put the brakes on a business model.

- A couple of examples:
  - Uniti Group (UNIT)
  - Most of the MLP sector.

## Dividend Growth Strategy for Total Return Step 1: The Hard Part

- Understand that dividend growth rates are not widely reported by financial news and information outlets.

- Target returns derive from average yield plus compound annual dividend growth rate – CAGR

- There are several hundred stocks that, using the yield + dividend growth formula, have the potential for mid-teens total returns.

- Many of these companies with higher yields will be pass-through entities: REITs, MLPs, and other publicly traded partnerships.

## Dividend Growth Strategy for Total Return Step 2

As you find dividend growth investment prospects, the evaluation process starts:

- Review past dividend history. Recent dividend cuts are sign to avoid. Dividend growth is a big positive.

- Review a company’s business operation to understand how revenues and cash flows are generated. Each company has its own story to tell.

- Calculate or figure out how each company reports free cash flow per share. This is not EPS.

- Review the cash flow (AFFO, DCF, etc.) coverage of recent dividends.

## Dividend Growth Strategy for Total Return Step 3

- Put together your own estimate of forward cash flow sustainability and potential dividend growth,
- Management guidance is usually provided for the current year.
- Sources of future growth from the long term plans provided by each company.
- This is fundamental business level understanding of how companies make money and grow.

## Dividend Growth Strategy for Total Return Step 4

Build a portfolio of dividend growth stocks. Some considerations:

- Stay focused on achieving industry diversification. It’s tough with this strategy.
- Limit the number of stocks you own to force a search for quality.
- Track dividend income as a primary metric whether your strategy is working.
- Decisions to add or drop stocks are based on business results and dividend payouts. Not short term share price swings.

## Dividend Growth Strategy for Total Return Step 5

- With each quarterly earnings review individual company results.
- Cash flow per share growth (AFFO, DCF) against your forecasts.
- Changes in management manner or guidance.
- Review results of stocks you don’t own, looking for new investment candidates.

## Portfolio Maintenance

- Take partial profits when you get above guidance share gains.
- Reinvest dividends and sale proceeds to generate a higher portfolio yield.
- Track your results by quarterly dividend income. This is my primary measurement of strategy success.
- Buy, buy, buy when the market corrects.
- Place more focus on portfolio management vs. individual stock price movement.

## Change Your Mindset About Share Prices!

- Falling share values are an opportunity not a curse.
- Buy low to earn a higher yield and larger dividends.
- Your stock selections are based on your cash flow per share research and not influenced by share prices.
- Take a profit if one of your shares moves rapidly higher, and the yield no longer make sense.

- As an individual investor you have no control, and very little foresight concerning dividend prices.
- You have a lot of control and future visibility of the dividend income from your stocks.

# Thank You!

## Some Income Stock Recommendations

- **Aircastle Ltd (AYR).** Just re-added it to Dividend Hunter recommendations list. 6% yield. Great cash flow coverage. Annual dividend increases. 6.7% or 10% increase later this year.
- **Antero Midstream Corp. (NYSE: AM).** Merger of AMGP and MLP including corporate conversion will produce great dividend growth over next few years. 10% yield. 20% annual total return potential.
- **NextEra Energy Partners LP (NEP).** High dividend growth. Yieldco. Stealthy and steady. 4% yield plus mid-teens dividend CAGR.

# Thank You!

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- Diversified portfolio of 20+ high-yield stocks
- Mix of monthly and quarterly paying stocks
- Average yield over 8% across the portfolio
- Tools to get you on track:
  - Monthly Dividend Paycheck Calendar
  - 36 Month Accelerated Income Plan
- Dedicated Start Out portfolio for new members
- Stock of the Week emails with new research and recommendations
- Low intro rate of just $49
- 1 year full money-back refund policy
- See one of my colleagues for more information

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