Why Airlines Should Raise Their Dividends And Retailers Shouldn't

Investors this summer are desperately seeking dividend payers because interest is impossible to achieve from bonds and the "conventional wisdom" is that the stock market is going no-where at the moment.

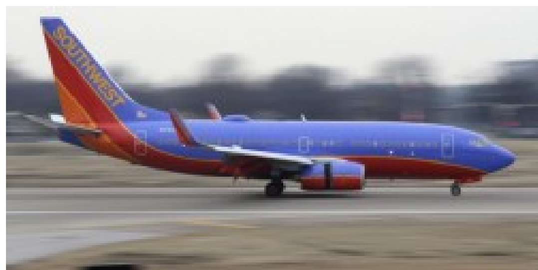
So, we took a look at the sectors and the companies that most need to increase their dividends as well as those that can, and should increase them. Dividend hikes would give investors a reason to take a second look at these stocks. To evaluate if a company can pay more dividends, we look at EBITDA/share, then EBITDA/sh/StockPrice. When we see double digit EBITDA/sh/StockPrice and still see very small dividends combined with growing earnings, we conclude these companies can pay higher dividends.

The worst offending sector is the airline sector. If you've flown recently you realize how busy airports are these days. You see flights that are completely over-booked. Passengers get nickeled and dimed for everything from seat selection to baggage fees. And all the benefits are accruing to the airlines balance sheets, not to airline investors.

Airline stocks are down an average of more than -15% this year already and if you include all of 2015 the average is worse than -20%. Increasing dividends would have the following positive effects on airline stocks:

- Stabilize their stock price – dividend payers have more stable stocks because investors are less likely to sell them during market volatility
- Attract an avalanche of investors who are desperate for INCOME!! This is probably the #1 question we get from investors, "Where can I get some income these days?"

The following are some relevant statistics about the airline sector. The dividend yields are tiny, yet these companies are making tons of cash.



Southwest Airlines (LUV) Photo Credit: Associated Press

- Southwest (LUV) div yield = 0.72%. Yet their P/E ratio is only 12. Their EBITDA/share = $7.89 which

is 18% of their stock price

- Delta (DAL) div yield = 1.3%. Yet their P/E ratio is only 7. Their EBITDA/share = $11.64 which is 26% of their stock price
- American (AAL) yield = 1.27%. Yet their P/E is only 3. Their EBITDA/share = $13.98 which is 42% of their stock price
- United (UAL) yield = 0.0%. Yet their P/E is only 2. Their EBITDA/share = $20.87 which is 45% of their stock price

What does it all mean?

As an activist, or hedge fund manager, If I buy an airline today (the whole airline so I am 100% owner), and I picked American Air, using EBITDA I would make all my cash spent back in 2.5 years and after that, all my earnings would be pure profit to me! Don't believe in EBITDA? Ok, fine. The P/E is only 3. So, using bottom line earnings, in 3 years (assuming stable, not even growing earnings), I get all my cash from the purchase back, AND every year after that is pure profit. That seems to be a pretty good way to spend $18billion if you have it lying around. Otherwise, just buy 5% of the stock and join the board of directors lobbying for dividend increases and stock buy-backs.

Investors either don't know about this, or don't believe that airlines can continue their earnings growth, or even remain stable for the next few years.

There are many other offenders in the Transportation sector including many Railroads with double digit EBITDA/Share/StockPrice:

- GWR (17%), CSX (16%), NSC (16%), UNP (13%). Some of these have "reasonable" dividends but should be increasing them

Multimedia is another sector with many offenders where these companies are making a lot of cash and need to be returning MORE to investors:

- CSCSA (17%), TWX (14%), DISCA (18%) and CBS (13%)
- VIAB (20%). Even though Viacom pays 4% dividend, it could go higher

There are also a few in the home building sector:

Pulte Homes (PHM) Source: Justin Sullivan/Getty Images

- LEN (11%), TOL (11%), PHM (Pulte 14%)

Insurance Companies/ Non-bank financials:

- BRK-A (13%), HIG (12%), LM (15%), MET(16%). While LM and MET have reasonable dividends, they could pay more.

Utilities are chock-full of companies with high earnings and amazingly high EBITDA/Sh/StockPrice. But they are already paying high dividends. If you look at the utility business as a highly regulated "Cost+" type business, as costs for fuel like nat gas have come down, the regulators will force them to charge less. So Yields should not necessarily go up.

Other individual stock offenders that could dramatically increase their dividends:

- GILD (20%) and AAPL (15%)

CAUTION: There are lots of stocks that appear to be offenders in the Retail space. Avoid these since many of these stocks are weak. Their relatively high EBITDA/share/StockPrice is actually reflecting a weak stock price instead of strong earnings/share.

- GPS (30%) with 5% dividend but likely to get a dividend cut. JWN (17%) with 3.78% dividend but struggling and may get a dividend cut
- Same is true with AEO (19%), ANF (20%), BKE (23%)
- The opposite is true for DKS (17%) who could be paying more than the current 1.49% dividend due to strength and decreasing competition

Again, CAUTION with the Energy space. These have some relatively high ratios, but have struggled with weak oil prices. Recovery is happening, but don't assume that just because CHK, WPX, and ETP have over 20% EBITDA/Sh/StockPrice that their dividends will be going up. Or in the case of ETP the dividend may be cut.

Again, CAUTION with Mining. Chock- full of high ratios, but the past few years have been nothing but cruel to these companies which drives down stock prices. They have rebounded some this year, but investors should remain cautious. Realize that if the globe does begin to churn out higher global growth, and commodities continue to recover, the earnings for these companies will improve and the dividends will start to flow.

Industrials are not unlike the Mining sector. Industrial companies have experienced a tough couple years. Take your signal from global growth, not from EBITDA/Sh/StockPrice. Most of these already pay sizable dividends.

Given this information what observations can investors make?

- If you've got the stomach as an investor to wait, it's a good bet that many of the companies identified above will be increasing their dividends soon. Not only will you get paid more for holding them, but a dividend increase could spark the stock price.
- If you would rather wait than jump into these stocks before dividends rise, at least be on the lookout for announcements from these companies. In some respects, these companies are an answer to the central question on investor's minds, "Where can I get some income these days?".

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