12 Top Dividend Stocks

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Returns from investments in listed companies come from two sources: capital appreciation and the distribution of profits through dividends. Capital gains were almost taken for granted before the global financial crisis, but volatility in financial markets in the past few years has changed that.

Investors now need to identify profitable companies that reward shareholders with consistent and sustainable dividends if they are to maintain a steady source of income from the sharemarket during the current global uncertainty.

Research indicates that around 70 per cent of the market (excluding resources) total return has come from dividends, which shows just how important identifying high-yielding dividend shares has become for many investors.

Dividends represent an investor's share of a company's profits. Management can either choose to reinvest profits back into the business to pursue opportunities for growth, or give some of them back to shareholders.

Average dividend yields in the past few years have been more or less steady, ranging from 4 to 5 per cent. We believe this will continue in the mid-term but will depend on the speed of the global economic recovery.

Nevertheless, by identifying well-run companies that have continued to perform despite the adverse macro-economic environment of late, and investing in companies trading at a discount to their intrinsic value, investors will be well placed to benefit when confidence returns to the market and business conditions start to improve.

The right characteristics

We should first define what a company with attractive investment characteristics looks like, because they are the companies that will reward shareholders with consistent and reliable returns. These characteristics include:

- High and sustainable return on equity driven by a competitive advantage
- Little or no debt and strong cash flows
- Sound management with (preferably) equity in the business
- A history of sensible capital management
- Positive industry outlook in which business can grow
- Available at a discount to its intrinsic value (the company's true value).

Examples of companies that Clime believes show many of these characteristics include Woolworths, Blackmores, CSL, ARB Corporation, IRESS Market Technology, and Cochlear.

(Editor's note: Do not read these examples as share recommendations. Do further research of your own or talk to your financial adviser before acting on ideas and themes in this article).

Although these are the characteristics of an attractive business, not all attractive businesses provide investors with attractive dividends and yield. In analysing companies when searching for yield, we tend to find the best ones display the following aspects:

- Dividends are consistent and sustainable.
- Dividends are franked.
- Dividends are paid from the business earnings and supported by real cash flows, not recent capital raisings.
- Yield is in excess of 6 per cent.
- The business displays a record of growth in dividends per share.

In a general sense, mining companies tend not to make great investments for those seeking yield, because they often prefer to use profits to pursue new mining opportunities, as seen by BHP Billiton's recent acquisition of Petrohawk.

It should also be noted that the absolute dividend figure is not necessarily of uppermost importance, but rather the percentage-based yield figure. In BHP Billiton's case, although it paid annual dividends of roughly $1 a share, it is yielding only 2.3 per cent, which is quite low considering you can place your money on deposit with a bank, risk free, and earn 6 per cent or more.

Clime takes a conservative stance in the construction of portfolios and over the past few years has put increasing emphasis on the need for yield. With this in mind, here are some high-yielding shares that Clime favours (they show the attractive investment characteristics noted above):

Company	Current Yield	Franking %
Adelaide Brighton Limited	7.3%	100%
ANZ Banking Group	6.4%	100%
Commonwealth Bank of Australia	6.1%	100%
Ethane Pipeline Income Fund	10.1%	0%
Mortgage Choice Limited	9.4%	100%
OrotonGroup Limited	6.6%	100%
Spark Infrastructure Group	7.1%	0%
Telstra Corporation Limited	9.1%	100%
Westpac Banking Corporation	7.1%	100%

Woolworths Limited	4.4%	100%
Fleetwood Corporation Limited	5.9%	100%
Perpetual Limited	7.8%	100%

Source: MyClime

Don't overlook risk

When searching for high-yield investments, investors often focus solely on the potential returns with little or no regard for the risks involved an important consideration that is often overlooked.

Although small-cap companies should not necessarily be avoided, investors should take their investment timeframe into consideration and allocate a lower percentage of their portfolio to higher-risk shares.

For example, you could buy Oroton shares at current prices on a yield of 6.6 per cent, while Woolworths only offers 4.4 per cent. However, Oroton has a much smaller capitalisation and operates in the discretionary spending sector. It would be wise to factor in these risks despite both companies being attractive and Oroton displaying a higher yield.

To quote Warren Buffett, "More people have lost money stretching for yield than at the point of a gun", and this is a lesson lost on many investors who disregard the risk side of the investing equation. For example, despite the attractive yields available on Greek bonds, the risk of capital loss is quite high given uncertainty surrounding European sovereign debt problems. We would argue that much more sustainable and less risky opportunities are available to prudent investors in the Australian sharemarket.

Another aspect many people tend to disregard is that in investing, and more importantly investing with the aim of capitalising on the benefits of dividends, they need to take a long-term view of the market. Investors can then avoid the unnecessary worry associated with short-term fluctuations in market price levels driven by sentiment. For people with shorter investment horizons, such as those nearing retirement, knowing how to identify quality, high-yielding businesses is essential.

Given the uncertainty surrounding global financial markets and the problems this brings to investing in the sharemarket, you could be forgiven for fleeing to more worry-free investments. However, by investing in attractive listed businesses that reward shareholders with dividends, at a discount to their intrinsic value, it is possible to secure returns that beat property or fixed interest. Also, it gives exposure to the future growth of the economy.

About the Author

Matthew Koroi is an analyst with Clime. Clime Asset Management and MyClime are part of Clime Investment Management (ASX:CIW). Using MyClime, our asset portfolio is ranked the #1 Best Performing Fund by Morningstar - Equity Australia Large Cap, 30 June 2011. For a free two-week membership, click here.