

Special Report: Dividend Changes Outlook for 2009

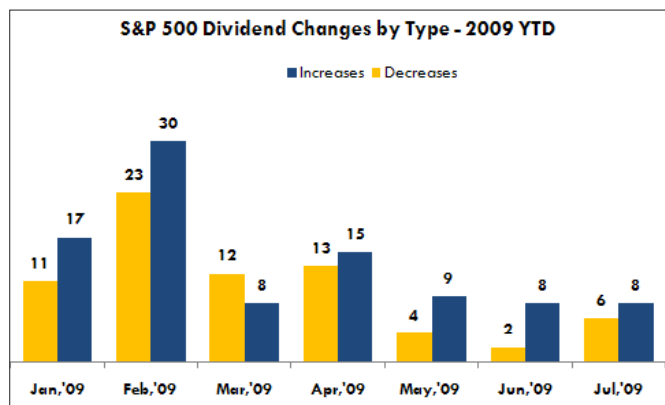
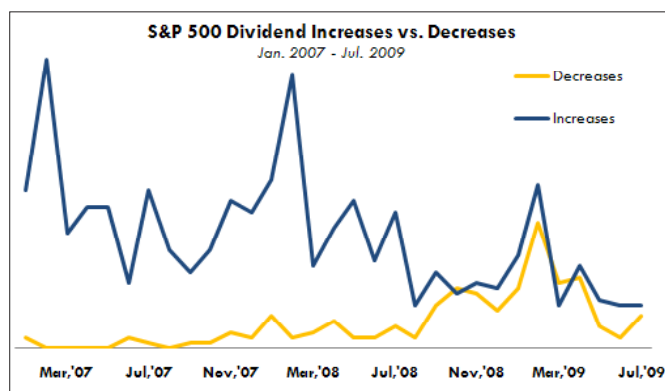
Ipreo's Corporate Analytics Team looks into the market impact of dividend changes made so far in 2009, and discusses the environment for future changes to cash usage policy by US issuers.

Dividend Changes - Market and Investor Reactions

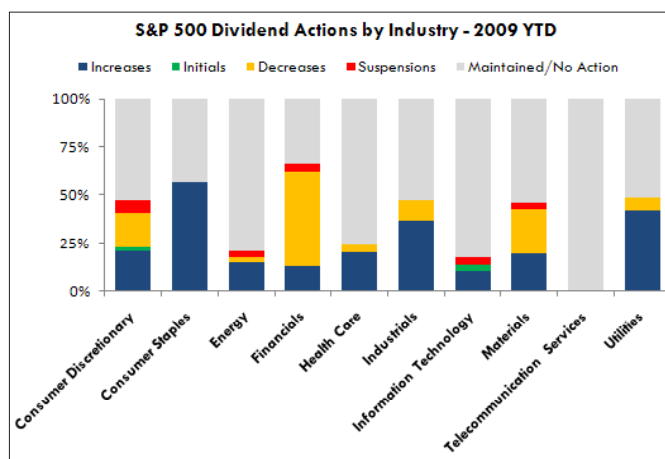
The first half of 2009 has seen an unprecedented number of dividend cuts from S&P 500 members as companies seek to preserve cash flow in the face of economic uncertainty. Year-to-date, 51 of 500 companies have reduced their dividend and 6 have eliminated it entirely, according to Standard & Poor's. In all of 2008, there were 62 dividend decreases, including 22 suspensions. Compare this with just 12 decreases in 2007, including 4 suspensions. Even dividends widely thought to be "safe" have been slashed, most notably by General Electric. Buoyed by the strongest rally since the 1930s, the last several months have seen some return to normalcy, but the number of cuts remains very high compared with historical levels. Between January 2003 and December 2007, dividend cuts and suspensions made up an average of just 4% of all dividend actions. Compare that with 23% for 2008 and 40% for 2009.

Sector-Specific Dividend Actions

As of early August, S&P 500 companies had cut dividends by over \$47B in 2009 – a record. Consumer Staples and Telecoms are the only sectors to escape any dividend cuts for the year. Financials are the most obvious victims; according to S&P, they now pay just 9.1% of index dividends, down from a high of 30%. While sporting one of just two index-wide dividend initiations (Coach), Consumer Discretionary issues are another hard-hit group, with four suspensions and 10 cuts since January. The mean dividend change has been negative for the year outside of Consumer Staples and Health Care, but the median change remains positive across most sectors, showing that despite the cuts, most companies with the ability to do so are still increasing payout. Consumer Discretionary, Financials, and Materials are the only sectors showing negative mean and median dividend changes, emphasizing their weakness in the downturn.



Data from Standard & Poor's as of 8/5/09; Includes dividend initiations and suspensions.



Data from Standard & Poor's as of 8/5/09

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Sector Highlight: Consumer Staples

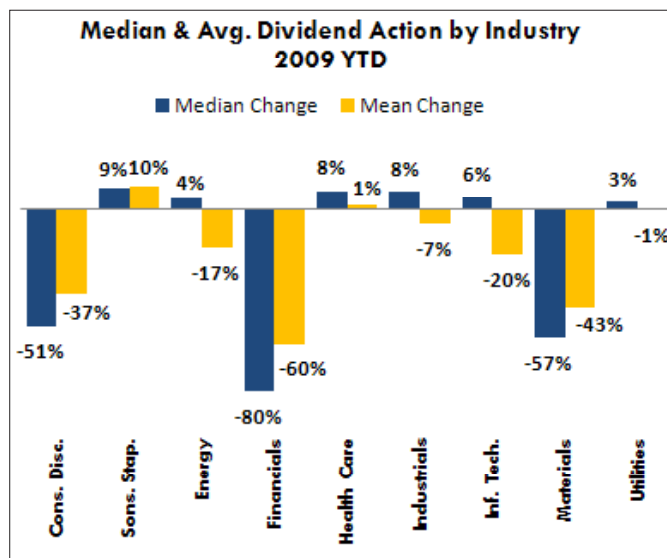
To date, Consumer Staples have seen only positive dividend actions in 2009, with a median change of 9.4% and an average increase of over 10%. Safeway, Molson Coors, and Walgreen Co. all increased payout by 20% or more, and 16 others raised dividends by anywhere from 1.5% (Heinz) to 14.3% (Coca-Cola) over the period. IROs should be cognizant of dividend actions in their sector over recent months, especially when gauging potential investor reactions to a dividend cut or increase – for example, investors may be more receptive of a cut in payout in the financial space than in consumer staples, given industry trends.

Dividend Actions & Price Performance

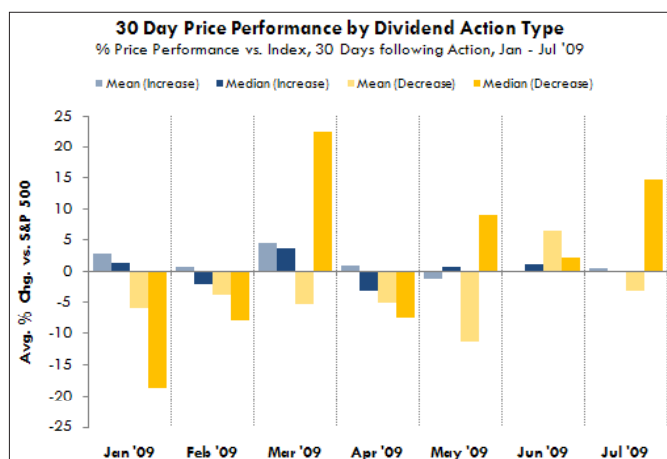
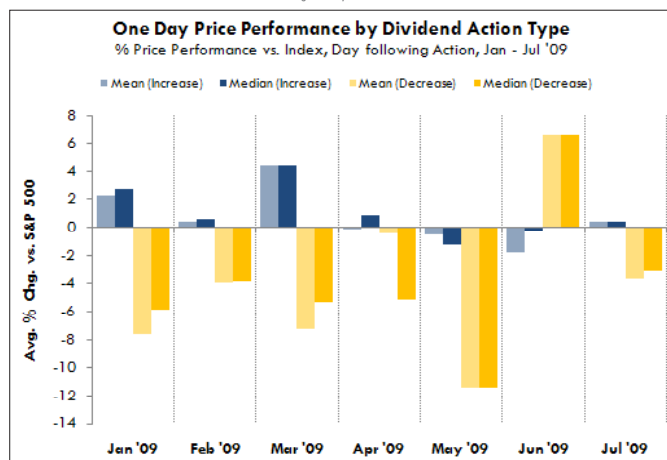
The day following a cut typically saw a stock dramatically underperform the S&P 500 in every month of the year but June (which saw only one cut). This contrasts with outperformance from stocks raising dividends early in the year, when increasing payout sent a very strong signal of financial health to investors. The market response to increase has been more muted since March, perhaps reflecting investors' increasing appetite for growth through the market rally. A look at price performance over the 30 days following dividend actions shows underperformance relative to the market early in the year, and strong relative outperformance in March, as stocks began to rally. The dramatic outperformance for companies cutting dividends in March was driven by cuts from "oversold" financials like Wells Fargo, Capital One, and US Bancorp, as well as industrial producers International Paper and Alcoa. Longer-term price performance has been positive for companies cutting dividends over the last three months.

Decreasing Volatility

A drop in market volatility over the year has coincided with moderation in share price movement following dividend actions. Median absolute price performance relative to the market shows a steady downward trend for both increases and decreases.



Analysis: Ipreo Research

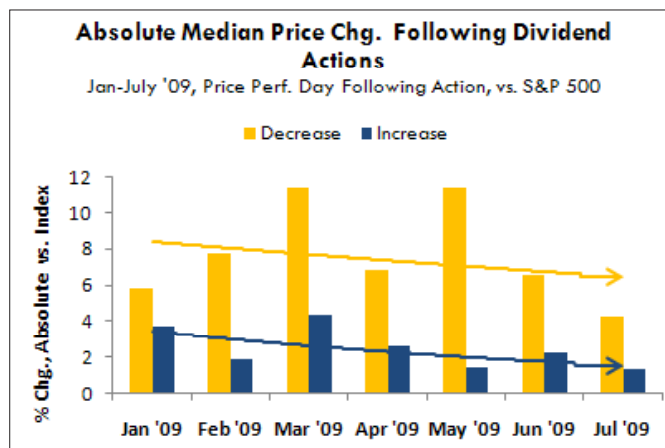


Analysis: Ipreo Research

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Dividend-Sensitive Investors are Significant

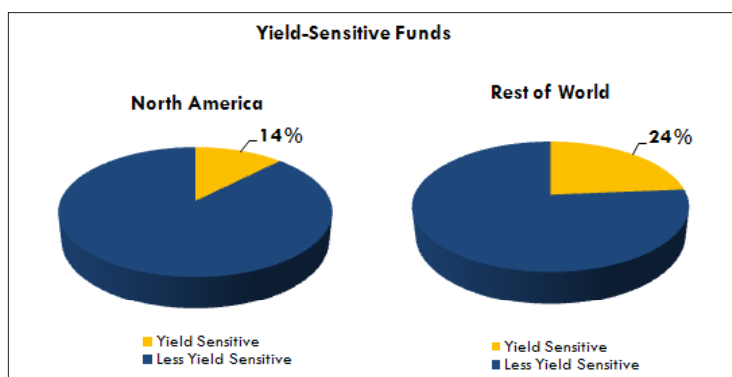
Companies taking dividend actions should be familiar with the volume of dividend-sensitive investors; worsening market volatility in 2008 has made high-yielding stocks particularly attractive. Though North American investors are less yield-conscious, over \$283B, or 6% of mutual funds' equity assets under management are in funds specifically following a yield strategy. Non-North American investors, heavily weighted by large European pension funds, are particularly focused on current income. Internationally, 22%, or over \$524B of assets are in yield-focused funds. Analysis of funds' portfolios shows dividends influence a much larger pool of capital: over 14% of North American assets are in portfolios that Ipreo considers particularly sensitive to dividend yields, accounting for \$572B. Outside of North America, this figure jumps to 24%, or \$649B in assets, based on Ipreo's proprietary measures and disclosed equity holdings.



Analysis: Ipreo Research

More Cuts on the Way? Tailor Dividend Actions to Fit Investors and the Marketplace

Many analysts are questioning whether the current rally is irrationally exuberant, and challenging the sustainability of corporate earnings in the coming quarters. If we are indeed headed for a "W" shaped recession, another spike in dividend cuts is possible. Managers short on cash are faced with few attractive options if the downturn lengthens: cutting a dividend is generally viewed as a last resort. Those needing to raise capital may find the markets less receptive should investor attitudes sour to corporate debt and equity offerings. IROs looking to measure risk involved in a cut will want a solid understanding of their investors' attitudes toward dividends and the company's cash usage strategy. Balance sheet strength has become a larger concern for many investors and a dividend cut that shows commitment to efficient and effective use of cash could be welcomed - a cut will be preferred to a payout plan that strains company resources and is not sustainable in the long run. Traditionally, managers have been wary of altering a dividend policy, fearing investor flight and immediate trading ramifications, but measuring the potential impact and finding the most appropriate level for a cut will help mitigate damage.



Analysis: Ipreo Research



Special Report: Continued...

Initiating & Increasing Dividends

Amid the doom and gloom of widespread dividend cuts, a few companies are finding themselves flush with cash after reducing costs and performing better than expected through the downturn. For managers with this luxury, a dividend initiation, especially in the current environment, could send a strong signal to investors on the company's commitment to generating income for shareholders (not to mention management's confidence in the company's financial strength). That being said, companies should not take this decision lightly. While easy to initiate when the going is good, dividends tend to be seen as "sticky," and the market penalty for cutting or eliminating them can be harsh. Companies with a very growth-oriented investor base may find that their shareholders would much prefer to see cash reinvested in the company than returned via dividends; typically, dividend paying companies have lower growth expectations and trade at a discount to their payout-free peers, and a token yield well below the market average may not attract many yield-oriented investors.

Corporate Finance & Investor Relations

Any decision to change the issuer's dividend policy should be made from both a corporate finance and an investor relations perspective. From the corporate finance side, management must evaluate its cash needs for internal usage, but from the investor relations side, management must also take into account investors' goals for a return on their capital. Examination of the marketplace and industry peers can help establish a dividend level that could retain dividend-sensitive investors and convince others that cash saved by the action is sufficient to secure or improve growth prospects.

After a decision is made, communicating the decision-making process to investors becomes a matter of explaining how both the current and future decisions by management will be made. The difference between a successful dividend change and a disastrous one can be driven by a company's understanding of shareholder behavior combined with an effectively communicated cash usage strategy. In any case, investor relations' role, both prior to and subsequent to the decision, is paramount.

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