



# Fisher Funds

## Investor Education Centre

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### How Important are Dividends?

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There is nothing nicer than receiving a cheque in the mail, or its modern day equivalent, a direct credit to your bank account. Dividends are your tangible reward for investing in shares, and are an important barometer of the health of your company.

In the old days, before companies were required to regularly disclose profit information, a company's ability to pay a dividend was one of the few signs of the health of the business. Typically, mature, profitable companies pay dividends. They retain whatever profits are needed to run the business and handle contingencies, then distribute the rest to shareholders.

However, if a company does not pay dividends, it does not mean that the company is unprofitable. Some young, growing companies choose to reinvest their profits for future growth rather than paying out their cash to shareholders. As an example Microsoft did not pay a dividend until 18 years after it floated on the share market as it chose to reinvest profits while it was growing.

As a growth investor, I have always been comfortable investing in companies that do not pay dividends, as long as I am sure that the companies are using the retained profits properly. I don't mind how I get my return – if a company doesn't pay me a dividend, but it grows its profitability each year leading to an increased share price, I am happy. If a company is profitable and doesn't need to reinvest profits for growth, I am happy to get my returns via a regular dividend.

The things to watch when considering dividends are their consistency and affordability.

If a company that has regularly paid a dividend suddenly cuts the dividend, it might mean trouble. A dividend is a public promise, and failure to pay one (when you have paid previously) is read by investors as a failure.

A quick comparison between the earnings per share and the dividend per share can tell you how affordable the dividend is. If the earnings cover the dividends by 2 or 3 times, investors can feel comfortable. If the ratio is more like one-to-one, there may be a dividend cut coming. If the ratio is very large, say 5 or 6 times, the company might not be paying out enough, so you should check that they are doing the right things with the retained profits and not squandering them.

Another thing to watch is the dividend yield. The yield is calculated by dividing the annual dividend per share by the share price. The higher, the better. But sometimes a yield is high because the share price is low and falling. It could mean a dividend cut is coming.

Dividends have taken on greater importance over the last year. With earnings tumbling left, right and centre, investors have leaned towards those companies that can still pay dividends. If a chief executive trying to run his business in these turbulent times, announces a dividend, it is probably a fair indication that he thinks his business is going to come through the cycle in good shape.

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