



IN PRACTICE WEBCAST: DIVIDEND POLICY – RELATIVE ANALYSIS

Aswath Damodaran

Dividend Policy: The Me Too Approach

- Just as many companies decide how much to borrow by looking at what other companies are borrowing, companies set dividend policies by looking at peer group practice.
- With dividends, this me-too-ism is reinforced by investors who judge the quality of companies by focusing primarily on their dividend yields, relative to their peer group.
- In some cases, analysts determine whether companies are paying too much or too little in dividends by comparing payout ratios.

Step 1: Define your peer group

- Focus: In relative analysis, your focus is on finding what similar companies carry as debt, and to make this judgment, you have to define “similar”.
- The Sector: For better or worse, in most cases, “similar” is defined as other companies in the same sector as you are.
- The Geography: To the extent that constraints on capital access and tax treatment can vary across geographies, “similar” is often defined as companies in the same geographical market.
- Other criteria: If there are enough firms that make it through the sector and geographic screens, you can add other ones including company size and growth potential.

Hormel: Peer Group

Publicly traded Package Food companies, US, Net Income>0, Mkt Cap > \$1 billion

Quad County Corn Processors Cooperative (OTCPK:QCCP)	Blue Buffalo Pet Products, Inc. (NasdaqGS:BUFF)
The Kraft Heinz Company (NasdaqGS:KHC)	Pilgrim's Pride Corporation (NasdaqGS:PPC)
Mondelez International, Inc. (NasdaqGS:MDLZ)	Post Holdings, Inc. (NYSE:POST)
General Mills, Inc. (NYSE:GIS)	Seaboard Corporation (AMEX:SEB)
Tyson Foods, Inc. (NYSE:TSN)	Flowers Foods, Inc. (NYSE:FLO)
Kellogg Company (NYSE:K)	The Hain Celestial Group, Inc. (NasdaqGS:HAIR)
The Hershey Company (NYSE:HSY)	Lancaster Colony Corporation (NasdaqGS:LANC)
Hormel Foods Corporation (NYSE:HRL)	Sanderson Farms, Inc. (NasdaqGS:SAFM)
Conagra Brands, Inc. (NYSE:CAG)	J&J Snack Foods Corp. (NasdaqGS:JJSF)
The J. M. Smucker Company (NYSE:SJM)	Tootsie Roll Industries, Inc. (NYSE:TR)
Campbell Soup Company (NYSE:CPB)	B&G Foods, Inc. (NYSE:BGS)
McCormick & Company, Incorporated (NYSE:MKC)	Calavo Growers, Inc. (NasdaqGS:CVGW)
Lamb Weston Holdings, Inc. (NYSE:LW)	Hostess Brands, Inc. (NasdaqCM:TWNK)
Pinnacle Foods Inc. (NYSE:PF)	

Step 2: Choose your dividend metric

- Dividend Yield: Dividends/ Market Capitalization
 - ▣ Portion of expected return that comes from dividends
 - ▣ Used by value investors as a measure of dividend attractiveness of a stock
- Dividend Payout: Dividends/ Net Income
 - ▣ Measure of dividend sustainability
 - ▣ Works best when dividends are only cash return and firm is a mature company
- Augmented Dividend Payout: (Dividends + Buybacks)/ FCFE
 - ▣ Aggregated Measure of Cash Return
 - ▣ Proxy for cash build up or draw down for company

Peer Group Dividend Metrics

<u>Company Name</u>	<u>Dividend Yield</u>	<u>Dividend Payout Ratio</u>	<u>Cash Return/ FCFE</u>
The Kraft Heinz Company (NasdaqGS:KHC)	0.00%	0.00%	0.00%
Mondelez International, Inc. (NasdaqGS:MDLZ)	1.82%	41.00%	78.29%
General Mills, Inc. (NYSE:GIS)	3.50%	70.22%	89.82%
Tyson Foods, Inc. (NYSE:TSN)	1.25%	12.38%	9.74%
Kellogg Company (NYSE:K)	3.06%	58.00%	48.12%
The Hershey Company (NYSE:HSY)	0.00%	0.00%	0.00%
Hormel Foods Corporation (NYSE:HRL)	1.90%	40.86%	38.20%
Conagra Brands, Inc. (NYSE:CAG)	2.53%	51.94%	143.35%
The J. M. Smucker Company (NYSE:SJM)	2.47%	27.60%	51.90%
Campbell Soup Company (NYSE:CPB)	3.09%	40.70%	33.76%
McCormick & Company, Incorporated (NYSE:MKC)	1.72%	49.77%	9.09%
Lamb Weston Holdings, Inc. (NYSE:LW)	1.01%	25.68%	11.70%
Pinnacle Foods Inc. (NYSE:PF)	1.94%	76.40%	147.21%
Blue Buffalo Pet Products, Inc. (NasdaqGS:BUFF)	0.00%	0.00%	14.27%
Pilgrim's Pride Corporation (NasdaqGS:PPC)	0.00%	0.00%	0.53%
Post Holdings, Inc. (NYSE:POST)	0.00%	0.00%	6.66%
Seaboard Corporation (AMEX:SEB)	0.12%	1.83%	0.73%
Flowers Foods, Inc. (NYSE:FLO)	3.15%	93.94%	69.81%
The Hain Celestial Group, Inc. (NasdaqGS:HAIN)	0.00%	0.00%	2.88%
Lancaster Colony Corporation (NasdaqGS:LANC)	1.85%	52.16%	39.25%
Sanderson Farms, Inc. (NasdaqGS:SAFM)	0.78%	8.47%	4.33%
J&J Snack Foods Corp. (NasdaqGS:JJSF)	1.21%	30.81%	20.85%
Tootsie Roll Industries, Inc. (NYSE:TR)	1.02%	33.73%	48.25%
B&G Foods, Inc. (NYSE:BGS)	5.52%	119.29%	18.97%
Calavo Growers, Inc. (NasdaqGS:CVGW)	1.01%	42.09%	20.00%
Hostess Brands, Inc. (NasdaqCM:TWNK)	1.01%	66.33%	NA

Step 3: Compare yourself to what is typical for the sector

- Average: The simple average across companies the sector can be defined as "typical". It is simple and intuitive, but it can also be skewed by outliers.
- Median: When outliers are an issue, the middle of the peer group or the median can be a better proxy for "typical".
- Quartiles: More generally, you can compute ranges based upon quartiles or deciles, especially if there is a lot of variability across the sector.

Comparison to "Typical"

	Yield	Payout	Cash Return/ FCFE
Hormel Foods Corporation	1.90%	40.86%	38.20%
Average	1.56%	35.07%	36.31%
Median	1.23%	37.22%	20.00%
First Quartile	0.29%	3.49%	6.66%
Third Quartile	2.33%	52.10%	48.25%

Looks like Hormel is pretty close to industry averages on every measure of dividend policy.

Step 4: Control for differences

- If your company returns more or less cash than is “typical” for the sector, the naïve conclusion that it is returning too much or too little.
- When you make that judgment, you are assuming that your firm’s dividend fundamentals are similar to that of the typical peer group company. These fundamentals include the items in the dividend trade off:
 - ▣ Growth rate (Higher -> Lower dividends)
 - ▣ Project Quality (Higher -> Lower dividends)
 - ▣ Capital Access (Higher -> Higher dividends)
 - ▣ Risk (Higher -> Lower dividends)
- You can control for these differences subjectively or use statistical tools (like regressions).

A Dividend Payout Regression

- In this sector, the fundamentals don't strongly explain the differences in dividend behavior. Focusing on dividend yield,
 - ▣ Dividend Yield = $0.0357 - 0.051 (\text{Exp Growth in EPS}) - .027 (\text{Beta})$
(1.00) (2.73) **R Squared = 19.1%**
- Plugging in Hormel's numbers for EPS growth(9.00%) and beta (0.41), here is what we get:
 - ▣ Dividend Yield = $0.0357 - 0.051 (.09) - .027 (0.41) = .02$ or 2%
 - ▣ Hormel's actual dividend yield of 1.90% would put it at about where it should be.

Step 5: Expand your assessment



- Since entire sectors can sometimes return too much or too little cash , you may want to expand your analysis by looking at a broader definition of sector, either by going across geographies or by defining your business more broadly.
- You can even expand your assessment to the entire market, and look at whether your company is returning too much or too little, relative to the market.

The Bottom Line

- Your end game: When you make an assessment of whether your firm is paying out too much or too little, relative to a peer group, you are determining whether your company has the right dividend policy, relative to the companies in that group.
- The twist: If your peer group is filled with companies that pay too much in dividends, your company may be returning less cash, relative to its sector, while returning too much cash, given its fundamentals.