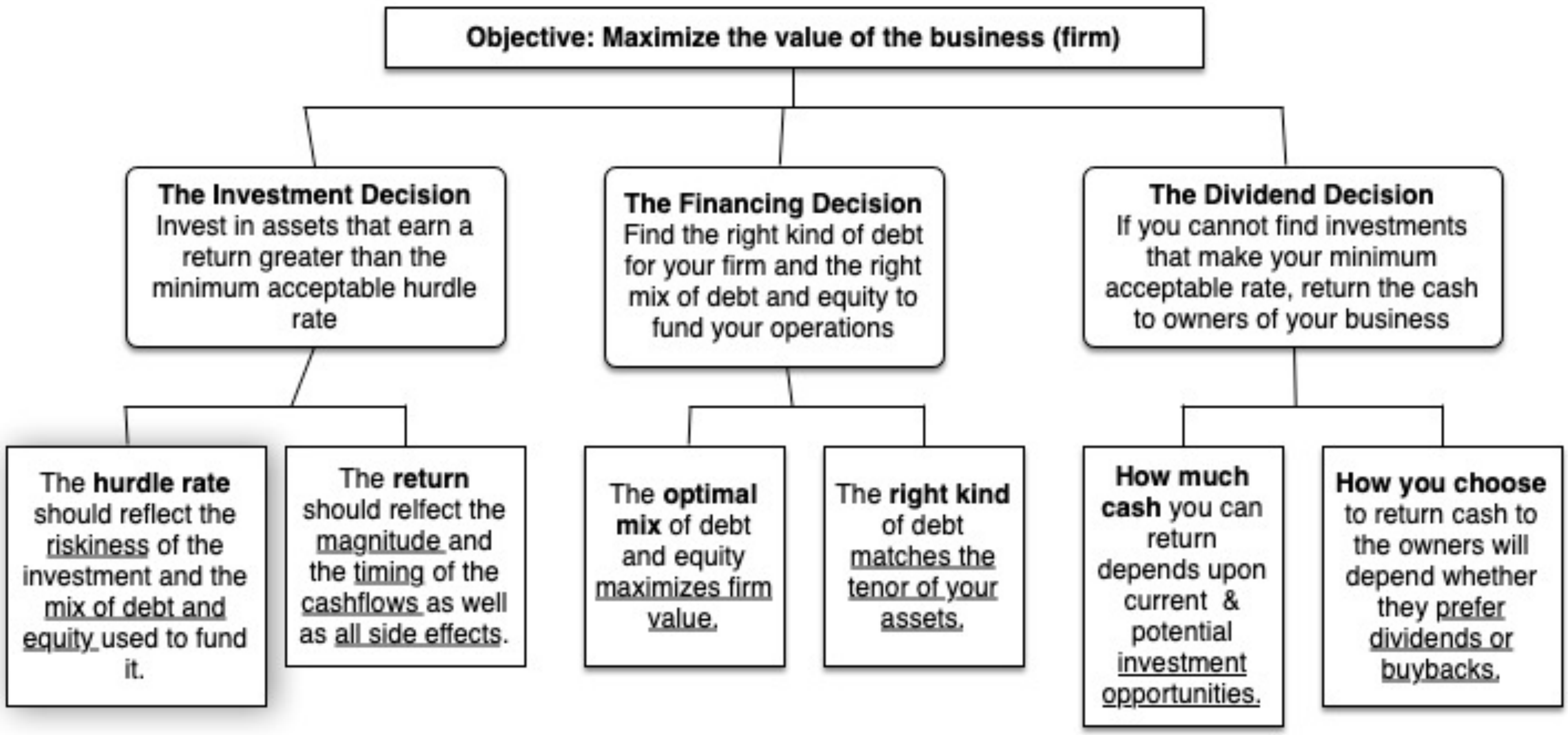
DATA UPDATE 7 FOR 2023: DIVIDENDS AND BUYBACKS

Seed and harvest!

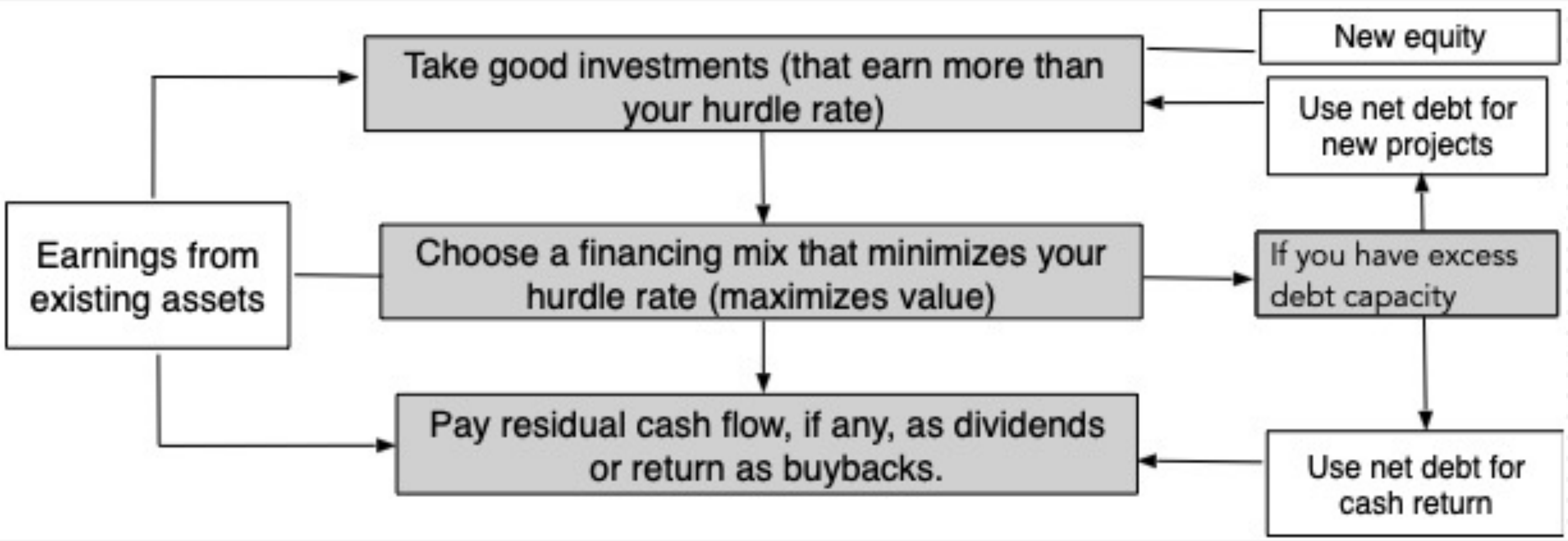
Data Update: Winding down…

- I plan to focus on dividends and buybacks, perhaps the most most misunderstood and misplayed aspect of corporate finance.
- To illustrate the heat that buybacks evoke, consider two stories in the last two weeks where buybacks have been in the news.
  - In the first, critics of Norfolk Southern, the corporation that operates the trains that were involved in a dreadful chemical accident in Ohio, pointed to buybacks that it had done as the proximate cause for brake failure and the damage.
  - In the second, Warren Buffet used some heated language to describe those who opposed buybacks, calling them "economic illiterates" and "silver tongued demagogues ".
- Going back in time to last year's inflation reduction act, buybacks were explicitly targeted for taxes, with the perspective that they were damaging US companies.

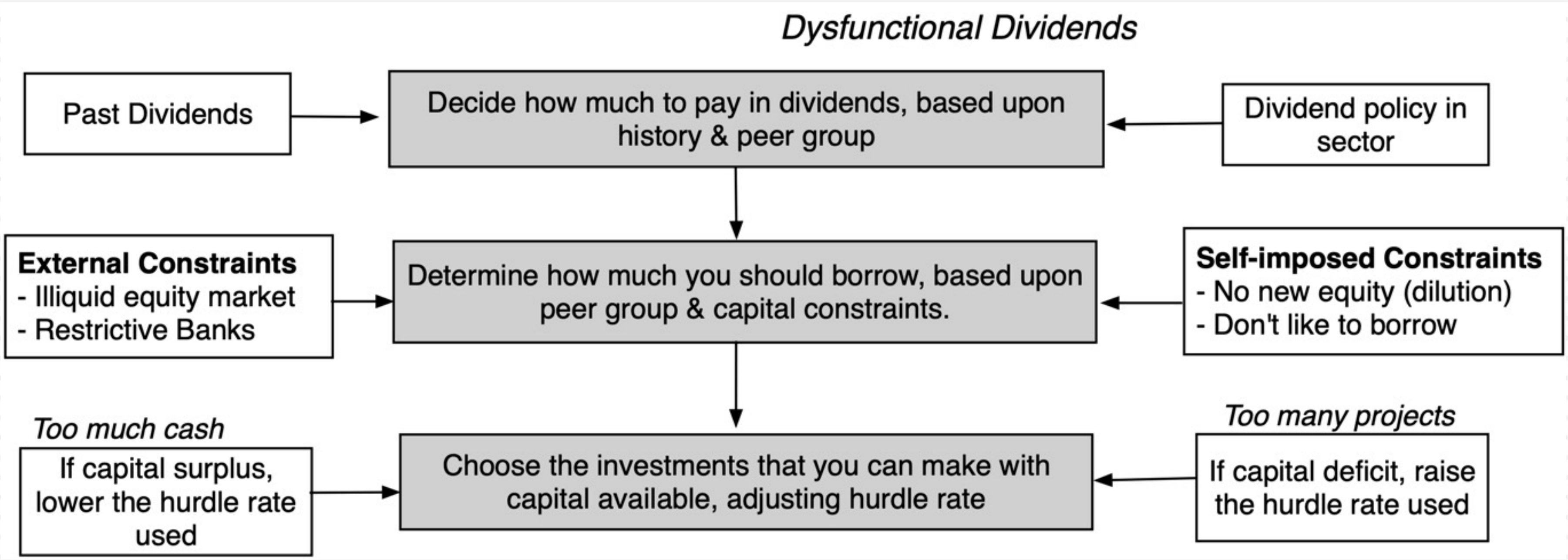
Dividend Policy in Corporate Finance



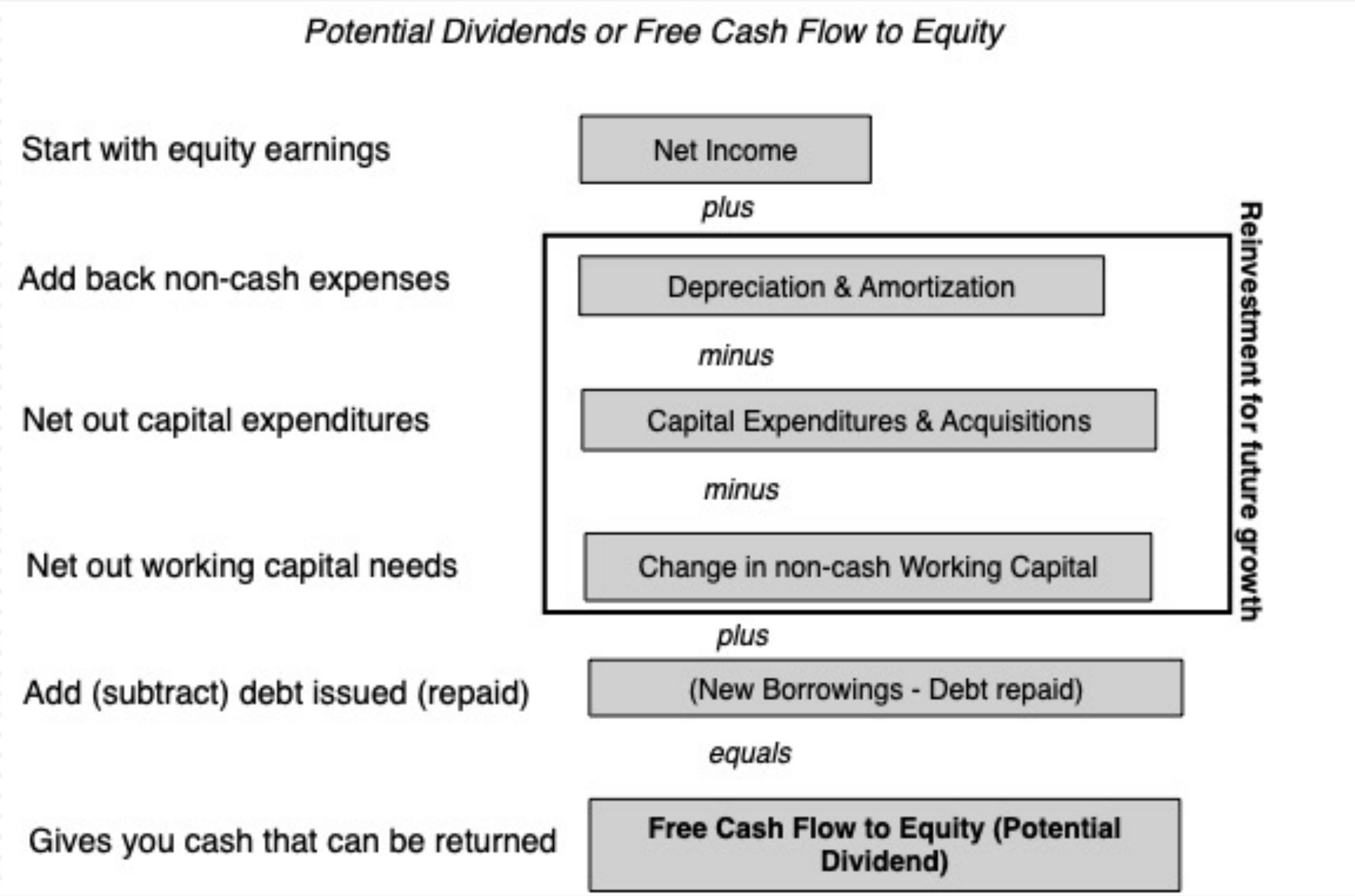
Dividends as residual cash flows



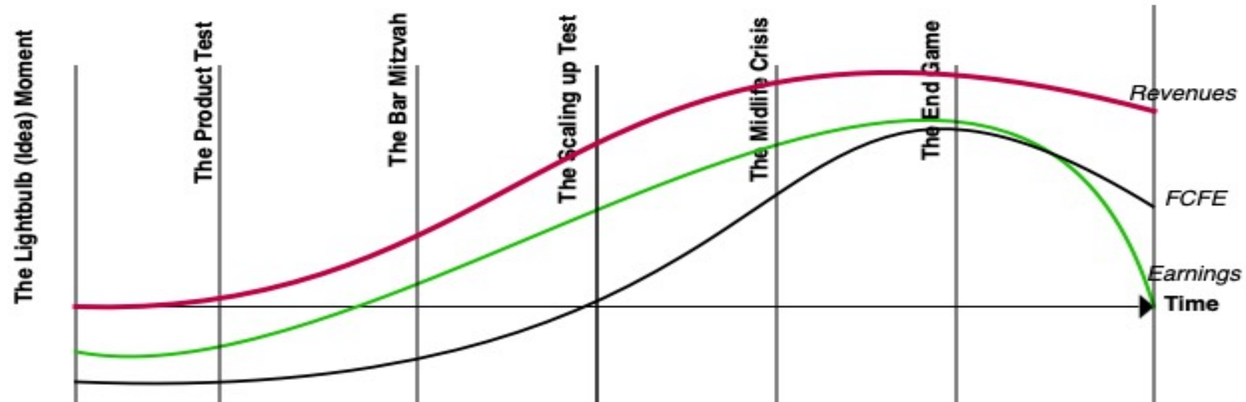
Dysfunctional Dividend Policy



Measuring Potential Dividends



Cash Return across the Life Cycle



Lifecycle Stage	**Start-up**	**Young Growth**	**High Growth**	**Mature Growth**	**Mature Stable**	**Decline**
Earnings	Large net losses	Net losses narrow	Net profits turn positive	Net profits grow quickly	Net profits level off, with debt as wild card.	Net profits decline
Reinvestment needed for growth	Very High	High	Remain large, but scale down in percent.	Continue to decrease on scaled basis.	Low	Divestment (creating positive cash flows)
Debt cash flow (Debt issued - repaid)	Usually none	Usually none	If debt exists, net positive, but small.	Net debt cash flow positive.	Net debt cash flow neutal.	Net debt cash flow negative.
Free CF to Equity (Potential cash return)	Negative	May get more negative, with growth	Turns positive as growth slows	Positive & growing (faster than earnings)	Positive & more stable	Positive & higher than earnings.
Cash from/to Equity	Equity Issuances		Self-funding	Equity Buybacks	Dividends + Buybacks	Liquidating Dividends

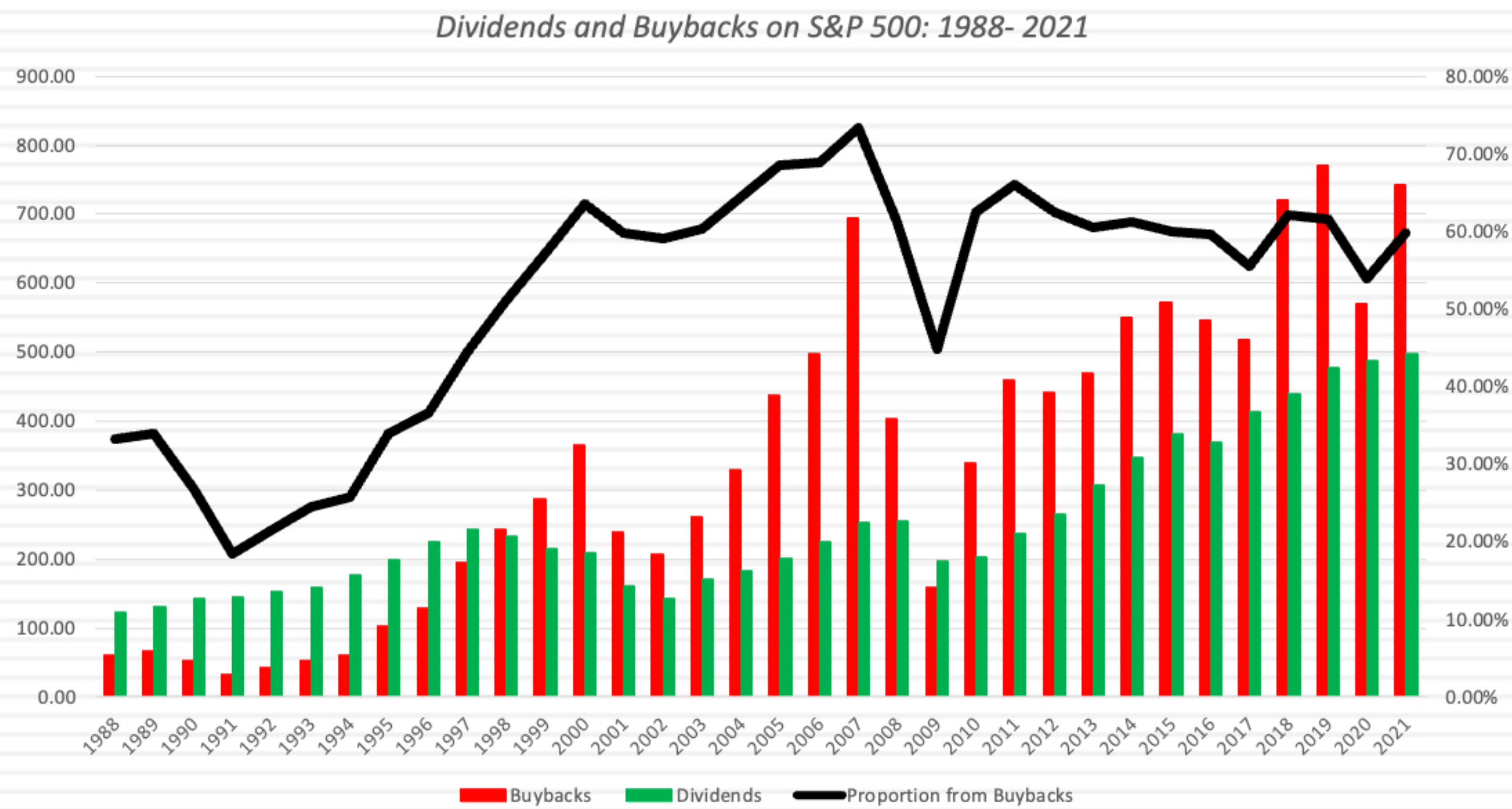
The Data on Age and Cash Return

		Net Income			FCFE			% of Companies		
Age Decile	Number of firms	% of Money-losing firms	$ Net Income	Net Income/ Market Cap	% Negative	FCFE	FCFE Yield	Paying Dividends	Buying back stock	Returning Cash
Youngest	**4,002**	**55.50%**	**$4,645**	**0.19%**	**60.29%**	**-$57,678**	**-2.41%**	**14.84%**	**14.24%**	**24.71%**
2nd decile	4,254	49.44%	$27,379	0.74%	63.38%	-$52,591	-1.42%	27.29%	16.20%	36.53%
3rd decile	5,021	39.35%	$248,223	4.58%	58.57%	$45,510	0.84%	38.68%	17.63%	46.21%
4th decile	4,165	34.19%	$229,596	4.57%	56.83%	$10,898	0.22%	49.05%	21.30%	56.97%
5th decile	3,889	29.93%	$391,668	4.76%	52.04%	$222,250	2.70%	53.54%	19.05%	59.86%
6th decile	5,054	29.17%	$278,045	4.24%	51.54%	$79,645	1.22%	50.00%	16.94%	55.46%
7th decile	4,686	28.72%	$506,648	6.33%	51.45%	$170,740	2.13%	47.55%	18.08%	54.12%
8th decile	4,429	21.54%	$746,254	5.93%	49.33%	$327,864	2.60%	58.88%	20.12%	64.53%
9th decile	4,467	18.13%	$743,058	6.48%	47.64%	$369,220	3.22%	68.26%	24.87%	72.80%
Oldest	**4,510**	**13.04%**	**$2,367,335**	**7.53%**	**42.71%**	**$1,354,396**	**4.31%**	**76.21%**	**40.82%**	**81.09%**
All firms	47,913	32.29%	$5,637,033	5.80%	53.09%	$2,499,056	2.57%	47.30%	20.39%	54.01%

Dividends and Buybacks: The Facts

- Four decades into the buyback surge, there are enough facts that we can extract by looking at the data that are worth highlighting.
  - First, it is undeniable that US companies have moved dramatically away from dividends to buybacks, as their primary mode of cash return, and that companies in the rest of the world are starting to follow suit.
  - Second, that shift is being driven by the recognition on the part of firms that earnings, even at the most mature firms, have become more volatile, and that initiating and paying dividends can trap firms in dangerous patterns.
  - Third, while much has been made of the tax benefits to shareholders from buybacks, as opposed to dividends, that tax differential has narrowed and perhaps even disappeared over time.

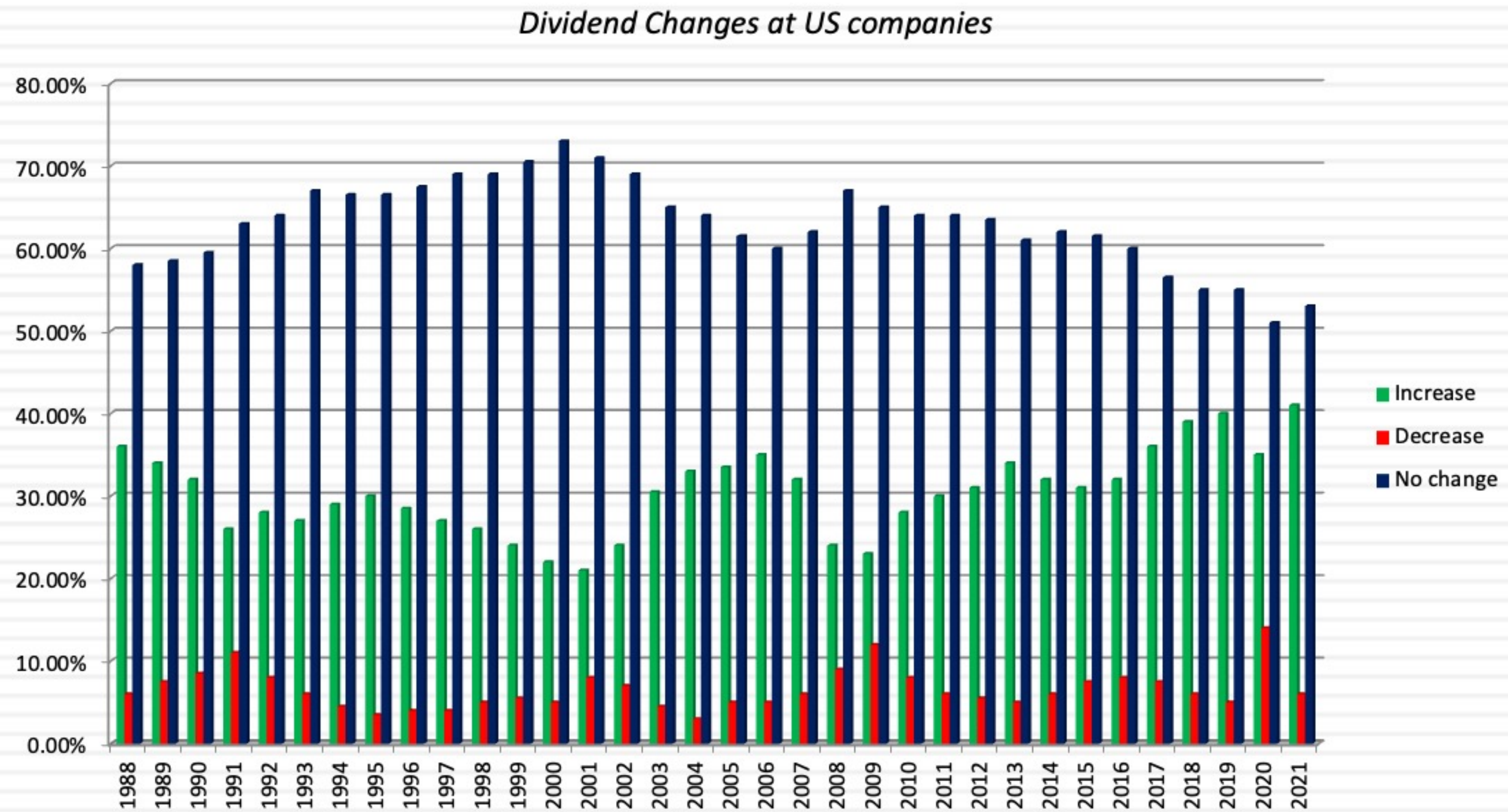
The Shift to Buybacks



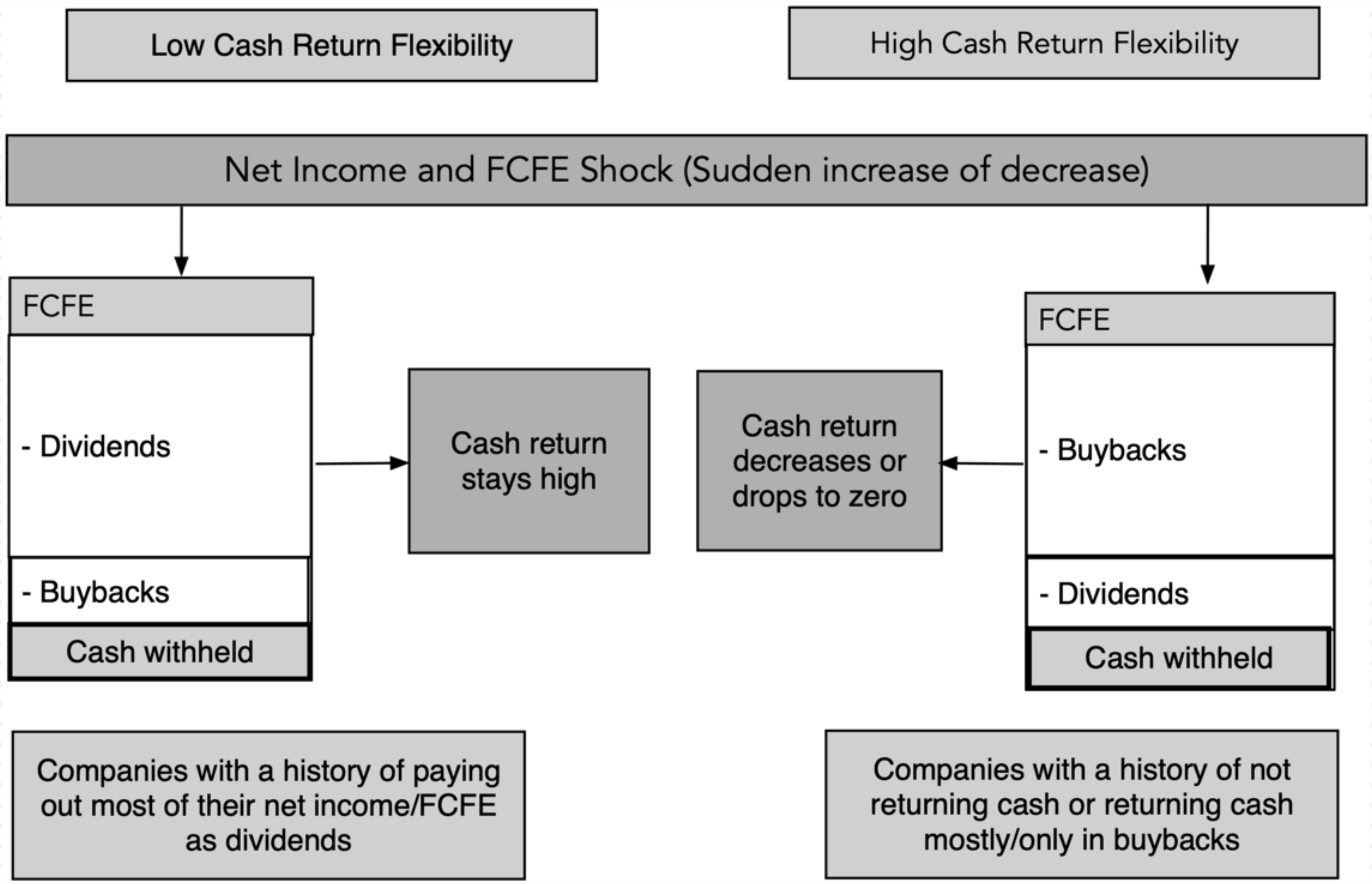
And it is not just the US…

Age Decile	Number of firms	Dividends			Net Income			FCFE			Buybacks		
		% of Payers	$ Dividends	Dividend Yield	% of Money-losing firms	$ Net Income	Net Income/ Market Cap	% Negative	FCFE	FCFE Yield	% of firms buying back	$ Buybacks	Buybacks as % of Cash Return
Eastern Europe & Russia	357	41.18%	$4,130	4.28%	22.69%	$14,807	15.35%	34.45%	$7,561	7.84%	14.01%	$674	14.03%
Australia & NZ	1,895	25.01%	$64,082	3.99%	66.23%	$114,373	7.12%	74.14%	$109,133	6.80%	9.92%	$20,937	24.63%
Latin America & Caribbea	1,023	60.90%	$67,914	4.26%	21.99%	$159,165	9.98%	42.23%	$70,750	4.44%	28.15%	$24,988	26.90%
Canada	2,900	12.45%	$71,749	2.74%	71.55%	$180,065	6.86%	75.24%	$134,493	5.13%	16.28%	$76,480	51.60%
India	4,149	33.00%	$45,820	1.35%	25.14%	$135,351	3.98%	43.12%	$139,320	4.09%	3.74%	$4,872	9.61%
Africa and Middle East	2,409	53.42%	$164,956	3.48%	23.54%	$363,168	7.67%	41.26%	$247,201	5.22%	12.08%	$8,015	4.63%
UK	1,232	45.62%	$107,251	3.53%	40.91%	$227,528	7.48%	61.53%	$50,544	1.66%	28.17%	$75,643	41.36%
Small Asia	9,591	54.49%	$184,032	3.17%	23.39%	$445,801	7.67%	51.21%	$144,272	2.48%	11.96%	$17,193	8.54%
Japan	3,974	68.70%	$114,262	2.15%	14.87%	$351,765	6.63%	43.61%	$28,648	0.54%	28.51%	$57,410	33.44%
EU & Environs	5,952	41.06%	$372,319	2.79%	31.25%	$904,611	6.78%	47.92%	$365,034	2.73%	21.47%	$214,706	36.58%
China	7,266	76.59%	$510,651	3.34%	28.89%	$905,910	5.92%	64.01%	$391,400	2.56%	20.56%	$68,615	11.85%
United States	7,165	26.20%	$636,300	1.58%	40.84%	$1,834,489	4.55%	50.33%	$810,701	2.01%	40.87%	$1,144,809	64.28%
Global	47,913	47.30%	$2,343,465	2.41%	32.29%	$5,637,033	5.80%	53.09%	$2,499,056	2.57%	20.39%	$1,714,342	42.25%

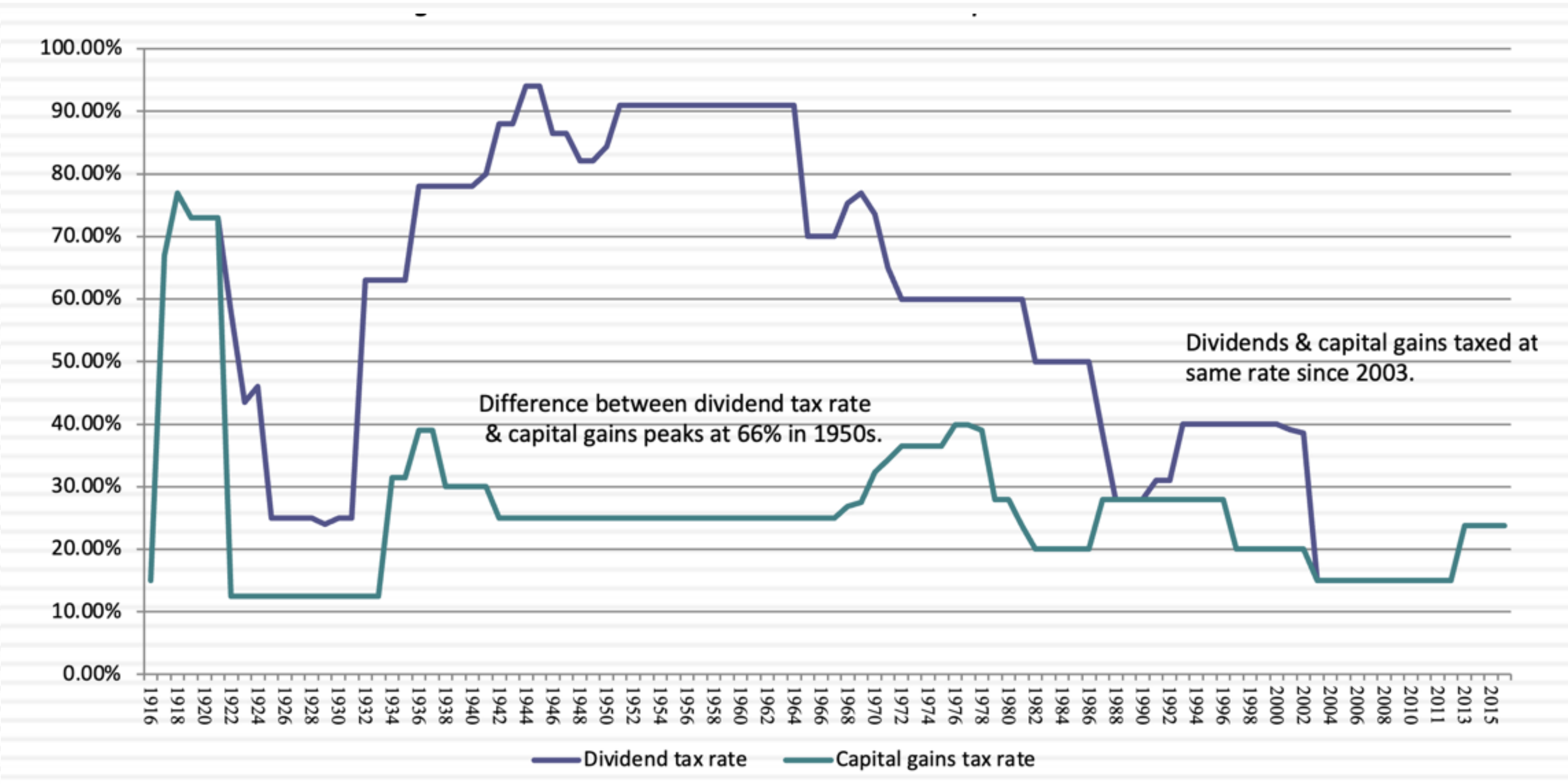
2. The Flexibility Argument for Buybacks



Dividends versus Buybacks



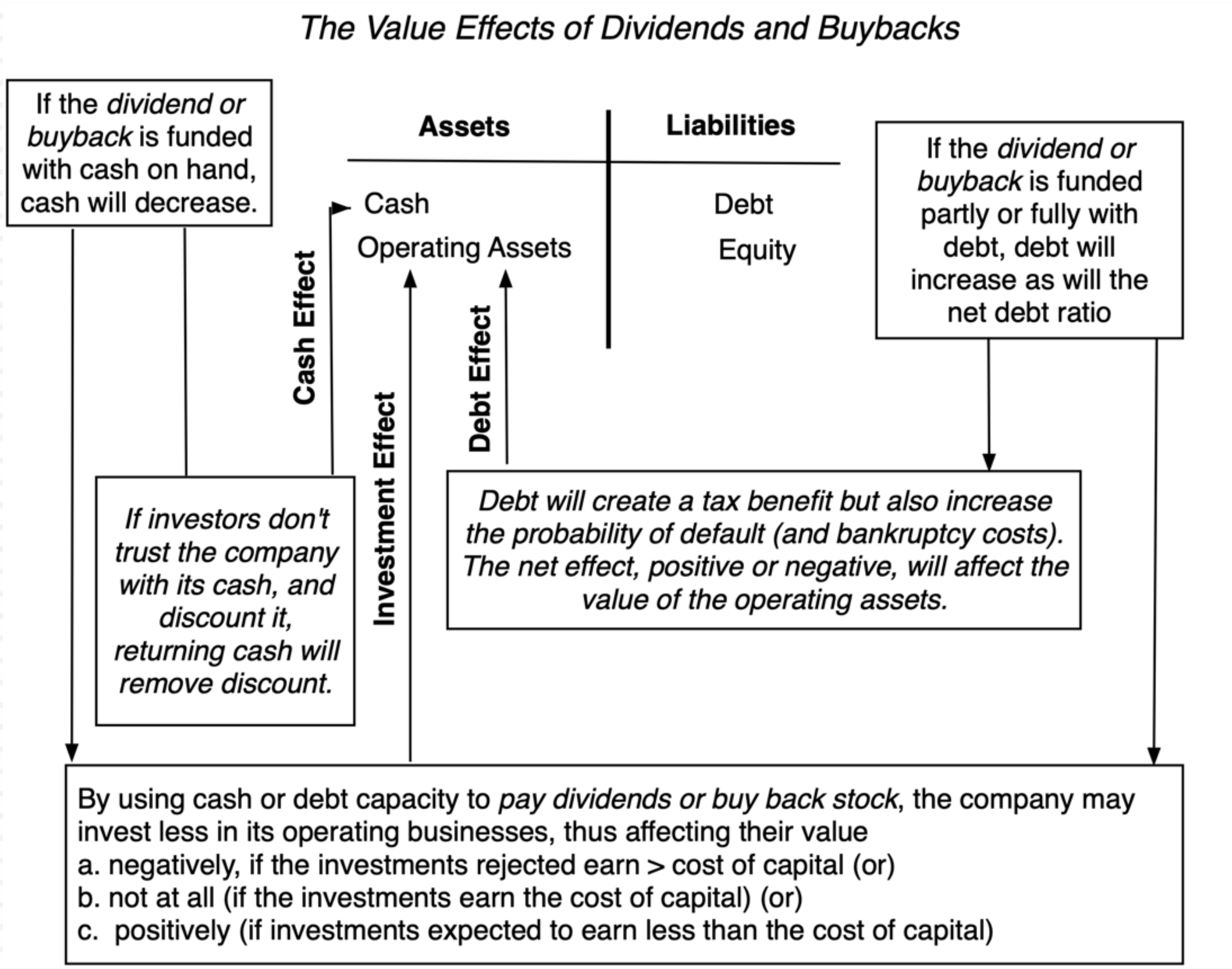
3. Buybacks have a tax advantage still, but it is much smaller than it used to be..



Buybacks: The Fiction

- The fictions about buybacks are widespread and are driven as much by ideological blinders as they by a failure to understand what a business is, and how to operate it.
  - The first is that buybacks can increase or decrease the value of a business, with buyback advocates making the former argument and buyback critics the latter. They are both wrong, since buybacks can only redistribute value, not create it.
  - The second is that surge in buybacks has been fed by debt financing, and it is part of a larger and darker picture of over levered companies catering to greedy, short-term shareholders.
  - The third is that buybacks are bad for an economy, with the logic that the cash that is being used for the buybacks is not being invested back in the business, and that the latter is better for economic growth.
  - The final argument is that the large buybacks at US companies represent cash that is being taken away from other stakeholders, including employees and customers, and is thus unfair.

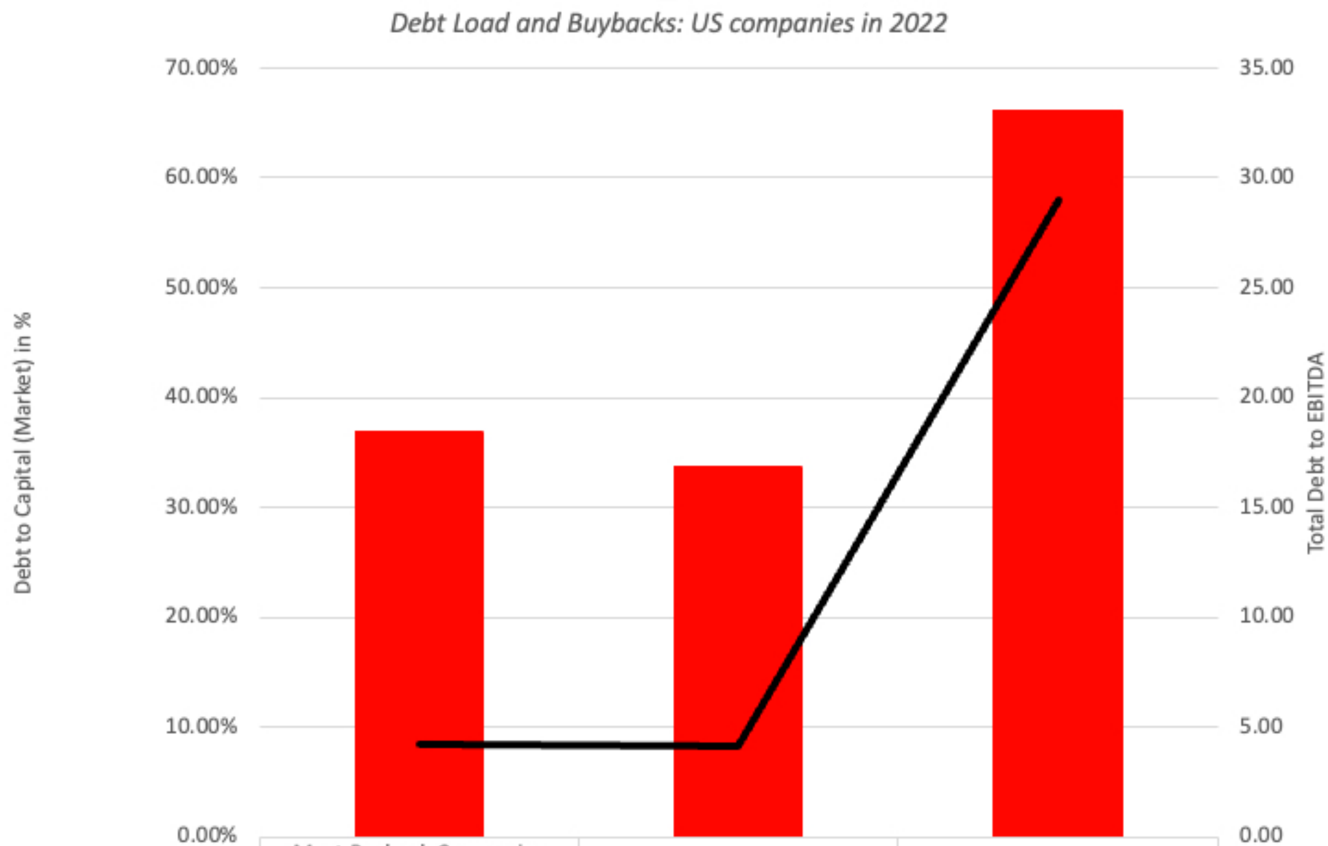
1. Buybacks add (destroy) value



But buybacks can redistribute value…

- Dividends are paid to all shareholders, and thus cannot make one group of shareholders better or worse off than others.
- Buybacks are selective, since only those shareholders who sell their shares back receive the buyback price, and they have the potential to redistribute value.
  - A company that buys back stock at too high a price, relative to its intrinsic value, is redistributing value from the shareholders who remain in the company to those who sell their shares back.
  - In contrast, a company that buys back shares at a low price, relative to its intrinsic value, is redistributing value from the shareholders who sell their shares back to those who stay shareholders in the firm.
- It is true that some companies buy back stock at the high prices, and if that is your reason, as a shareholder in the company for taking a stand against buybacks, I have a much simpler and more effective response than banning buybacks. Just sell your shares back and be on the right side of the redistribution game!

2. Buybacks are being funded with debt..



	Most Buyback Companies (Top Decile)	All Buyback Companies	No Buyback Companies
Total Debt/ Capital	36.96%	33.74%	66.16%
Total Debt/ EBITDA	4.18	4.10	29.02

3. Buybacks are bad for the economy

- Companies that return cash to shareholders, whether as dividends or buybacks, are not reinvesting the cash, and that fact alone is sufficient for some to argue against buybacks. There are two premises on which this argument is built, and they are both false.
  - The first is that a company investing back into its own business is always better for the economy than that company not investing, and that misses the fact that investing in bad businesses, just for the sake of investing is not good for either shareholders or the economy.
  - The second is that the money returned in buybacks, which exceeded a trillion dollars last year, somehow disappeared into a black hole, when the truth is that much of that money got reinvested back into the market in companies that were in better businesses and needed capital to grow?

4. Buybacks are unfair to other stakeholders

- If the argument against buybacks is that the money spent on buybacks could have been spent paying higher wages to employees or improving product quality, that is true.
- That argument is really one about how the pie is being split among the different shareholders, and whether companies are generating profits that excessive, relative to the capital invested.
  - I argued in my fifth data post that if there is backing for a proposition, it is that companies are not earning enough on capital invested, not that they are earning too much.
- I will wager that if you did break down pay per hour or employee benefits, they will be much better at companies that are buying back stock than at companies that don't. Unfortunately, I do not have access to data at the company-level on either statistic, but I am willing to consider evidence to the contrary.

Buybacks: Symptom, not cause…

- It is telling that some of the most vehement criticism of buybacks come from people who least understand business or markets, and that the legislative solutions that they craft reflect this ignorance.
- Taxing buybacks because you are unable to raise corporate tax rates may be an effective revenue generator for the moment, but pushing that rate up higher will only cause the cash return to take different forms. Just as the attempts to curb top management compensation in the early 1990s gave rise to management options and a decade of even higher compensation, attempts to tax buybacks may backfire.
- If the end game in taxing buybacks is to change corporate behavior, trying to induce invest more in their businesses, it will be for the most part futile and if it does work, will do more harm than good to the economy.