Dividend Plays

High yield, good value

BY : KENNETH LIM

CAN investors have their cake and eat it too? Consider the dividend-paying stock. That is an investment that seems to offer some of the steady cash flow of coupon-paying bonds as well as the potential for capital appreciation inherent in all equities. Dividend plays have been strong contributors to returns in recent years, and analysts say there is still good value and payout assurance in certain sectors and stocks. An improving economic outlook could, however, make cyclicals more attractive going forward, and historical data suggests that targeting other forms of value such as low earnings and book-value multiples could actually generate strong returns.

The idea of dividend investing has been around as long as companies have paid them. Charles Dow wrote as early as 1920 that the value of a stock can be measured essentially by its dividend outlook.

The value of a stock "should be considered essentially with reference to its ability to maintain or increase its dividends", Mr Dow wrote. "If the stock seems likely to continue a current rate of dividend, and the return on the cost is such as to make it fairly satisfactory as an investment, it is a good stock to buy when, in sympathy with decline in the general market, it has fallen below its normal price."

Singapore, in particular, has emerged as a relatively good market to find companies happy to dole out some of their profits. The market's strong real estate investment trust (Reit) and business trust sector notwithstanding, Singapore Exchange in March specifically highlighted that Singapore stocks were the best dividend-yielding counters among Asia's largest listed companies.

Among the 12 Asian countries included in the FTSE Global Equity Index series, the FTSE Singapore benchmark yielded 3.6 per cent, compared to a median yield of 2.5 per cent for the 12 Asian indices, SGX noted. Dividend plays have done particularly well over the past few years as low interest rates pushed yield-hungry investors away from the more traditional fixed-income instruments into more risky equities.

"Our studies show that over the last five years, dividends (re-invested) accounted for 42 per cent of total returns in the Singapore market," said Kum Soek Ching, head of South-east Asia research at Credit Suisse Private Banking and Wealth Management. But cash-paying companies have not always been that impressive.

The Business Times constructed three simple model portfolios: One comprising the 20 Singapore-listed stocks with the highest current dividend yield; a second comprising the 20 Singapore-listed stocks with the lowest price-earnings ratio; and a third made up of the 20 Singapore-listed stocks with the lowest price-to-book value ratio.

Those portfolios were then backtested over 10 years, with monthly rebalancing, based on Bloomberg's historical data.

Against the blue-chip Straits Times Index, the portfolio of highest-yielding stocks did well, with a cumulative total return of 378 per cent over a decade, compared to just 126 per cent for the benchmark. That seems like pretty decent outperformance, until those numbers are stacked against the other two portfolios.

The earnings-multiple portfolio had a cumulative total return of 787 per cent over the same period, while the book value portfolio posted a cumulative total return of a stunning 6,861 per cent.

Those results may reflect more than just a Singapore-only phenomenon.

In a recent piece of research, Gregg Fisher, chief investment officer of US-based independent investment management and advisory firm Gerstein Fisher, argued that most of the excess return from a high-dividend yield portfolio between 1979 and 2012 actually came from value with regards to earnings and book value.

In fact, "when the factors explaining the returns were decomposed, it was determined that the dividend yield factor actually contributed negative 1.02 percentage points annualised to the excess return," Mr Fisher wrote in the Journal of Financial Planning. "In other words, the factor actually detracted from performance."

That dividends do not automatically translate into stellar returns is not surprising when considering the concept of the dividend payout. In general, companies tend to return dividends only when they cannot find a better way to reinvest their cash to generate growth.

"Dividend plays are typically no-growth businesses that generate a steady cash-flow profile," said Kenneth Ng, head of research at CIMB. "Since the companies have little new expansion to use their generated earnings, they are expected to pay the bulk of it as dividends." Investors should look beyond the headline dividend yield and understand the fundamental basis for the payout, Mr Ng added.

How leveraged does a company have to be to deliver that yield? Does the yield have a downside, and is it artificially boosted by income support?

What is the scope for earnings growth to continue delivering those yields? Market conditions can threaten the ability of historical dividend plays to continue paying out cash.

"They are valuation traps if the underlying assets' pricing power is dependent on certain market conditions," Mr Ng said. "If it loses the ability in an industry of oversupply, it might not generate a yield for you for a couple of years. Examples are the shipping trusts."

The current interest rates cycle may also dull some of the attractiveness of dividend-paying stocks.

"Although we do not see interest rates rising in the US before the second half of 2015, the dividend theme no longer enjoys the tailwind of declining interest rates," Ms Kum said. "With the global economy in a recovery mode, cyclicals are also likely to be more sought after than dividend stocks."

But the dividend play should not be too easily dismissed, especially for risk-averse and long-term investors.

"The Singapore market's 12-month forward yield of 3.7 per cent should still be attractive for conservative buy-and-hold investors," Ms Kum said. "Singapore is also a relatively low earnings growth market (we expect about 9 per cent for 2014), and dividends can be a material portion of total returns."

Ms Kum recommended keeping an eye out for payout increases to find potential opportunities. "Generally, it is not so much the dividend yield but the change in the dividend payout ratio that has a signalling effect," she said. "For example, if the payout ratio increases, it could be taken as management's affirmation of the company's cash-flow strength or earnings growth outlook."

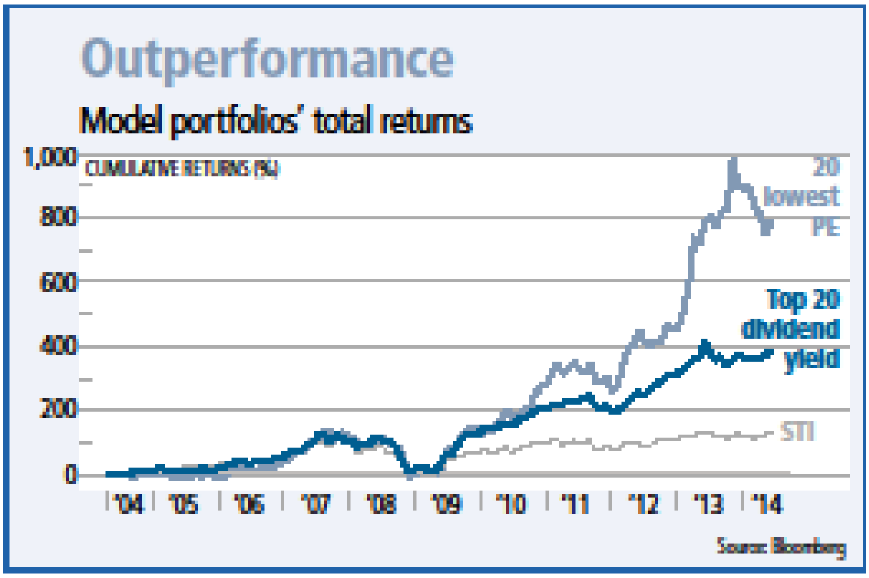
In Singapore, the Reits and business trusts are actually regaining favour after being beaten down over the past few months amid expectations of rising interest rates. Mr Ng said: "Singapore has a lot of Reits, business trusts and dividend stocks. There is a good case to be made for them...as yields can be quite good."

CIMB prefers hotel and office Reits, including Mapletree Greater China Commercial Trust, Frasers Centrepoint Trust and Croesus Retail Trust.

At Credit Suisse, Ms Kum is also partial to Singapore Reits, which are paying an average yield of 6.3 per cent at the moment.

Beyond the trusts, Singapore Technologies Engineering, SATS, SIA Engineering Co and M1 are among "good yield plays" recommended by CIMB. Credit Suisse is also up on M1 and Keppel Corp.

"Obviously rising interest rates will be headwinds for Reits that have a high gearing and higher financing costs which will reduce the distribution per unit for investors," Mr Ng said. "Like-for-like, if there is a steady cash flow generating business that generates the same yield as a Reit and is net cash, one should prefer a stock to a Reit, which are typically geared."



Top 20 Best yielding Singapore-listed stocks

COMPANY	12-MONTH FORWARD DIVIDEND YIELD (BLOOMBERG ESTIMATES) (%)	ONE-YEAR TOTAL RETURN (%)	MAY 20 CLOSING PRICE ($)
Asian Pay TV	10.74	NA*	0.77
Elec & Eltek	10.26	-27.79	1.88
Pac Andes Resources	9.05	-11.20	0.12
Viva Industrial	9.02	NA*	0.79
Croesus Retail	8.98	-6.34	0.97
Karin Tech	8.86	4.04	0.31
Religare Health	8.80	-3.48	0.87
Serial System	8.18	13.82	0.14
Ascendas H-Trust	8.00	-18.70	0.74
Soilbuild Business	7.97	NA*	0.78
Aims Amp Capital	7.83	-16.31	1.42
Sabana	7.68	-15.24	1.06
OUE H-Trust	7.66	NA*	0.89
China Merchants	7.57	11.06	0.91
Lippo Malls	7.54	-22.22	0.41
UMS	7.48	112.28	0.91
Keppel Infrastructure	7.46	7.33	1.05
Hutchison Port Holdings Trust	7.45	-7.02	0.90
Telechoice	7.41	8.57	0.25
Cache Logistics	7.37	-10.03	1.20

*Listed less than a year ago

Source: Bloomberg