ABC COMPANY

Sample Case Study

Considerations for Initiating a Dividend

Peer Dividend Analysis

rivel

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Methodology

With regards to the considerations for initiating a dividend for the first time, our findings and recommendations reflect conversations with two retired CFOs. These conversations reinforced and validated the internal knowledge and experience of the two senior Investor Relations professionals at Rivel who contributed to this presentation.

One of the CFOs issued dividends and one did not. One of the CFOs has a doctorate in finance and consulted for the buy-side for ten years before retiring. ABC Company's name was not disclosed in our discussions.

The data for dividend yield expectations, discussed on slide 12, is from Rivel's most recent Investment Community Research Study conducted in August 2022.

We analyzed nine of ABC Company's peers and have reviewed their dividend and capital allocation policies as part of this effort.

METHODOLOGY

Process

01

Reviewed each peer company's capital allocation policies and historical dividend data to find answers to the following questions:

- Do they pay out dividends?
- When did they start paying dividends?
- How often do they pay out dividends?
- How often do they raise their dividend?
- Have they ever lowered their dividend?
- What is their current dividend yield?

02

Sorted all historical dividend information into an Excel document which was then used to create the visuals for this presentation.

03

Reviewed each peer company's investor presentations to see how they present their capital allocation policy and dividend information to their investors.

Considerations for Initiating a Dividend

To Dividend or Not to Dividend?

Need to determine what the company's objective is in initiating a dividend.

What is the board of directors and management team trying to achieve with a dividend payout?

- To send a message to the investment community about the company's future prospects and performance?
- To broaden the appeal of the stock to a new audience of fixed income investors?
- To generate appreciation in the stock value?
- Is it a way to decrease the excess cash on the company's balance sheet that can make them vulnerable to activists?
- Other?

The company will need to look at its long-term (five-year) strategic plan to determine what their capital needs will be and how much is allocated for each line item, ensuring there is a reserve for turbulent times if necessary.

The company's board of directors should also consider factors like reinvestment opportunities and balance sheet stability as it determines whether to initiate a dividend and what the potential dividend payout ratio will be.

To Dividend or Not to Dividend?

The expectations for capital allocation from the company's top shareholders should be taken into consideration.

- This information can be obtained from conversations with investors or through the execution of a perception study.
- Shareholders pay very close attention to capital allocation.
    - How is the company going to use the free cash flow that's generated over the next several years?
        - A company with slowed growth that has matured and is generating healthy cash flow may consider paying a dividend.
            - If this is the case, it may not be long before shareholders will demand it anyway.
            - A dividend may be appropriate if a company is vulnerable with too much cash on the balance sheet and no medium-term plans for its use (i.e., an acquisition, accretive share buybacks, etc.).
    - Are you using it in a shareholder-friendly way or not?

You should be able to articulate a dividend policy.

- What are you thinking about as far as a payout ratio?
- How capital-intensive is your company?
- How cyclical is your company?
- What do you think is sustainable?

Shareholders like to see growth in the dividend in line with the growth of the free cash flow of the corporation.

What Will the Dividend Signal?

A dividend will signal that the company is no longer in the same growth mode as it once was and is now more mature.

- A company that is still growing rapidly usually doesn't pay dividends because it is investing as much as possible into further growth.
- Mature firms that believe they can continue to increase value by reinvesting their earnings also generally choose not to pay dividends.

Signaling growth-to-maturity is very hard and a lot of companies do not make the transition well.

This signal could have an impact on the company's valuation and shareholder make-up.

- Make sure the company understands the intricacies of its current valuation as well as the make-up of its shareholder base.
    - If most of the shareholders are growth-oriented, a dividend may come as a surprise.

What Are the Market Expectations?

The market expects that once a dividend is announced it will continue to be paid. There is no turning back.

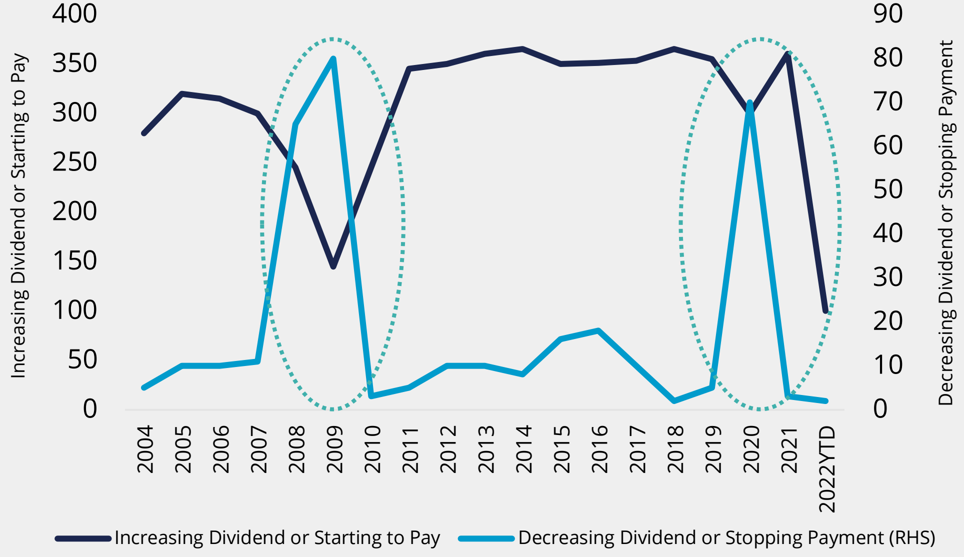
The company's stock price will be negatively impacted by a reduction or cancelation of the dividend.

The company also needs to determine if it is in a position to increase the dividend periodically going forward, based on the company's short-term and long-term projections.

- Investors will expect to see an increase in earnings and the dividend over time.
- High dividend payers with more financial leverage, lower profitability and lower earnings growth may be more likely to cut their dividends in a volatile, low-growth market.
- In 2020, dividend cuts piled up in the global economic recession brought on by COVID-19 (see Exhibit 1). Historically, a similar trend was observed during the 2008 Global Financial Crisis.

EXHIBIT 1

Amount of Dividend Actions of S&P 500 Companies



Source: S&P Dow Jones Indices LLC. Data as of March 31, 2022. Chart is provided for illustrative purposes.

What Are the Market Expectations?

DIVIDEND ARISTOCRATS

Stocks that have increased their dividend growth rate annually for at least

25

consecutive years

DIVIDEND KINGS

Stocks that have increased their dividend growth rate for at least

50

straight years

The ability to continually increase dividend payouts annually for multiple decades highlights a company's ability to generate enough excess cash flow despite any adverse economic conditions or market downturns.

Overall, a dividend growth rate that increases annually over time is a very good indicator of a strong dividend stock.

What Should the Cadence of the Dividend Payout be?

One-time, Annual or Quarterly Dividend?

There is generally no valuation credit given to companies for a one-time dividend.

We would not recommend an annual dividend.

It is best for the company to avoid shareholders hanging on to the stock for the dividend and then selling the stock post dividend.

If instituting a dividend, a quarterly dividend is recommended.

- To reward shareholders on a regular basis
- To improve retention of shareholders
- It is in-line with ABC Company's peers who pay dividends

Some companies have monthly dividends (REITs in particular); however, quarterly dividends are more typical, less administratively costly and less burdensome.

DETERMINING THE DIVIDEND PAYOUT

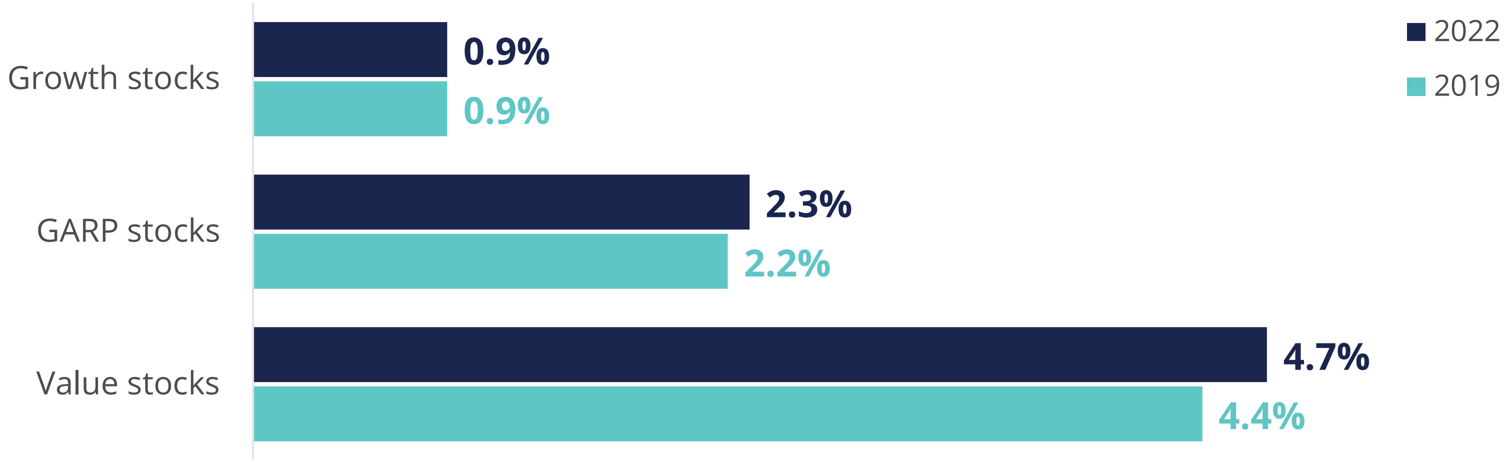
HOW SHOULD THE COMPANY DETERMINE HOW MUCH DIVIDEND TO PAY OUT?

Too small of a dividend and it will get dismissed. Based on Rivel's recent investment community research, anything with less than a 2% payout is not considered compelling for GARP stocks or value stocks. Growth stocks that pay dividends are considered attractive with yields of 0.9% or higher.

DIVIDEND YIELD

Performance Considered Attractive

Post-pandemic (2022) vs. Pre-pandemic (2019)



Information compiled by: rivel

Determining the Dividend Payout

The company's board of directors should consider factors like **reinvestment opportunities and balance sheet stability** as it determines its dividend payout.

The dividend payout amount is typically determined through **forecasting long-term earnings and calculating a percentage of earnings to be paid out**.

In the case that EPS is used to assess the company's ability to pay dividends, the dividend payout ratio is generally used.

- The dividend payout ratio is the dividend per share divided by EPS.
- Some companies pay dividends that exceed earnings per share, using cash set aside from previous years to pay dividends. Having a large retained earnings balance can help the company to pay consistent dividends and avoid negative surprises.

Under the stable policy, companies may create a target payout ratio, which is a percentage of earnings that is to be paid to shareholders in the long term. While payout ratios will vary between companies, a ratio between 30% to 60% is considered sustainable for most companies. Conversely, anything over 60% may be a red flag as the company may risk going into debt or may not have enough earnings to push continued growth.

An analysis of ABC Company's peers with regards to dividend yield, dividend payout ratio, dividend cadence, etc. is provided starting on page 19 of this report.

Dividend-Paying Methods

COMPANIES THAT DECIDE TO PAY A DIVIDEND GENERALLY USE ONE OF THE FOLLOWING METHODS:

Residual Method

- Companies using the residual dividend policy choose to rely on internally-generated equity to finance any new projects. As a result, dividend payments can come out of the residual or leftover equity only after all project capital requirements are met.

- The benefit to this policy is that it allows a company to use their retained earnings or residual income to invest back into the company, or into other profitable projects, before returning funds back to shareholders in the form of dividends.

- A company's stock price fluctuates with a rising or falling dividend, so if the company's management team doesn't believe they can adhere to a strict dividend policy with consistent payouts, it might opt for the residual method.

Positive:
The management team is free to pursue opportunities without being constricted by their dividend policy.

Negative:
Investors might demand a higher stock price relative to companies in the same industry that have more consistent dividend payouts.

Negative:
Another drawback to the residual method is that it can lead to inconsistent and sporadic dividend payouts resulting in volatility in the company's stock price.

Dividend-Paying Methods

Stable Method or Regular Dividend Policy

Under the stable dividend policy, companies consistently pay a dividend each year regardless of earnings fluctuations.

- The dividend payout amount is typically determined through forecasting long-term earnings and calculating a percentage of earnings to be paid out.
- Under the stable policy, the company may create a target payout ratio, which is a percentage of earnings that is to be paid to shareholders over the long term.
- The company may choose a cyclical policy that sets dividends at a fixed fraction of quarterly earnings, or it may choose a stable policy whereby quarterly dividends are set at a fraction of yearly earnings. In either case, the aim of the stability policy is to reduce uncertainty for investors and to provide them with income.

Stock Dividends

Through stock dividends, companies pay out investors with additional shares of a stock instead of cash.

Dividend Reinvestment Programs or DRIPs

Through DRIPs, investors are given the opportunity to reinvest any dividends received back into the company's stock, usually at a discounted rate.

Dividend-Paying Methods

Hybrid Method

The final approach combines the residual and stable dividend policies.

Hybrid is a popular approach for companies that already pay dividends.

- As a company experiences business cycle fluctuations, it may use the hybrid approach to establish a set dividend, which represents a relatively small portion of yearly income and can be easily maintained.
- In addition to the set dividend, it can offer an extra dividend paid only when income exceeds certain benchmarks.

The Bottom Line

The policy a company chooses can impact the income stream for investors and the profitability of the company.

Investor Follow-Up

IF ABC COMPANY DECIDES *NOT* TO ISSUE A DIVIDEND …

WE SUGGEST THE FOLLOWING WHEN INVESTORS ASK ABOUT A DIVIDEND:

- Indicate that there is no change to the company's capital deployment strategy which includes:
  1. Funding growth organically;
  2. Bolt-on acquisitions;
  3. Opportunistic share repurchases.
- The IR team should repeat the growth metrics it has issued, noting the company is still in growth mode.
- If it is applicable to ABC Company, reiterate that the management team reviews the capital deployment strategy each year, including whether implementation of a dividend makes sense.

Peer Analysis

Peer Dividend Analysis Overview

Company	Dividend? (Yes/No)	Dividend Start Date	Cadence	Raise Cadence	Has it ever been lowered?	Yield
[Redacted]	Yes	[Redacted]	Quarterly	Yearly	No	[Redacted]
[Redacted]	Yes	[Redacted]	Quarterly	Yearly	Yes, once in XXX	[Redacted]
[Redacted]	Yes	[Redacted]	Quarterly	Yearly	No	[Redacted]
[Redacted]	Yes	[Redacted]	Quarterly	Yearly	Yes, once in XXX	[Redacted]
[Redacted]	No	NA	NA	NA	NA	NA
[Redacted]	Yes	[Redacted]	Quarterly	Yearly	No	[Redacted]
[Redacted]	Yes	[Redacted]	Quarterly	Yearly	No	[Redacted]
[Redacted]	Yes	[Redacted]	Quarterly	Yearly	No	[Redacted]
[Redacted]	Yes	[Redacted]	Quarterly	Ad Hoc	No	[Redacted]

All but one of ABC Company's peers pay a dividend.

Among ABC's peers that do pay a dividend, they were all initiated prior to the millennium, and all pay on a quarterly basis.

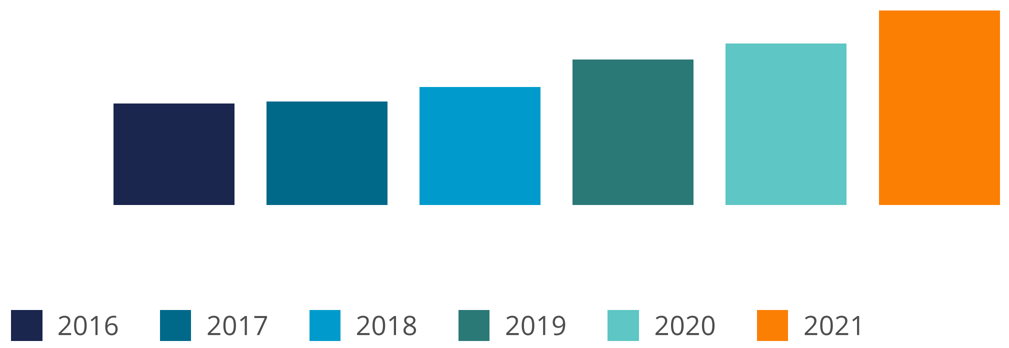
All of ABC's peers who pay a dividend raise it consistently each year, except for one.

PEER COMPANY #1

[Company name redacted]	
Dividend (Y/N)	Yes
Dividend Start Date	[Redacted]
Start in Last 2 Years?	No
Cadence	Quarterly
Raise Cadence	Yearly
Date Lowered	NA
Yield	[Redacted]

Yearly Payout Growth (2016-2021)

Yearly Payout (2016-2021)



Peer Company #1

No investor presentation or slides in the annual report on capital deployment strategy.

They have a section of their website dedicated to dividend information.

[Visual graphic redacted; each Peer Company's investor presentation is evaluated separately.]

GLOSSARY

Declaration date. The date a company announces it will be issuing a dividend in the future.

Ex-dividend date. The cutoff date on or after which purchasers of a stock won't receive the next dividend payment.

Record date. The date a company makes final the list of shareholders who are eligible to receive the dividend payment. If you invest in the company's shares after the record date, you won't receive that dividend payment.

Payment date. The day the company credits dividends to shareholder accounts.

Dividend growth rate. The annualized average rate of increase in the dividends paid by a company. Growth rates can be based on any interval.

Dividend per share. The company's total annual dividend payment divided by the total number of shares outstanding.

Dividend yield. A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Information compiled by: rivel

GLOSSARY

Dividend payout ratio. The percentage of net income distributed to shareholders in the form of dividends.

Total return. The gain or loss generated from a stock, based on its price change and dividend payments.

Qualified dividend. A dividend that is taxed at capital gains tax rates, rather than ordinary income tax rates, because it meets certain IRS criteria, including how long the investor has held the stock. Capital gains rates are 0%, 15% or 20%, depending on an investor's income level.

Non-qualified dividend. A dividend that doesn't meet IRS criteria for capital gains tax treatment and is thus taxed at the investor's ordinary income tax rate, which can range from 10% to 37%, depending on income level.

Dividend rollover plan. A strategy in which an investor buys a dividend-paying stock shortly before its ex-dividend date and then sells shares after the dividend is paid, hoping to secure income.

Dividend reinvestment plan. A program that automatically uses the proceeds from dividend stocks to purchase more shares of the company.

Sources: Investopedia, Corporate Finance Institute