CIBC CAPITAL MARKETS

EQUITY RESEARCH

Ian de Verteuil
+1 416-594-7462
Ian.deVerteuil@cibc.com

Shaz Merwat
+1 416-956-6428
Shaz.Merwat@cibc.com

Jinzhu Zhai
+1 416-581-2164
Jinzhu.Zhai@cibc.com

Jin Yan, CFA
+1 416-594-8877
Jin.Yan@cibc.com

May 7, 2023 **Industry Update**

It's Raining Dividends In Canada

Even With Increases In Interest Rates, Canadian Dividend Yields Look Attractive

Sector:
Portfolio Strategy

Our Conclusion

Canada's public companies have continued to increase dividends over time. From the end of 2019 to today, S&P/TSX dividends have increased by a third – with most of the contribution coming from sectors with excellent track records of stable dividend distributions.

Dividend yields have made up 30%-40% of overall Canadian equity returns over the past several decades. In an uncertain economic environment – with little confidence in the direction of interest rates – we continue to highlight the importance of dividend yield in overall investment returns.

Key Points

After a difficult 2020 due to the effects of COVID, members of the S&P/TSX have responded with significant bumps in dividends in 2021 and 2022. Compared to the end of 2019, current dividends are now 33% higher.

Canadian dividend yield compares favourably with that offered on U.S. equities and with prevailing interest rates. Canadian companies now offer investors dividend yields that are twice that of U.S. peers – a record level of relative yield. Interest rates have certainly risen, but given the tax advantages for dividends, the after-tax yield on the S&P/TSX is still 50% better than a 10-year Canadian Government bond. In our opinion, this more than justifies the higher risk associated with dividends.

Four groups of stocks do most of the heavy lifting when it comes to dividend payments from the S&P/TSX – Financials, Pipelines, Communications and Utilities. These currently contribute over two-thirds of dividends. Furthermore, our bespoke analysis of the past decade and a half highlights the excellent track record of these entities in increasing dividends over time – and the low odds of dividend cuts.

Investors continue to face a barrage of concerns regarding the economy. The significant spike in interest rates has certainly had the effect of moderating inflation, but it has also resulted in a slowdown in economic activity. As well, recent stress in the U.S. banking system is a cause for concern.

Having said this, we believe Canadian equities remain attractive – yields are compelling, stable businesses underly most of our dividends and our banking system continues to exhibit tremendous stability.

All figures in Canadian dollars unless otherwise stated.

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Dividends Are Important, Especially Now

Dividends typically make up one-third of Canadian equity returns.

The post-COVID inflation spike, aggressive action by most central bankers, and the recent banking turmoil have all added significant tail risk to economic forecasts. However, even before these events, we harped on the need to focus on dividends. They are particularly important for Canadian investors given the tax-preferred treatment when compared to interest income.

In addition, Canadian equity investors received a larger proportion of overall returns from dividend yield when compared to U.S. equities. Exhibit 1 table shows the percent of total equity returns arising from dividends – both for the S&P 500 and the S&P/TSX. Dividends typically make up one-fifth of U.S. equity returns, but 30%-40% of Canadian returns.

Exhibit 1: S&P 500 And S&P/TSX Comp. – Dividend Return As Percent Of Total Return, Varying Time Periods

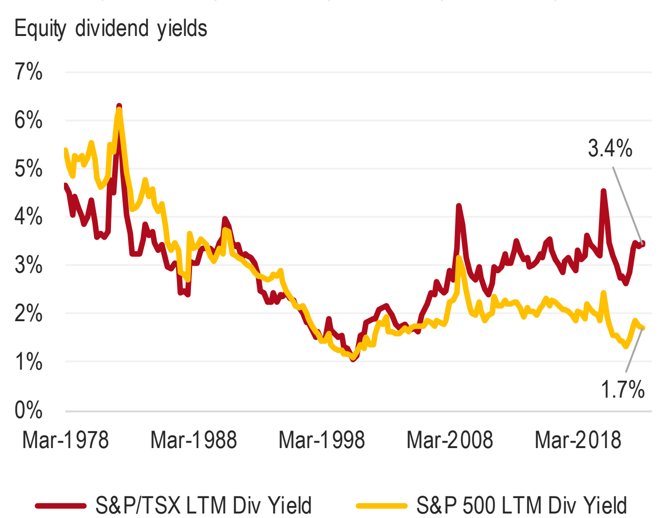
	S&P 500 Total Return Breakdown					S&P/TSX Comp. Total Return Breakdown			
CAGRs	Price Return	Dividend Return	Total Return	% Dividend Return	CAGRs	Price Return	Dividend Return	Total Return	% Dividend Return
30 Year	7.8%	2.1%	9.9%	21.3%	30 Year	5.8%	2.6%	8.4%	31.0%
20 Year	7.9%	2.1%	10.0%	21.4%	20 Year	5.9%	3.0%	8.9%	33.6%
10 Year	10.1%	2.1%	12.2%	17.4%	10 Year	5.2%	3.2%	8.4%	38.5%
5 Year	9.5%	1.9%	11.4%	16.8%	5 Year	5.7%	3.3%	9.1%	36.7%
2 Year	-0.1%	1.5%	1.4%	109.9%	2 Year	3.9%	3.2%	7.1%	44.8%
1 Year	0.9%	1.7%	2.6%	65.5%	1 Year	-0.6%	3.4%	2.8%	121.9%

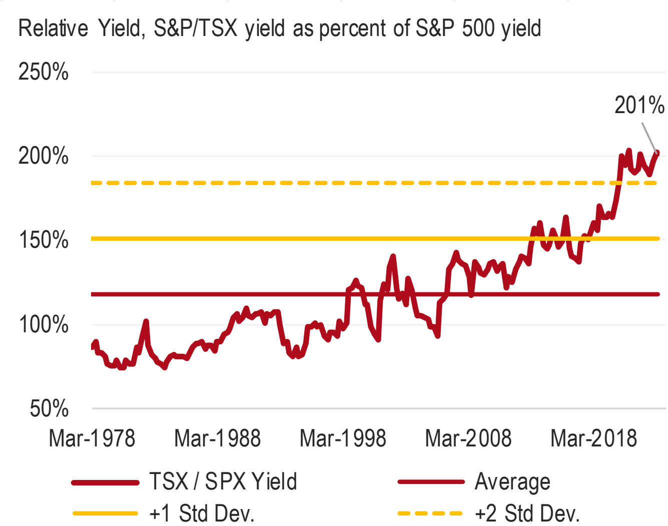
Source: TSE, Bloomberg and CIBC World Markets Inc.

The S&P/TSX offers the best relative yield in over 50 years.

It is also interesting to note that Canadian companies have become even more focussed on dividends than have U.S. peers. As we show in Exhibit 2 graphs, yields in Canada lagged those in the U.S. before the Financial Crisis, but since, Canadian companies have become dividend converts and today, Canadian yields are a multiple of the yield on the S&P 500.

Exhibit 2: S&P 500 And S&P/TSX Comp. – Dividend Yields And Relative Yields, 1978-2023





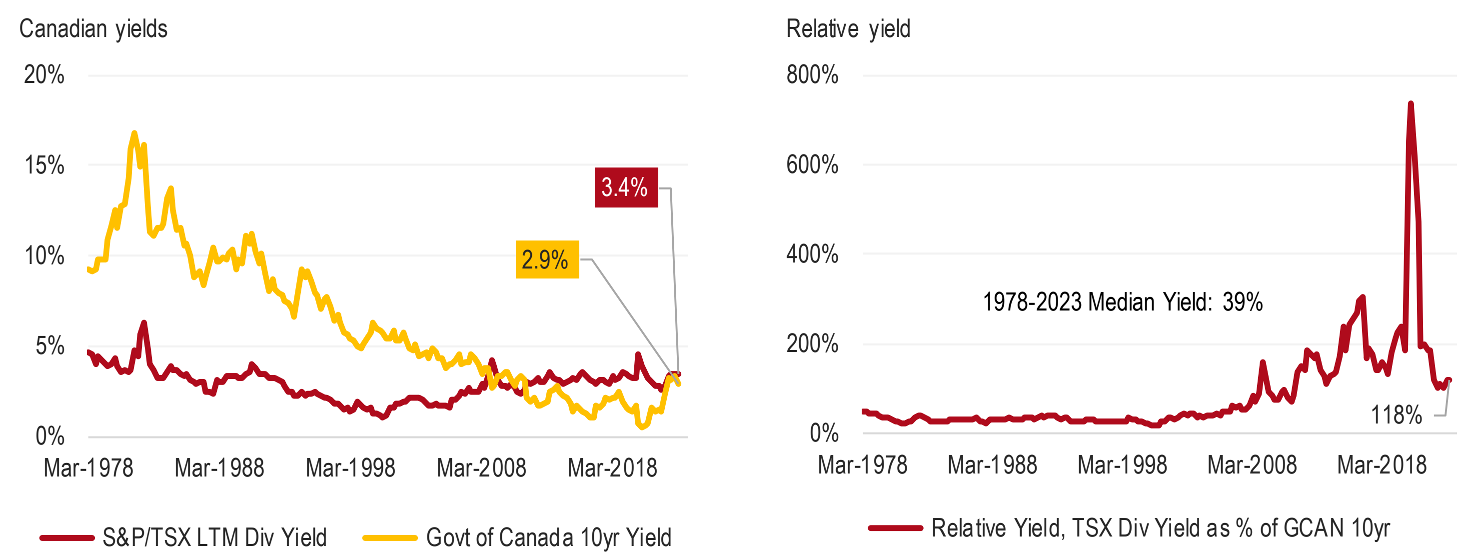
Source: TSE, Bloomberg and CIBC World Markets Inc.

Dividends are always more stable than buybacks.

This is to some extent a shift in Canada, but also in the U.S. where buybacks are more meaningful. Of course, in the current uncertain economic environment, dividends should have more appeal for equity investors. It goes without saying that companies will reduce buybacks well in advance of considering a dividend cut!

Canadian yields should not only be considered in the context of U.S. equities – they should also be considered against the prevailing interest rate environment. In Exhibit 3 graphs, we show Canadian equity yields and those yields offered on Canadian Government 10-year bonds. Note that though interest rates have certainly risen from COVID lows, dividend yields are still very attractive vis-à-vis bond yields.

Exhibit 3: Canadian Relative Yield – S&P/TSX Comp. Dividend Yield And Govt. Of Canada 10yr Yield, 1978-2023



Source: FRED, TSE, Bloomberg and CIBC World Markets Inc.

Even vis-a-vis the higher rates, dividend yield looks attractive.

At 3.4% currently, the dividend yield on the S&P/TSX index can be compared to the Canadian 10-year government yield of 2.9%. For high-income Canadians who face a marginal rate of over 50% for interest income but 40% for dividend income, the after-tax yield on the S&P/TSX is currently 50% higher than on a Canadian government bond. No matter how you cut it, dividend yields on Canadian equities look attractive.

Of course, the reality is that government bonds are much lower risk. Dividends can, and sometimes are, cut. The quality of these dividends needs to be considered. To do this, we look at the history and composition on Canadian equity dividends to understand their stability.

It's Raining Dividends In Canada

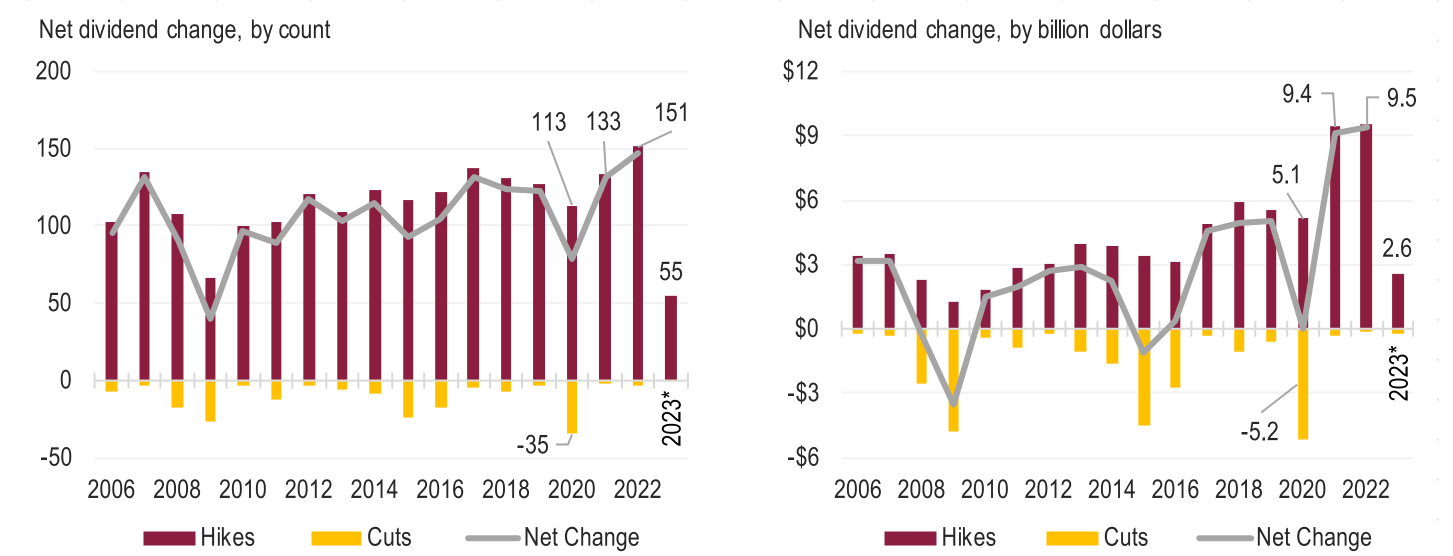
According to Van Gogh – great things are achieved by a series of small things brought together. That is certainly the situation that has occurred in the Canadian equity market when it comes to dividends.

Bumps in Bank, Pipeline, Telecom and Utility dividends have become so routine that most investors have missed the massive cumulative increase in dividends being paid by Canada's public companies. Specifically, S&P/TSX members have increased their annualized dividends by over 10% in each of 2021 and 2022.

A record number of Canadian companies have increased dividends.

From the Financial Crisis until COVID, dividend increases of $5 billion-$6 billion by the S&P/TSX members in any given year would be impressive. This number spiked substantially since COVID to over $9 billion in both 2021 and 2022, as we show in the chart on the right of Exhibit 4. The count (i.e., the number of companies that boosted dividends – the left-hand chart) has modestly increased, but even this number is striking. Note that in 2022 there were 151 incidents of companies increasing their dividends, while there are only ~240 members. The point being that well over half of all index constituents increased their dividends in 2022!

Exhibit 4: S&P/TSX Comp. – Net Dividend Change By Count And Dollar Time Series, Since 2006



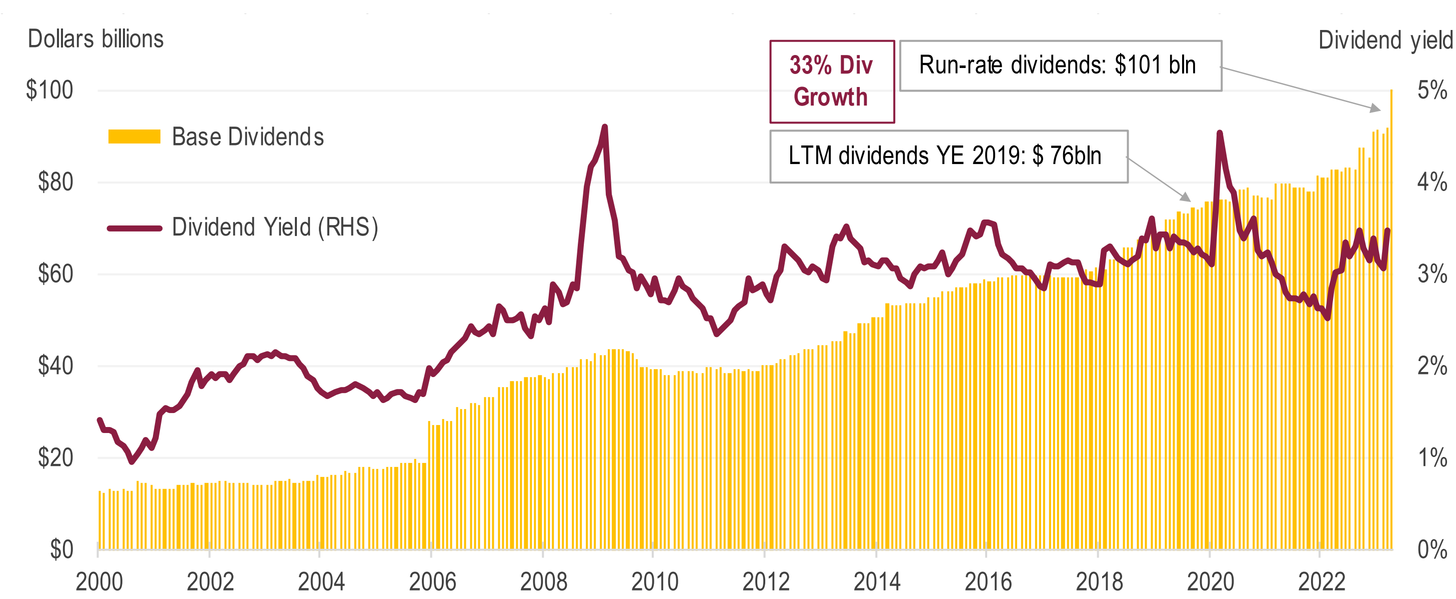
Note: 2023* data as of May 5, 2023. Source: Bloomberg, CapIQ, Refinitiv, Company reports and CIBC World Markets Inc.

33% dividend growth in just over three years.

Now, this analysis is distorted by the unique circumstances surrounding COVID, and the resulting shutdowns. As shown in Exhibit 4, we also experienced a large number of dividend cuts in 2020, amounting to $5.2 billion on an annualized basis. Clearly, some of the increases are simply either reintroduction or a return to more “normal” dividend levels, with Suncor and Cenovus as notable examples.

A more appropriate comparison is to consider aggregate dividends – not just cuts and increases, and this is shown in Exhibit 5 graph. At current levels, the S&P/TSX constituents are paying over $100 billion annually, compared to $76 billion before COVID.

Exhibit 5: S&P/TSX Comp. – Index Dividend Yield And Total Dollar Dividends, Since 2000



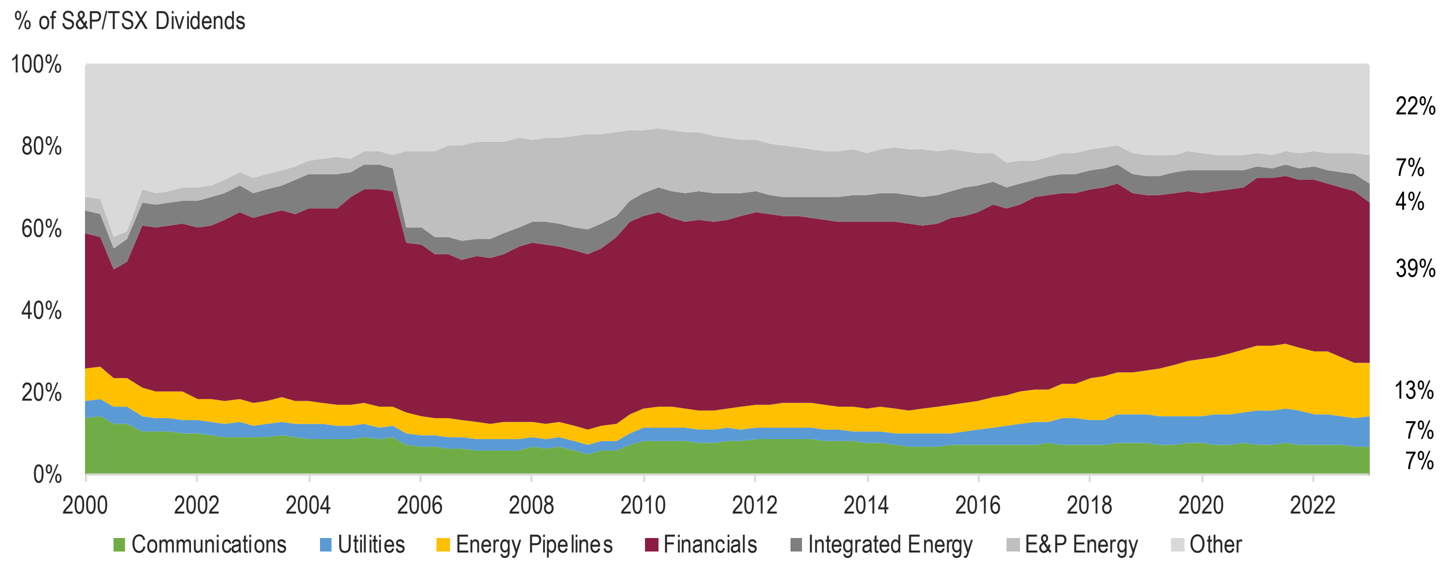
Note: Chart shows total trailing dividends, expect for the last bar which shows current (run-rate) dividends. Source: Compustat, TSE, Bloomberg and CIBC World Markets Inc.

Higher Dividends, And High-quality Dividend Payers

A dividend increase is rightly taken as a sign that management and the Board of Directors of a company are optimistic about the future. Having said this, there is a long history of dividend cuts in the S&P/TSX. As such, we need to consider the entities that are contributing to the over $100 billion in annual dividends.

As a starting point, we have built a 20+ year database of dividends to understand the changing contribution of different sectors to S&P/TSX aggregate dividends. As we show in Exhibit 6 graph, Financials have consistently been the largest contributor to overall dividends. The sector is large and Banks (and to a lessor extent, Insurers) have a track record of managing dividend pay-outs, so that they are able to handle the inherent cyclicality in their businesses without a high likelihood of dividend cuts.

Exhibit 6: S&P/TSX Comp. – Total Trailing Dividends Paid By Sector, Since 2000



Note: Values to the far right represent proportions based on most recent trailing dividend data. Source: Compustat and CIBC World Markets Inc.

Financials, Pipelines, Utilities and Telecom pay two-thirds of S&P/TSX dividends.

Other major sectors (and subsectors) that contribute to overall dividends unsurprisingly include the higher yield sectors – Communications, Utilities and Pipelines. In aggregate, these businesses (together with Financials) make up about two-thirds of overall S&P/TSX dividends – close to a record proportion.

In Exhibit 6, for general interest we also show dividends paid by the Integrated producers and the E&P companies (Energy). We would note that a significant component of the E&P dividends come from one company – Canadian Natural, which has never cut its dividend!

Income trust – boom and bust.

We would note the varying importance of the Energy sector, exclusive of the Pipelines, in the 2005 to 2010 period (Exhibit 6). An important factor here was the development of the income trust sector. Many Energy companies migrated to the income trust structure because of their extensive cash flow generation, and they became a significant proportion of overall index dividends. Legislation to change the tax treatment of the structure in 2006 (well remembered as the "Halloween Massacre") did provide a grace period until 2010, but effectively marked the beginning of the end for the structure. The variability caused by income trusts is also clearly visible in Exhibit 5.

A payout ratio is important, but future earnings are uncertain.

While payout ratios are certainly an indication of dividend resiliency, the reality is earnings are variable. Commodity businesses are typically at the mercy of global supply and demand, and even forecasted levels of profitability only carry so much weight.

One approach we prefer involves a long-term analysis of dividend increases and cuts by sector. While no individual company is immune from missteps or overly aggressive dividend increases, some sectors have well established track records of stable dividends over various economic cycles.

The "big four" have well established track records of stable dividends.

In Exhibit 7 table, we itemize all dividend increases and cuts by individual sectors, since 2006. We have separated the Energy Pipelines from the rest of the Energy sector for obvious reasons. The three sectors with the best track record of "net hikes" are Communications, Utilities and Financials. Pipelines show well but are less impressive than Industrials. However, Pipelines have had one of the lowest incidences of cuts – only matched by Information Technology, Staples and Discretionary, which are modest dividend payers. if history is a guide, one would assume there is less than a 2% chance of any Pipeline cutting its dividend in any given year.

Exhibit 7: S&P/TSX Comp. – History Of Dividend Hikes And Cuts By Sector, Since 2006

		Dividend Increases		Dividend Decreases		Net Hikes
Sector	Avg # of Div Payers	# Div Hikes Since 2006	Hikes Per Member/yr	# Div Cuts Since 2006	Cuts Per Member/yr	Per Member Per Year
Communication Services	6	110	1.14	3	0.03	1.10
Utilities	12	220	1.11	10	0.05	1.06
Financials	24	436	1.05	10	0.02	1.03
Industrials	19	333	1.03	35	0.11	0.92
Information Technology	2	29	0.79	0	0.00	0.79
Consumer Staples	11	135	0.71	1	0.01	0.71
Real Estate	19	185	0.58	18	0.06	0.53
Materials	27	232	0.50	30	0.06	0.43
Consumer Discretionary	17	103	0.37	7	0.02	0.34
Energy	40	258	0.38	69	0.10	0.27
Energy Pipelines	6	90	0.80	2	0.02	0.79
Non-Pipeline Energy	34	168	0.29	67	0.12	0.18
Health Care	2	11	0.26	4	0.10	0.17
All Sectors	**180**	**2,052**	**0.67**	**187**	**0.06**	**0.61**

Source: Bloomberg, CapIQ, Refinitiv, Company reports and CIBC World Markets Inc.

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