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Divine Dividends

Dividend payouts reached a record high in 2004, and this year they're expected to top that. In fact, after a steady decline in the 1980s and 1990s when stock-price appreciation in rising markets became a more favored form of return, dividends are roaring back to reach—by one measure—their highest level since 1981.

Dividend announcements tend to cluster following a fiscal year-end, typically in January and February. This February, there were 239 dividend increases reported by the 7,000 U.S. public companies tracked by Standard & Poor's. That's a 25% increase from February 2004 and 51% above February 2003. In fact, February's dividend increase was the highest for that month since 1981, according to Joseph Lisanti, editor-in-chief of S&P's publication *The Outlook*.

For the first two months of 2005, dividend increases totaled 439, which is 13% ahead of the corresponding period in 2004. If that 13% pace continues, 2005 will end with 1,972 dividend increases, which would be the highest since 1998. Last year there were 1,745 increases, up 7.2% from 2003. It was the third consecutive year that the number of increases had risen after plunging to 1,326 in the recession year of 2001. That had been the lowest number since the previous recession, in 1991.

Conversely, with profits generally rising last year, there were only 64 companies that cut or eliminated their dividend, a record low, down from a total of 104 in 2003, according to Standard & Poor's. The previous record low for negative dividend actions came in 1997 when there were 98 such moves. The data goes back to 1955.

Among large companies—those in the S&P 500—469 paid dividends in 1980. By 2002, that number was down to 351. Today, at 377, it's on its way back up, and so are the dollar amounts. Through mid-March, some of the larger dividend increases from among the S&P 500 came from American International Group, up 66.67%; Devon Energy, up 50%; First Data, up 200%; Hasbro, up 50%; and News Corp. "A" shares, up 100%.

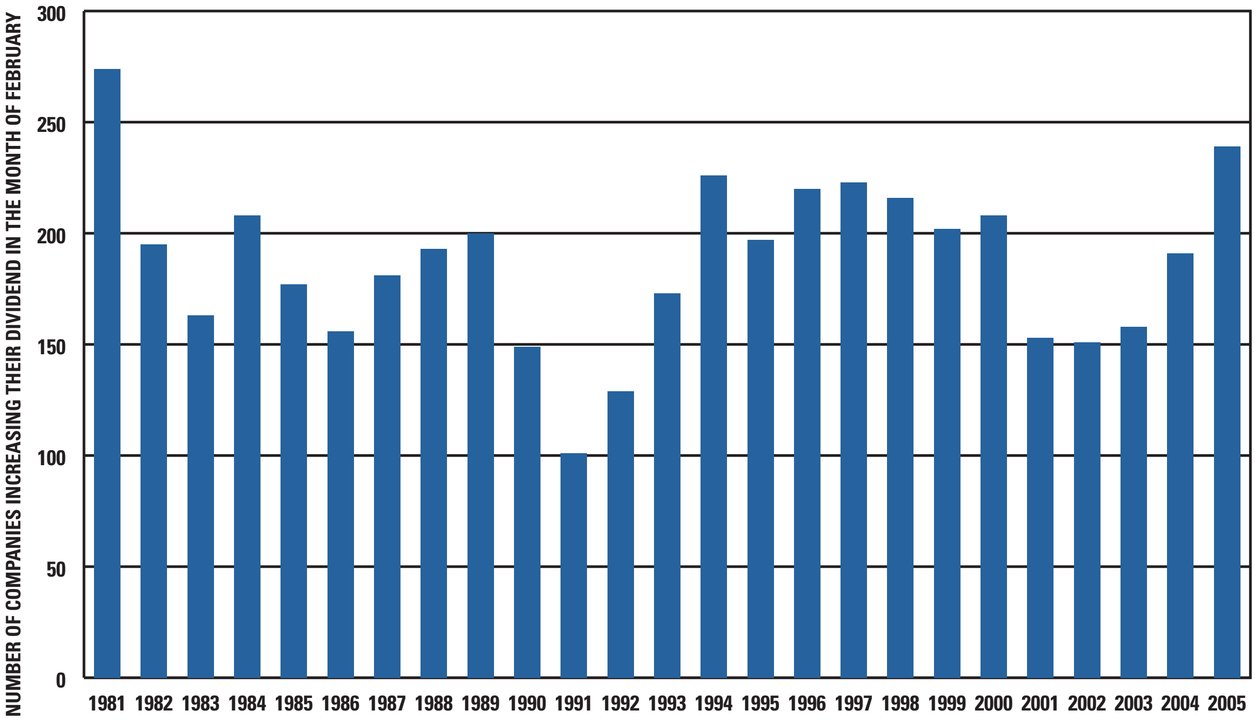
There can only be a limited number of explanations for the comeback of dividends.

By most accounts, the federal dividend-tax cut announced in January 2003 and enacted in May 2003 has been a big factor. It lowered the tax on dividends to 15%, making dividends more attractive to individual taxpayers than they had been. Thirty-four percent of the stocks in the S&P 500 are held by individuals. At about the same time dividend taxes were cut, capital-gains taxes were cut, too, to a maximum of 15%. That made it as attractive to take a capital gain as to receive a dividend—more so for some people because the capital gain may come years down the road, postponing the tax.

Since the dividend-tax cut 22 months ago, 28 companies in the S&P 500 started paying dividends for the first time—the fastest pace ever. Initiation of dividends from among the 4,000 largest U.S. companies by market capitalization in-

The February Surprise

The number of dividend increases in February was the highest since 1981.



Source: Standard & Poor's. Data from among 7,000 companies that S&P tracks.

creased from 20% in the fourth quarter of 2002 to 25% in the second quarter of 2004, according to a study for the National Bureau of Economic Research by Raj Chetty and Emmanuel Saez, economics professors at the University of California at Berkeley. The study further showed that the number of companies that raised regular dividends by at least 20% rose from 19 per quarter before the tax cut to 50 after it.

More often than not, companies initiating or increasing dividends are in for the long haul. They wouldn't do it if they couldn't sustain it. Companies that initiate or increase their dividends are signaling to the market that they expect to be financially healthy enough to continue to make these cash payouts at the same or a higher rate. Otherwise, decreasing or eliminating the dividend would signal that the company is in financial distress. The exception could be the one-time "special" dividend. But the Chetty-Saez study showed the number of special, one-time dividends rising from seven per quarter before the tax cut to 18. Noteworthy is Microsoft Corp., which last year paid out a record $32.6 billion in a special one-time dividend.

Next to the dividend-tax cut, record levels of cash that companies have been sitting on might be a factor for the rising number of companies increasing or initiating a dividend. The nonfinancial companies of the S&P 500 ended 2004 with a total of about $600 billion in cash and cash equivalents on their books, up nearly $100 billion in 2004 alone and double that of 1999.

So what's a cash-rich company to do? If they don't reinvest in the business, acquire another one, or buy back their shares, they've got to pay it out to shareholders.

There are worse problems to have, of course, though some critics say the cash piles show a lack of better ideas on how to use the money. Others cite caution in the wake of the recession, bear market, and focus on new corporate governance rules. While companies can fake sales and profits, a dividend check typically indicates the company's stated profits are real.

More and larger dividends may indeed continue. S&P 500 companies last year distributed about 34% of their profits as dividends, way off the historical average of nearly 54%. "We believe there is room for companies to boost their dividend payments significantly in the months and years ahead," S&P reported in late March. ■