A Case Study in Dividend Success

At Young Research, when we look for dividend stocks for the Retirement Compounders, we favor companies with strong balance sheets, stable businesses, a healthy dividend yield, and a history of increasing dividends.

What does that look like in practical terms? While the ideal company financial position for the RCs can vary by industry and sector, Procter & Gamble serves as a nice case study in dividend success.

A Strong Balance Sheet

We look for companies with strong balance sheets because financial strength provides flexibility during tumultuous times in the business cycle.

Procter & Gamble (P&G) has one of the strongest balance sheets among large U.S. businesses. Its debt is rated Aa3/AA- by Moody's and S&P. Only about 2% of firms in the S&P 500 have a credit rating as good as P&G's.

P&G's debt after backing out cash on the balance sheet is about equal to the company's cash flow before taxes and interest. In other words, P&G could theoretically pay off its debt in a little longer than one year if it used all cash for debt reduction.

With a balance sheet that strong, P&G could fund its dividend for several years even if it runs into a rough patch.

How could P&G fund the dividend during a rough patch? For starters, there is $10 billion in cash on the balance sheet. Assuming a rough patch for P&G caused profit margins to go from

19% today to zero, P&G could fully fund a year's worth of dividend payments with cash on the balance sheet. The second line of defense for the dividend would be for P&G to borrow money. P&G could easily borrow 2-3 years' worth of dividend payments without losing its investment-grade rating. Obviously, the definition of a rough patch can vary, but in the scenario outlined above, P&G could have a 3–4-year rough patch without putting the dividend in jeopardy.

Business Stability

P&G's dividend reliability is also bolstered by the nature of its business. Toilet paper, diapers, toothpaste, and cleaning products are staple purchases for most consumers. That is true whether the economy is in boom or bust. Stable businesses tend to be better equipped for long-term dividend payments and dividend growth than cyclical businesses.

Dividend Payout Ratio

When possible, we also favor companies with modest dividend payout ratios. The payout ratio is the percentage of net earnings paid to shareholders in the form of dividends. Firms with lower payout ratios can more easily continue to pay and raise dividends even during a business downturn. If a company has a payout ratio of 100%, any drop in earnings will either require the company to reduce the dividend because the earnings aren't there to support it, use cash on hand, or borrow money.

Procter & Gamble pays out about 60% of its earnings to shareholders in the form of dividends. That means earnings could fall by 40% without requiring alternate means to fund the dividend. In practice, for many industries, we compare the dividend to free cash flow instead of earnings to get a truer picture of the payout ratio. P&G looks even better on that metric.

The Dividend

Next is the dividend and the dividend policy. Everything else equal, higher dividend yields are better than lower dividend yields, and a stronger commitment to the dividend in the form of a long record of dividend payments and a long record of dividend increases is better than a weaker commitment to the dividend.

- P&G shares yield 80% more than the S&P 500
- P&G has paid a dividend every year since 1891
- P&G has increased its dividend for 66 consecutive years

The Model of Dividend Success

With a strong balance sheet, a stable business, a modest dividend payout ratio, and an enviable dividend track record, P&G truly is *the* model of dividend success.

Gold's True Story

Back in 1971, I had just started in the institutional research and trading business on Federal St. in Boston. Our firm traded and researched gold shares. I would in fact shortly be on the way to London to begin research on a lengthy gold study. This presentation by Claudio Grass published on *LewRockwell.com* is pretty much as I remember events, and is a great summary of the facts and events of that time. He writes (abridged):

> *This year marked the 50th anniversary of President Nixon's decision to unilaterally close the "gold window". The impact of this move can hardly be overstated. It triggered a tectonic shift of momentous consequences and it changed not just the*

global economy and the monetary realities, but it also shaped modern politics and severely affected our society at large.

The Nixon Shock

In July 1944, representatives from 44 nations convened in the resort town of Bretton Woods, New Hampshire, to figure out how the global monetary system should be structured after the end of the war. The US took the clear lead during these talks, exploiting the considerable leverage it had over other countries devastated by WWII or even still occupied by Germany. After all, at that point, Americans were the creditors of the world and had accumulated tons of gold throughout the 1930s and during the war, as the US was widely seen as a safe haven amid the conflict and uncertainty that prevailed at the time.

Indeed, the Bretton Woods system didn’t last long. It wasn’t fully implemented until 1958 and by the mid 60s it was already obvious that its days were numbered. The US gold stockpiles were dwindling as European central banks soon began redeeming their dollar claims, and there were real fears that US gold holdings might eventually be exhausted. Also, the Bretton Woods system, even though it was “managed” and much weaker form of the classical gold standard, did still at least partially keep government spending and deficits in check, something that Nixon resented, especially with a view to the next election.

Indeed, the Bretton Woods system didn’t last long. It wasn’t fully implemented until 1958 and by the mid 60s it was already obvious that its days were numbered. The US gold stockpiles were dwindling as European central banks soon began redeeming their dollar claims, and there were real fears that US gold holdings might eventually be exhausted. Also, the Bretton Woods system, even though it was “managed” and much weaker form of the classical gold standard, did still at least

partially keep government spending and deficits in check, something that Nixon resented, especially with a view to the next election.

And yet, there were a few voices that spoke out, for common sense and Reason. As the Cato Institute outlined, "Milton Friedman wrote in his Newsweek column that the price controls "will end as all previous attempts to freeze prices and wages have ended, from the time of the Roman emperor Diocletian to the present, in utter failure." Ayn Rand gave a lecture about the program titled "The Moratorium on Brains" and denounced it in her newsletter. Alan Reynolds, now a Cato senior fellow, wrote in National Review that wage and price controls were "tyranny … necessarily selective and discriminatory" and unworkable. Murray Rothbard declared in the New York Times that on August 15 "fascism came to America" and that the promise to control prices was "a fraud and a hoax" given that it was accompanied by a tariff increase."

Claudio Grass is an independent precious metals advisory based in Switzerland.

Click here to read about how to invest in gold.