DIVIDENDS: PEER GROUP ANALYSIS

Me too, Me too..
The Investment Decision
Invest in assets that earn a return greater than the minimum acceptable hurdle rate

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

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

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

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

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
The Peer Group Approach

- In the peer group approach, you compare your company to similar companies (usually in the same market and sector) to assess whether and if yes, how much to pay in dividends.

<table>
<thead>
<tr>
<th>Company</th>
<th>Dividend Yield 2013</th>
<th>Average 2008-12</th>
<th>Dividend Yield 2013</th>
<th>Average 2008-12</th>
<th>Comparable Group</th>
<th>Dividend Yield</th>
<th>Dividend Payout</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disney</td>
<td>1.09%</td>
<td>1.17%</td>
<td>21.58%</td>
<td>17.11%</td>
<td>US Entertainment</td>
<td>0.96%</td>
<td>22.51%</td>
</tr>
<tr>
<td>Vale</td>
<td>6.56%</td>
<td>4.01%</td>
<td>113.45%</td>
<td>37.69%</td>
<td>Global Diversified Mining &amp; Iron Ore (Market cap&gt; $1 b)</td>
<td>3.07%</td>
<td>316.32%</td>
</tr>
<tr>
<td>Tata Motors</td>
<td>1.31%</td>
<td>1.82%</td>
<td>16.09%</td>
<td>15.53%</td>
<td>Global Autos (Market Cap&gt; $1 b)</td>
<td>2.13%</td>
<td>27.00%</td>
</tr>
<tr>
<td>Baidu</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>Global Online Advertising</td>
<td>0.09%</td>
<td>8.66%</td>
</tr>
<tr>
<td>Deutsche Bank</td>
<td>1.96%</td>
<td>3.14%</td>
<td>362.63%</td>
<td>37.39%</td>
<td>European Banks</td>
<td>1.96%</td>
<td>79.32%</td>
</tr>
</tbody>
</table>
A closer look at Disney’s peer group

<table>
<thead>
<tr>
<th>Company</th>
<th>Market Cap</th>
<th>Dividends</th>
<th>Dividends + Buybacks</th>
<th>Net Income</th>
<th>FCFE</th>
<th>Dividend Yield</th>
<th>Dividend Payout</th>
<th>Cash Return/FCFE</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Walt Disney Company</td>
<td>$134,256</td>
<td>$1,324</td>
<td>$5,411</td>
<td>$6,136</td>
<td>$1,503</td>
<td>0.99%</td>
<td>21.58%</td>
<td>360.01%</td>
</tr>
<tr>
<td>Twenty-First Century Fox, Inc.</td>
<td>$79,796</td>
<td>$415</td>
<td>$2,477</td>
<td>$7,097</td>
<td>$2,408</td>
<td>0.52%</td>
<td>6.78%</td>
<td>102.87%</td>
</tr>
<tr>
<td>Time Warner Inc</td>
<td>$63,077</td>
<td>$1,060</td>
<td>$4,939</td>
<td>$3,019</td>
<td>$-4,729</td>
<td>1.68%</td>
<td>27.08%</td>
<td>NA</td>
</tr>
<tr>
<td>Viacom, Inc.</td>
<td>$38,974</td>
<td>$555</td>
<td>$5,219</td>
<td>$2,395</td>
<td>$-2,219</td>
<td>1.42%</td>
<td>23.17%</td>
<td>NA</td>
</tr>
<tr>
<td>The Madison Square Garden Co.</td>
<td>$4,426</td>
<td>$0</td>
<td>$0</td>
<td>$142</td>
<td>$-119</td>
<td>0.00%</td>
<td>0.00%</td>
<td>NA</td>
</tr>
<tr>
<td>Lions Gate Entertainment Corp</td>
<td>$4,367</td>
<td>$0</td>
<td>$0</td>
<td>$232</td>
<td>$-697</td>
<td>0.00%</td>
<td>0.00%</td>
<td>NA</td>
</tr>
<tr>
<td>Live Nation Entertainment, Inc</td>
<td>$3,894</td>
<td>$0</td>
<td>$0</td>
<td>$-163</td>
<td>$288</td>
<td>0.00%</td>
<td>NA</td>
<td>0.00%</td>
</tr>
<tr>
<td>Cinemark Holdings Inc</td>
<td>$3,844</td>
<td>$101</td>
<td>$101</td>
<td>$169</td>
<td>$-180</td>
<td>2.64%</td>
<td>63.04%</td>
<td>NA</td>
</tr>
<tr>
<td>MGM Holdings Inc</td>
<td>$3,673</td>
<td>$0</td>
<td>$59</td>
<td>$129</td>
<td>$536</td>
<td>0.00%</td>
<td>0.00%</td>
<td>11.00%</td>
</tr>
<tr>
<td>Regal Entertainment Group</td>
<td>$3,013</td>
<td>$132</td>
<td>$132</td>
<td>$145</td>
<td>$-18</td>
<td>4.39%</td>
<td>77.31%</td>
<td>NA</td>
</tr>
<tr>
<td>DreamWorks Animation SKG Inc.</td>
<td>$2,975</td>
<td>$0</td>
<td>$34</td>
<td>$-36</td>
<td>$-572</td>
<td>0.00%</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>AMC Entertainment Holdings</td>
<td>$2,001</td>
<td>$0</td>
<td>$0</td>
<td>$63</td>
<td>$-52</td>
<td>0.00%</td>
<td>0.00%</td>
<td>NA</td>
</tr>
<tr>
<td>World Wrestling Entertainment</td>
<td>$1,245</td>
<td>$36</td>
<td>$36</td>
<td>$31</td>
<td>$-27</td>
<td>2.88%</td>
<td>317.70%</td>
<td>NA</td>
</tr>
<tr>
<td>SFX Entertainment Inc.</td>
<td>$1,047</td>
<td>$0</td>
<td>$0</td>
<td>$-16</td>
<td>$-137</td>
<td>0.00%</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Carmike Cinemas Inc.</td>
<td>$642</td>
<td>$0</td>
<td>$0</td>
<td>$96</td>
<td>$64</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.27%</td>
</tr>
<tr>
<td>Rentrak Corporation</td>
<td>$454</td>
<td>$0</td>
<td>$0</td>
<td>$-23</td>
<td>$-13</td>
<td>0.00%</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Reading International, Inc.</td>
<td>$177</td>
<td>$0</td>
<td>$0</td>
<td>$-51</td>
<td>$15</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Average</td>
<td>$20,462</td>
<td>$213</td>
<td>$1,083</td>
<td>$1,142</td>
<td>$-232</td>
<td>0.85%</td>
<td>41.28%</td>
<td>79.02%</td>
</tr>
<tr>
<td>Median</td>
<td>$3,673</td>
<td>$0</td>
<td>$34</td>
<td>$129</td>
<td>$-27</td>
<td>0.00%</td>
<td>6.78%</td>
<td>5.63%</td>
</tr>
</tbody>
</table>
Going beyond averages... Looking at the market

- Regressing dividend yield and payout against expected growth across all US companies in January 2014 yields:

\[
\begin{align*}
\text{PYT} &= 0.649 - 0.296 \text{ (BETA)} - .800 \text{ (EGR)} + .300 \text{ (DCAP)} \quad R^2 = 19.6\% \\
&\quad (32.16) \quad (15.40) \quad (8.90) \quad (7.33) \\
\text{YLD} &= 0.0324 - .0154 \text{ (BETA)} - .038 \text{ (EGR)} + .023 \text{ (DCAP)} \quad R^2 = 25.8\% \\
&\quad (38.81) \quad (19.41) \quad (13.25) \quad (13.45)
\end{align*}
\]

PYT = Dividend Payout Ratio = Dividends/Net Income
YLD = Dividend Yield = Dividends/Current Price
BETA = Beta (Regression or Bottom up) for company
EGR = Expected growth rate in earnings over next 5 years (analyst estimates)
DCAP = Total Debt / (Total Debt + Market Value of equity)
Using the market regression on Disney

- To illustrate the applicability of the market regression in analyzing the dividend policy of Disney, we estimate the values of the independent variables in the regressions for the firm:
  - Beta for Disney (bottom up) = 1.00
  - Disney’s expected growth in earnings per share = 14.73% (analyst estimate)
  - Disney’s market debt to capital ratio = 11.58%

- Substituting into the regression equations for the dividend payout ratio and dividend yield, we estimate a predicted payout ratio:
  - Predicted Payout = 0.649 – 0.296 (1.00) – 0.800 (.1473) + 0.300 (.1158) = .2695
  - Predicted Yield = 0.0324 – 0.0154 (1.00) – 0.038 (.1473) + 0.023 (.1158) = .0140

- Based on this analysis, Disney with its dividend yield of 1.09% and a payout ratio of approximately 21.58% is paying too little in dividends. This analysis, however, fails to factor in the huge stock buybacks made by Disney over the last few years.
The problem with changing dividends

- Investors pick companies based on dividend policy and companies generally pick dividend policies that reflect their characteristics (growth, reinvestment needs etc.)

- When a company’s characteristics change, and it needs to change its dividend policy, the clientele may not react well to the change, no matter how well intentioned.
Dividend Policy and Clientele

Assume that you run a phone company, and that you have historically paid large dividends. You are now planning to enter the telecommunications and media markets. Which of the following paths are you most likely to follow?

a. Courageously announce to your stockholders that you plan to cut dividends and invest in the new markets.

b. Continue to pay the dividends that you used to, and defer investment in the new markets.

c. Continue to pay the dividends that you used to, make the investments in the new markets, and issue new stock to cover the shortfall.

d. Other
Time for a reset on dividends

- Dividends, as we know them, were designed and structured for equity investments a century ago, when these investments were competing with bonds for investor money.

- In today’s unpredictable and uncertain world, equity investments in most businesses cannot be viewed as bonds (fixed dividend yield) with price appreciation.

- Thus, the notion of fixed dividends may have to be abandoned for more flexible dividends, and this may already be happening in the shift to buybacks.
Task
Relative to the sector in which your company operates, evaluate whether it returns too much or too little cash.