

“For the vast majority of stocks, the dividend record and prospects have always been the most important factor controlling investment quality and value.”

Security Analysis,
Benjamin Graham
David L. Dodd
Sydney Cottle



THE SECRET LANGUAGE OF DIVIDEND GROWTH

WHAT CONSISTENT DIVIDEND GROWTH TELLS US ABOUT INVESTMENTS

As the investing world waits to reach the bottom of the market, outstanding values can be found in depressed equities held down not by performance or value, but by the negative environment. Whether in a bear or bull market, investors seeking such timely purchases should keep the basic philosophy of Graham and Dodd in mind: amongst the indicators of a company’s potential long term value, there is no greater barometer than dividend growth. Management can cover up losses, can manufacture signs of strength on the balance sheet and in the income statement, and can forecast growth based on any number of developments. But as their strategies unfold, dividend growth speaks volumes about the true state of the organization.

At its core, a consistent dividend increase demonstrates equitable treatment of shareholders. It sends a message that the company values their support and is willing and able to reward them accordingly.

Companies that take a sound fundamental approach to building their value avoid debt and prioritize self-sufficient sustainability. That means developing a high quality service, seeking opportunity in market disruption, and maturing to a level that enables them to increase dividends while also investing in critical growth areas such as R&D.

Dividend growth offers great insight along these lines, and demonstrates corporate health in several key areas:

Strength of Capital

Steady, reasonable dividend increases over a period of years are a trustworthy indicator that a company is managing its capital wisely. Those that deliver erratic dividends or grow them quickly only to cut back in a year or two are revealing that their long term strategy may not be in place. Or worse yet, that their desire to court investors outweighs their willingness to put money back into R&D.

In the end, a strong balance sheet is what gives companies their power in the marketplace, allowing them to develop new product, distribution channels, retain talent, etc. Without a sound capital strategy that includes respecting shareholders, management is likely taking on debt or misallocating funds – moves that will be detrimental to all parties at some point down the line.

Commitment of Management

Cash flow can be diverted to any number of areas; very often, it finds its way into executive compensation packages. Certainly management deserves compensation, but those who exhaust other avenues and reward themselves later are demonstrating a true commitment to the long term health of the company. Steadily growing dividends tells shareholders first that they are valued, and second that executives anticipate that their time for increased compensation will come as the company continues to grow.

Business Maturity

With capital and a committed management in place, companies can create vast opportunity by building towards market leadership. As they mature, dividend growth is all but expected and is closely watched as an indication that corporate direction and ethical values are firmly in place.

In fact, dividend growth is an important sign that a young company is breaking through to a new plateau. Smart teams might spend years pouring capital into R&D in order to develop their

future, and shareholders in these ventures must be patient. When the time comes, these organizations will step into the spotlight, reap the benefits of well-constructed strategy, and pass them onto their investors.

On the other hand, companies that aren't able to sustain a dividend after that breakthrough may be showing themselves to be short-term contenders or "flash in the pan" enterprises. Again, prioritizing a steady dividend increase indicates a long term mindset for growth.

A Flexible Future

A strong balance sheet, well-funded R&D, and consistently rising yield on cost for investors paint the picture of a company that is in control of its destiny. While they may stay focused on the opportunities they originally created for themselves, they also have the flexibility to develop other assets.

Whether just emerging or already established as a powerful player in any sector, companies that chart a course of steady dividend growth give investors transparent evidence that they are building on a solid foundation. Over time, the yield for shareholders will be substantial and opportunities will be leveraged for greater value.