SCREENING FOR FIRMS OFFERING DIVIDEND REINVESTMENT PLANS

By Kenneth J. Michal

Firms with dividend reinvestment plans offer investors advantages. But make sure you are optimistic about the stock's performance, not just enticed by the dividend reinvestment plan.

Every June, the *AAII Journal* publishes a guide that lists 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. This article explores the characteristics of stocks with DRPs and performs a basic dividend yield screen.

This year's survey of domestic companies offering dividend reinvestment plans covers 974 firms, 948 of which are tracked by and included in AAII's fundamental screening software program *Stock Investor Pro*.

Table 1 presents an industry breakdown of the firms with DRPs versus those without DRPs. Dividend reinvestment plans have traditionally been offered to the shareholders of utilities and financial institutions because such 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, then, to see that financials and utilities make up 28.0% and 12.6%, respectively, of the DRP stock universe. In contrast, financials make up 14.8% and utilities a mere 0.8% of the non-DRP universe.

Other segments that make up a larger percentage of the DRP stocks relative to the non-DRP stocks include basic materials, conglomerates, and consumer non-cyclicals. While it is difficult to make any generalizations about conglomerates except that they obviously tend to be larger firms, the other two segments tend to be more stable, low relative growth sectors of the market.

In the non-DRP universe the technology, services, 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 their selection to companies with dividend reinvestment plans would end up excluding these sectors from their portfolios, or would at least be limited to those companies within these sectors that are larger, more mature and pay dividends. In the technology sector, only 48 firms out of a universe of 2,116 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 clearly shows up in the historical growth rate for sales as well as the earnings growth forecasts. The earnings growth rate for the DRP stocks is, however, higher than that for the non-DRPs. This is due in large part to a group of low outlying firms—several small, new companies with very large negative five-year earnings growth figures that have skewed the median and average earnings growth figures for the non-DRP group. As you would expect though, the DRP firms show a higher growth rate for dividends.

Over the last few years, large-cap stocks have outperformed small-cap issues. However, in late 1999 and for much of this year small-cap stocks

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TABLE 1. SECTOR BREAKDOWN: DRPs VS. NON-DRPs

Sector	DRPs No. of Firms	DRPs Percent of Total	Non-DRPs No. of Firms	Non-DRPs Percent of Total
Basic Materials	86	9.1	467	5.6
Capital Goods	50	5.3	462	5.6
Conglomerates	17	1.8	18	0.2
Consumer Cyclical	50	5.3	435	5.2
Consumer Non-Cyclical	61	6.4	282	3.4
Energy	22	2.3	333	4.0
Financial	265	28.0	1,232	14.8
Healthcare	25	2.6	871	10.5
Services	191	20.1	1,915	23.1
Technology	48	5.1	2,068	24.9
Transportation	14	1.5	161	1.9
Utilities	119	12.6	63	0.8
Total	**948**		**8,307**	

have displayed stronger performance and the valuation measures reflect this small-cap run-up. The price-earnings ratio of 14.3 for the non-DRP firms exceeds the larger cap DRP multiple of 13.3.

The median dividend yield for the roster of DRPs is greater than that of the non-DRP group—3.1% versus a median yield of 0%, respectively. In fact, more than half of the firms without DRPs pay no dividends at all.

The ratio of price-earnings to earnings growth (PEG ratio) is often used to measure the balance between value and growth. A firm with a low price-earnings 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 PEG 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 slightly lower median price-earnings ratio versus the non-DRPs, it would seem that their median 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 PEG ratio median of 0.8 versus 1.2 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 to a more attractive range at 0.9.

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. Almost half of the shares for this group are held by institutions, versus just 14.8% for the non-DRP group. While 245 institutions have a position in a DRP firm, only 25 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, then, that the insider ownership statistics are much higher for the smaller, non-DRP companies than the larger companies with DRPs.

Lower prices are often associated with smaller-cap stocks, and the price statistics reflect this tendency—the prices of the non-DRP group tend to be significantly lower—$7.94 versus $22.06 for the DRP firms.

While both groups have underperformed the S&P 500, as measured by the 52-week relative strength, the larger-capitalization DRP stocks have been weaker performers on a relative basis, down 22.0% compared to –12.0% for the non-DRP firms.

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 may highlight some companies that warrant further research and analysis.

For comparison purposes, 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 yield screens; otherwise, a simple screen for high dividend yields would be heavily weighted with securities from these groups.

Our first screen filtered out financial, utility, and real estate stocks. This requirement reduced the number of non-DRP firms from 8,307 to 6,833, and DRP firms from 948 to 473.

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 360 and the non-DRPs to 4,536.

It is important that the companies show the ability to increase dividend payments over time, and therefore the next screen looked for companies with a dividend growth rate greater than the growth rate for their industry. This screen dropped our totals to 261 DRP stocks and 276 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 157, while the number of non-DRP stocks was whittled down to 164.

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 102 stocks with DRPs and 117 stocks without DRPs.

Our final screen required a minimum level of earnings growth. This criterion 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.

Sixty-nine stocks with DRPs and 72 stocks without DRPs passed all of the filters, and the top 10 dividend-yielding stocks from each group are presented in Table 3.

Two data points included in the table but not used as screening criteria are worth mentioning, as they reveal some interesting figures. These two data fields are the 52-week relative strength figure and the one-year price change.

Relative strength reflects the price performance of a stock over the last year relative to the performance of the S&P 500. The base figure, reflecting performance equal to the S&P 500, is 0%. Any number above 0% reflects performance greater than that of the market and any negative number points to a stock underperforming the market. For example, the top-yielding DRP firm, Standard Register Company, has a relative strength figure of –61%, which indicates that Standard Register has underperformed the S&P 500 by 61% over the last 52 weeks.

As you can see, each firm presented in these two lists has underperformed the S&P 500 relative strength benchmark—some significantly so, with four out of the top eight DRP firms registering percentages below –40%, and five out of the top seven non-DRP stocks falling below –35%. This is due in part to the high-yielding nature of

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

Size	DRPs	Non-DRPs
Market Capitalization ($ mil)	1,069.5	84.1
Sales—Latest 12 Months ($ mil)	1,135.0	65.8
Growth (Five-Year Annual)		
Sales (%)	9.7	14.8
Earnings per Share (%)	8.5	6.9
Estimated Earnings per Share (%)	11.4	20.0
Dividends (%)	6.1	0.0
Valuation		
Price-Earnings (X)	13.3	14.3
Dividend Yield (%)	3.1	0.0
Price-to-Book (X)	1.7	1.9
Price-Earnings to Growth (X)	1.2	0.8
Price-Earnings to Growth—Adjusted (X)	0.9	0.7
Profitability		
Gross Margin (%)	36.4	37.2
Net Profit Margin (%)	8.4	1.6
Return on Equity (%)	12.8	5.7
Financial Structure		
Long-Term Debt to Total Capital (%)	37.2	10.0
Total Liability to Total Assets (%)	70.4	54.0
Shares/Ownership		
Institutional Ownership (%)	49.5	14.8
Number of Institutional Owners	245	25
Insider Ownership (%)	20.0	44.5
Shares Outstanding (mil)	48.3	12.4
Price		
Price ($)	22.06	7.94
Price as a % of 52-Week High (%)	74.0	55.0
52-Week Relative Strength (%)	–22.0	–12.0
One-Year Price Change (%)	–14.2	–4.8

** All values are medians—the midpoints of the range*

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

Company (Exchange: 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 (52 wk.) (%)	Description
Firms With Dividend Reinvestment Plans									
Standard Register Co. (N: SR)	7.0	3.0	5.3	10.6	10.0	34.9	–61	–58	Business forms, equip & sys
Universal Corp. (N: UVV)	6.6	3.7	4.7	59.4	13.0	33.9	–33	–27	Leaf tobacco merchant
Quaker Chemical Corp. (N: KWR)	4.6	4.5	3.8	11.3	12.0	44.3	–3	5	Chemicals for indus & mfg
Genuine Parts Co. (N: GPC)	4.2	3.2	6.2	6.4	7.9	49.1	–18	–11	Distribs auto replace parts
Modine Manufacturing Co. (M: MODI)	4.2	2.2	12.8	11.7	20.0	39.0	–33	–27	Heat exchangers & systems
Dana Corp. (N: DCN)	4.1	2.9	8.4	6.1	11.2	40.1	–43	–38	Components & sys for mfg
R.R. Donnelley & Sons Co. (N: DNY)	4.1	2.2	7.5	6.4	11.9	35.5	–46	–41	Printing & related services
Arvin Industries, Inc. (N: ARV)	4.0	2.9	2.3	48.2	8.6	22.6	–46	–41	Mfrs & distribs auto parts
Quanex Corp. (N: NX)	3.9	2.5	2.7	23.8	16.0	22.6	–38	–33	Metal products
Vulcan Materials Co. (N: VMC)	3.9	2.3	12.1	21.7	13.3	34.6	–15	–7	Construction materials
Median for Top Ten Yielders	**4.2**	**2.9**	**5.8**	**11.5**	**12.0**	**35.2**	**–36**	**–30**	
Median All DRP Firms	**3.1**	**2.5**	**6.1**	**8.5**	**11.4**	**40.0**	**–22**	**–15**	
Firms Without Dividend Reinvestment Plans									
Maritrans Inc. (N: TUG)	7.0	4.3	82.1	14.6	na	37.7	–15	–7	Oil tankers, tugs and barges
Wallace Computer Services (N: WCS)	6.0	2.0	14.9	10.9	11.5	40.2	–57	–53	Business office products
Superior Uniform Group (A: SGC)	5.8	3.5	11.0	0.0	na	47.9	–38	–32	Uniforms & service apparel
Fleetwood Enterprises (N: FLE)	5.2	2.2	7.3	17.2	14.7	25.8	–46	–41	Mf'd housing & RVs
Raven Industries (M: RAVN)	5.0	2.7	13.4	–2.2	na	40.8	–12	–4	Plastic, electr & sewn prods
Oxford Industries (N: OXM)	4.9	3.4	3.5	7.2	na	29.6	–41	–35	Consumer apparel
Russ Berrie & Co. (N: RUS)	4.7	3.5	5.9	47.2	na	46.2	–37	–31	Gift products
MOCON Inc. (M: MOCO)	4.0	2.4	9.0	12.1	na	43.5	–3	6	High-tech instrumentation
Benetton Group S.p.A. (N: BNG)	3.9	1.6	10.2	3.6	12.5	36.2	–4	5	Casual apparel
Skyline Corp. (N: SKY)	3.5	2.3	6.6	15.9	na	35.0	–36	–30	Mf'd housing & RVs
Median for Top Ten Yielders	**5.0**	**2.6**	**9.6**	**11.5**	**12.5**	**39.0**	**–36**	**–30**	
Median All Non-DRP Firms	**0.0**	**2.0**	**0.0**	**6.9**	**20.0**	**0.0**	**–12**	**–5**	

Statistics are based upon figures as of April 28th, 2000.

Source: AAII's Stock Investor Pro/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 over the last 52 weeks. A figure of 5% indicates that the stock outperformed the market by 5% over the last 52 weeks.

Price Change (52-Week): The percentage change in price over the last year.

these stocks.

Many of the passing stocks in both groups have been beaten down as of late, evident by the one-year price changes. The 52-week price change is simply the percentage change in a company's stock price over the last 12 months. The high yields are the result of these price drops, but the cause of the drops most plausibly is due to the cyclical nature of the industries of these firms and, in some cases, firm-specific cyclicality.

The list of passing DRP stocks is not a diversified portfolio, nor is it a recommended list of companies. More than half are 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.

This initial screen for high yielding DRP and non-DRP firms is meant only to be a starting point toward further analysis. Throughout the year, the *AAII Journal* and the AAII Web site (www.aaii.com) present articles to illustrate how individual investors can analyze the prospects of specific stocks by applying a variety of secondary screens and demonstrating how these techniques might be useful. Applying screens to actual stocks enables individual investors to become familiar with the interpretation of financial data and the process of individual stock selection in a fundamental analysis framework.

Before making any investment decision, you should gather all pertinent information and understand the investment thoroughly. Also, keep in mind that no one investment technique will be best in all market environments and that the techniques that worked in the past may not be as useful in the future.

Diversifying your investments, minimizing taxes and transactions costs, maintaining a portfolio of investments at a level of risk that you are comfortable with, and taking a longer-term perspective are investment approaches that will prove the most valuable over time.

Firms with dividend reinvestment plans offer investors advantages, but remember to buy them because you are optimistic about performance, and not simply because the company offers a DRP plan. ◆