DIVIDENDS: JUST THE FACTS!

Dividends are sticky.
The Investment Decision
Invest in assets that earn a return greater than the minimum acceptable hurdle rate

The Financing Decision
Find the right kind of debt for your firm and the right mix of debt and equity to fund your operations

The Dividend Decision
If you cannot find investments that make your minimum acceptable rate, return the cash to owners of your business

Hurdle Rate
4. Define & Measure Risk
5. The Risk free Rate
6. Equity Risk Premiums
7. Country Risk Premiums
8. Regression Betas
9. Beta Fundamentals
10. Bottom-up Betas
11. The "Right" Beta
12. Debt: Measure & Cost
13. Financing Weights

Investment Return
14. Earnings and Cash flows
15. Time Weighting Cash flows
16. Loose Ends

Financing Mix
17. The Trade off
18. Cost of Capital Approach
19. Cost of Capital: Follow up
20. Cost of Capital: Wrap up
21. Alternative Approaches
22. Moving to the optimal

Financing Type
23. The Right Financing

Dividend Policy
24. Trends & Measures
25. The trade off
26. Assessment
27. Action & Follow up
28. The End Game

Valuation
29. First steps
30. Cash flows
31. Growth
32. Terminal Value
33. To value per share
34. The value of control
35. Relative Valuation

Set Up and Objective
1: What is corporate finance
2: The Objective: Utopia and Let Down
3: The Objective: Reality and Reaction

36. Closing Thoughts
First Principles

Maximize the value of the business (firm)

**The Investment Decision**
Invest in assets that earn a return greater than the minimum acceptable hurdle rate

- The hurdle rate should reflect the riskiness of the investment and the mix of debt and equity used to fund it.
- The return should reflect the magnitude and the timing of the cashflows as well as all side effects.

**The Financing Decision**
Find the right kind of debt for your firm and the right mix of debt and equity to fund your operations

- The optimal mix of debt and equity maximizes firm value

**The Dividend Decision**
If you cannot find investments that make your minimum acceptable rate, return the cash to owners of your business

- How much cash you can return depends upon current & potential investment opportunities
- How you choose to return cash to the owners will depend on whether they prefer dividends or buybacks

Maximize the value of the business (firm)
Steps to the Dividend Decision...

- **How much did you borrow?**
  - Cashflow from Operations
    - Cashflows to Debt (Principal repaid, Interest Expenses)
  - Cashflows from Operations to Equity Investors

- **How good are your investment choices?**
  - Reinvestment back into the business

- **What is a reasonable cash balance?**
  - Cash held back by the company

- **What do your stockholders prefer?**
  - Cash available for return to stockholders
  - Stock Buybacks
  - Dividends
I. Dividends are sticky

Dividend Changes at US companies

Increase
Decrease
No change
II. Dividends tend to follow earnings

S&P 500: Dividends and Earnings - 1960 to 2013
II. Are affected by tax laws...

In 2003

In the last quarter of 2012

- As the possibility of tax rates reverting back to pre-2003 levels rose, 233 companies paid out $31 billion in dividends.
- Of these companies, 101 had insider holdings in excess of 20% of the outstanding stock.
IV. More and more firms are buying back stock, rather than pay dividends...
V. And there are differences across countries...
Measures of Dividend Policy

- **Dividend Payout** = \( \frac{\text{Dividends}}{\text{Net Income}} \)
  - Measures the percentage of earnings that the company pays in dividends
  - If the net income is negative, the payout ratio cannot be computed.

- **Dividend Yield** = \( \frac{\text{Dividends per share}}{\text{Stock price}} \)
  - Measures the return that an investor can make from dividends alone
  - Becomes part of the expected return on the investment.
Dividend Payout Ratios

Dividend Payout Ratios in 2014

- Global
- US
Dividend Yields

Dividend Yields in 2014

- Global
- US
Figure 10.7: Life Cycle Analysis of Dividend Policy

<table>
<thead>
<tr>
<th>Years</th>
<th>Revenues</th>
<th>Earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>External funding needs</td>
<td>High, but constrained by infrastructure</td>
<td>High, relative to firm value.</td>
</tr>
<tr>
<td>Internal financing</td>
<td>Negative or low</td>
<td>Negative or low</td>
</tr>
<tr>
<td>Capacity to pay dividends</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Growth stage</td>
<td>Stage 1 Start-up</td>
<td>Stage 2 Rapid Expansion</td>
</tr>
</tbody>
</table>
Dividend Yields and Payout Ratios: Growth Classes

![Dividend Yields and Payout Ratios: By Growth Class](chart.png)
## Dividend Policy: Disney et al.

<table>
<thead>
<tr>
<th></th>
<th>Disney</th>
<th>Vale</th>
<th>Tata Motors</th>
<th>Baidu</th>
<th>Deutsche Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend Yield - Last 12 months</td>
<td>1.09%</td>
<td>6.56%</td>
<td>1.31%</td>
<td>0.00%</td>
<td>1.96%</td>
</tr>
<tr>
<td>Dividend Payout ratio - Last 12 months</td>
<td>21.58%</td>
<td>113.45%</td>
<td>16.09%</td>
<td>0.00%</td>
<td>362.63%</td>
</tr>
<tr>
<td>Dividend Yield - 2008-2012</td>
<td>1.17%</td>
<td>4.01%</td>
<td>1.82%</td>
<td>0.00%</td>
<td>3.14%</td>
</tr>
<tr>
<td>Dividend Payout - 2008-2012</td>
<td>17.11%</td>
<td>37.69%</td>
<td>15.53%</td>
<td>0.00%</td>
<td>37.39%</td>
</tr>
</tbody>
</table>
Task
Evaluate how much your company has paid out in dividends, relative to earnings & market cap.