



## MACDOUGALL, MACDOUGALL & MACTIER INC.

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### Dividend Matters .....Why Dividends Matter So Much

There is no more accurate indication of long-term financial performance in a public company than a trend of rising dividends. Dividends are real money, a spendable (or re-investable) return on one's investment. Dividends are the surest confirmation of a company's profitability, since dividends ultimately can arise only from the reality of earnings. Enlightened investors understand that it is usually one condition – higher earnings or management's reasonable expectation of higher earnings – that prompts a dividend increase.

For the dividend of a “blue chip” company to be increased, strong prospects for near-term and foreseeable future earnings growth improvement need be evident. A dividend will not be raised if future earnings growth is in doubt (think here of the Canadian Financial sector recently). Therefore, a rising dividend trend is so important that, **dividend growth** should be included in calculations of total return.

### True Total Return

It is well understood that total return refers to the dividend yield, plus the potential for capital gain.

$$\text{Dividend Yield} + \text{Capital Gain} = \text{Total Return}$$

A very good way to understand **true total return** would be to add another important factor to that equation – dividend growth.

### ***Dividend Yield + Dividend Growth + Capital Gains = True Total Return***

The idea of true total return is, and always will be, the main underlying reason why investors are willing to risk their capital on common stocks. It has to be the fundamental attraction of stock market investing.

Bonds and other fixed income securities – including Preferreds – can offer a fixed return and may offer, depending on the trend in interest rates, some potential for capital gains. However, Bonds and Preferreds simply do not have the inherent ability to provide the necessary growth of income necessary to allow investors to maintain their style of living, particularly since we are all living much longer than ever before.

## Where to Find Dividend Growth

Growth of dividend income is available only with stocks. Dividend growth accompanies and inspires rising share prices. Only in the stock market can true total return be so superbly rewarding. For taxable accounts in Canada, there are significant tax advantages for investors who receive both dividend income and capital appreciation. The true total return from stocks that are held long enough for this concept to work will easily outpace inflation, even after taxes.

True Total Return should convince investors that a long-term outlook and a conservative investment orientation are a very good way to both measure results and attain the increasing income all investors will need over time.

## Yield on Cost – Return on Invested Capital – The Magic of Rising Dividends

The calculation of Yield on Cost is quite simple – divide the current annual dividend by the original total cost of the shares. An example is helpful:

Company:		<u>Toromont Industries Ltd.</u>					
		Yield on Cost			The Cumulative Dividend Effect		
Cost of 1,000 shares Jan 1st (\$)	Dividends (\$) in the First Year of Ownership	Current Yield at Purchase Date	Current Yield on Cost	Total Dividends (\$) Received to Date	% of Original Investment Paid Back		
1989	650.00	25.00	3.8%	92.3%	4,048.50	622.8%	
1990	750.00	30.00	4.0%	80.0%	4,023.50	536.5%	
1991	690.00	30.00	4.3%	87.0%	3,993.50	578.8%	
1992	780.00	28.50	3.7%	76.9%	3,963.50	508.1%	
1993	1,000.00	35.00	3.5%	60.0%	3,935.00	393.5%	
1994	2,095.00	40.00	1.9%	28.6%	3,900.00	186.2%	
1995	3,445.00	70.00	2.0%	17.4%	3,860.00	112.0%	
1996	3,690.00	80.00	2.2%	16.3%	3,790.00	102.7%	
1997	6,690.00	100.00	1.5%	9.0%	3,710.00	55.5%	
1998	8,250.00	130.00	1.6%	7.3%	3,610.00	43.8%	
1999	7,880.00	140.00	1.8%	7.6%	3,480.00	44.2%	
2000	8,130.00	160.00	2.0%	7.4%	3,340.00	41.1%	
2001	8,750.00	170.00	1.9%	6.9%	3,180.00	36.3%	
2002	10,240.00	180.00	1.8%	5.9%	3,010.00	29.4%	
2003	10,330.00	210.00	2.0%	5.8%	2,830.00	27.4%	
2004	16,530.00	260.00	1.6%	3.6%	2,620.00	15.8%	
2005	20,720.00	320.00	1.5%	2.9%	2,360.00	11.4%	
2006	25,400.00	400.00	1.6%	2.4%	2,040.00	8.0%	
2007	24,500.00	480.00	2.0%	2.4%	1,640.00	6.7%	
2008	28,260.00	560.00	2.0%	2.1%	1,160.00	4.1%	
2009	22,990.00	600.00	* 2.6%	2.6%	600.00	2.6%	
2010	27,790.00	600.00	2.2%	2.2%			

To better understand the dividend growth table:

- Looking across row "1996" - 14 years ago:
  - Buying 1,000 shares in early 1996, for \$3,690, yielding 2.2% or \$80 of return.
  - The current yield on invested capital (cost) is 16.3%. Better than the invested capital yield available on any bond or preferred share.
  - The total dividends returned to you are \$3,790, more than you paid for the shares (102.7% - return on invested capital).
  - And the 1,000 shares, that cost \$3,690, are now worth \$27,790.

- Looking across the row "2004" - 6 years ago:
  - Buying 1,000 shares in early 2004, cost \$16,530 yielding 1.6% or \$260 of annual dividends.
  - Current yield on 2004 cost is 3.6%, more than twice the yield at purchase.
  - The last two columns show the total amount of dividends received since purchase (\$2,620) and a 15.8% dividend return on your original investment.
  - Those 1,000 shares, that cost \$16,530, are now worth \$27,790,

Column 5 on the table demonstrates the Yield on Cost based on various dates of purchase and gives an idea of what one's yield on cost might be. It also demonstrates that the longer one owns shares of a company, when dividends are regularly increased; the yield on one's total investment (cost) actually accelerates, over time.

Perhaps more importantly, Column 2 of the table also shows the very attractive capital appreciation possibilities that accompany dividend increases.

## **How Dividend Growth Works**

Of course it is critical to hold such income investments for a long time. As long as the company continues to be a reliable producer of increasing income and maintains a conservative, longer-term perspective, the ideal would be to hold such an investment forever.

As the objective is to obtain increasing income over time, the best measure of success in achieving this objective is to calculate current Yield on Cost for each investment, to see how it has increased over time. If the Yield on Cost has continually increased over the holding period, there is very little reason to sell one's shares.

With a simple calculation of Yield on Cost, one can easily determine how well income investments have performed when there may be a temptation to sell these sources of dependable and growing income. This is a great way to measure the success of any investment. This is particularly true for an investor whose primary objective is to receive increasing dividend income over a long period of time.

## **Some Investment Suggestions**

The next time you look at a valuation of your investment portfolio take a moment to calculate the Yield on Cost of your individual holdings – some results might well provide a pleasant surprise.

$$***Current Dividend \div Invested Capital = Yield on Cost***$$

Most investors should therefore look for high quality investments that pay increasing dividends and keep them as long as they continue to produce a rising Yield on Cost over time. The table on the following page lists some of the companies that will help build and maintain an increasing dividend income portfolio that is designed to last a lifetime.

The Power of Increasing Dividends					Current Yield on Historical Costs					
Company Name	Symbol	5 Year Compound Dividend Growth Rate	10 Year Compound Stock Price Growth Rate	Stock Price January 8, 2010 (\$)	Price January 2005	Current % Yield on Jan 2005 Cost	Price January 2000	Current % Yield on Jan 2000 Cost	Price January 1995	Current % Yield on Jan 1995 Cost
<b>Financial Services</b>										
Bank of Montreal	<b>BMO</b>	<b>12.0%</b>	<b>12.3%</b>	53.74	57.92	<b>4.83</b>	23.70	<b>11.81</b>	13.06	<b>21.44</b>
Bank of Nova Scotia	<b>BNS</b>	<b>12.2%</b>	<b>17.2%</b>	47.46	41.25	<b>4.75</b>	15.55	<b>12.60</b>	6.66	<b>29.45</b>
Great West Lifeco	<b>GWO</b>	<b>12.4%</b>	<b>18.8%</b>	26.95	26.46	<b>4.65</b>	11.15	<b>11.03</b>	2.78	<b>44.24</b>
I.G.M. Investors Group	<b>IGM</b>	<b>13.2%</b>	<b>19.0%</b>	42.33	36.10	<b>5.68</b>	19.10	<b>10.73</b>	8.63	<b>23.77</b>
National Bank	<b>NA</b>	<b>11.8%</b>	<b>14.2%</b>	58.65	49.71	<b>4.99</b>	17.90	<b>13.85</b>	9.50	<b>26.11</b>
Power Corp	<b>POW</b>	<b>18.9%</b>	<b>18.1%</b>	28.90	30.53	<b>3.80</b>	12.05	<b>9.63</b>	4.84	<b>23.95</b>
Power Financial	<b>PWF</b>	<b>15.2%</b>	<b>19.4%</b>	30.98	31.26	<b>4.48</b>	11.73	<b>11.94</b>	3.53	<b>39.66</b>
Royal Bank	<b>RY</b>	<b>14.6%</b>	<b>16.3%</b>	55.29	31.91	<b>6.27</b>	15.44	<b>12.96</b>	7.03	<b>28.44</b>
Toronto Dominion Bank	<b>TD</b>	<b>12.4%</b>	<b>14.0%</b>	63.73	49.95	<b>4.88</b>	38.00	<b>6.42</b>	10.63	<b>22.96</b>
<b>Energy</b>										
Canadian Oil Sands	<b>COS.UN</b>	<b>17.6%</b>	<b>23.4%</b>	30.25	13.01	<b>10.76</b>	4.54	<b>30.84</b>	2.29	<b>61.03</b>
Enbridge Inc	<b>ENB</b>	<b>10.1%</b>	<b>10.2%</b>	47.33	29.77	<b>5.71</b>	14.40	<b>11.81</b>	7.16	<b>23.76</b>
Encana Corp	<b>ECA</b>	<b>51.6%</b>	<b>15.0%</b>	35.98	17.68	<b>4.52</b>	5.25	<b>15.24</b>	4.76	<b>16.82</b>
Ensign Resource Service	<b>ESI</b>	<b>19.4%</b>	<b>16.3%</b>	16.23	12.18	<b>2.87</b>	5.29	<b>6.61</b>	0.90	<b>39.07</b>
Suncor Energy	<b>SU</b>	<b>21.1%</b>	<b>13.4%</b>	38.69	20.05	<b>2.00</b>	7.69	<b>5.20</b>	2.00	<b>20.00</b>
<b>Industrials</b>										
Canadian National	<b>CNR</b>	<b>21.0%</b>	<b>19.0%</b>	58.53	36.13	<b>3.04</b>	12.20	<b>9.02</b>	3.44	<b>32.00</b>
SNC Lavalin Group	<b>SNC</b>	<b>28.2%</b>	<b>24.6%</b>	52.93	19.13	<b>3.76</b>	3.67	<b>19.64</b>	2.50	<b>28.80</b>
Toromont Industries	<b>TIH</b>	<b>18.7%</b>	<b>17.0%</b>	27.69	20.97	<b>3.05</b>	8.20	<b>7.80</b>	3.28	<b>19.51</b>
<b>Consumer</b>										
Metro Inc. "A"	<b>MRU.A</b>	<b>10.1%</b>	<b>17.5%</b>	39.12	24.15	<b>2.48</b>	9.08	<b>6.61</b>	2.88	<b>20.87</b>
Reitmans Ltd "A"	<b>RET.A</b>	<b>33.5%</b>	<b>27.2%</b>	16.69	13.94	<b>5.17</b>	2.56	<b>28.10</b>	1.91	<b>37.77</b>
1 approximations due to currency of dividend changing from CAD to US In 2004.									e. & o.e.	C.E.K.

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