Dividends:
Room for a larger payout

This is the first of two special reports on dividends.

Companies that pay dividends demonstrate i. confidence in their ability to generate growing earnings ii. that its earnings are real and iii. admit, to an extent, that businesses cannot grow indefinitely, and that they need to start returning money to shareholders. Investors like getting dividends: they can spend the money to purchase more shares or spend it on something else. And if they are institutional investors, they themselves can dividend this out. Consequently dividends play an important role for most shareholders, including institutional investors, who consider this critical in their stock selection process.

Companies are showing limited enthusiasm to invest and are sitting on a larger cash-pile than before. Investors have passively pocketed whatever dividend they received. There is a compelling case for them to ask and for companies to pay more.

IiAS studied the dividend payout data of S&P BSE500 companies for the five year period between 2007-08 and 2011-12. The general patterns and trends observed in our analysis are discussed in the first of two special reports. In the second report we have identified companies from the S&P BSE200 that can pay higher dividends.

Chart 1: S&P BSE 500 - Dividend Vs PAT (Rs. bn)

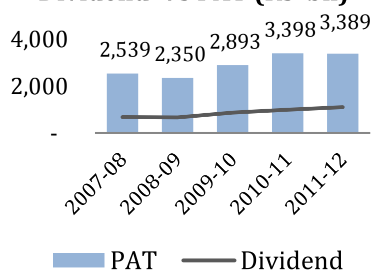
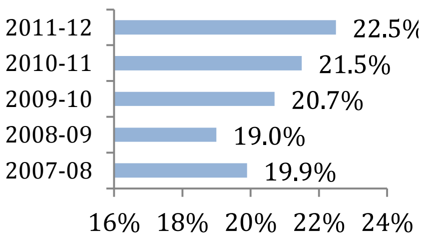


Chart 2: S&P BSE500 - Dividend Payout Ratios (Median)



Source: CMIE data, IiAS Research

Key trends:

- In aggregate, S&P BSE500 companies increased dividends by 64% to Rs.1,106 bn, between 2007-08 and 2011-12. This outpaced its bottom-line growth of 33% to Rs.3,389 bn (refer Chart 1).
- The median payout ratio for these 500 companies increased from 19.9% in 2007-08 to 22.5% in 2011-12 (Chart 2). Average payouts were higher at 26.4% in 2008-09 and 32.6% in 2011-12. This is despite the fact that over 200 companies in the S&P BSE500 index had a lower dividend payout in FY12 than in FY08.
- Despite this increase in payouts, data shows that companies have been accumulating cash over the five year period. Aggregate closing cash balances and non-core investments with companies, excluding banks and NBFCs, grew by 21% from Rs.1,853 bn in 2007-08 to Rs.2,248 bn in 2011-2012. Non-core investments include investments in mutual funds, equity shares, debentures and preference shares of non-group companies and government bonds (- hereinafter referred to as 'investments')

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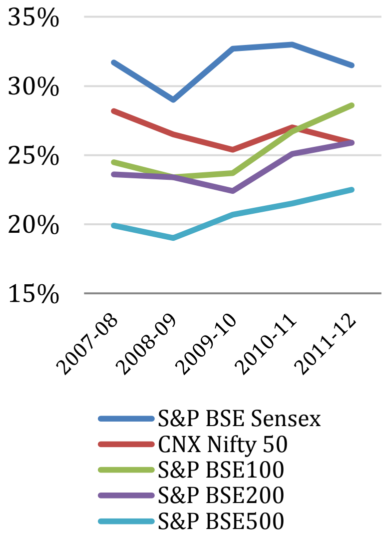
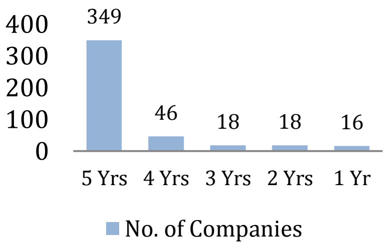
Note: In preparing this report IiAS has relied on data provided by CMIE. Unless specified percentages refer median data. Standalone company data has been used for our analysis. Note the analysis is based on FY12 data.

Chart 3: Dividend Payout Ratio - Indices



Source: CMIE data, IiAS research

Chart 4: S&P BSE500 Companies declaring dividends consistently



Source: CMIE data, IiAS research

- Amongst the broader indices, S&P Sensex companies have consistently had the highest dividend payouts since 2007-08 with 31.5% in 2011-12. Data indicates that the payout ratios of both S&P Sensex and CNX Nifty 50 companies have fallen by over 100 basis points in comparison to the earlier year (- refer Chart 3). Profits for both indices rose faster than dividends in FY12. In contrast the S&P BSE100 companies improved payouts from 24.5% in 2007-08 to 28.6% in 2011-12, but only because profits rose at a slower clip than increase in dividends. The S&P BSE500 companies showed, by far, the lowest payout in comparison with other index companies during the five year window peaking to 22.5% in 2011-12 (- refer annex for average payouts).

- Of the S&P BSE500 index, 349 companies have consistently paid out dividends in the last five years. 46 companies have declared dividends in four out of five years since 2007-08, while 18 companies each have declared dividends in two and three financial years during this period. Put differently, 53 companies included in the S&P BSE500 index have not declared any dividends over the last five years.

- MNCs have the highest average payout ratios, of 42%, with median payout at 28% over the five year period. This is followed by professional companies (- with shareholding dispersed amongst institutions) and PSUs with average payouts at 37% and 32% (- median payout at 23% and 25% respectively). Promoter-owned companies have been the most miserly, with average payouts at 24% with median payout at 16% over the five year period. This is discussed in more detail in the next section.

- Between 2007-08 and 2011-12, capex has been funded by borrowings, equity issuances and plough back of earnings. Capital expenditure by S&P BSE500 companies, excluding banks and NBFCs, aggregated to Rs.12,056 bn over the five year period. During this period the total change in long term borrowings (-including NCDs, ECBs and Euro convertible bonds) was Rs.3,924 bn while the change in networth was Rs.11,370 bn (chart 5). Companies retained headroom for incremental payouts.

Chart 5: S&P BSE500 - Capex Vs Networth Vs LT Borrowings (Rs.Bn)

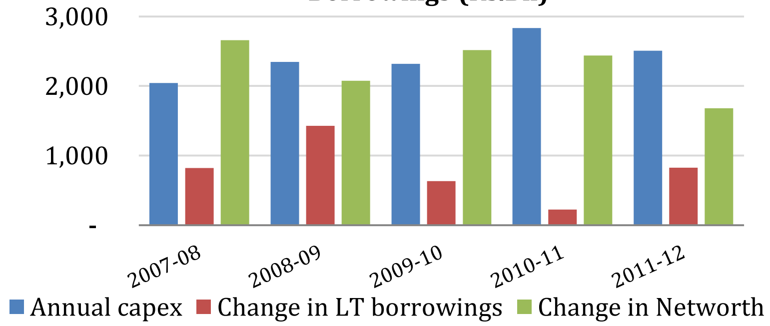


Chart 5: S&P BSE500 index excluding banks and NBFCs
Source: CMIE data, IiAS Research

Dividend trends: Based on ownership

In our analysis, we have classified companies into four broad categories based on equity ownership viz. (i) Foreign sponsors (- where a foreign multi-national company is the controlling shareholder) (ii) Professional companies (- where shareholding is dispersed amongst institutions) (iii) Promoter owned (- where an individual or a family is the controlling shareholder) (iv) and Public Sector Undertaking or PSU (- where the government of India is the controlling shareholder).

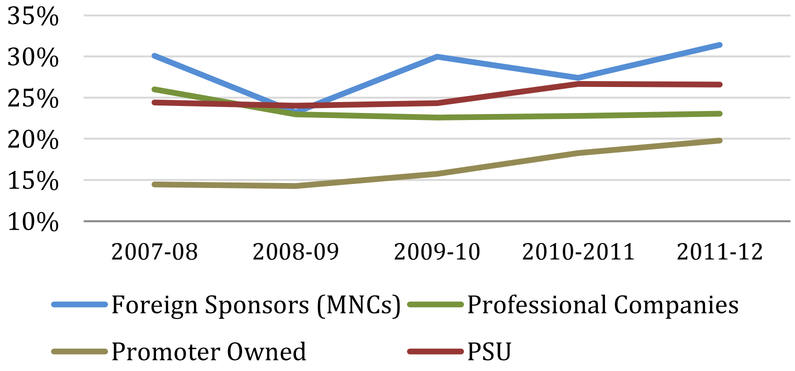
As, highlighted earlier, MNC's have the highest payout ratios, with an average of 42%, with median payout at 28% over the five year period. This may partly be due to foreign promoters' large equity holdings in Indian subsidiaries - enabling them to repatriate majority of the payout, in addition to royalties (- read our report on 'Royalty payments and minority shareholders'). The period under review has coincided with slow growth in developed markets, increasing pressure on Indian subsidiaries to pay more. In certain sectors like FMCG, where MNC's dominate, they have followed an 'asset lite' model, outsourcing production to local units, freeing cash to dividend.

Fiscal pressures have resulted in PSUs steadily increasing dividends over the five year period. While aggregated profits jumped by 44% to Rs.1,415 bn, dividends increased by 56% to Rs.472 bn in 2011-12 over 2007-08. Payouts stood at 27% in 2011-12.

Professional companies follow, with average payouts at 37% and median payout at 23% respectively between 2007-08 and 2011-12. Comprising mostly of banks and NBFCs, and a handful of manufacturers, these companies doubled their bottom-line while increasing dividend payouts by 125% over the five years.

Although promoter owned companies have increased payouts to 20% in 2011-12, median payout over the five year period remains at 16%, almost half that of MNC's. However, promoter companies exhibited the sharpest increase in payouts of 70% vis-à-vis others considering its profits grew by only 18% in 2011-12 over 2007-08. (- refer annex for average payouts)

Chart 6: Dividend Payout (Median) based on Equity Ownership



Source: CMIE data, IiAS Research

Recent payouts (2011-12)

IiAS analysis of data of 2011-2012 indicates that:

- Of the 457 profit making companies in S&P BSE500, only 409 declared dividends in FY12.
- 67 companies had payout ratios greater than 50%. Companies with dividend payouts consistently above 50% since 2007-08 include HCL Infosystems, GlaxoSmithKline Pharmaceuticals, Castrol India and Colgate-Palmolive.
- The payout ratios of the larger indices such as S&P BSE100, S&P BSE200 and S&P BSE500 increased while those of BSE S&P Sensex and CNX Nifty50 dropped in 2011-12 over 2010-11. As discussed this increase is explained by the fact that profits grew at a slower clip than increase in dividends, or growth in profits for the S&P BSE Sensex or CNX Nifty 50.
- Excluding loss making companies, 10 companies in the S&P BSE100, four in CNX Nifty50 and two in S&P BSE Sensex have not paid dividends or paid low dividends (payout <10%) in 2011-12.

As companies benefit from inclusions in frontline indices – they are able to attract a wider pool of investors and enjoy higher liquidity, we believe that these companies should declare a dividend. Dividend track record should be a criterion for index inclusion; companies skipping dividend should be excluded.

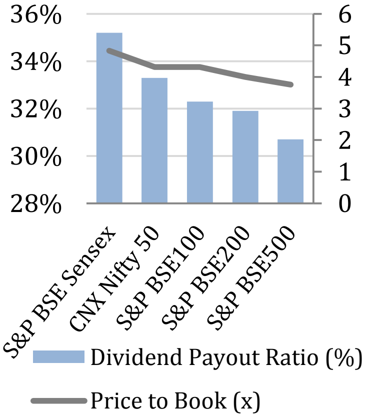
Table 1: Companies with nil or <10% payout (2011-12)

Company	Payout	S&P BSE Sensex	CNX Nifty 50	S&P BSE 100
Adani Power Ltd[2]	0.0%			✓
Bharti Airtel Ltd	7.7%	✓	✓	✓
Cairn India Ltd[1]	0.0%		✓	✓
G M R Infrastructure Ltd[1]	0.0%			✓
Housing Dev. & Infra. Ltd	0.0%			✓
Idea Cellular Ltd[1]	0.0%			✓
Jindal Steel & Power Ltd	7.2%	✓	✓	✓
Kotak Mahindra Bank Ltd	4.8%		✓	✓
Ranbaxy Laboratories Ltd[2]	0.0%		✓	✓
Reliance Power Ltd	0.0%			✓
Satyam Computer Services Ltd[1]	0.0%			✓
Suzlon Energy Ltd.[2]	0.0%			✓
Unitech Ltd[1]	0.0%			✓

[1]Did not pay any dividend in 2011-12. Proposes to pay/paid dividends for 2012-13
[2]Loss making companies in 2011-12.
Source: CMIE, IiAS research

Correlation between dividend and valuations

Chart 7: PB Vs Payouts (2011-12)



*Excludes loss making companies

Source: CMIE data, IiAS Research

As expected, we find that higher the dividend payout ratios, higher are the valuations (- refer annex for S&P BSE100 companies). Dividend paid is one of the factors that have a bearing on company valuations but markets read these as a sign of confidence in the companies to generate growing earnings.

Sensex companies had the highest dividend payout in 2011-12 with an average of 35.2%. Incidentally, these companies also showed higher valuations considering average price to book ratios (PB), as a surrogate, of 4.8x.

It may appear that this correlation does not apply to S&P BSE500 companies. The average payout for the index was higher than S&P BSE100 and S&P BSE200 at 32.6% for 2011-12, its price to book was lower at 3.8x. This de-linking is due to a relatively high number of loss making companies (41) in S&P BSE500 index vis-à-vis the other indices. Excluding these loss making companies, the correlation reasserts itself and shows with average payout at 30.7% and PB at 3.8x (Chart 7).

This does provide a clear market signal to companies: return more to shareholders.

Promoter Holdings Vs. Dividend Payouts

Although who owns the shares appears to impact dividend levels, the percentage of share ownership surprisingly does not appear to have a material impact on the dividend declared.

IiAS analysed the payout ratios of S&P BSE500 data based on extent of promoters' equity ownership i.e. (i) Less than 50% (ii) Between 50% and 75% and (iii) More than 75%.

As can be seen in table 2 below, the percentage of companies paying more than 50% dividend remains broadly unchanged across the three categories.

Chart 8: Promoter holdings Vs. Payouts

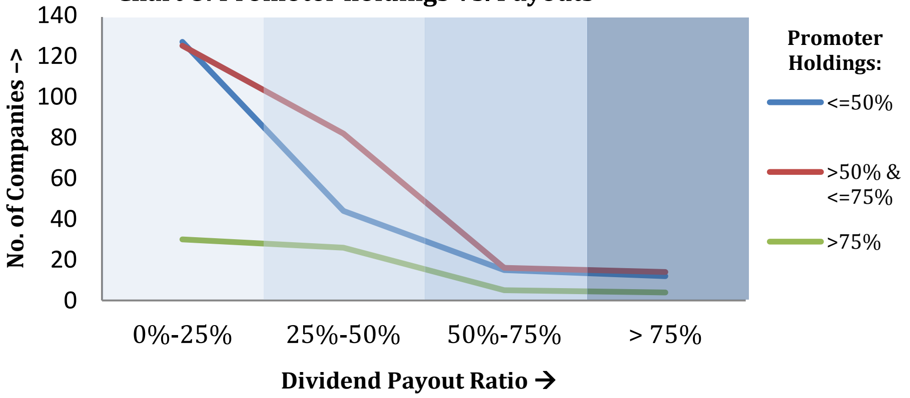


Table 2: S&P BSE 500 companies, ownership distribution

Promoter Holding	Dividend payout			
	0-25%	25%-50%	50%-75%	75%-100%
<=50%	64.1%	22.2%	7.6%	6.1%
>50% & <=75%	52.7%	34.6%	6.8%	5.9%
>75%	46.2%	40.0%	7.7%	6.2%

Source: CMIE data, IiAS Research

IiAS's View and Conclusion

- **Dividend policy**: Companies should state their dividend policy to shareholders. This should also be placed before shareholders' for ratification.
    - Companies that make profits and yet propose not to pay dividends in any given financial year in line with stated dividend policy should detail the reasons in the director's report.
- **Retention Policy**: While declaring dividends, companies should state the quantum of earnings they propose to retain. Managements should detail reasons for retaining this cash.
    - Companies that have large investments in non-core businesses should give the rationale for these investments and the timeframe for exiting them. This should be a part of the directors' report.
- Companies benefit from inclusions in frontline indices as they are able to attract a wider pool of investors. IiAS believes that companies that do not pay dividends should be excluded from the indices.

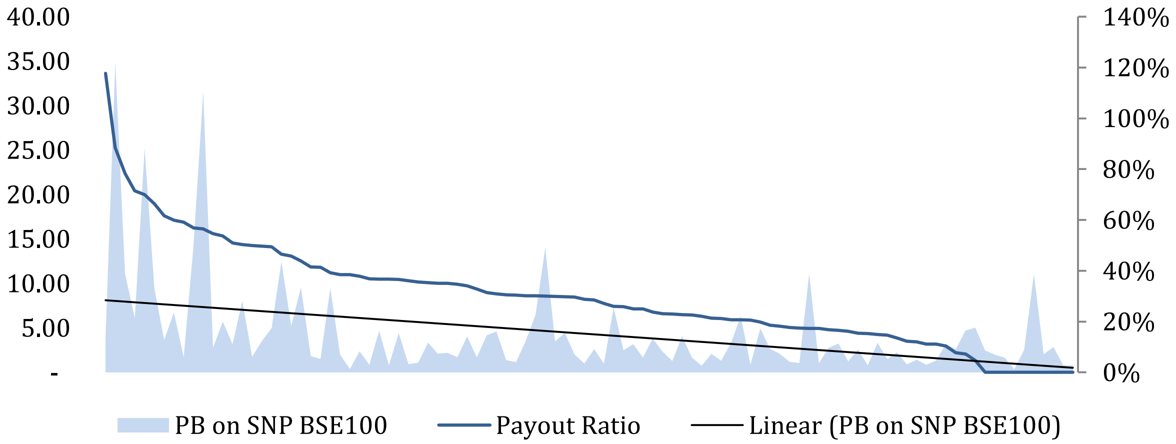
These moves will enable shareholders to better evaluate their cash expectations from investments.

Managements must remember that the cash is not theirs to keep, and needs to be returned to shareholders.

This is the subject of our second report.

Annexure

S&P BSE100 Index – Dividend Payout vs. Price to Book



Source: CMIE data, IiAS Research

Table 3: Equity ownership – Dividend Payouts

Average payouts	2007-08	2008-09	2009-10	2010-11	2011-12
Foreign Sponsors (MNCs)	44.0%	40.5%	35.0%	37.6%	52.4%
Professional Companies	32.7%	32.2%	41.9%	37.8%	36.3%
Promoter Owned	20.0%	21.9%	24.7%	24.7%	28.8%
PSU	30.8%	31.5%	33.1%	31.8%	33.4%

Source: CMIE data, IiAS Research

Table 4: Indices – Dividend Payouts

Average Payouts	2007-08	2008-09	2009-10	2010-11	2011-12
S&P BSE Sensex	31.7%	30.7%	35.5%	35.5%	35.2%
CNX Nifty 50	30.6%	29.9%	33.3%	32.8%	33.3%
S&P BSE100	27.4%	29.0%	31.6%	31.5%	32.3%
S&P BSE200	27.1%	28.4%	30.5%	29.4%	31.9%
S&P BSE500	26.4%	28.0%	30.2%	29.3%	32.6%

Source: CMIE data, IiAS Research

About IiAS

Institutional Investor Advisory Services India Limited (IiAS) is a proxy advisory firm, dedicated to providing participants in the Indian market with independent opinion, research and data on corporate governance issues as well as voting recommendations on shareholder resolutions for over 300 companies.

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