Bird's Eye View of Dividends

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Dave: . All right folks. Welcome to Investing for Beginners podcast. Today, Andrew and I are going do a bird's eye view of dividends. We are going to talk about maybe where you can find them in the financial statements, and we're also gonna look at three different businesses and maybe examine why they pay dividends, why they don't pay dividends, and kind of give you an idea of what you can look for when you're trying to analyze or assess a company that does pay a dividend.

So, without any further ado, let's go ahead. Dive in. So I guess the drip king, I'm gonna give you a first stab at this. Where can we find dividends? Like what a, let's start with what is a dividend and where would we be able to find something like that on a financial statement?

Andrew: Perfect. So a dividend is just, Part of the profits that a company gives back to its owners.

So when you buy a share of stock, you are part owner of that company. Some companies will pay a dividend to return some of the profits back to their owners, their shareholders, and that's what a dividend is generally. Most companies that pay a dividend will try to grow that dividend over time. So maybe I'll pay you a dollar this year, a dollar 10 next year.

Um, and that's all per share. So you're gonna get however many dividends per share. Um, so you know, if you look up a stock and it says they pay a 2 cent dividend, it doesn't necessarily mean you're only gonna get 2 cents, right? If you have. 20 shares, you'll get 2 cents times 20 shares. But generally they'll try to increase that every year.

And that's where you can get the compounding magic of dividends, because if you're reinvesting those dividends, that's where the drip comes in. Dividend reinvestment plan, if you're reinvesting the dividends, you're accumulating more shares of the company. Plus if it's, if they're increasing their dividend every year, the dividend.

The dividends you get are now higher and you didn't have to do anything. So I used the example with my daughter, uh, last night, and it didn't really take, because I was like, oh yeah, the dividend went from a dollar to a dollar 20. And she's like, who cares? But you know it. So if you're, if you have a stock at like $80 and now it's at $130, You only paid 80 and even though the stock costs more now, you're gonna get dividends on the, on the most recent price.

Um, because the business is bigger. So I, I, that probably doesn't really help much, but that's kind of the big gist of it. So you're gonna get compounding through accumulating more, plus the payments you receive are gonna be bigger every year and you didn't have to do a thing. That's the magic. To find it.

Would you like to talk about where to

Dave: So there are basically two places in the financial statements that you can find information about the dividends. The first one's gonna be in the income statement. At the bottom of the income statement, you will be able to find a. Where, how much the company pays per share.

So for example, Andrew's company that pays a whopping 2 cents per share, that is where you'll find that at the bottom of the income statement, there will be a line item that will say dividends per share, and it'll tell you how much most companies pay. The dividend quarterly. Some pay it monthly, some pay it biannually like every six months.

It just kind of depends. But majority of them pay it quarterly. So when you see the dividend come into your account, it you may go, well, wait a minute. I thought they were paying me a dollar. A dividend, a dollar per share, and I'm only getting 25 cents. What's going on? It's because they pay it every quarter, and so you won't get the whole, the whole dollar in at the beginning of the year and nothing.

The next three quarters, you'll get it every quarter that they, that they pay the dividend. So there, there's one place that you can find information about it. The other place that you can find it is in the cashflow statement. And the cashflow statement has three sections. It has the operating section.

Investment section and the financing section, which is generally at the bottom. In the financing section, there will be a line item that will say dividends paid or something along those lines. And that will show the gross amount that they pay out in dividends every year. And so if you really wanted to be geeky about it, you could look at that number and then go back to the income statement and see how many shares outstanding they have and then divide it.

Uh, not every company will. Do the, the calculation for you. So that's how you would do that. Try to figure it out yourself, would be to look at the finan, uh, I'm sorry, look at the cash flow statement. Look at the gross amount, and then divide that by the shares outstanding. And that will give you the dividends per share.

So those are the two places in a company's financial statement that you can find information concerning the dividend.

Andrew: If someone's an absolute beginner of the financial statements, maybe they want a shortcut. How would you suggest finding that? So, not in the financial statements.

Dave: Uh, the easiest way that I think of is, uh, control f and type in dividends per share.

And it will, it should find that for you. Uh, the other option is to go to our favorite websites, stratosphere.com and look there. They'll tell you how many dividends per share they pay as.

on the. Whether they're gonna pay a dividend.

And then maybe we could talk about some of the metrics you could use to kind of analyze the dividends that they do pay. Sure.

Andrew: So looking at the grocery industry, there's three companies that are all in different life cycles of their business and all have different, well, I'd say two of 'em kind of have a similar dividend policy.

One would arguably pay more of a dividend than the other. So we're talking about Sprouts, target, and Costco. And full disclaimer, I own Target and Costco. I'll still give you an unbiased opinion on them, but. Sprouts is one of those companies that does not pay a dividend, but it is in a early growth stage and it makes sense for them to not pay a dividend.

Costco is somewhere in the middle where they are still growing and still opening stores, but they also still pay a dividend. It's not as big as some of their other peers, but it is still there. And then Target is a company that has a bigger dividend and they are. Opening new stores. They are reinvesting in their business by doing these remodels across their existing store base.

And they also reinvest through inventory, but they are not investing in the same way and growing in the same way that somebody like Costco or Sprouts is. So to give you an idea of why we've kind of. Hum up with that classification. It's not like Target walks around saying, Hey, by the way, you know, I'm a mature company.

I don't grow fast. Um, you can look at Sprouts. Let's start with Target. So Target has, if you look at their annual report, they have 1,948 stores across the 50 states. Costco has less than half of that, and about a third of that in the United States. So Costco has 578 stores and they're only in 46 states.

And then you take it down to Sprouts. And Sprouts only has 300. Where go 386 stores in 23 states. So you can see Sprouts could basically double the number of states they're in. So management has to ask themselves, do we wanna kinda reap the profits now or do we wanna reinvest and try to expand? And I think when you're smaller like that, it makes a lot of sense to, to reinvest, um, somebody like Target.

They're already pretty saturated. They've got 2000 stores across the country where I'm at in most major metropolitan areas. You can get to two or three targets pretty easily, so it doesn't make much sense for them to necessarily open a lot of new stores. So they're, if they can't find good uses and they're not gonna open stores, then it makes sense for a lot of that to come back to shareholders.

That's kind of the gist.

Dave: Gotcha. So can we, can we go back and maybe unpack a little bit the idea of, of, uh, like a growth site or a life cycle for a business? Like in, I guess overall like a 30,000 foot view? What does that mean?

Andrew: Hmm. It's a pretty simple concept, right? Right.

Dave: It's.

Andrew: Okay. 3, 2, 1. It's, it's, it's a pretty relatable life cycle. So you have early on in the business they're trying to expand and they generally will do it very fast. And then the middle stage is, uh, like a stable growth stage. Can you, can you explain it? I'm, for whatever reason I'm struggling, so Sure. No problem.

3, 2, 1. It's a pretty simple and relatable life cycle that these businesses go through. Would you like to tackle it? Yeah. So

Dave: if you think about any new business, they're gonna go through kind of an evolution of a life cycle, and it doesn't matter what business it is, even Apple, someday may die. Most likely not, not for sure.

But if you think about, uh, Microsoft maybe would be an easy one to kind of explain. When companies first start out, they, they, they all make money and they have a choice of what they wanna do with that money, and it's called capital allocation. And generally, as you move through the life cycle, the decisions they make with capital allocation will change based on what the company is trying to do.

So early on in the seventies, Microsoft was just getting off the ground. Every penny they made went into trying to grow the business, so there was no conversation about paying a dividend at that point because every dollar that they made went to try to grow the business, grow revenues, grow the stores, create new products, all just expand in general.

And that's normal in an early stage of a life cycle for businesses. If you move into more of the middle. Middle age, I guess, if you will, of of life cycles. Then people kind of start, then businesses start to change. They will still be looking to grow, but their capital allocation may start to change. Like they may not have to throw, they may not throw every penny into growing because they may not have as many opportunities.

Early on in their life cycle, they'll have lots of opportunities. Everything's their oyster. They can do whatever they want, but when they get to be more middle age, then maybe they may not have as many choices, and so the capital allocation may start to switch, and instead of investing all of it, they may invest half of it, and then maybe they start paying a dividend to shareholders to thank them for investing.

Along the ride to this point. So now let's say that the business starts to move into more of a mature cycle, or even maybe on the downward cycle, they may not have any opportunities to grow at all. They've saturated the market, they don't have any real places to put money, and so as the company at this point is mature, they're probably very established and are making lots and lots of cash.

And so instead of hoarding all that cash, Pay a growing dividend to shareholders to try to entice them to either come to the company or stay with, with the, with the investment. Because now the growth is, is gone. And so as you look through this, the life cycle of businesses, that's kind of what you'll see with the capital allocation in, in relates to dividends.

And that's kind of how they will. So young companies like Sprout, they'll want to grow. They're not gonna pay a dividend. A company like Target, who is maybe. Let's rephrase that. A company like Costco who still has opportunities to grow, will pay a dividend, albeit smaller. They will still pay a dividend because they have some extra money they want to give back, and maybe they're more conservative and they don't see as many opportunities to grow as fast.

And then target who is maybe on the more mature side of the things, still has room to grow, but they're also more mature, so they're gonna pay more of a dividend because the reinvestment choices have changed. And so that's, I guess kind of how you look at the, the life cycle, or at least that's how I look at it.

Andrew: Yeah, that's perfect. The only thing I would say is everyone and everything dies. My friend. Yeah. Even Apple. Everything. Yeah.

Dave: Even Apple.

Andrew: So what are some metrics that investors can use when they're learning about dividends, trying to apply them to their approach? What, um, what are some things they can hang their head on?

Dave: Um, I, well, there are several that kind of spring to mind. I think the first one is, uh, dividend growth. Like how mu how fast is the dividend growing? And that's something. All dividend investors want to see, they wanna see the company growing the dividend. Uh, the stock market also likes that too. If a company stops growing a dividend, especially after they've been paying a growing dividend for a long time, that's generally not a good thing for the business.

And it could be a signal that there's. Trouble in Paradise, uh, if they cut the dividend. That's very much a, a, a, a signal to the market that there is trouble in paradise or there very strong possibility of trouble in Paradise. But you wanna see a, a, a growing dividend. Uh, I think, was it Visa the other day?

Uh, a few, a few quarters ago raised at like 25% or something like that, so Oh yeah. Yeah. That was like, um, They can announce these at any time. So it doesn't have to just be at the annual, at the end of the year or the beginning of the year. They can, they can announce it every quarter. And there's a, a class of dividend, uh, payers called dividend aristocrats that pay growing dividends for 25 years, have a certain level of market cap, and are in the s and p 500.

And there's, uh, 56, 58 of 'em. I, I don't keep track of. Very closely. But there's about that many of those companies and some of these companies have been paying dividend for over a hundred years. I think it's, American Water has been paying, uh, that utility has been paying a dividend for over a hundred years.

It's kind of crazy, a growing dividend over a hundred years. So it's kind of nuts. But, um, so that's, I guess that's the first one I would look at. What about you?

Andrew: A simple one as well would be the payout ratio. So it's basically how much of their profits are they paying out? So to, to use our examples, um, that we were just using, which I think is very helpful. Of course, these numbers can change as a company's profits change, but in general, you can kind of make. Big picture determinations from them.

So to look at Costco, their payout ratio right now just pulling up on a, on a quick website is 25%. So 25% of last year's profits basically went to, went back to shareholders in the dividend. And then you look at, you look at Target and their payout ratio was 65, 60 6%. To that same argument of they're paying more back in dividends.

That's an easy way to kind of see, um, generally rules of thumb. You definitely don't wanna see payout ratios above a hundred percent. For a very long time because that basically means they're paying out more in dividends than they are making them profits. And it doesn't take a rocket scientist to know that's not sustainable over the very long term.

Um, So payout ratio, you know, pe some people talk about, well, I want it to be at least this much. And I know I've, I've said that when I was young and dumb. Um, but I really, I would say anything up to like 90%. I think when you get to 85 or 90% and the company keeps hitting that, you might start to wonder, okay, are they really just.

Either I'm not gonna get any growth from this, or is this just an unsustainable payout? Because they're gonna want to keep increasing it. And if you're paying basically everything out and there's no margin, what happens if you have a down year? And then now we're gonna have to draw down. It could get messy.

So, you know, hopefully a payout ratio is a little more conservative. 65 I I like that. I think that's fine. But the closer you get to a hundred, the more you start to be like, Hmm, maybe this is something to look further into.

Dave: Yeah, yeah, for sure. Uh, it, I, I remember looking at Koch a while back, and I think their payout ratio was in the eighties or something like that, and that made me nervous.

Yeah. All right. So I guess what's, what's another ratio that you would look at be besides the payout ratio?

Andrew: Did we talk about yield yet? Okay. I mean, yield is a pretty simple one too. You can just take the dividend paid and divide it by the share price, and that's going to give you the yield that you get.

That's basically, you can think of it like your interest rate, like, uh, that you would get on the savings account. So if I buy Target today at the yield of 2.73%, my dividend's gonna be. 2.73% of however much I invest in them. So I put in a hundred dollars, I'm gonna get $2 and 73 cents.

And then with, sorry. That's okay. Uh, 3, 2, 1. And with that, again, there are rules of thumb where if it gets, if it's like super high, like 10%, 11%, 12%, It could be something that's too good to be true because sometimes when the stock gets beaten down, its yield shoots up, but it's not because the company's paying a lot more in dividends.

It's because people hate the stock and so they don't even wanna hold it, even if it's paying you 10% a year. Right. So that's something to keep in mind with the yield as well.

Dave: Do you think about the yield as part of your return that you would get on the investment?

Andrew: Oh yeah, absolutely. Kind of to that point, you could have a lower growing stock, but if you paid, if you got a, a nice yield on it, um, you could still beat the market even though the stock grows less than average.

Dave: So let's say the stock grows at 5%, but you're getting a four, 4% yield on the dividend, that's a 9% return, which is nothing to sneeze at.

Andrew: And it actually, it actually grows exponentially. So, you know, if we're talking about one year, then yeah, 9%, but it's actually much higher if you are looking at a 10 or 20 year time period because that extra 4% is compounding.

Um, and, and you're getting that. And if the stock stays low, you're getting that every year. And so the impact of that is seen more so on a long.

Dave: Yeah, that makes sense. So how are, so we know Sprout doesn't pay a dividend. What are the yields for Costco and

Andrew: Target? Yeah, that's a good, that's a good example too.

So target's at, like I said, 2.73 versus Costco at 0.73. So you kind of have to double whammy. Investors have bid up Costco stock much more than they have target stock. And it's because we all expect them to grow more than target will. So it's not a big surprise. So that will push the dividend yield down because the stock's more popular. And then also when you combine it with the fact the payout ratio is lower.

Because Costco's paying less of its profits back to shareholders that also contributes to the lower yield. Mm-hmm. So it is, I'm glad you brought up the whole total return mindset, because you're constantly balancing between do I want higher growth and more dividend or lower growth and the bigger dividend.

Mm-hmm. And I would say it really depends. Obviously I have both. And so depending on what the market's giving you sometimes. A slower grower is a better deal and sometimes a faster grower is a better deal. Mm-hmm. And you just have to kinda figure that out for yourself.

Dave: Would you, would it be fair to say that a, a company that's maybe in the more mature side of the cycle will pay a higher yield just by and large than a company that still has more

Andrew: growth ahead of it?

Yeah, a hundred percent. I think you see that too because of the double Amy effect, like we just talked about. The faster growers tend to be more popular, so those will be more expensive, so you won't get as high of a yield. And then because the slower growers are paying more out in the dividend, you also get that to push up the yield.

Dave: That's perfect. That's perfect. So is there, when you're looking at, um, companies and are paying a dividend, do you kind of assess these three markets, these three metrics that we talked about in totality and kind of balance how that affects your decision to buy this company or that company? Like if you're looking at, let me maybe back that up.

Let's say you're looking at company A and company B and company A. Let's say they grow roughly the same, but one pays a higher yield than the other. Will that help sway you towards giving that, you know, more consideration?

Andrew: Not really. Uh, I feel like these metrics are pretty simple and, and they're good at helping beginners get a good grasp on a lot of different stocks.

For me personally, my investment style, I'm trying to buy and hold something for at least 10 years. Doesn't always work out that way, but that's the goal. And so I'm trying to think more on that mindset of do I think this company is gonna do better than that company? And then comparing what the price is, and so dividend yield becomes much less of a discussion in there because if the company can take care of business.

Then the dividends will take care of themselves. Right.

Dave: Okay. Anything else about dividends you think we should cover?

Andrew: Um, not really. How about

Dave: you? Mm-hmm. No, I can't think of, I've been racking my brain like there's something I'm missing. I know there's something I'm missing.

Andrew: Oh, we talked about, you talked about the aristocrats, talked about some of the risks and dangers, some of the trade-offs. Mm-hmm. Um, Yeah, I remembered something I did wanna say. Okay. Just to kinda, because it's the drip king, you

Dave: know. Right. Okay.

Andrew: And that, and that hopefully is a good bird's eye view of dividends and gives people somewhere the start and really grasped the, uh, the concept of dividends.

Dave knows I get really fired up about dividends every once in a while, and I'm gonna take the opportunity since the mic is on and I am live to talk about, um, where dividends can become really nice. So I've written about this before in, um, in the emails that, that we send out to people on their free new.

I talked about my luckiest investment ever, and it was the first stock I ever bought. It was Microsoft back in 2012. And I literally just bought the stock because I knew that they made Xbox and I liked Xbox, and I knew X. They had a new Xbox coming out. That was the extent of it. So back then they paid a 20, it was something like 27 cents of a dividend, and I bought one share and.

They continue growing that dividend every year. So you know that 27 cents maybe became 35, maybe became 45, on and on and on. You look today, Microsoft's dividends, $2 and 72 cents. So the dividend itself has grown by 10 x. So what does that mean? So I spent $27 and now I'm getting, I spent $27 once and now I'm getting $2 and 72 cent.

A year plus that's continuing to grow. So let's, let's put that into like some numbers that, that people would actually care about. So if you had like a thousand dollars and you were getting a

1% yield, that's $10 a year. If the dividend were to grow over a 10 year time period, like Microsoft's has, let's say, and at 10 x now you're getting a hundred dollars a year.

Basically a, a 10% return on a thousand dollars you put in a while ago, and you continue to generate that for some reason, that gets me really excited. Um, and we're not talking about the reinvestment either, but just that idea that you can put in the work once and watch it grow like you would watch a tree grow is really, really cool.

And, um, hopefully illustrates the potential that dividends can have for.

Dave: I think it does. No, that's a, that's a great illustration. Thanks. You're welcome. All right. Well with that we will go ahead and wrap up our bird's eye view discussion on dividends and how they can help you. I would be remiss if I don't mention, we are running a survey right now to.

Gather some information about what you guys like about the show, what we we could do better, and just an overall general help the show. If you are interested, we have a link in the show notes that you can fill out the survey. It takes about five minutes or so, and if you are kind enough to fill it out, you will be entered in a raffle to win a $500 gift card from Amazon.

So this is all being done via AirWave Media, our podcast platform, and it's to help the show so we appreciate it. If. Take a few minutes and click the link and fill out a survey. Uh, it's all easy stuff to answer. If you have any questions about anything that we talked about, dividends in particular, we have articles on our website that will help explain this in more in depth.

I think Andrew did a fantastic job, but if you're one of those people that like to read, Go to our website re-investing for beginners.com. There's a huge search bar at the top, and if you're interested to learn about dividend yield, you will find lots of articles about dividend yield to help explain it to you in better detail and with other examples.

So without any further ado, I'll go ahead and sign this off. You guys go out there and invest with the margin of safety, emphasis on the safety. Have a great week and we'll talk to y'all next week out.

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