Philequity Corner

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Investment Basics: Cash Dividend Yield

One investment ratio that has become very relevant today amid falling interest rates and the market consolidation is cash dividend yield. Recall that in previous articles, we mentioned that there are two ways of generating returns on our stock investments: through capital appreciation and cash income through cash dividends.

Dividends and payout policy

A cash dividend is the share of investors in the profits made by a company for a given year. Companies with stable earnings (usually the blue chips) have established a policy as to how much of their earnings in the previous year will be paid out to shareholders as cash dividends. This is called a dividend payout ratio and expressed as a percentage of previous year's recurring earnings.

Sometimes, certain companies tend to be more generous. If earnings have been particularly good, and in the absence of urgent reinvestment requirement, these companies declare additional dividends (called special dividends) on top of the regular payout. One can take this into account in measuring the dividend yield especially if a company has been consistent in declaring both regular and special dividends.

If we take all the cash dividends (regular and special) paid out by a company vs. the share price of the company, we get a ratio called cash dividend yield. It is usually expressed in percent for easy reference vs. other yield (e.g. interest rates).

$$\textbf{Dividend yield} = \frac{\text{Cash dividend per share}}{\text{Share price}} \times 100\%$$

Basis of dividend payout

The extent of dividend payout usually depends on the prospective investment plans of the company, and the stability of earnings and cash flows. Companies that are either at the tail-end or have completed their investment plans tend to have more cash flows for dividend pay out. The reason is that they are already reaping the benefits from these investments in terms of strong cash flows and earnings. In the current Philippine setting, telecom companies are the ones with higher dividend payout precisely because they have completed the bulk of their capital expenditures and any prospective spending are just for maintenance or incremental expansion of their network.

A high dividend payout per se is not bad. But this should be taken in conjunction with other possible uses of cash flows such as reinvestments, debt repayment and share buyback. Reinvestments, in particular, ensure that there will be future sources of earnings and cash flows that will enable a company to sustain its payout policy. Thus, be cautious of companies that keep on paying dividends for the sake of doing so and disregarding the need for reinvestments to ensure future growth.

PLDT and BPI top the list

We compiled a roster of listed companies which offer the highest dividend yields. We computed the cash dividends for 2007 based on the payout policy and 2006 earnings of these companies. PLDT tops the list because of the reason we mentioned above. Meanwhile, Bank of the Philippine Islands ranked second in the list because of its consistency in declaring both regular and special dividends. Aside from its dividend payout ratio of about 58%, the bank has in the past declared special dividends thereby raising the payout to 90%. This resulted in a dividend yield of 4.9%

Best in prospective dividend yield

Company	Dividend payout*	Prospective 2007 dividend yield (%)
PLDT	70	5.3
BPI	90**	4.9
GLO	75	4.6
URC	50	3.6

** % of previous year's income*
*** inclusive of special dividends*
Prices as of March 16, 2007
Source: Company data

Still better than interest yield

Taken in the context of today's interest rates, stock investments still provide an attractive alternative to deposit rates. In other words, assuming that stock prices stay at current levels until the end of the year, an investor will tend to generate better returns from dividend yield rather than putting his money in special deposit accounts or in T-bills.

In the recent auction, the rates for T-bills were at 2.935% for the 91-day bills, 3.395% for the 186-bill, and 3.82% for the one-year bills. Thus, owning PLDT shares which offer a 5.3% dividend yield for the year is better than investing in the one-year T-bill with just a 3.395% return. While T-bills are generally low-risk instruments, one can also note that blue chip companies are also relatively stable firms that can provide room for both capital appreciation and cash yield.

With the market moving sideways, share price appreciation is still uncertain in the near-term. As such, investors should learn to focus on the basics and turn to what is more apparent: a calculable and guaranteed return through dividend yield. But when the market resumes its upturn, investors will be able to generate returns from both capital appreciation and cash dividends. This is one more compelling reason why we continue to encourage investors to maintain a long-term view on their investments and avoid the pitfalls and risks associated with punting or short-term investing.

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