November 4, 2014

Five reasons to stick with 3M for the long run

By JOHN HEINZL

This well-diversified company offers some 50,000 products, and has raised its dividend in each of the past 56 years

John Heinzl is the dividend investor for Globe Investor's Strategy Lab[1]*. Follow his contributions* here[2]*. You can see his* model portfolio here[3]*.*

When it comes to dividend yields, good things sometimes come in small packages.

Consider 3M Co.

Over the past decade, the stock's yield has averaged just 2.4 per cent – not enough to get most dividend investors out of bed. Yet 3M's dividend and share price have both grown steadily, producing an impressive total return – assuming all dividends were reinvested – of 155 per cent for the 10 years ended Oct. 31.

That works out to 9.8 per cent on an annualized basis, which tops the S&P 500's annualized total return – also including dividends – of 8.2 per cent for the same period, according to Bloomberg.

These are backward-looking numbers, of course, but there are reasons to believe that 3M will continue to generate solid returns. What the stock does in the short term is anybody's guess – it's had a big run lately and could be due for a pullback – but over the long term I expect investors will be rewarded nicely.

Here's why:

It's a dividend powerhouse

3M has paid dividends without interruption for 97 years, and it has increased its dividend annually for 56 consecutive years. Last year's increase was an unusually large 35 per cent, which the company attributed to a more aggressive capital structure and "the confidence we have in the sustained performance of 3M in the future."

Shareholders shouldn't expect such outsized increases every year; 3M said it intends to raise its dividend, which now yields 2.2 per cent, roughly in line with earnings growth.

"We view 3M's dividend as one of the safest in the industrials sector," Edward Jones analyst Matt Arnold said in a recent note. Given the company's strong balance sheet, more than $4-billion of annual free cash flow and diverse business lines, "we remain confident in 3M's ability to uphold its dividend record."

It's highly diversified

Mention 3M and most people think of Scotch Tape and Post-it Notes. But the company makes about 50,000 other products, generating more than $30-billion (U.S.) in annual sales across its six business segments: consumer and office products, display and graphics, electronics and communication, health care, industrial and transportation, and safety and protection.

From the reflective material in road signs to furnace filters to orthodontic appliances, 3M has a presence in virtually every corner of the economy.

If one sector experiences a slowdown, another area of 3M's business can pick up the slack.

It's constantly innovating

The company spends about 5 per cent of its revenue – or about $1.6-billion annually – on research and development. This results in a constant flow of new products and improvements to existing ones. Innovations in one sector can often be applied to products in another, maximizing the value of the company's R&D spending.

"In addition, 3M bundles multiple technologies together ... to improve product performance and justify a premium selling price," Odlum Brown analyst Stephen Boland said in a note. "The 3M brand itself garners great respect across a broad range of businesses."

It's levered to emerging markets

The company generates more than 60 per cent of its sales outside the United States, allowing it to capitalize on the faster-growing economies of China, India and other developing markets. "Countries around the world, especially emerging markets, are also noting an increase in urbanization and a rising middle class, which should drive the demand for more goods and services," Mr. Arnold said. "3M is well positioned to participate in global economic growth."

It's not outrageously expensive

Notice I didn't say the stock is cheap – it isn't. After the recent share-price gains triggered by better-than-expected third-quarter results, 3M trades at about 18.6 times estimated 2015 earnings. That's a premium multiple, but it's justified given the company's strong growth prospects, according to some analysts. Of the 21 analysts who follow the company, nine rate it a "buy," 11 a "hold" and one a "sell," according to Bloomberg.

I think 3M is a great company whose dividend will almost certainly grow for many years to come. However, I would be nervous buying it at these levels, particularly with the Canadian dollar trading at just 87.64 cents (U.S.). For those reasons, I am putting 3M on my "wish list" for now. If the Canadian dollar strengthens appreciably or 3M's stock hits a rough patch, I would consider purchasing the shares as a long-term investment.