# CHARACTERISTICS OF FIRMS WITH DIVIDEND REINVESTMENT PLANS

By John Bajkowski

Companies with DRPs are significantly larger, more mature firms, but remember to buy them because you are optimistic about performance—not just because of the DRP.

Every June the *AAII Journal* publishes a list of companies offering a dividend reinvestment plan (DRP). Many individuals are attracted to companies with DRPs because these firms offer a low-cost approach to purchasing shares. However, an investor should purchase and hold a company with a dividend reinvestment plan only if it is still an attractive investment when considered against other investment opportunities. This article explores the overall characteristics of stocks with DRPs and performs a basic dividend yield screen.

This year's survey of domestic companies offering dividend reinvestment plans covers 877 firms, 851 of which are tracked by AAII's *Stock Investor*.

Table 1 presents an industry breakdown of the firms with DRPs versus those without DRPs. Dividend reinvestment plans have traditionally been offered to the customers of utilities and financial institutions because firms have a steady need for equity capital, pay an above average dividend yield, and benefit from the goodwill of turning their customers into owners. It is not surprising to see that financials and utilities make up 25.6% and 17.5%, respectively, of the DRP stock universe. In contrast, financials make up 15.0% and utilities only 0.6% of the non-DRP universe. The other segments that make up a larger percentage of the DRP universe relative to the non-DRP universe include basic materials, conglomerates, and consumer non-cyclicals. While it is difficult to make any generalizations about conglomerates except that they tend to be larger firms, the other segments are more stable, low relative growth areas.

In the non-DRP universe, the services, technology, and healthcare sectors have proportions significantly higher than in the DRP universe. These are higher growth sectors that often contain smaller firms that pay little, if any, dividends. An investor limiting the selection to companies with dividend reinvestment plans would end up excluding these sectors from their portfolios or would be limited to the larger, more mature dividend-paying companies within the industry. In the technology sector, only 46 firms out of a universe of 1,804 stocks offer DRPs.

Table 2 lists the characteristics of the DRP universe versus companies without DRPs. Medians are used (midpoints of the complete range of numbers) instead of averages because they are not skewed by extreme values.

The companies with DRPs are significantly larger, more mature firms than those firms without dividend reinvestment plans. Companies do not typically start paying cash dividends until they are past their rapid growth stage, when they are generating excess cash from operations and cannot find very profitable capital projects for the firm. This factor shows up on the growth rate differences for the two groups. The historical growth rates for sales and earnings, as well as the consensus earnings growth forecast reported by I/B/E/S are higher for the non-DRP stocks. The DRP firms show a higher growth rate for dividends.

The higher growth prospects of non-DRP firms are reflected in the market multiples. The price-earnings ratio is 20.8 for non-DRP firms versus 19.9 for the firms with DRPs. However, the dividend yield for the group with DRPs is 1.9% versus a median yield of 0% for the non-DRP group. More than half of

*John Bajkowski is AAII's senior financial analyst and editor of* Computerized Investing.

**TABLE 1. INDUSTRY BREAKDOWN: DRPS VS. NON-DRPS**

| | DRPs | | Non-DRPs | |
|---|---|---|---|---|
| Sector | No. of Firms | Percent of Total | No. of Firms | Percent of Total |
| Basic Materials | 94 | 11.0 | 483 | 5.9 |
| Capital Goods | 48 | 5.6 | 517 | 6.3 |
| Conglomerates | 16 | 1.9 | 24 | 0.3 |
| Consumer Cyclical | 50 | 5.9 | 506 | 6.2 |
| Consumer Non-Cyclical | 60 | 7.1 | 292 | 3.6 |
| Energy | 30 | 3.5 | 341 | 4.2 |
| Financial | 218 | 25.6 | 1,225 | 15.0 |
| Healthcare | 27 | 3.2 | 927 | 11.4 |
| Services | 102 | 12.0 | 1,849 | 22.7 |
| Technology | 46 | 5.4 | 1,758 | 21.6 |
| Transportation | 11 | 1.3 | 169 | 2.1 |
| Utilities | 149 | 17.5 | 51 | 0.6 |
| **Total** | **851** | | **8,142** | |

the firms without DRPs pay no dividends at all.

The ratio of price-earnings to earnings growth is often used to measure the balance between value and growth. A firm with a low P/E ratio may not be a bargain if the company has poor earnings growth prospects. Firms with higher growth prospects are attractive if you do not pay too much for the earnings. Companies with a price-earnings-to-growth ratio near 1.0 are considered to be fairly valued; a ratio at 0.5 or less is considered undervalued, while a ratio near or above 1.5 is considered overvalued. While the stocks with DRPs have a lower price-earnings ratio, it would seem that the price-earnings ratio is not low enough given the earnings growth rates of these firms. The stocks of the non-DRP group have a more attractive price-earnings-to-growth ratio median of 1.0 versus 1.5 for the DRPs. Many investors like to adjust the ratio by adding the dividend yield to the growth rate. This adjustment acknowledges the contribution that dividends make to an investor's return. This adjusted ratio is calculated by dividing the price-earnings ratio by the sum of the earnings growth rate and the dividend yield. For the DRP group this brings the ratio down, but only to 1.3.

The DRP companies tend to have better profitability ratios than the non-DRP companies, but it is difficult to make any generalizations about these ratios since profit margins are very industry-specific. Given the difference in market industry breakdowns for the two groups, the different ratios may or may not be significant.

When it comes to measures of the financial structure, some observations can be made. Large, established firms with proven track records have much greater access to the debt markets than smaller firms. The differences in the ratio of long-term debt to total capital certainly bear this out. Smaller firms must rely more on equity financing, short-term bank loans, and growth in supplier-provided accounts payable as sources of external funding. The ratio of total liabilities to total assets considers the complete debt structure.

The companies with DRPs have attracted much more institutional coverage than the non-DRP group. Approximately half of the shares for this group are held by institutions versus 21.1% for the non-DRP group. While 267 institutions have a position in a DRP firm, typically only 24 institutions have an ownership position in a non-DRP company.

Managers and founders are more likely to own a higher portion of outstanding stock for smaller firms. It is not surprising that the insider ownership statistics are much higher for the smaller, non-DRP companies than the larger companies with DRPs.

The price statistics highlight some interesting differences. The stock prices of the non-DRP group tend to be significantly lower—$11.80 versus $37.94. Lower prices are often associated with smaller-cap stocks.

While both groups have underperformed the S&P 500, as measured by the 52-week relative strength, the smaller-capitalization non-DRPs have been weaker performers on a relative basis. The DRP firms are up by 37.1% over the last year, while the non-DRP firms are up 26.5% over the same period.

Overall, stocks with dividend reinvestment plans tend to be larger companies with concentrations in the financial and utility sectors; they tend to have lower past and projected growth rates, slightly lower multiples of earnings and sales; significantly higher dividend yields; and they are heavily followed by institutions. An investor would have a difficult time constructing a completely diversified portfolio strictly from this group. An investor looking for an aggressive, high-growth portfolio must look beyond the DRP universe. However, applying a screen searching for out-of-favor, high relative yield stocks might be an appropriate strategy for this group.

To make for an interesting comparison, the same screening criteria were applied separately to the DRP and the non-DRP universe. The screen searched for companies with high relative dividend yields and above average dividend and earnings growth.

Traditionally, financials and utilities trade with higher dividend yields and require separate relative dividend screens. A simple screen for high dividend yields would be

heavily weighted with securities from these groups. Our first screen filtered out financials and utilities. This requirement reduced the number of non-DRP firms from 8,142 to 6,604. The effect was even more dramatic for the stocks with DRPs, cutting the group down to 483 from the starting point of 851.

The next screen looked for companies that have paid a dividend for each of the last six years and have not reduced their dividend over the period. This screen cut down our DRP list to 369 and the non-DRPs to 4,406. Dividend levels are set by the board of directors taking the company, industry, and economic conditions into account. Dividends are set at levels that the company should be able to afford throughout the economic cycle. However, it has been seven years since we have had our last recession. The optimal dividend screen should cover a complete economic cycle. It is common for cyclical firms like Chrysler, which passed the screen, to trade with high yields and low multiples well into an economic expansion.

It is important that the companies show the ability to increase dividend payments over time. The next screen looked for companies with a dividend growth rate greater than the growth rate for their industry. This screen cut down the list of companies to 267 DRP stocks and 302 non-DRP stocks.

The next filter required that the company's current dividend yield be higher than its five-year average dividend yield. This filter identifies companies whose dividends have increased faster than increases in share price, or whose current share price has dipped recently. This contrarian filter tries to identify stocks that are out-of-favor, hopefully due to a short-term overreaction to bad news. This criterion cut down the list of DRP stocks to 45, while the number of non-DRP stocks was whittled down to 66.

The safety of the dividend is also important. A high dividend yield may be a signal that the market expects the dividend to be cut shortly and has pushed down the price of the stock accordingly. A high relative dividend yield is attractive only if the dividend level is expected to be sustained and even increased.

The payout ratio is the most common measure of dividend safety. It is computed by dividing the dividends per share by the earnings per share. The lower the ratio, the more secure the dividend. Any ratio above 50% is generally considered a warning flag, but some stable industries such as utilities have higher payout ratios. We screened for payout ratios below 50%, which left 30 stocks with DRPs and 43 stocks without DRPs.

Our final screen required a minimum level of earnings growth. The screen looked for firms with earnings growth rates in the upper half of their respective industries. This type of filter recognizes the differences between industries and tends to lead to more meaningful screening results. Eighteen stocks with DRPs and 22 stocks without DRPs passed all of the filters, and the top 10 dividend-yielding stocks from each group are presented in Table 3.

The list in Table 3 of stocks passing all screens is not a diversified portfolio. There is a heavy concentration of cyclical firms, which carry more risk late into an economic cycle. As with all contrarian screens, your analysis should focus on whether the market is too pessimistic in its assessment of the future of these stocks.

Firms with dividend reinvestment plans offer investors advantages, but remember to buy them because you are optimistic about performance, not simply because of the dividend reinvestment feature.◆

**TABLE 2. CHARACTERISTICS OF DRP VS. NON-DRP* STOCKS**

| Size | DRPs | Non-DRPs |
|---|---|---|
| Market Capitalization ($ mil) | 2,196.0 | 94.3 |
| Sales—Latest 12 Months ($ mil) | 1,523.3 | 65.4 |
| **Growth (Five-Year Annual)** | | |
| Sales (%) | 7.6 | 14.3 |
| Earnings per Share (%) | 10.9 | 12.9 |
| Estimated Earnings per Share (%) | 11.0 | 15.0 |
| Dividends (%) | 5.4 | 0.0 |
| **Valuation** | | |
| Price-Earnings (X) | 19.9 | 20.8 |
| Dividend Yield (%) | 1.9 | 0.0 |
| Price-to-Book (X) | 2.75 | 2.33 |
| Price-Earnings to Growth (X) | 1.5 | 1.0 |
| Price-Earnings to Growth—Adjusted (X) | 1.3 | 1.0 |
| **Profitability** | | |
| Operating Profit Margin (%) | 13.1 | 5.7 |
| Net Profit Margin (%) | 7.4 | 3.1 |
| Return on Equity (%) | 13.1 | 7.3 |
| **Financial Structure** | | |
| Long-Term Debt to Total Capital (%) | 35.0 | 11.7 |
| Total Liability to Total Assets (%) | 68.1 | 52.7 |
| **Shares/Ownership** | | |
| Institutional Ownership (%) | 54.7 | 21.1 |
| Number of Institutional Owners | 267 | 24 |
| Insider Ownership (%) | 16.9 | 42.1 |
| Shares Outstanding (mil) | 57.0 | 9.9 |
| **Price** | | |
| Price ($) | 37.94 | 11.80 |
| Price as % of 52-Week High (%) | 92.0 | 80.0 |
| 52-Week Relative Strength (%) | –1.0 | –6.0 |
| One-Year Price Change (%) | 37.1 | 26.5 |

* All values are medians—the midpoints of the range

## TABLE 3. HIGHEST DIVIDEND YIELD FIRMS: DRPs VS. NON-DRPs

| Company (Exch: Ticker) | Dividend Yield Current (%) | Dividend Yield 5-Year Avg. (%) | Annual Growth Rate Dividend (%) | Annual Growth Rate EPS (%) | Annual Growth Rate Est. EPS (%) | Payout Ratio (%) | 52-Week Relative Strength (%) | Price Change (1 Yr.) (%) | Description |
|---|---|---|---|---|---|---|---|---|---|
| ***Firms With Dividend Reinvestment Plans*** | | | | | | | | | |
| Chrysler Corp. (N:C) | 4.0 | 3.4 | 39.8 | 30.2 | 5.0 | 37.4 | –3.0 | 34.2 | Mfrs, sells, autos & trucks |
| A.M. Castle & Co. (A:CAS) | 3.3 | 2.7 | 25.7 | 44.5 | 12.5 | 38.4 | –1.0 | 37.7 | Metals distributor |
| Amcast Industrial Corp. (N:AIZ) | 2.6 | 2.5 | 3.1 | 31.0 | 10.5 | 38.4 | –35.0 | –5.2 | Metal prods |
| Hercules Inc. (N:HPC) | 2.3 | 2.0 | 5.9 | 21.2 | 12.0 | 31.3 | –13.0 | 21.4 | Chem specialties & food prods |
| CSX Corp. (N:CSX) | 2.3 | 2.2 | 7.3 | 105.6 | 12.0 | 32.9 | –16.0 | 12.6 | Freight transportation |
| ConAgra, Inc. (N:CAG) | 2.2 | 2.1 | 15.3 | 12.3 | 13.0 | 43.5 | –26.0 | 1.3 | Consumer food prods |
| Modine Mfr'g Co. (M:MODI) | 2.1 | 1.9 | 12.3 | 17.7 | 12.0 | 31.6 | –2.0 | 39.0 | Mfs, sells heat transfer equip |
| Cummins Engine Co. (N:CUM) | 2.0 | 1.6 | 60.9 | 23.9 | 10.0 | 24.1 | –31.0 | –3.1 | Diesel engines, natural gas |
| Caterpillar, Inc. (N:CAT) | 1.8 | 1.7 | 44.7 | 22.3 | 9.0 | 21.4 | –10.0 | 28.0 | Construction machinery |
| Fluor Corp. (N:FLR) | 1.7 | 1.1 | 13.7 | 89.9 | 12.5 | 46.7 | –39.0 | –14.1 | Engineering, construction |
| **Median** | **2.3** | **2.1** | **14.5** | **27.1** | **12.0** | **35.2** | **–14.5** | **17.0** | |
| **Median-All DRP Firms** | **1.9** | **2.8** | **5.4** | **10.9** | **11.0** | **36.8** | **–1.0** | **37.1** | |
| ***Firms Without Dividend Reinvestment Plans*** | | | | | | | | | |
| Friedman Industries (A:FRD) | 3.9 | 3.5 | 20.1 | 49.9 | na | 42.6 | 6.0 | 49.3 | Steel processing |
| Federal Screw Works (M:FSCR) | 3.9 | 3.6 | 24.6 | 29.2 | na | 29.5 | –7.0 | 51.6 | Industrial metal parts |
| Raven Industries, Inc. (M:RAVN) | 3.0 | 2.2 | 14.9 | 5.6 | 15.0 | 33.3 | –37.0 | –11.7 | Plastics, electronics |
| Robinson Nugent, Inc. (M:RNIC) | 2.5 | 1.7 | 8.4 | 21.7 | 10.0 | 41.4 | –39.0 | 4.7 | Electronic connectors |
| Arctic Cat, Inc. (M:ACAT) | 2.4 | 1.5 | 51.6 | 11.1 | 15.0 | 28.9 | –27.0 | 0.0 | Design, mfrs snowmobiles |
| W.H. Brady Co. (M:BRCOA) | 1.9 | 1.6 | 22.3 | 44.3 | 15.0 | 36.8 | –4.0 | 21.4 | Industrial safety prods |
| OEA, Inc. (N:OEA) | 1.8 | 0.6 | 24.6 | 18.2 | 20.0 | 22.0 | –63.0 | –46.9 | Propellent devices |
| Magna Int'l (N:MGA) | 1.8 | 1.4 | 41.7 | 23.2 | 14.0 | 18.2 | 2.0 | 43.1 | Vehicle systems |
| Cooper Tire & Rubber Co. (N:CTB) | 1.6 | 1.1 | 15.5 | 24.4 | 10.0 | 23.9 | –22.0 | 8.5 | Rubber products |
| First Brands Corp. (N:FBR) | 1.5 | 0.9 | 71.9 | 17.3 | 16.5 | 41.4 | –25.0 | 5.7 | Household, auto prods |
| **Median** | **2.2** | **1.6** | **23.5** | **22.5** | **15.0** | **31.4** | **–23.5** | **7.1** | |
| **Median-All Non-DRP Firms** | **0.0** | **0.0** | **0.0** | **12.9** | **15.0** | **0.0** | **–6.0** | **26.5** | |

*Statistics are based on figures as of April 30, 1998.*
*Source: AAII's Stock Investor/Market Guide Inc. and I/B/E/S*

*Exchange Key: N = New York Stock Exchange*
*A = American Stock Exchange*
*M = Nasdaq*

## DEFINITIONS OF SCREENS AND TERMS

***The following is a short description of the screens and terms used in Table 3.***

**Dividend Yield—Current:** Indicated dividend divided by current price. Provides a relative valuation measure when compared against historical average dividend yield.

**Dividend Yield—Five-Year Average:** Average company dividend yield during the last five years.

**Growth Rate—Dividend:** Annual growth rate in dividends per share over the last five years. An indication of the past company strength and dividend payment policy.

**Growth Rate—EPS:** Annual dividend growth rate in earnings per share over the last five years. A measure of how successful the firm has been in generating the bottom line, net profit.

**Growth Rate—Est. EPS:** Consensus estimate of the long-term (five years) growth rate in earnings as tracked by I/B/E/S.

**Payout Ratio:** Dividends per share for the last 12 months divided by earnings per share for the last 12 months. Provides an indication of the safety of the dividend. Figures between 0% and 50% are considered safer. Figures ranging between 50% and 100% are considered early warning flags. Negative values and values above 100% are considered red flags for a dividend cut if the levels persist. Beyond examining a single year, look for trends.

**52-Week Relative Strength:** The price performance of a stock during the last year relative to the performance of the S&P 500. A figure of 0% indicates the stock had the same percentage price performance as the market. A figure of 5% indicates that the stock outperformed the market by 5%.

**Price Change (One-Year):** The percentage change in price over the last year.