

Low dividend yield stocks - better bets in a bear market?

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Theme report

The Sensex has been in a bear phase, post its peak in early January 2008. A series of global and domestic events impacted liquidity. Global events include all-time high crude oil prices, food and commodity price inflation, geopolitical instability, US financial crisis and ongoing US recession, while domestic events comprised of political instability, industry slowdown, rising inflation with increasing interest rates.

Both in bull and bear markets, a large number of investors seek out high dividend yield stocks, as the latter apparently provide returns similar to that on say fixed deposits with banks. Most investors are also of the view that high dividend yield stocks are safe bets, because the high yield is on account of the “low” or “attractive” price. However, investors tend to overlook capital appreciation, for which equities as an asset class are known. In other words, primary objective of equity investments is capital gains, rather than fixed returns.

We conducted a study in order to understand the market’s perception of high dividend yield and low dividend yield stocks and arrived at some interesting conclusions.

Universe of stocks

Our universe of stocks has been drawn from the constituents of the S&P CNX 500 and BSE 500 indexes, adding up to 477 stocks in all.

Methodology

From this universe, we shortlisted stocks and segregated them into 2 groups,

- i) high yield stocks: those with a minimum yield of 3.5%, rate of interest on savings accounts (82 stocks), and
- ii) low yield stocks: those with a maximum yield of 1% (141 stocks)

We considered various parameters like market cap changes, earnings growth, dividend payout and dividend yield.

We considered prices and changes in market capitalizations between two cut-off dates, viz., January 10, 2008 (when the Sensex peaked) and August 13, 2008. Dividend yield has been computed on the basis of prices of August 13.

We computed changes in market cap, y-o-y bottomline growth over last 2 years (FY07 and FY08), average dividend payout and average yield.

Summary of findings

- Aggregate earnings growth: Remarkably, low yield stocks reported a higher average earnings growth y-o-y (65% in FY07 and 37.5% in FY08) vis-à-vis high yield stocks (30.5% in FY07 and 14.9% in FY08).
- Aggregate market cap changes: High yield stocks (down 32.5%) however outperformed low yield stocks (down 32.9%) during the period under consideration.
- Dividend payout: High yield stocks reported higher payout of 35.4%, while the payout of low yield stocks was far lower at 11.8%.
- Sector prospects: Stocks from emerging and high growth sectors offered low yield, while stocks from sectors with low to moderate growth offered high yield.
- Average yield: High yield stocks had an average yield of 4.3% and low yield stocks, 0.5%.
- Safe bets? If profit growth in high yield stocks is indeed lagging that in low yield stocks, can the former really be considered “safe bets”? We believe slower profit growth may indicate a lower probability of dividend percentage and payout being maintained going forward, failing which the yield could decline, making these stocks “less attractive” than they appear currently.

Conclusion

We therefore conclude that high yield stocks may not necessarily be safe bets after all, especially as they most probably belong to low-to-moderate growth companies, while it is the low yield stocks that could actually have a higher likelihood of giving better returns, by virtue of belonging to moderate-to-high growth sectors.

Dividend yield analysis

Top 20

We present below a list of top 20 stocks in each category. Interestingly, the top 20 high yield stocks in our list reported high dividend payout ratio, while the payout of top 20 low yield stocks is low. Stocks from emerging and high growth sectors offered low yield, while stocks from sectors with low to moderate growth offered high yield.

Please note that we are not recommending individual stocks in these lists.

High yield stocks: low earnings growth, high payouts

| Company Name | Earnings growth | | Dividend Payout Ratio | | | Dividend Yield |
|------------------|-----------------|----------------|-----------------------|------|------|----------------|
| | 2007 over 2006 | 2008 over 2007 | 2006 | 2007 | 2008 | |
| Monsanto India | -20.8% | 9.5% | 156% | 34% | 287% | 12.40% |
| Bongaigaon Ref. | 22.1% | 37.9% | 31% | 33% | 34% | 7.39% |
| Varun Ship. Co. | -47.1% | 131.9% | 29% | 62% | 33% | 7.01% |
| VST Inds. | -19.3% | -3.7% | 28% | 56% | 58% | 6.90% |
| Andhra Bank | 10.5% | 8.0% | 35% | 34% | 33% | 6.72% |
| HCL Infosystems | 24.8% | 13.0% | 47% | 49% | 43% | 6.62% |
| Wyeth | 30.0% | -10.7% | 81% | 75% | 84% | 6.18% |
| Munjal Showa | 24.9% | -23.1% | 39% | 31% | 41% | 6.04% |
| PNB Gilts | -46.1% | 182.8% | 36% | 0% | 45% | 5.99% |
| MIRC Electronics | 36.2% | -1.4% | 40% | 29% | 40% | 5.88% |
| Chennai Petroleu | 18.6% | 98.0% | 37% | 32% | 23% | 5.83% |
| Merck | 1.7% | -14.4% | 32% | 42% | 49% | 5.73% |
| Wockhardt | -24.1% | 96.4% | 21% | 28% | 32% | 5.70% |
| Bank of Mah. | 420.8% | 20.8% | 33% | 32% | 26% | 5.58% |
| NIIT Tech. | 96.8% | 2.0% | 36% | 20% | 30% | 5.53% |
| MRO-TEK | -40.4% | 48.7% | 26% | 39% | 37% | 5.33% |
| Allahabad Bank | 7.5% | 31.0% | 25% | 18% | 16% | 5.28% |
| M U S C O | -29.0% | -36.8% | 23% | 32% | 34% | 5.26% |
| Tata Metaliks | -34.4% | 138.8% | 33% | 50% | 25% | 5.17% |
| Finolex Inds | 118.7% | 10.6% | 136% | 62% | 56% | 5.17% |

Low yield stocks: high earnings growth, low payouts

| Company Name | Earnings growth | | Dividend Payout Ratio | | | Dividend Yield |
|-------------------|-----------------|----------------|-----------------------|------|------|----------------|
| | 2007 over 2006 | 2008 over 2007 | 2006 | 2007 | 2008 | |
| MMTC | 18.2% | 63.7% | 21% | 18% | 20% | 0.04% |
| Jai Corp | NC | 252.2% | 0% | 0% | 8% | 0.07% |
| Educomp Solution | 106.2% | 146.1% | 17% | 12% | 6% | 0.07% |
| Core Projects | 192.1% | 162.5% | 3% | 4% | 2% | 0.08% |
| Info Edge (India) | 103.8% | 101.0% | 12% | 8% | 4% | 0.09% |
| Glenmark Pharma | 251.2% | 104.2% | 9% | 3% | 3% | 0.11% |
| Kotak Mah. Bank | 20.4% | 86.7% | 4% | 4% | 3% | 0.11% |
| Pantaloon Retail | 68.1% | -5.7% | 15% | 11% | 13% | 0.12% |
| NESCO | 66.5% | 131.9% | 4% | 5% | 2% | 0.12% |
| UTV Software | 119.5% | 123.0% | 0% | 26% | 7% | 0.12% |
| Advanta India | 627.1% | 35.0% | 57% | 5% | 4% | 0.13% |
| REI Agro | 38.3% | 19.7% | 11% | 7% | 7% | 0.14% |
| Punj Lloyd | 248.6% | 70.1% | 9% | 4% | 4% | 0.14% |
| Unitech | 1362.7% | 26.8% | 19% | 3% | 2% | 0.14% |
| Shree Renuka Sug | 116.1% | -31.6% | 8% | 4% | 6% | 0.14% |
| Blue Dart Exp. | 11.2% | 38.9% | 8% | 5% | 3% | 0.15% |
| Provogue (India) | 61.4% | 31.7% | 16% | 15% | 13% | 0.19% |
| Jindal Steel | 21.8% | 75.8% | 8% | 8% | 5% | 0.20% |
| Tulip Telecom | 105.8% | 87.4% | 6% | 6% | 3% | 0.21% |
| EID Parry | -18.4% | -4.7% | 28% | 45% | 4% | 0.21% |

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