Dangerous Dividend Warning Signs

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Learning Objectives and Presentation Overview

Learning Objectives

- Key warning signs a stock's dividend might be at risk
- Practical examples for avoiding dividend cuts or suspensions
- How using a dividend screener/grader can help you identify sustainable dividend-paying stocks

Presentation Overview

- State of the market
- Dividend safety signs and warnings flags
  - What is the level and quality of payments?
  - How well are dividends covered?
  - Can debt be repaid?
- Screeners/graders help identify sustainable dividend-paying stocks

State of the market

Dividend safety signs and warning flags

Screeners/graders help identify sustainable dividend-paying stocks

State of the Market

Bulls	Bears
• Leading economic indicators positive ○ Unemployment claims ○ Consumer spending ○ Manufacturing & construction/building permits • Corporate earnings continue to outperform expectations	• Markets trading at historic levels • Fed tapering is imminent • Stubbornly high inflation • Earnings growth has peaked • Delta variant prolonging the pandemic • Supply chain disruptions

Signs point to favorable outlook with more volatility

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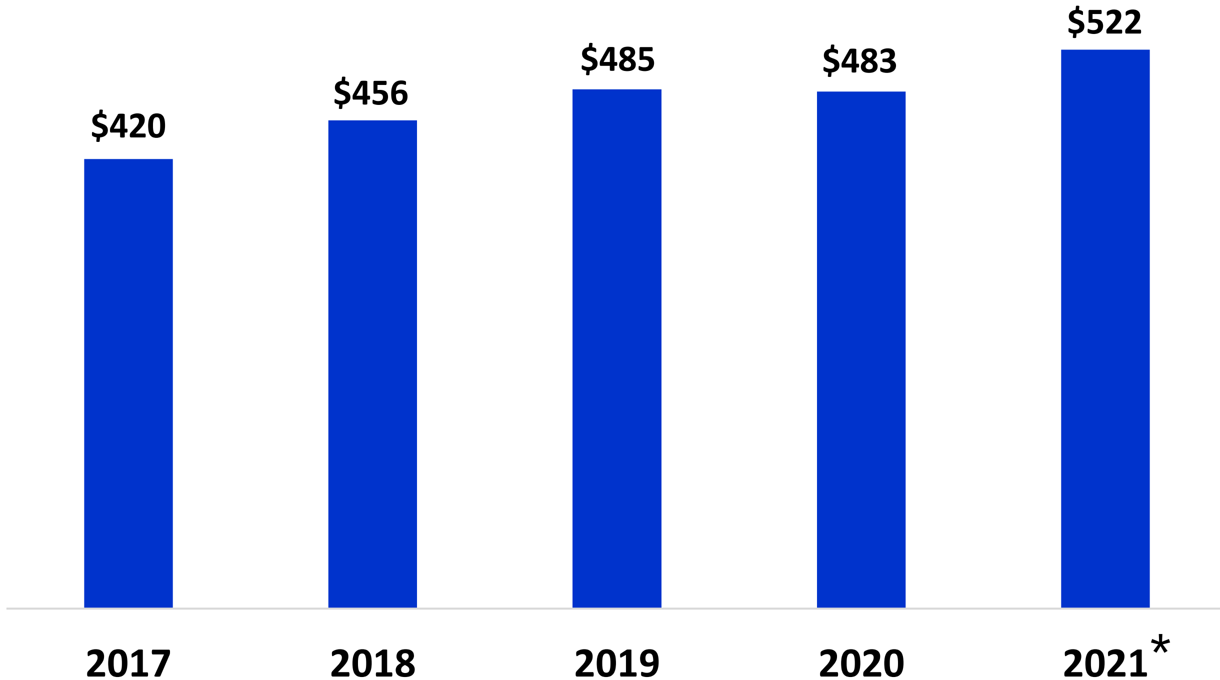
State of Dividends – Record Payments

S&P 500: Yearly Dividend Payments

(In $ billions)



*Source: S&P Dow Jones Indices. *Data as of September 30, 2021.*

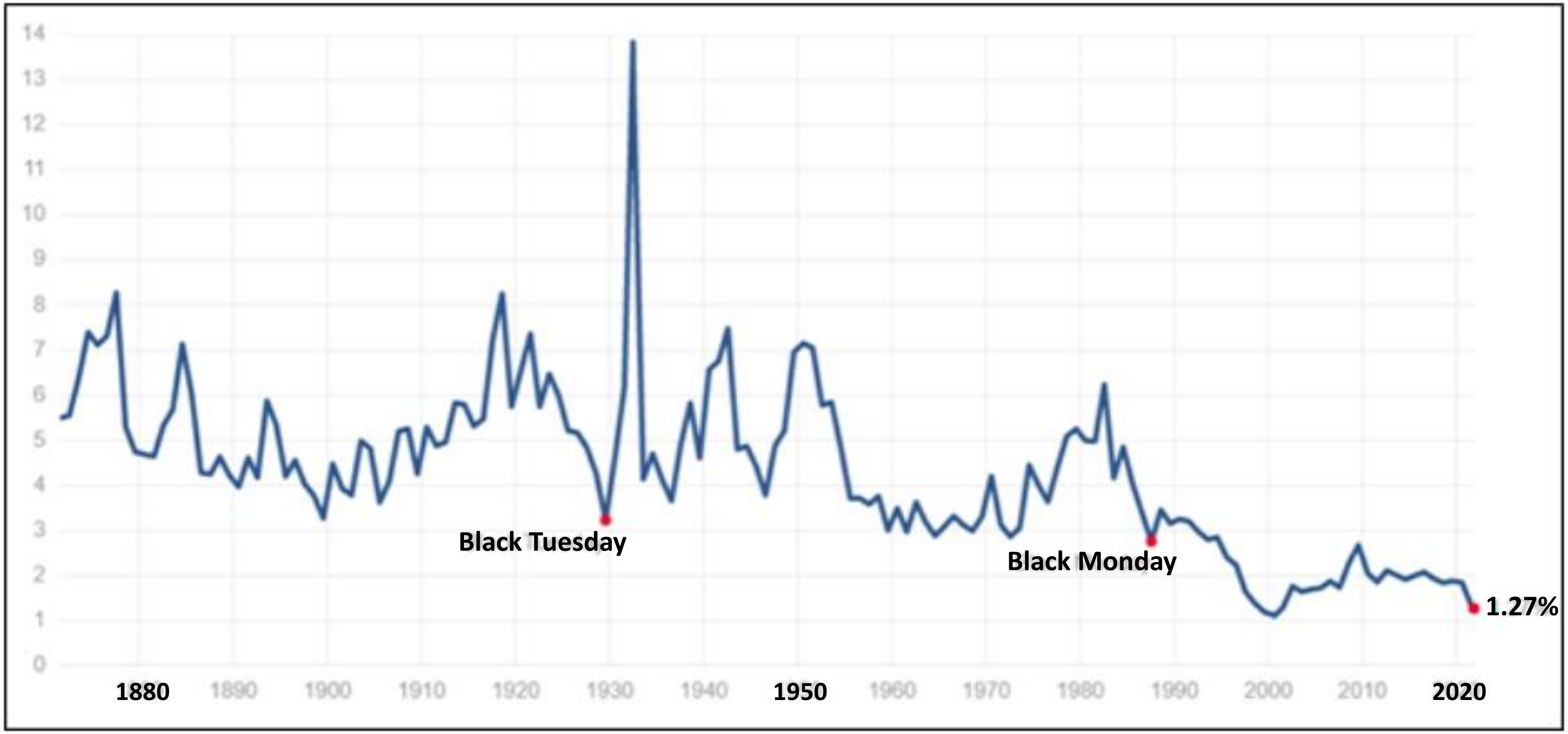
“S&P 500 dividends are back, as record earnings, sales and margins have allowed companies to get back to returning dividends to shareholders. Larger dividend increases and a lack of cuts produced a record payment to S&P 500 shareholders in the third quarter of 2021.”

– Senior index analyst at S&P Dow Jones Indices Howard Silverblatt

For frequent dividend-oriented research and analysis postings, Silverblatt can be followed on Twitter at www.twitter.com/hsilverb.

The Incredible Shrinking Dividend Yield

S&P 500 Dividend Yield

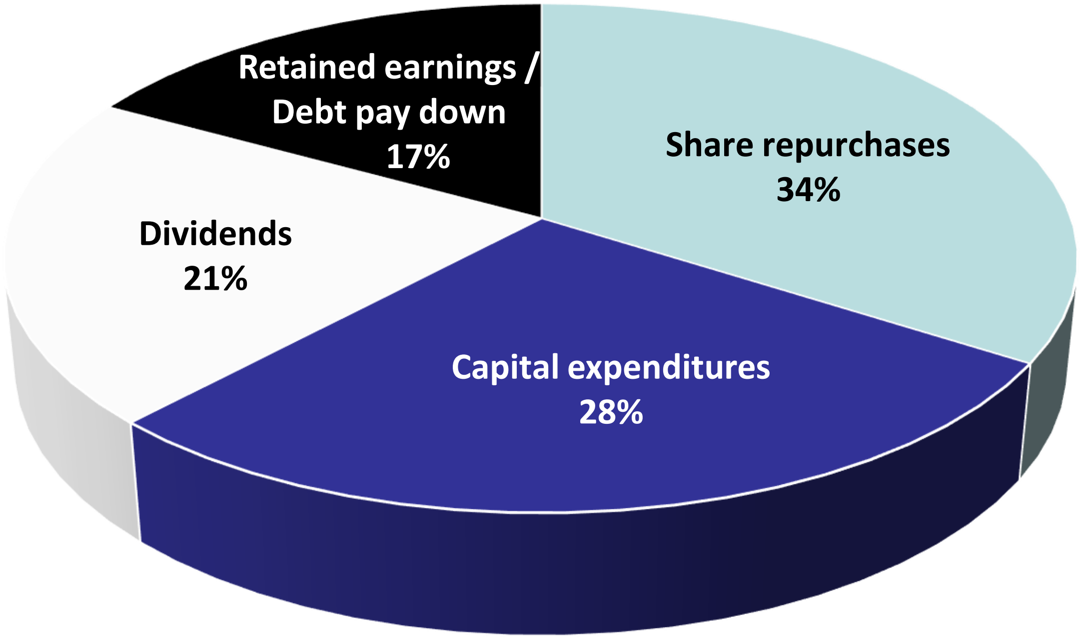


Source: www.multpl.com/s-p-500-dividend-yield. Data as of November 11, 2021.

Dividend yields near historic lows

Dividends as a Percentage of Cash Flow Are Shrinking

S&P 500 Companies' Cash Flow Allocation



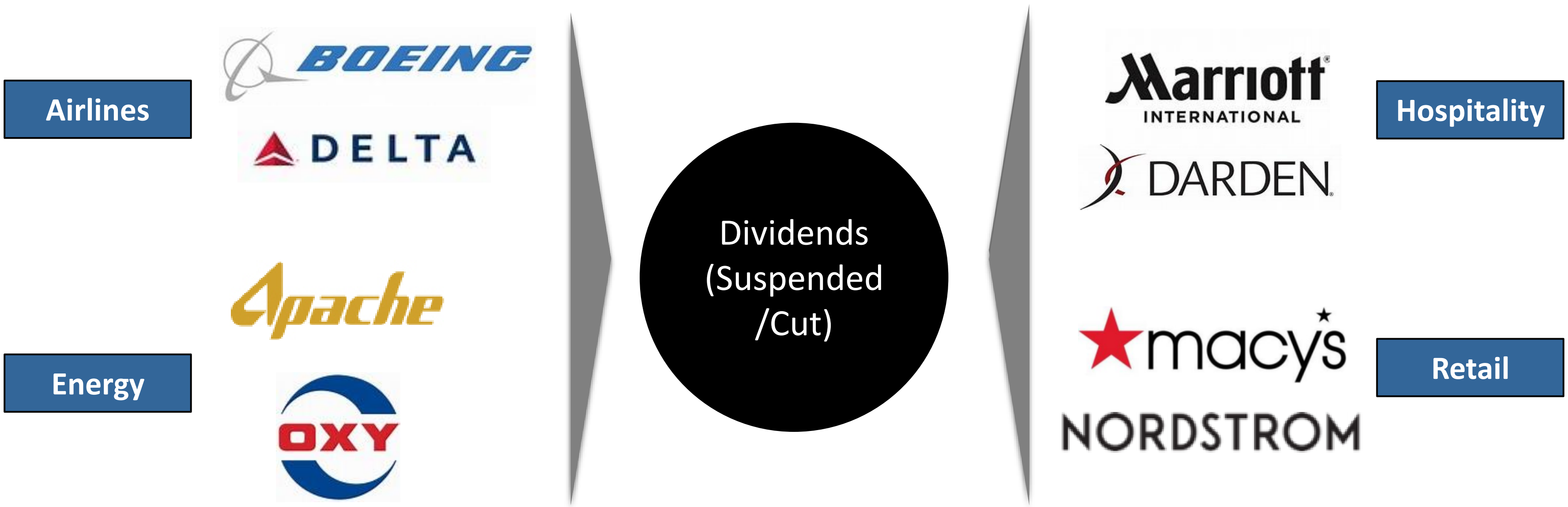
Source: S&P Dow Jones Indices.

Despite the dollar value of dividends rising this year, dividends as a percentage of cash flow have decreased slightly in recent years. Companies are spending more cash flow on share repurchases and capital expenditures than dividends.

Companies Preserving Cash in Uncertain Times

Dividend investors saw companies reduce or eliminate payouts during pandemic:

- Companies started to withdraw their quarterly and full-year outlooks amid the uncertainty
- Intense pressure for companies to preserve cash due to impact of the coronavirus pandemic
- Several actions that companies can take to increase financial flexibility and preserve cash
  - Reduce labor and operating costs
  - Lower capital expenditures
  - Draw down revolving credit lines
  - Suspend share buybacks
  - Cut or eliminate the dividend



Dividend investors need to be prepared for the possibility of further cuts and suspensions

Dividend Cuts & Suspensions Slowing

Dividends (Suspended)

Dividends (Cut)

Coronavirus-caused flood of dividend cuts and suspensions has slowed to a trickle, but some notable names have still slashed payouts of late

*National Cinemedia cut dividend twice since May 2020. From $0.19 per share to $0.07 per share and then to $0.05 per share in March 2021.

State of the market

Dividend safety signs and warning flags

Screeners/graders help identify sustainable dividend-paying stocks

Dividend Safety Signs and Warning Flags

SAFETY What is the level and quality of payments?

Dividend-seeking investors need to evaluate the dividend payments themselves, how steady they have been and how much you are paying for them

Characteristics Analyzed:
- Dividend yield
- Annual dividend payments
- Dividends vs. reported annual earnings

SAFETY How well are dividends covered?

Dividends that are higher than reported annual earnings can be a warning sign that the firm is facing some difficulties, since firms pay dividends primarily from earnings. However, strong cash flow can help cover a dividend payment when earnings temporarily drop.

Characteristics Analyzed:
- Earnings payout ratio
- Free-cash-flow payout ratio
- Dividend coverage ratio

SAFETY Can debt be repaid?

Heavier debt loads saddle a company with required cash outflows to bondholders, who must be paid before dividends can be paid to shareholders

Characteristics Analyzed:
- Debt-to-equity ratios
- Liquidity: Quick ratio
- Interest coverage ratio

SAFETY What are the long-term trends?

Trends can help you understand if a company's position is improving or deteriorating.

Characteristics Analyzed:
- Dividend and earnings growth rate

Level and Quality of Payments

What is the level and quality of payments?

Dividend-seeking investors need to evaluate the dividend payments themselves, how steady they have been and how much you are paying for them

Characteristics Analyzed:
- Dividend yield
- Annual dividend payments
- Dividends vs. reported annual earnings

Dividend yield
(dividends per share ÷ price per share)

A measure of the market value of the dividend income stream. Dividend yields that are above average for the company historically, or that are above average for the industry, may indicate higher risk, but you need to determine if the market has correctly evaluated this risk.

Annual dividend payments

Dividends paid with no interruptions over a significant time period are a positive sign; dividend increases during prosperous years (with no subsequent decreases) are an even more positive sign.

Dividends vs. reported annual earnings

Dividends higher than reported annual earnings are a warning sign, since this level of payment cannot be sustained over long time periods.

Level and Quality of Payments Examples

Dividend yield
(dividends per share ÷ price per share)

SAFETY

Dividend yields that are above average for the company historically, or that are above average for the industry, may indicate higher risk.

AT&T*

Pending dividend cut?

Its current dividend yield of 8.4% compares to its five-year average of 5.7% and its seven-year average high of 6.6%.

Annual dividend payments

SAFETY

Dividends paid with no interruptions over a significant time period are a positive sign.

PEPSICO

Paid a dividend since 1952 and has consecutively increased its payment for 49 years

Dividends vs. reported annual earnings

SAFETY

<u>Dividends higher than reported annual earnings are a warning sign</u>, since this level of payment cannot be sustained over long time periods.

Altria

Indicated dividend of $3.60 is greater than diluted earnings per share of $1.49

*<u>Note</u>: AT&T has not cut its dividend yet. This is based on AT&T projections. AT&T last increased its dividend in December 2019. According to AT&T CFO Pascal Desroches' June 15 update to shareholders, the company will pay out between $8 billion to $9 billion annually for dividends. That's approximately 40% to 43% of the $20 billion or more in free cash flow it expects to generate once WarnerMedia's been spun off.

In the first quarter ended March 31, AT&T paid out $3.83 billion in dividends. That's $15.32 billion on an annualized basis. Based on the midpoint of the company's dividend payout guidance post-closing in mid-2022, AT&T will reduce its dividend by 45% to an estimated $1.19 per share.

Dividend Coverage

How well are dividends covered?

Dividends that are higher than reported annual earnings can be a warning sign that the firm is facing some difficulties, since firms pay dividends primarily from earnings. However, strong cash flow can help cover a dividend payment when earnings temporarily drop.

Characteristics Analyzed:

- Earnings payout ratio
- Free-cash-flow payout ratio
- Dividend coverage ratio

Earnings payout ratio
(dividends per share ÷ earnings per share)

A measure of how much profit the company is paying out to shareholders in dividends. The lower the ratio, the more secure the dividend. Any ratio above 50% is generally considered a warning flag.

Free-cash-flow (FCF) payout ratio
(dividends per share ÷ free cash flow per share)

The percentage of free cash flow per share paid out as dividends. Free cash flow is cash flow from operating activities less capital expenditures. A measure of a company's ability to both pay dividends and increase its cash balance.

Dividend coverage ratio
(cash flow per share ÷ dividends per share)

A measure of how secure the dividend is based on the company's cash flow. The higher the better; minimum coverage should be 1.2, indicating 120% coverage.

Dividend Coverage Examples

Earnings payout ratio
(dividends per share ÷ earnings per share)

The lower the ratio, the more secure the dividend. Any ratio above 50% is generally considered a warning flag.

The Clorox Company Clorox Co. (CLX)

Earnings payout ratio = 128.2% = $4.49 ÷ $3.50
Payout ratio seven-year avg. = 62.4%

International Flavors & Fragrances Inc. (IFF)

Earnings payout ratio = 238.5% = $3.08 ÷ $1.29
Payout ratio seven-year avg. = 60.9%

Apogee Enterprises Inc. (APOG)

Fiscal Year	2017	2018	2019	2020	2021
Earnings Payout Ratio:	20.7%	39.4%	30.5%	128.2%	617%

Procter & Gamble Co. (PG)

Fiscal Year	2017	2018	2019	2020	2021
Earnings Payout Ratio:	46.5%	74.3%	199.6%	59.0%	57.0%
Div. per share:	$2.69	$2.78	$2.89	$3.02	$3.24
Earnings per share:	$5.80	$3.75	$1.45	$5.13	$5.69

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Dividend Coverage Examples

	2014	2015	2016	2017
Earnings payout ratio:	104.1%	140.8%	163.9%	—
Div. per share:	$1.52	$1.52	$1.52	$0.91
Earnings per share:	$1.46	$1.08	$0.91	($3.07)
Free-cash-flow (FCF) per share:	$0.33	($0.10)	($0.54)	($1.85)

Dividend sustainability: Mattel, Inc. (MAT)

- Mattel cut its dividend 60% in June 2017, from $0.38 to $0.15 per share
- Dividend cut freed up $50 million per quarter
- Took share price more than four years to recover back to pre-dividend cut levels
- No longer paying a dividend

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Dividend Investors Prefer Moderate Debt Levels

Can debt be paid?

Heavier debt loads saddle a company with required cash outflows to bondholders, who must be paid before dividends can be paid to shareholders

Characteristics Analyzed:

- Debt-to-equity ratios
- Liquidity: Quick ratio
- Interest coverage ratio

Long-term debt-to-equity ratio
(long-term debt ÷ stockholder's equity)

A measure of financial leverage. A higher ratio indicates higher financial leverage and therefore more risk; look for levels that are within the industry norm.

Short-term debt coverage ratio
(operating income ÷ short-term debt)

A measure of whether a company's short-term debt obligations can be easily paid using cash generated from company operations. Should equal at least 2.0.

Quick ratio
[(current assets – inventory) ÷ current liabilities]

A measure of liquidity risk. The higher the quick ratio, the better, but it should have a minimum of 1.0.

Times Interest Earned
(earnings before interest & taxes ÷ the total interest payable)

A measure of a company's ability to meet its interest payments. Should equal at least 1.0. The larger and more stable, the better.

Dividend Investors Prefer Moderate Debt Levels

Times Interest Earned
(earnings before interest & taxes ÷ the total interest payable)

A measure of a company's ability to meet its interest payments. Should equal at least 1.0. The larger and more stable, the better.

MAXAR TECHNOLOGIES	2017	2018	2019	2020	2021
Times interest earned:	(2.6x)	(3.6x)	1.4x	(0.6x)	(0.3x)
EBIT (in $ mil):	($161.9)	($723)	$274	$99	$32
Interest expense (in $ mil):	$61.1	$200	$197	$168	$119
Industry times interest earned:	1.6x	0.0x	0.1x	0.4x	1.0x

Dividend sustainability: Maxar Technologies Inc. (MAXR)

- Space technology company specializing in manufacturing communication, Earth observation, radar and on-orbit servicing satellites, satellite products and related services
- Maxar cut its dividend 96% in February 2019, from $1.13 to $0.04 per share

Deteriorating Growth Values are a Warning Sign

What are the long-term trends?

Trends can help you understand if a company's position is improving or deteriorating.

Characteristics Analyzed:

- Year-to-year changes in financial ratios, earnings, cash flow and revenues
- Dividend growth rate
- Earnings growth rate

Year-to-year changes in financial ratios, earnings, cash flow and revenues

Look for positive values or values that are at least within acceptable ranges over time. Deteriorating values are a warning sign.

Dividend growth rate
(compound annual increase in dividend per share)

An indication of past company strength and dividend payment policy. Look for a five-year average greater than average for the industry.

Earnings growth rate
(compound annual change in earnings per share)

An indication of past company strength and the ability to generate earnings. Look for firms with earnings growth rates in the upper half of their respective industries.

Dividend & Earnings Growth Rate Examples

Dividend growth rate (compound annual increase in dividend per share)

Look for a five-year average greater than average for the industry.

Earnings growth rate (compound annual change in earnings per share)

Look for firms with earnings growth rates in the upper half of their respective industries.

UNITEDHEALTH GROUP®

	1-Yr. Avg.	3-Yr. Avg.	5-Yr. Avg.	7-Yr. Avg.
Div. growth rate:	16.7%	18.9%	20.8%	24.3%
Industry div. growth rate:	17.7%	15.5%	14.8%	15.3%
Earnings growth rate:	11.9%	19.0%	21.7%	16.5%
Industry earnings growth rate:	(0.5%)	17.6%	21.7%	16.5%

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Dividend & Earnings Growth Rate Examples

Dividend growth rate (compound annual increase in dividend per share)

Look for a five-year average greater than average for the industry.

Earnings growth rate (compound annual change in earnings per share)

Look for firms with earnings growth rates in the upper half of their respective industries.

LUMEN Lumen Technologies Inc. (LUMN)*

	1-Yr. Avg.	3-Yr. Avg.	5-Yr. Avg.	7-Yr. Avg.
Div. growth rate:	0.0%	(22.6%)	(14.3%)	(10.4%)
Industry div. growth rate:	0.0%	(1.4%)	(2.8%)	0.0%
Earnings growth rate:	76.8%	(64.9%)	(22.2%)	(16.3%)
Industry earnings growth rate:	6.8%	11.4%	4.3%	0.3%

*Note: Formerly known as CenturyLink Inc. (CTL), an integrated communications firm.

Source: Big Charts from MarketWatch

A 12/21/2012 CTL's Last Dividend Before Cut
B 2/27/2013 CTL Cuts Quarterly Dividend 25.5% from $0.725 per share to $0.54
C 12/7/2018 CTL's Last Dividend Paid of $0.54 Before Second Cut
D 3/1/2019 CTL Cuts Quarterly Dividend Again 53.7% from $0.54 per share to $0.25
E 11/21/2019 CTL Declares Quarterly Dividend of $0.25 per share

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Select Dividend Safety Screening Characteristics

Dividend-paying company examples:

	Huntington Ingalls Industries	Allstate You're in good hands.
▪ Level and quality of payments		
○ Current yield <u>greater</u> than 5-year avg.:	Yes; 2.5% > 1.5%	Yes; 2.8% > 2.0%
○ At least 7 consecutive yrs. of annual div. increases:	Yes; 9 years	Yes; 11 years
▪ Dividend coverage		
○ Earnings payout ratio 12m <= 50%:	Yes; 27.4%	Yes; 24.6%
○ Minimum dividend coverage ratio 1.2:	Yes; 3.01x	Yes; 5.36x
▪ Debt coverage		
○ Long-term debt to capital Q1 <= 50%:	No; 60.3%	Yes; 23.0%
○ Times interest earned 12m >= 2x:	Yes; 8.1x	Yes; 26.7x
▪ Long-term trends		
○ 5-year dividend growth rate > 3%:	Yes; 20%	Yes; 12.1%
○ 5-year earnings growth rate > 3%:	Yes; 15.4%	Yes; 27.9%

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State of the market

Dividend safety signs and warning flags

Screeners/graders help identify sustainable dividend-paying stocks

Screeners/Graders Help Identify Sustainable Dividend-Paying Stocks

Seeking Alpha$^{\alpha}$

CVX - Chevron Corporation

seekingalpha.com/symbol/CVX/dividends/dividend-safety

115.94 0.45 (+0.39%) 4:00 PM 11/16/21

NYSE | Pre-Market: $115.50 -0.44 (-0.38%) 7:08 AM

Summary | Ratings | Financials | Earnings | **Dividends** | Valuation | Growth | Profitability | Momentum

Dividend Scorecard | Dividend Yield | Dividend Growth | **Dividend Safety** | Dividend History | Dividend Estimates

Dividend Safety Grade

CVX Dividend Safety Grade C

	Sector Relative Grade	CVX	Sector Median	% Diff. to Sector	CVX 5Y Avg.	% Diff. to 5Y Avg.
Cash Dividend Payout Ratio (TTM)	D+	69.74%	43.23%	61.32%	158.90%	-56.11%
Dividend Payout Ratio (TTM) (GAAP)	C-	101.54%	67.51%	50.42%	162.91%	-37.67%
Dividend Payout Ratio (TTM) (Non GAAP)	D+	94.60%	57.40%	64.82%	148.55%	-36.31%
Dividend Payout Ratio (FY1) (Non GAAP)	C	64.45%	54.41%	18.45%	851.77%	-92.43%
Cash Flow Payout Ratio (TTM)	D+	40.37%	19.83%	103.59%	NM	NM
Cash Flow Payout Ratio (FY1)	C-	32.47%	23.85%	36.12%	38.74%	-16.18%
Free Cash Flow Yield to Dividend Yield Ratio (TTM)	D+	1.43%	2.38%	-39.69%	NM	NM
Dividend Yield to Dividend Payout Ratio (TTM)	D+	4.76%	7.29%	-34.75%	4.06%	17.22%
Dividend Coverage Ratio (FY1)	C	1.55	1.86	-16.41%	NM	NM
Interest Coverage (TTM)	A	17.29	3.96	337.02%	NM	NM
Net Long Debt/Assets (TTM)	B	12.93%	26.84%	-51.82%	9.89%	30.79%
Net Long Debt/EBITDA (TTM)	B+	108.69%	281.09%	-61.33%	125.45%	-13.36%

Screeners/Graders Help Identify Sustainable Dividend-Paying Stocks

MORNINGSTAR Premium

Chevron Corp CVX ★★★

Rating as of Nov 16, 2021

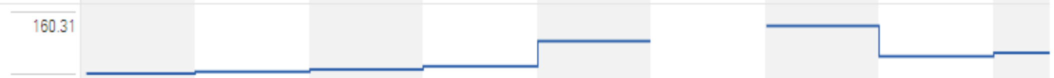
morningstar.com/stocks/xnys/cvx/dividends

Quote | Stock Analysis | News | Price vs Fair Value | Sustainability | Trailing Returns | Financials | Valuation | Operating Performance | Dividends | Ownership

Dividends & Splits

Dividends | Splits

Calendar	2011	2012	2013	2014	2015	2016	2017	2018
Dividend Per Share	3.09	3.51	3.90	4.21	4.28	4.29	4.32	4.48
Trailing Dividend Yield %	2.90	3.25	3.12	3.75	4.76	3.64	3.45	4.12
Buyback Yield %	1.23	1.97	1.88	2.07	0.64	—	—	—
Total Yield %	4.13	5.22	5.00	5.82	5.40	3.64	3.45	4.12



	2011	2012	2013	2014	2015	2016	2017	2018
Payout Ratio %	22.22	26.35	31.10	38.12	92.84	—	125.95	59.76

Ex-Dividend Date	Declaration Date	Record Date	Payable Date	Dividend Type	Amount
Upcoming Dividends					
Nov 17, 2021	Oct 27, 2021	Nov 18, 2021 *	Dec 10, 2021 *	Cash Dividend	1.3400
▼ 2021					
Aug 18, 2021	Jul 28, 2021	Aug 19, 2021	Sep 10, 2021	Cash Dividend	1.3400
May 18, 2021	Apr 28, 2021	May 19, 2021	Jun 10, 2021	Cash Dividend	1.3400
Feb 16, 2021	Jan 27, 2021	Feb 17, 2021	Mar 10, 2021	Cash Dividend	1.2900
▸ 2020					
▸ 2019					
▸ 2018					
▸ 2017					

Dividend Yield (TTM) 4.48%

Div Reinvestment Plan Yes

USD | As of Nov 16, 2021 | *Indicates upcoming reported dividend information

Screeners/Graders Help Identify Sustainable Dividend-Paying Stocks

AAII DIVIDEND INVESTING

di.aaii.com/grader/index.cfm?ticker=cvx

AAII.com | DI Portfolio | DI Ideas | Dividend Grader | Dividend Screener | Weekly Update | Monthly Report | How To | Articles

AAII Dividend Grader

Enter company or ticker | Evaluate

DI Snapshot | DI Scorecard

CHEVRON CORPORATION (CVX)

Price: $117.28 ▲ $0.4600 | 0.39%

Price as of: November 16, 2021 4:02 PM | EST Volume: 10,566,262

POWERED BY STOCK INVESTOR PRO

DIVIDEND PILLARS

	2021-11-16	2021-09-30	2021-06-30	2021-03-31
Dividend Valuation	B	B	A	B
Dividend Growth	B	C	D	D
Dividend Strength	B	B	C	B

Energy : Oil & Gas - Refining and Marketing
SECTOR: INDUSTRY

$225,192 (Mil)
MARKET CAP

4.6%
DIVIDEND YIELD

DIVIDEND VALUATION SCORE: 34 | **DIVIDEND GROWTH SCORE: 68** | **DIVIDEND STRENGTH SCORE: 80**

DIVIDEND VALUATION GRADE	DIVIDEND GROWTH GRADE	DIVIDEND STRENGTH GRADE
B Value	B Strong	B Strong

A	B	C	D	F
0-20 Deep Value	21-40 Value	41-60 Average	61-80 Expensive	81-100 Ultra Expensive

A	B	C	D	F
81-100 Very Strong	61-80 Strong	41-60 Average	21-40 Weak	0-20 Very Weak

A	B	C	D	F
81-100 Very Strong	61-80 Strong	41-60 Average	21-40 Weak	0-20 Very Weak

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Screeners/Graders Help Identify Sustainable Dividend-Paying Stocks

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di.aaii.com/grader/screen.cfm

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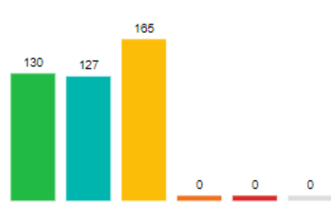
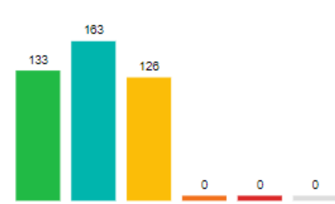
AAII Dividend Screener

Data as of 11/16/2021



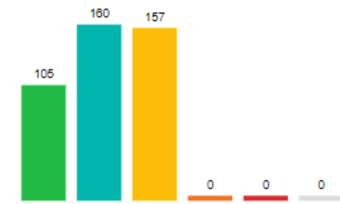
Dividend Valuation

A B C D F NA



Dividend Growth

A B C D F NA



Dividend Strength

A B C D F NA

Reset | Load Portfolio | Load Screens | Select a sector | Select an industry

Showing 422 dividend-paying companies. Move the slider at the top under each investment factor to adjust this list.

Ticker	Company Name	Valuation		Growth		Strength	
		Score	Grade	Score	Grade	Score	Grade
ITIC	Investors Title Company	52	C	96	A	99	A
PCH	Potlatchdeltic Corp	57	C	80	B	99	A
PSB	PS Business Parks Inc	50	C	72	B	99	A
SAFM	Sanderson Farms, Inc.	43	C	95	A	99	A
AC	Associated Capital Group Inc	37	B	83	A	98	A
FNV	Franco Nevada Corp	57	C	80	B	98	A

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AAII Dividend Investing

https://di.aaii.com

AAII Dividend Investing Strategy

- **Dividend Investing's strategy:** Seeks stocks that have the potential to rise in price and make larger dividend payments in the future—a total-return strategy
- DI seeks to identify the best dividend investment opportunities by **focusing on a select universe of well-financed companies** that have a long history of:
  - Sales, earnings and dividend growth
  - Positive free cash flow
  - Attractive valuations
- Strategy based on robust studies of market factors that have contributed to strong long-term market returns
- <u>Unique value proposition</u>: provides subscribers complete control (addition/deletion decisions, tax situation, etc.)
- Weekly email/commentary; Monthly *Dividend Investing* newsletter with article archive

Provides the education and tools necessary to analyze, research and manage a successful dividend portfolio

AAII Dividend Investing Model Portfolio

AAII Dividend Investing

- Model portfolio with real capital investment
- Portfolio inception: 2012
- 24 hand-picked dividend-paying growth stocks
  - U.S. exchange-traded; large-cap value tilt
  - Diversified across sectors; no REITs or MLPs
  - Pays monthly dividends; current portfolio composition
  - Current yield ~2.5% vs. market yield ~1.0%
  - Compared to Dow Jones U.S. Index (IYY)
- Proprietary quantitative strategy, rules-based
- Alert members of portfolio additions/deletions

Current DI holdings - sample

Former DI holdings - sample

DI Portfolio Return Versus Vanguard High Dividend Yield ETF (VYM) & Dow Jones U.S. Index (IYY)

	Annualized	Annual Returns (%)									
	Return (%)	YTD	2020	2019	2018	2017	2016	2015	2014	2013	2012
Dividend Investing Portfolio	13.3	26.6	3.5	29.9	(11.5)	22.3	18.2	(7.7)	12.2	36.5	10.2
Vanguard High Dividend Yield ETF (VYM)	12.8	21.2	1.1	24.1	(5.9)	16.4	17.1	0.3	13.5	30.1	12.7
Dow Jones U.S. Index (IYY)	15.9	21.9	20.1	30.8	(5.2)	21.3	12.0	0.4	12.9	32.6	14.4

Source: Morningstar and AAII's A+ Investor. Data from January 3, 2012, through October 22, 2021.

AAII Dividend Investing Offer

https://invest.aaii.com/di-member-sale

Thank You!

Contact me at dhageman@aaii.com

with questions or comments

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Wednesday, December 15, 2021
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Note special time

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