Australian Dividend Investing for Neophyte by Isol

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A well-designed portfolio of high dividend paying stocks is a great foundation upon which to build a strategy to achieve financial independence. It is the passive income which grants us financial freedom. There is no point in being asset-rich if we are cash-flow poor. In this article I will discuss how beginners can get start in stock market with Australian dividends investing.

What is ASX Dividend?

ASX dividends are payments made out of earnings from a company to its shareholders. What is paid the portion of profits which a company doesn't need in order to maintain and grow the business? The answer is that it is the reward which shareholders receive in return for providing capital to the business. Along with capital gains, it is how an investor profits from buying shares.

Dividend Yield

The dividend yield is simply the amount of a company's annual dividend payments by the current share price expressed as a percentage. So a company paying an annual amount of $0.25 with a current share price of $5.00 has a yield of 5%. You don't really need to calculate this figure though because it is published in the financial pages of many newspapers, is available in the research section of many online stock brokers and can also be found on financial portals like Yahoo Finance.

Dividend yield is sometimes compared to the interest rate on a bank account. They are similar in that they both express the cash return an investor receives as a percentage of the original investment. However it is important to remember that a dividend is paid at the discretion of the company's management.

Dividend Reinvestment

Another important concept in the world of Australian dividend stocks is the DRP or dividend reinvestment plan. In simple terms a DRP is a mechanism whereby investors can elect to receive their payments in shares in lieu of cash. So instead of receiving a cash payment, the investor will receive an equivalent amount in shares. An investor who is entitled to a total of $500 in payment from a company whose shares are trading at $5.00 would instead receive 100 new shares.

Build A Income Oriented Investment Portfolio

Building the ideal income oriented investment portfolio should be a simple matter of buying a group of high dividend yield stocks then sitting back to watch the cash roll in. While in theory this is the case, in practice a serious share investor will need to dig a little deeper.

ASX Dividend Payout Ratio

When buying shares for income, you want to see is for the level of income to fall, or even worse - to stop all together. For this reason it pays to look at the payout ratio. This ratio is simply the amount of Australian dividends paid as a percentage of net profit. What we are looking for is a ratio of 100% or less. If the payout ratio is greater than 100% this means a company has paid out more than it earns and this can't continue for long. The ASX dividends rate will need to fall - and so will your income.

Sustainable dividends

Now we have established a company to earn at least as much money as it pays out but in order to create a stable income we also need to make sure those earnings are stable. For this reason we need to look at the company's history of profitability. We want to see net profit after tax being stable or preferably growing over a number of years. We had also liked to see a history of paying dividends. Look back over the past 5 years and make sure the company is paying a regular dividend.

Rising Dividends

While you are checking on the dividend history, check to see whether the amount paid is rising each year. A rising dividend is good for two reasons. Firstly, it normally indicates a growing company in good financial shape. Secondly it means that your income will grow along with it.

You have to do some homework

I would like to say you that stock market investing does require some work. Doing the research required to whittle down the list of investment opportunities to those with the best prospects takes time. But I think it's worth it. Watching the steady stream of passive income which results from Australian dividend investing is rewarding in more ways than one.

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