

Few Able Today to Maintain Annual Dividend Increases

From 15,000 to 55

by Philip J. Keating, CFA

Editor's note: This screen developed by Philip J. Keating, a Chartered Financial Analyst who also creates the BetterInvesting Growth Screen, combines the elements of dividend yield and earnings growth. We are deeply indebted to Phil, a longtime BetterInvesting volunteer, for his efforts in creating this screen. No investment recommendation is intended for any of the companies mentioned in this article. Screens are useful for identifying stock-study candidates but are only a first step in the research process.

There are several good reasons to focus on dividends. First, many people, whether in retirement or accumulating retirement funds, want more predictable cash flows. Well-covered and growing dividends provide them.

Second, contrary to popular belief, recent studies demonstrate that companies paying dividends have better growth. In a 2003 article in the *Financial Analysts Journal* ("Surprise! Higher Dividends = Higher Earnings Growth"), Robert D. Arnott and Clifford S. Asness hypothesize that companies paying out a meaningful dividend to shareowners are more disciplined and less wasteful in their allocation of capital to projects (less empire building). They also may be signaling confidence about future earnings growth.

Third, tax law changes in 2003 and in place through 2010 put dividends on the same preferential footing as long-term capital gains — a maximum tax rate of 15 percent and a rate as low as 0 percent for those in the 15 percent or lower tax bracket in 2009-10. Fourth, dividend-paying stocks usually sell at cheaper valuations than so-called growth stocks that don't pay dividends. Fifth, stocks with meaningful dividend yields and with consistent records of growth generally have less downside volatility in bear markets — some studies show about 30 percent less volatility. That fact should be of great interest to risk-averse investors after the especially turbulent markets of the past 10 years.

Our latest dividend growth screen queried 14,981 companies from the Thomson/Baseline Database on Dec. 1, 2009, for stocks that met all the following criteria: increased their dividend every year for the past five years (357 made it); had a five-year compounded annual dividend growth rate of 8 percent or more (905 qualified); had a current dividend yield of 2.5 percent or greater (2,160 met the test); and had an estimated future long-term (five years) earnings-per-share growth rate of 8 percent or more (2,918 qualified). Only 58 companies, or 0.4 percent, qualified on all four items. This was less

than one-third the 189 companies that made it through the last published screen from the June/July 2008 issue.

The effects of the financial panic of 2008 and the recession resulted in very few companies maintaining long records of annual dividend increases. This was especially true for financial companies. Because of non-comparability and incomplete data, I removed three of the companies to reach the final list of 55.

The five-year Treasury note currently yields less than 2.5 percent. Combining a 2.5 percent current dividend yield and projected growth of 8 percent or more implies a total return of 10.5 percent or more. The average compounded total return of large-company stocks was 9.6 percent over the past 83 years ending in 2008, according to Ibbotson Associates. The average dividend yield for that period was 4.2 percent. The average annual appreciation was 5.3 percent. Therefore, more than 42 percent of the total return of stocks historically has been from dividends (4.2 percent) and their reinvestment (0.1 percent).

In the past 10 years companies have been paying out only about 32 percent of their earnings as dividends versus a historical average payout ratio of 50 percent. In 2008 the payout was 42 percent of depressed earnings. Because of investors' aversion to risk, the pendulum may swing in the other direction and dividends may grow faster than earnings for some time. In fact, just in time for the 80 million baby boomers who may retire in the next 15 years or so.

In a low-return world with a tremendous surplus of global capital searching out durable returns, dividend achievers will win many gold medals. Companies such as Johnson & Johnson and Philip Morris have historically been gold medal winners in the investment marathon. Surprisingly, many large-capitalization dividend achievers still sell at a price-earnings discount to the Standard & Poor's 500 index.

A good screen should produce a manageable but robust list of promising candidates for further study. This list isn't perfectly diversified, but there are representatives from each major economic sector.

Remember that most foreign companies pay dividends only once or twice per year, less frequently than the U.S. norm of four times per year. All other factors equal, more frequent dividends are more valuable, in my opinion. There's less uncertainty about returns, greater compounding and a higher present value (the time value of money).

The item averages for the 55 companies that made it through the screen are appealing to both value and growth investors. The item averages for the companies are: dividend yield (3.5%), dividend past 5-year growth (20%), dividend 5-year estimated growth rate (5%), yield + long-term projected EPS growth (14.5%), dividend payout ratio (59%), cash flow to earnings (150%), earnings reinvestment yield (3.7%), earnings stability (0.61), S&P ranking (A-), market capitalization (\$22 billion), % long-term debt to capital (36%), P/E ratio last four quarters (16.9), earnings long-term future growth rate (11%), net profit margin (11.6%), return on equity 5-year average (21.7%), return on capital 5-year average (13.9%), total free cash flow (\$298.5 million) and % price change over 5 years (26%).

A final word of caution and disclaimer: A good screening is only a time-saving short cut to a starting point for analysis, not to a decision. Always check the most recent and most timely information. Never select companies only because they have the highest dividend yields. Choose the optimum combination of current dividend yield and growth to meet your long-term goals while minimizing risks. Remember that a 3 percent dividend yield today that grows by 10 percent per year will be a 6 percent dividend yield on purchase price in a little over seven years and a 12 percent yield in a little over 14 years. The cumulative income will exceed most bond returns over a 14-year horizon (at current rates). Diversification is always important. Bottom line, these are the kinds of companies I value most highly in my portfolios.

A disclosure: Several of the companies that made it through the screening are also stock holdings in client and personal portfolios. At this writing we currently own various positions in McGraw-Hill, Sysco, Kimberly-Clark, PepsiCo, Procter & Gamble, Coca-Cola, General Mills, Abbott Laboratories, Dover, Emerson Electric, Lockheed Martin, Honeywell, Linear Technology, Microchip Technology and Nucor. Of course, this disclosure is in no way an endorsement. We also own many companies that did not meet all these screening criteria.

Change is constant. Data and information becomes dated; always check for the latest information. These particular stocks may or may not be suitable for your portfolio and they may or may not be among our holdings when you read this. You be the judge! I hope you find the Dividend Growth Screen of value in your efforts to be a better investor, and I welcome your comments.

SECTOR/ COMPANY NAME	PRICE PER SHR 12/01/09	DIV YIELD	DIV 5-YEAR GROWTH	DIV LT EST GR RATE	YIELD + LT PRJ EPS GRW	DIV IND RATE	DIV PAYOUT RATIO	CASH FLOW TO EARNINGS
CONSUMER DISCRETION								
MEREDITH	\$26.27	3.4%	13%	0%	18.4%	\$0.90	47%	180%
POLARIS INDUSTRIES	43.61	3.6	10	0	17.6	1.56	52	170
SHAW COMMUNICATIONS	19.79	3.5	51	10	13.5	0.69	65	220
V.F.	74.11	3.2	18	1	13.2	2.40	47	130
MCGRAW-HILL	30.32	3.0	9	0	12.0	0.90	40	160
CONSUMER STAPLES								
SYSCO	27.59	3.6	12	0	18.6	1.00	55	140
KIMBERLY-CLARK	66.82	3.6	8	8	14.6	2.40	52	140
PEPSICO	63.87	2.8	16	7	13.8	1.80	48	130
CLOROX	60.73	3.3	15	10	13.3	2.00	49	130
MCCORMICK & COMPANY	36.22	2.9	10	8	12.9	1.04	43	130
PROCTER & GAMBLE	62.91	2.8	12	10	12.8	1.76	40	120
FLOWERS FOODS	23.07	3.0	28	9	12.0	0.70	48	160
HEINZ (H.J.)	43.13	3.9	9	3	11.9	1.68	61	130
COCA-COLA	58.08	2.8	10	5	11.8	1.64	54	120
CAMPBELL SOUP	35.56	3.1	10	8	11.1	1.10	45	130
GENERAL MILLS	68.68	2.7	9	8	10.7	1.88	42	130
FINANCIAL								
AMER RIVER BANKSHS	6.26	9.1	9	0	24.1	0.57	102	130
HUDSON CITY BANC	13.16	4.6	21	15	22.6	0.60	57	110
BANCOLOMBIA SA ADR	43.87	2.6	18	0	16.6	1.15	25	140
MERCURY GENERAL	37.19	6.3	9	8	14.3	2.36	114	140
PEOPLES UNITED FIN'L	16.14	3.8	11	5	13.8	0.61	174	150
DONEGAL GROUP 'A'	14.65	3.1	11	10	13.1	0.45	55	110
REPUBLIC BANCORP KY	18.49	2.9	14	10	12.9	0.53	25	120
CHUBB	50.16	2.8	13	0	12.8	1.40	23	110
CORPORATE OFC PROP	34.94	4.5	10	0	12.5	1.57	57	100
HARLEYSVILLE GROUP	31.31	4.2	16	0	12.2	1.30	41	110
CULLEN/FROST BANKERS	48.03	3.6	11	0	11.6	1.72	56	120
HEALTH CARE								
UTAH MEDICAL PRODUCT	29.20	3.2	10	—	18.2	0.94	54	110
NAT'L HEALTHCARE	35.75	2.9	16	6	14.9	1.04	47	190
ABBOTT LABORATORIES	54.48	2.9	9	9	14.9	1.60	43	140
INDUSTRIALS								
HEALTHCARE SERVICES	19.68	4.1	38	16	20.1	0.80	103	110
WATSCO	50.79	3.8	34	8	16.8	1.92	135	120
DOVER	41.32	2.5	11	0	16.5	1.04	41	160
NORFOLK SOUTHERN	52.35	2.6	30	0	14.6	1.36	43	170
MCGRATH RENTCORP	20.50	4.3	13	0	14.3	0.88	61	290
WASTE MANAGEMENT	33.20	3.5	10	0	13.5	1.16	59	220
EMERSON ELECTRIC	42.19	3.2	12	0	13.2	1.34	55	140
LOCKHEED MARTIN	78.93	3.2	21	0	13.2	2.52	30	130
HONEYWELL INT'L	39.37	3.1	10	0	13.1	1.21	42	140
NORTHROP GRUMMAN	55.26	3.1	14	0	13.1	1.72	29	140
GRACO	28.56	2.7	12	0	12.7	0.76	76	160
INFORMATION TECHNOLOGY								
LINEAR TECHNOLOGY	27.40	3.2	21	0	18.2	0.88	80	120
XILINX	23.42	2.7	23	0	15.7	0.64	59	130
AUTOMATIC DATA PROC	43.84	3.1	20	5	15.1	1.36	55	130
MICROCHIP TECH	26.83	5.1	31	0	13.1	1.36	197	170
MATERIALS								
NUCOR	43.29	3.2	58	15	18.2	1.40	NM	NM
TELECOMMUNICATIONS								
TELEFONICA ADR	88.43	4.8	33	8	14.8	4.24	62	100
ROGERS COMMUNICATION	31.41	3.5	214	11	14.5	1.09	53	270
UTILITIES								
PPL	31.23	4.4	10	10	14.4	1.38	73	220
ONEOK	40.18	4.2	12	0	14.2	1.68	62	200
WISCONSIN ENERGY	45.80	2.9	9	9	12.9	1.35	44	150
AQUA AMERICA	16.76	3.5	8	8	12.5	0.58	71	210
NORTHEAST UTILITIES	24.35	3.9	8	2	11.9	0.95	50	110
PG&E	42.89	3.9	22	7	11.9	1.68	53	270
SOUTH JERSEY INDUS	36.55	3.6	9	7	11.6	1.32	55	150
UNIVERSE AVG (EQ WT)	\$39.32	3.5%	20%	5%	14.5%	\$1.35	59%	150%

COMPANY NAME	EARNINGS REINV YIELD	EARNINGS STABILITY (R2)	S&P RANKING	MKT CAP (MILL) 12/01/09	LT DEBT TO CAPITAL	P/E LATEST 4 QTRS	EPS LT FUTURE GR RATE	NET PROFIT MARGIN	ROE 5-YR AVG	ROC 5-YR AVG	TOTAL FREE CASH FLOW (000)	PRICE CHG 5 YR	INDUSTRY	TICKER SYMBOL	EXCH
MEREDITH	3.9%	0.01	B+	\$1,200	42%	13.6	15%	6.3%	20.2%	11.0%	\$ 117,785	-51%	PUBLISHING	MDP	NYSE
POLARIS INDUSTRIES	3.3	0.20	A-	1,400	53	14.4	14	6.1	52.7	32.2	49,611	-34	LEISURE PRODUCTS	PII	NYSE
SHAW COMMUNICATIONS	1.9	0.98	B	8,200	52	18.7	10	15.1	21.3	9.1	207,109	136	CABLE & SATELLITE	SJR	NYSE
V.F.	3.5	0.79	A	8,300	20	14.9	10	7.7	18.6	14.7	288,658	39	APPAREL & ACCESSORY	VFC	NYSE
MCGRW-HILL	4.4	0.39	NR	9,500	42	13.5	9	11.9	37.6	29.2	755,520	-33	PUBLISHING	MHP	NYSE
SYSCO	2.9	0.72	A+	16,000	40	15.6	15	2.9	32.1	20.9	567,375	-24	FOOD DISTRIBUTORS	SY	NYSE
KIMBERLY-CLARK	3.3	0.84	A	28,000	46	14.4	11	10.2	29.5	18.5	659,044	4	HOUSEHOLD PRODUCTS	KMB	NYSE
PEPSICO	3.0	0.98	A+	100,000	33	17.3	11	13.5	33.8	27.0	2,009,637	25	SOFT DRINKS	PEP	NYSE
CLOROX	3.4	0.88	A	8,500	NM	15.2	10	10.2	—	21.6	282,874	6	HOUSEHOLD PRODUCTS	CLX	NYSE
MCCORMICK & COMPANY	3.6	0.98	A+	4,700	40	16.0	10	9.3	24.0	14.8	115,003	-2	PACKAGED FOODS/MEATS	MKC	NYSE
PROCTER & GAMBLE	4.1	0.88	A+	184,000	25	14.7	10	16.2	22.8	14.7	6,625,880	11	HOUSEHOLD PRODUCTS	PG	NYSE
FLOWERS FOODS	3.2	0.98	B	2,100	25	16.4	9	4.9	13.8	11.9	-45,199	72	PACKAGED FOODS/MEATS	FLO	NYSE
HEINZ (H.J.)	2.5	0.78	B+	14,000	72	15.7	8	8.6	39.4	11.5	349,859	14	PACKAGED FOODS/MEATS	HNZ	NYSE
COCA-COLA	2.4	0.94	A	135,000	17	19.2	9	22.9	30.3	27.4	2,085,698	43	SOFT DRINKS	KO	NYSE
CAMPBELL SOUP	3.6	0.95	B+	12,000	76	15.5	8	10.7	58.5	21.7	469,425	19	PACKAGED FOODS/MEATS	CPB	NYSE
GENERAL MILLS	3.6	0.90	A-	22,000	52	16.0	8	9.5	21.5	12.7	686,628	46	PACKAGED FOODS/MEATS	GIS	NYSE
AMER RIVER BANKSHS	NM	0.08	A	36	21	11.2	15	12.0	13.6	12.3	6,552	-66	REGIONAL BANKS	AMRB	NASDAQ
HUDSON CITY BANC	3.4	0.84	A	6,900	85	12.7	18	45.2	9.4	1.7	225,354	7	THRIFTS/MORTGAGE FIN	HCBK	NASDAQ
BANCOLOMBIA SA ADR	7.7	0.81	NR	3,100	11	9.6	14	14.4	27.3	17.2	-529,826	290	DIVERSIFIED BANKS	CIB	NYSE
MERCURY GENERAL	NM	0.67	B	2,000	13	18.1	8	3.9	15.9	11.7	-109,540	-34	INSURANCE-PROP/CAS	MCY	NYSE
PEOPLES UNITED FIN'L	NM	0.16	B	5,600	4	46.1	10	13.6	6.9	5.2	-10,451	34	THRIFTS/MORTGAGE FIN	PBCT	NASDAQ
DONEGAL GROUP 'A'	2.5	0.20	B	373	4	18.1	10	5.4	11.5	10.5	41,790	20	INSURANCE-PROP/CAS	DGICA	NASDAQ
REPUBLIC BANCORP KY	8.4	0.29	A-	384	70	8.9	10	20.0	14.1	4.4	40,931	-20	REGIONAL BANKS	RBCAA	NASDAQ
CHUBB	9.3	0.61	A-	18,000	20	8.3	10	18.9	17.0	13.7	2,025,933	34	INSURANCE-PROP/CAS	CB	NYSE
CORPORATE OFC PROP	3.2	0.97	B+	2,000	65	13.2	8	20.2	6.0	1.8	-164,185	24	OFFICE REITS	OFC	NYSE
HARLEYSVILLE GROUP	5.7	0.83	B	866	13	10.3	8	8.7	10.9	8.6	165,088	30	INSURANCE-PROP/CAS	HGIC	NASDAQ
CULLEN/FROST BANKERS	2.7	0.38	A	2,900	25	15.9	8	21.5	16.0	11.7	76,392	2	REGIONAL BANKS	CFR	NYSE
UTAH MEDICAL PRODUCT	2.7	0.15	B+	105	4	17.0	15	23.9	21.1	19.5	3,141	31	HC-SUPPLIES	UTMD	NASDAQ
NAT'L HEALTHCARE	3.2	0.07	NR	489	2	16.6	12	4.3	13.2	12.5	-5,747	4	HC-FACILITY	NHC	AMEX
ABBOTT LABORATORIES	3.7	0.89	A-	84,000	35	15.1	12	18.6	21.6	15.0	3,880,239	25	PHARMACEUTICALS	ABT	NYSE
HEALTHCARE SERVICES	NM	0.79	B+	855	0	27.3	16	4.7	14.3	14.3	-9,996	115	DIVERSIFIED SUPP SER	HCSG	NASDAQ
WATSCO	NM	0.07	A-	1,600	5	36.3	13	2.5	13.9	12.8	60,111	57	TRADE COS & DISTR	WSO	NYSE
DOVER	3.5	0.59	A-	7,700	31	16.7	14	7.7	16.1	11.6	657,057	0	MACHINERY INDUSTRIAL	DOV	NYSE
NORFOLK SOUTHERN	3.4	0.68	A-	19,000	40	16.6	12	13.8	15.1	8.9	702,187	49	RAILROADS	NSC	NYSE
MCGRATH RENTCORP	2.7	0.26	A-	487	0	14.4	10	11.7	19.1	11.2	-29,230	-2	DIVERSIFIED SUPP SER	MGRC	NASDAQ
WASTE MANAGEMENT	2.4	0.85	B+	16,000	55	16.9	10	8.2	18.5	8.0	822,792	7	SERVICES-ENVIRONMNTL	WM	NYSE
EMERSON ELECTRIC	2.6	0.78	A	32,000	32	17.4	10	8.7	23.1	16.4	1,555,791	24	ELECTRICAL COMPONENT	EMR	NYSE
LOCKHEED MARTIN	6.8	0.94	B+	30,000	53	10.3	10	6.7	32.9	20.7	2,759,669	33	AEROSPACE/DEFENSE	LMT	NYSE
HONEYWELL INT'L	4.2	0.80	B+	30,000	40	13.7	10	6.8	21.1	14.0	2,098,231	11	AEROSPACE/DEFENSE	HON	NYSE
NORTHROP GRUMMAN	7.4	0.98	B+	18,000	25	9.6	10	5.2	8.7	5.6	2,004,080	-1	AEROSPACE/DEFENSE	NOC	NYSE
GRACO	0.8	0.00	A	1,700	37	28.6	10	10.0	52.6	44.3	87,489	-22	MACHINERY INDUSTRIAL	GGG	NYSE
LINEAR TECHNOLOGY	0.8	0.11	A-	6,100	NM	24.9	15	27.3	34.2	19.9	182,279	-28	SEMICONDUCTORS	LLTC	NASDAQ
XILINX	1.7	0.54	B	6,500	20	23.9	13	16.4	16.9	13.1	248,413	-21	SEMICONDUCTORS	XLNX	NASDAQ
AUTOMATIC DATA PROC	2.4	0.96	A+	22,000	1	18.3	12	13.7	20.7	20.5	677,905	9	SERVICES-DATA PROC	ADP	NASDAQ
MICROCHIP TECH	NM	0.00	B+	4,900	22	38.9	8	16.1	18.7	14.4	-40,249	3	SEMICONDUCTORS	MCHP	NASDAQ
MATERIALS															
NUCOR	NM	0.03	B	14,000	29	NM	15	NM	33.8	25.6	547,531	73	STEEL	NUE	NYSE
TELECOMMUNICATION															
TELEFONICA ADR	3.0	0.79	NR	139,000	72	12.9	10	13.6	33.9	10.6	5,630,305	68	INTEG TELECOM SVC	TEF	NYSE
ROGERS COMMUNICATION	2.9	0.93	B-	15,000	63	16.4	11	9.0	16.9	3.9	-350,241	170	WIRELSS TELECOM SVC	RCI	NYSE
PPL	1.7	0.02	B+	12,000	56	16.4	10	8.6	18.1	7.4	-651,483	24	ELECTRIC UTILITIES	PPL	NYSE
ONEOK	2.5	0.30	A-	4,200	67	15.2	10	2.7	17.2	6.7	-1,160,388	46	GAS UTILITIES	OKE	NYSE
WISCONSIN ENERGY	3.8	0.89	B+	5,400	51	14.8	10	8.5	10.0	4.6	-526,104	37	MULTI-UTILITIES	WEC	NYSE
AQUA AMERICA	1.3	0.64	A	2,300	54	21.8	9	15.8	10.7	4.9	-114,171	-5	WATER UTILITIES	WTR	NYSE
NORTHEAST UTILITIES	3.9	0.69	B	4,300	55	12.8	8	6.0	6.7	2.4	-734,432	38	ELECTRIC UTILITIES	NU	NYSE
PG&E	3.4	0.95	B	16,000	51	13.7	8	8.6	21.8	9.9	-1,423,438	36	MULTI-UTILITIES	PCG	NYSE
SOUTH JERSEY INDUS	2.7	0.81	A-	1,100	39	16.5	8	7.4	14.6	8.0	-68,531	47	GAS UTILITIES	SJI	NYSE
UNIVERSE AVER(EQ WT)	3.7%	0.61	A-	\$22,000	36%	16.9	11%	11.6%	21.7%	13.9%	\$298,520	26%			—