

# Dividends from US large-cap IT stocks growing by fastest rate since 2014

#### Monday, September 24, 2018

# Data from IHS Markit Dividend Forecasting shows dividends paid by firms in the S&P 500 Information Technology index will top \$75bn in 2018

- Dividends paid by growth stocks (P/E over 25x) have outpaced dividends from value stocks in recent years, but we expect this to reverse
- Dividend growth in both growth and value stocks were highest in 2012, 66% and 48% respectively
- Dividend growth from value stocks rebounded strongly in 2017 after close to zero growth in 2016. Growth stocks have had a more stable dividend growth rate, with average growth rate of 15% in the last four years
- Average total return from growth and value stocks since initiations have moved together
- We expect significant dividend increases from both growth and value stocks over the next year



#### Growth vs. Value Stocks: Aggregate dividends and average payout growth

- Average dividend growth rate is calculated year over year, excluding initiations that did not occur at the beginning of the year.

- Excludes special dividends

- Source: IHS Markit

We take a deeper dive into how the S&P 500 Information Technology has done thus far for dividend investors and a look ahead into 2019 as **Alphabet (GOOGL)** and **Facebook (FB**), two of the largest technology companies, change sectors today due to the MSCI and S&P GICs sector reclassification. We focus on the most interesting growth and value stocks in the Information Technology Sector; our analysis shows that dividends paid by growth stocks have outpaced dividends from value stocks in recent years. However, we expect this trend to reverse as we forecast significant dividend increases from both growth and value stocks over the next year. We have omitted non-payers and special dividends from our sample data. The entire list can be found in appendix A.

Some of the largest technology companies that have become household names such as **Facebook (FB)**, **Microsoft (MSFT)**, **Apple (AAPL)**, and **Alphabet (GOOGL)** all have one thing in common, a market cap over \$450 billion and top line revenue in the tens and hundreds of billions. Impressively, AAPL recently crossed the trillion-dollar mark and stands on top with a market cap of \$1.06 trillion. Despite the similarities and astronomical numbers, they have very different financial metrics, debt profiles, and capital return policies.

In the late 90's and early 2000's, finding a tech company paying a dividend was not as common as today. However, overtime through shareholder pressure and excess cash flows, companies began revisiting their capital allocation policies and implementing more generous dividend policies and share repurchase plans.

Of the aforementioned names, **AAPL** was the first to pay an ordinary dividend as early as 1987. However, the company suspended its dividend policy in 1995 for 17 years before reinitiating on August 13, 2012. **AAPL** has grown the dividend 67% over the past 5 years resulting in a payout ratio of approximately 25%. Since reinitiating, revenue, earnings, and free cash flow grew at an average rate of 8%, 10%, and 6%, respectively. In addition to the strong growth over the past few years, **Apple** significantly benefited from the recent tax reform and one-time tax repatriation holiday. From repatriating part of the \$285 billion it had sitting overseas and the tax reform, the company increased the dividend by 16% this year, more than the usual annual 10% increases. We anticipate **Apple** to continue returning capital back to shareholders via buybacks and dividends with the next 10% hike in May 2019.

**Microsoft** followed years later announcing its first dividend of \$0.08 on February 21, 2003. The company has a payout ratio of approximately 79% while growing its dividend by 83% over the past five years. Despite the high payout ratio, the company's free cash flow covers the annual dividend payments of \$13.2 billion by 2.8 times. Markit expects the company to continue increasing its dividend in the future, with hikes expected in September every year. Consensus estimates revenue and earnings to continue improving by 11% and 10%, respectively, in FY '19 and 10% and 16%, respectively, in FY '20, much of the growth driven by cloud services, and productivity and business processes such as Office 365.

Unlike **Apple** and **Microsoft**, **Facebook** and **Alphabet** do not pay dividends. Despite the large cash balances, healthy balance sheets, and growth expectations, both companies have kept shareholders wondering if they will receive a dividend soon.

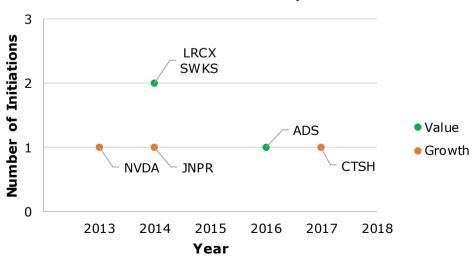
As of June 30, 2018, **Alphabet** held \$102.25 billion of cash, cash equivalents, and marketable securities. Analysts expect the cash balance to continue growing with free cash flow estimated to grow to \$24.2 billion, \$33.8 billion, and \$42.0 billion in '18, '19, and '20, respectively. The company has a healthy debt profile with only \$1 billion of debt maturing through 2023. Furthermore, over the past five-year

period Google only spent a fraction of its cash towards M&A activity, \$16.25 billion. During the Morgan Stanley Technology, Media & Telecom Conference last year, management stated they "haven't paid a dividend and don't intend to in the foreseeable future. And again, that goes to the flexibility that we see in the approach that we are taking." Given the current share price of \$1,178 and number of outstanding shares 695.7 million, if **Alphabet** were to issue a 2% dividend yield in line with dividend paying tech companies it would cost the company \$16.4 billion per annum or \$23.57 per share per annum. Based on analyst estimates for the year and the proposed dividend, the resulting cash flow cover and dividend cover would be 2.42 times and 1.71 times.

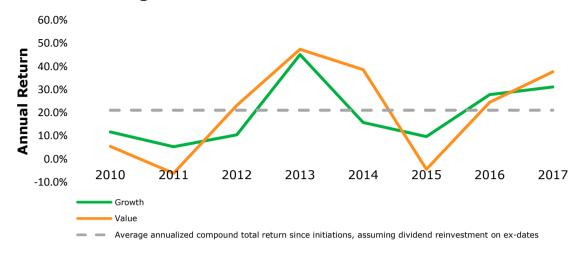
Facebook has a cash balance of \$42.3 billion, less than half that of Alphabet, and approximately 2.89 billion shares outstanding compared to Google's 695.7 million. Despite the difference, **Facebook**, just like **Alphabet**, has the capacity to pay a dividend to shareholders. The company's free cash flow is expected to continue growing year over year to \$21.6 billion in 2020. Given the strong revenue and cash positions, the company has been running debt free for the past two years, again leaving shareholders wondering what they will do with all the cash. Like Alphabet, **Facebook** has spent a minimal amount of its cash flow towards M&A, \$6.8 billion over the past five years. Given the fundamentals, the company could theoretically pay a 2.0% dividend yield, comparable to dividend paying tech companies, and afford it. A 2% vield on its \$162 share price is a dividend amount of \$3.24 per annum. Given the current number of shares outstanding, 2.89 billion, the dividend would cost the company approximately \$9.36 billion per year. Using 2018 consensus estimates for cash flow per share and earnings per share of \$8.83 and \$7.14, respectively, the expected cash flow and dividend cover would be 2.75 times and 2.20 times, respectively.

## Total return since dividend initiations

Since 2013, there have been three initiations from value stocks (**ADS**, **LRCX**, **SWKS**) and three from growth stocks (**CTSH**, **JNPR**, **NVDA**) as shown below. All six have grown the dividend since, benefit shareholders of **GOOGL** and **FB** are yet to enjoy.



#### Initiations Across Value/Growth



#### **Average Total Return Since Dividend Initiation**

- Return at year end e.g year ended 2010

- Annualized compound total return since initiation assuming dividend reinvestment on ex-dates

- Source: IHS Markit

The total return since initiations assuming dividend reinvestment on ex-date on value stocks and growth stocks have moved together over time. We notice significant returns in 2013 driven by yearly returns of 101%, 101%, 90%, and 83% from **Western Digital (WDC)**, **HP Inc (HPQ)**, **Seagate Technology (STX)** and **Xerox Corp (XRX)**, respectively. Interestingly, two years later, the average return from value stocks decreased to -4%, again driven by yearly returns of -42%, -33%, and -24% from **STX**, **HPQ**, and **Applied Materials (AMAT)**, respectively. Additionally, annualized returns since initiations seems to be fairly in-line for both growth and value stocks as highlighted below.

				Annualized compound
Stock name	Ticker	Growth/Value	Initiation Date	total return
Hewlett Packard	HPE	Growth	11/12/2015	33%
MasterCard Inc	MA	Growth	12/2/2008	33%
NVIDIA Corp	NVDA	Growth	11/8/2012	72%
KLA Tencor	KLAC	Value	2/19/2009	29%
Lam Resh	LRCX	Value	4/29/2014	32%
Seagate Technology	STX	Value	1/23/2009	41%

- Return at year end e.g year ended 2010

- Annualized compound total return since initiation assuming dividend reinvestment on ex-dates

- Source: IHS Markit

### Biggest increases forecasted in 2018 and 2019

Since 2012, the average growth rate decreased to about 10%, with the average growth rate among growth stocks higher than value stocks. However, due to the favourable tax policy and one-time repatriation tax holiday this year, we have noticed an increase in divided growth.

		Value/	2018 E	2019 E	YOY growth
Stock name	Ticker	Growth	dividend(\$m)	dividend(\$m)	
DXC Technology	DXC	Value	159	221	39%
Lam Research	LRCX	Value	607	789	30%
Broadcom Ltd	AVGO	Growth	3,226	4,110	27%
Mastercard Inc	MA	Growth	1,034	1,230	19%

- Payout is calculated by multiplying the NOSH by the dividend amount on the ex-date

- Source: IHS Markit

We expect these benefits to accrue to shareholders in the form of dividends and buybacks for the remainder of 2018 and 2019. We are thus forecasting large increases from both growth stocks such as **Broadcom Limited (AVGO)**, **Mastercard Inc (MA)** and value stocks such as **DXC Technology (DXC)** and **Lam Research (LRCX)**.

**Broadcom (AVGO)** intends to distribute approximately 50% of free cash flow on a trailing twelve-month basis. Based on the management's newly adopted policy, we expect the company to raise the dividend to \$2.32, half of the expected free cash flow per share for the trailing twelve months. We derive our forecasts by using consensus analyst estimate for free cash flow in FY '18 of \$7.99bn, taking the target payout of 50%, dividing it by the outstanding shares (currently 432m), and dividing the quotient by four quarters. The total expect payout is \$4.1bn in '19 compared to \$3.2bn expected in '18.

We also expect **Mastercard (MA)** to increase its January 2019 dividend by 20% to \$0.30 per share. Historically, the company aggressively raised the dividend annually at the beginning of the year with recent hikes ranging from \$0.03 to \$0.05. Analyst consensus estimate 2019 revenue, earnings, and free cash flow to grow by 13%, 17%, and 14%, respectively. Based on the aforementioned pattern and strong growth expected in '19, we are forecasting an increase on the higher end of the noted range. The expected total payout is \$1.2bn in '19 compared to \$1bn expected in '18.

Despite the noted 2016 decrease in dividends, we expect **DXC Technology (DXC)** to increase the quarterly dividend to \$0.20 in Q1 FY '20. Management stated they intend to return 30% or more of capital to shareholders in the form of dividends and buybacks over the next three years. The company usually raises the dividend annually in May ranging from \$0.01 to \$0.04, the former being the most recent. Based on slower earnings growth anticipated than recent years and management's intention to de-lever the balance sheet, we are forecasting a hike on the lower end of the aforementioned range. However, despite the minimal increase, the company's total payout has significantly increased due to a surge in number of shares outstanding in 2017. The expected total payout is \$221m in '19 compared to \$159m expected in '18.

We expect **Lam Research (LRCX)** to raise the June 2019 dividend by 19% to \$1.31. The company plans to return at least 50% of free cash flow to stockholders over the next five years through share repurchases and dividends. The company aggressively increased quarterly dividend annually with the most recent hike occurring in June. Raises have ranged from \$0.05 to \$0.60. Based on the most recent timing and the newly adopted dividend policy we are forecasting dividends to grow in line with free cash flow (FCF). Analyst consensus estimate FCF to improve by 19% in FY '19. The expected total payout is \$1.2bn in '19 compared to \$1bn expected in '18.

In summary, we expect shareholder pressure to keep mounting on companies such as **Alphabet** and **Facebook** to initiate dividends so as the former can partake even more in the two companies' abundant wealth regardless of their new sectors. Shareholders' case will be further strengthened by the reduced opportunities for growth in the case of **Facebook** and the lackluster nature of **Alphabet's** 'Other Projects'' pipeline as it currently stands. Additionally, the fact that peers of equal or 'lesser' wealth have demonstrated it's possible to balance growth with capital return to shareholders means they're increasingly running out of excuses.

#### Appendix A

Company Name	Symbol	ISIN	Growth/Value
Activision Blizzard	ATVI	US0530151036	Growth
Amphenol Corp	APH	US0326541051	Growth
Analog Devices	ADI	US00507V1098	Growth
Automatic Data Procs	ADP	US0320951017	Growth
Broadcom Ltd	AVGO	US11135F1012	Growth
Broadridge Financial Solutions Llc	BR	US11133T1034	Growth
CA Inc	CA	US12673P1057	Growth
Cognizant Tech Sol	CTSH	US1924461023	Growth
Corning Inc	GLW	US2193501051	Growth
Flir Systems Inc	FLIR	US3024451011	Growth
Global Payments	GPN	US37940X1028	Growth
Hewlett Packard Enterprise Comp	HPE	US42824C1099	Growth
International Business Machines	IBM	US4592001014	Growth
Intuit Inc	INTU	US4612021034	Growth
Juniper Networks	JNPR	US48203R1041	Growth
Mastercard Inc	MA	US57636Q1040	Growth
Microchip Technology	MCHP	US5950171042	Growth
Microsoft Corp	MSFT	US5949181045	Growth
Motorola Solutions	MSI	US6200763075	Growth
Netapp Inc	NTAP	US64110D1046	Growth
Nvidia Corp	NVDA	US67066G1040	Growth
Oracle Corp	ORCL	US68389X1054	Growth
Paychex Inc	PAYX	US7043261079	Growth
Qualcomm Inc	QCOM	US7475251036	Growth
Texas Instruments	TXN	US8825081040	Growth
Total System Services	TSS	US8919061098	Growth
Visa Inc	V	US92826C8394	Growth
Western Digital Cp	WDC	US9581021055	Growth
Western Union Company	WU	US9598021098	Growth
Xerox Corp	XRX	US9841216081	Growth
Xilinx Inc	XLNX	US9839191015	Growth
Accenture Plc	ACN	IE00B4BNMY34	Value
Alliance Data Systems Corp	ADS	US0185811082	Value
Apple Inc	AAPL	US0378331005	Value
Applied Materials	AMAT	US0382221051	Value
Cisco Systems Inc	CSCO	US17275R1023	Value
Dxc Technology Company	DXC	US23355L1061	Value
Fidelity National Information Services	FIS	US31620M1062	Value
Hewlett-Packard Company	HPQ	US40434L1052	Value
Intel Corp	INTC	US4581401001	Value
K L A-Tencor Corp	KLAC	US4824801009	Value
Lam Research Corp	LRCX	US5128071082	Value
Seagate Tech Ord Shs	STX	IE00B58JVZ52	Value
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Skyworks Solutions	SWKS	US83088M1027	Value
Skyworks Solutions Symantec Corp	SWKS SYMC	US8715031089	Value

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