S&P CAPITAL IQ
McGRAW HILL FINANCIAL

Market Intellect
from Global Markets Intelligence

Sector Disruptors: Buybacks And Dividends

Michael G Thompson
Managing Director
Global Markets Intelligence
(1) 212-438-3480
michael.thompson@spcapitaliq.com

Kenneth M Leon
Global Director
Equity Research
(1) 212-438-4638
kenneth.leon@spcapitaliq.com

Scott H Kessler
Deputy Global Director
Equity Research
(1) 212-438-9528
scott.kessler@spcapitaliq.com

Stock repurchases and dividend payouts continue to be a leading option for corporate America. According to S&P Dow Jones Indices (which operates independently from S&P Capital IQ), S&P 500 companies had $1.3 trillion in cash and equivalents, available for discretionary purposes, on their balance sheets as of June 2015. This amount is increasingly being committed to buybacks and dividends.

As investors consider how managements and boards of directors drive shareholder value, it is instructive to consider how the current environment for corporate governance and investor activism may contribute to future changes in corporate capital allocations. More specifically, we think companies could be more willing to part with available cash on a combination of buybacks and dividends, instead of or in addition to investment intended to grow businesses long term.

In fact, in the past 10 calendar years, from 2005 to 2014, S&P 500 companies increased the sums they spent on buybacks and dividends by $428 billion, or 85%, to $934 billion from $507 billion. The amount allocated to repurchases and dividends has risen in each of the past five years, and we see this trend continuing.

Dividend payouts increased every year but one in the past decade to $369 billion in 2014 from $191 billion in 2005, a 94% increase. In 2009, reflecting the Great Recession, dividends declined 10%.

Stock repurchases showed more notable variability with dramatic declines in 2008 (of 40%) and 2009 (61%) and considerable increases in 2010 (119%), 2013 (27%), and 2014 (16%). In the past 10 years, buybacks expanded to $566 billion from $316 billion, rising 79%.

We think this supports the notion that dividends tend to be more consistent and resistant to economic cycles, and buybacks more broadly reflect the economic and stock market backdrop.

Consideration of the 10-year period, however, masks some notable interim fluctuations. The percentage allocated to buybacks and dividends hit a high water mark of 90% of operating cash flows in 2007--the last year before the credit crisis sparked a change in behavior. By 2009, such spending had plummeted to a mere 27% of cash from operations before once again rising. In

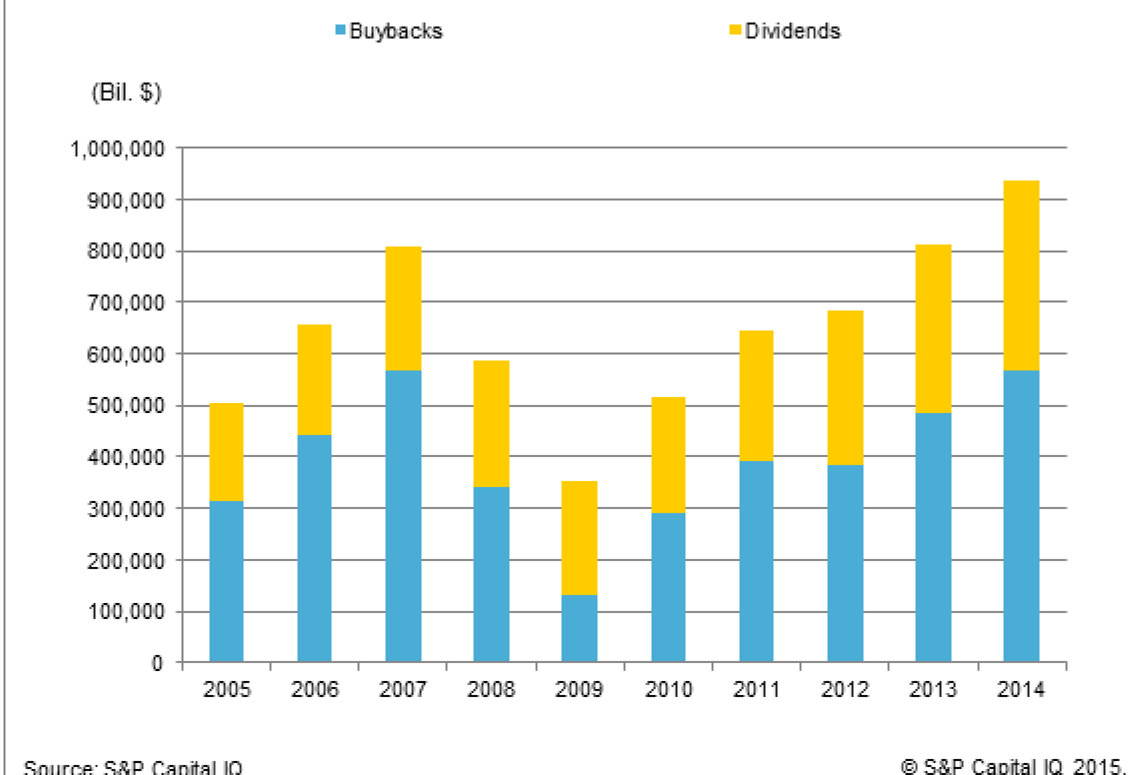
2009, dividend payments fell 10%, but buyback spending fell a staggering 61% from 2008. We anticipate that if the U.S. economy weakened considerably, S&P 500 companies would likely look to conserve capital--but perhaps after the stock market bottomed. We note that the prior stock market low came in March 2009, the same year when buybacks would have been well-timed, in retrospect.

There is much disparity across sectors and companies within the same sectors, on whether to focus on buybacks or dividends when it comes to such capital allocations. At an aggregate level, however, the dividend portion increased marginally in 2014 (40%) from 2005 (38%). By definition, this implies a roughly 60/40 split between buybacks and dividends at both ends of our study period. However, once again, in the interim, major changes occurred. In 2009--the year when buyback spending fell 61%--the buyback/dividend split shifted to 38/62, basically a reversal of the normal pattern. We believe that shareholders and management consider dividends as more consistent and buybacks as much more variable, and consequently, when the economy weakens, buyback activity is often initially affected.

By 2014, only three sectors (consumer staples, telecommunication services, and utilities) still allocated more than half of such spending to dividends, as opposed to buybacks. However, six sectors (consumer discretionary, consumer staples, energy, information technology, telecommunication services, and utilities) raised their dividend portions, relative to 2005. In only three sectors did we see the share of dividends decline: materials (down 15%), industrials (down 5%), and financials (down 2%). Health care stayed relatively flat, comparing 2014 to 2005.

Chart 1

S&P 500 Buybacks And Dividends By Year (2005-2014)



Source: S&P Capital IQ.

In 2005, financials was the top sector for dividends, accounting for 26.7% of the payouts of S&P 500 companies, equating to $51 billion. Technology bought back the most stock that year at $76 billion, or 24.1% of the total spent.

In 2014, financials paid $61 billion in dividends but only 16.6% of the total--10.1 percentage points less than 10 years prior--reflecting the financial crisis and regulations designed to prioritize balance sheets over spending. Nonetheless, it still accounted for more in dividends than any other sector, followed closely by technology at $54 billion (14.7%) and consumer staples at $49 billion (13.2%).

As for buybacks, technology continued to lead with $156 billion, or 27%, of S&P 500 in repurchases in 2014, an increase of 3.1 percentage points from 2005. Consumer discretionary (14.7%) and industrials (12.5%) followed.

Appropriately, sectors perceived as more income-oriented, such as telecom services and utilities, had a much greater mix of dividends in 2014 (87.7% and 94.7%, respectively). Those two sectors also recently had the highest indicated yields in the S&P 500 (5.4% and 3.8%, respectively). Conversely, more growth-focused sectors, such as technology, consumer discretionary, and materials, had the largest buyback contributions (74%, 70%, and 70%, respectively) in 2014.

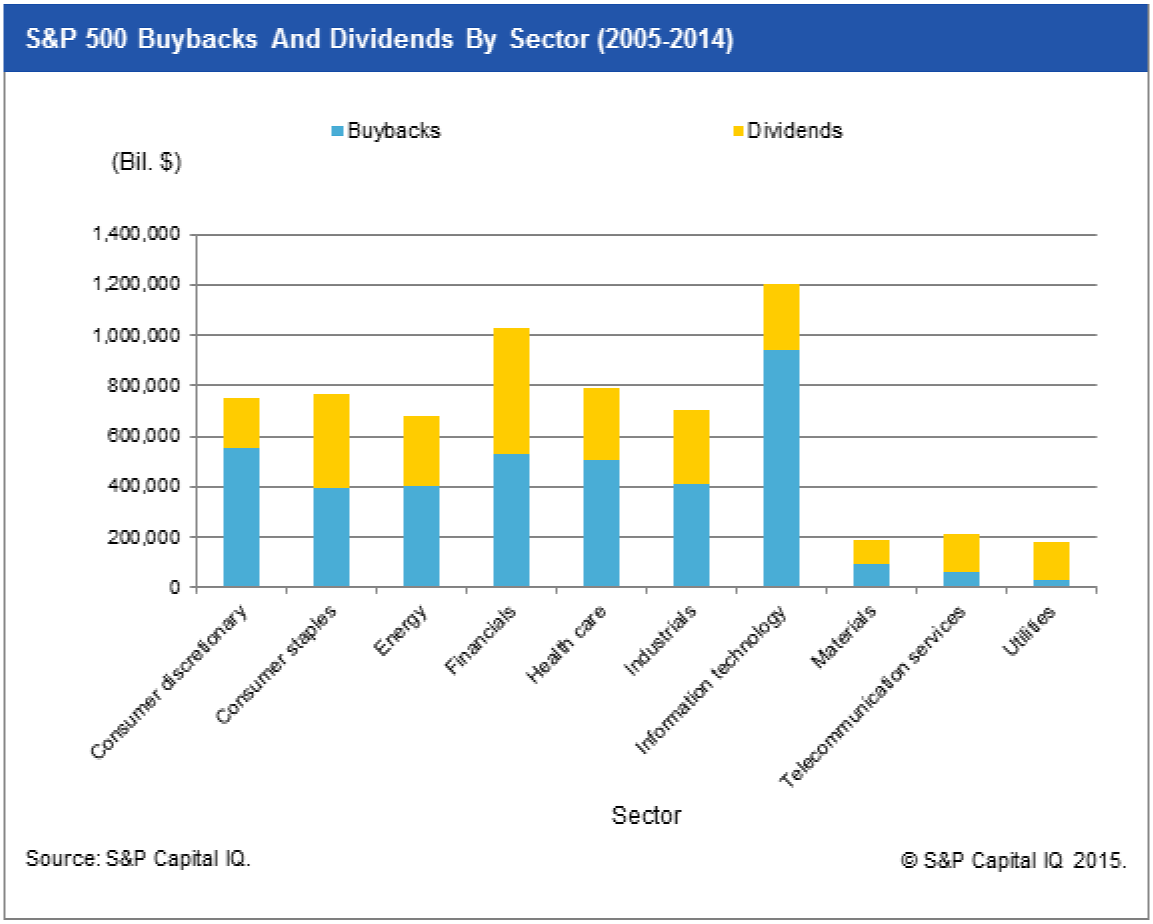
Dramatic commodity price declines could negatively affect how energy and materials companies deploy cash. In the energy patch, we see limited growth in dividends and repurchase reductions. For materials, we have noted the involvement of prominent investor activists and recent corporate actions that should support significant buybacks.

Health care companies have witnessed healthy buyback and dividend activity in the past few years. Most S&P 500 pharmaceutical companies repurchase stock and pay dividends, and it recently was the only health care subindustry with a dividend yield (2.5%) above the market's (2.2%). Interestingly, biotechnology had an indicated yield of 1.3%, and we think this subindustry, with strong cash flows and balance sheets, will become more active with repurchases and dividend actions.

The consumer sectors, namely consumer discretionary and consumer staples, have benefited from the strength of the global consumer, activist involvement, and notable merger and acquisition (M&A) actions. We see these companies continuing considerable buyback and dividend efforts.

In our assessments that follow, we address buyback and dividend activity across all 10 sectors within the S&P 500, with analysis of historical data, observations regarding industries and companies, and thoughts on future actions and trends. Our goal with this latest report in our Sector Disruptors series is to analyze stock repurchases and dividend payouts from a broader market perspective and through the disparate lenses of all of the S&P 500 sectors, and offer some related insights to better inform consideration of this important topic.

Chart 2



Consumer Discretionary

Historical sector data and analysis

The consumer discretionary sector has been fairly active in returning capital to shareholders via buybacks and dividends. In 2014, the 84 consumer discretionary companies within the S&P 500 returned about 67% of their combined operating cash flow to shareholders via share repurchases and dividends, based on S&P Capital IQ data. Although that was still shy of a recent peak of about 71% in 2007, it was notably the third highest rate of return among the 10 sectors in 2014 and well above a recessionary nadir of only 21% in 2009.

Although share repurchases remain a slightly preferred mechanism for consumer discretionary companies, we note that dividends comprised a still significant 48% of the aggregate volume of shareholder returns in 2014, up from 42% in 2005. Even so, the sector recently offered a relatively modest dividend yield of 1.4%--consistent with an average yield of 1.5% in the past 10 years--below the S&P 500's 2.2% yield and currently the lowest of the 10 sectors. Of the 421 S&P 500 companies that currently pay dividends, 65 are consumer discretionary companies.

We surmise that a confluence of historically low borrowing costs and investor activism has recently influenced the capital allocation priorities of consumer discretionary companies. Through the post-recessionary years, the sector has largely rebuilt its cash reserves, which had grown to more than $127 billion in 2014--and to $121 billion through the first half of 2015--versus $77 billion in 2008. Meanwhile, with the benefit of improving fundamentals, operating cash flow had also nearly doubled to more than $176 billion in 2014 (versus a recessionary low of $91 billion in 2008).

Industry and company observations

Looking at the past decade, approximately one-third of consumer discretionary constituents returned an annual average of at least 70% of their respective operating cash flow via aggregate dividends and share buybacks. This top cohort spans a number of industry groups led by media; hotels, restaurants, and leisure; and apparel, accessories, and luxury goods. Others include leisure equipment and products, household durables, and specialty retail.

In addition, about a fifth of the consumer discretionary companies returned an average of more than 90% of their operating cash flow during the 10-year period, while 11 companies returned at least 100%, including Wyndham Worldwide Corp., AutoNation Inc., Marriott International Inc., Hasbro Inc., Nordstrom Inc., Tiffany & Co., CBS Corp., Starwood Hotels & Resorts, Time Warner Inc., PulteGroup Inc., and Mattel Inc. At the other end of the spectrum, another cohort returned an average of less than 10%, including Mohawk Industries Inc., Hanesbrands Inc., Ford Motor Co., Amazon.com Inc., and Goodyear Tire & Rubber Co.

Our review of buyback efficiency--defined as the percent of declined reported outstanding shares relative to the estimated average number of shares repurchased throughout the 10-year period--also showed some notable observations. L Brands, Carnival, CBS, Target, and Best Buy all achieved at least 90% on this measure. Conversely, notable companies, such as O' Reilly Automotive Inc., V.F. Corp., GameStop Corp., and Harman International Industries Inc., attained 10% or less. Remarkably, others had negative buyback efficiency--implying a significant increase in outstanding shares relative to their average share repurchases--including TripAdvisor Inc., Michael Kors Holdings Ltd., Hanesbrands, Mohawk, DR Horton Inc., Goodyear Tire & Rubber, Ford, PVH Corp, Lennar Corp., Pulte Group, and Scripps Networks Interactive Inc.

Anticipated future actions and trends

We expect shareholder return initiatives for the consumer discretionary sector to stay apace through 2015 and 2016. Indeed, through the first half of 2015, the sector returned about 75% of its aggregate operating cash flow via dividends and share buybacks--seemingly on track for a new all-time record by year-end.

In our view, the recent volatility in stock prices could provide some of these companies with further incentive for accelerated share repurchases with fundamentals also supporting recurring dividends (or potential increases). With the sector still relatively attractive to activist investors and cash reserves still at elevated levels, we see a continuing bias toward shareholder-friendly initiatives for select consumer discretionary companies across the hotel and leisure, media, retail, and auto-related industry groups.

Table 1

Consumer Discretionary Buybacks And Dividends--Top Company Contributors (2012-2014)

Company	Buybacks (mil. $)	Dividends (mil. $)	Total (mil. $)
The Home Depot Inc.	19,530	6,516	26,046
The Walt Disney Co.	14,132	3,908	18,040
McDonald's Corp.	7,592	9,227	16,819
General Motors Co.	10,813	5,556	16,369

Source: S&P Capital IQ.

--Tuna N. Amobi, CFA, CPA and Efraim Levy, CFA, S&P Capital IQ Equity Analysts

Consumer Staples

Historical sector data and analysis

Because of historically strong and stable cash flows, the consumer staples sector often ranks among the largest utilizers of dividend payments and share repurchases as a percent of operating cash flow. These companies deployed an average of 69% of cash from operations in 2014 to either dividend payments or repurchase shares, significantly surpassing the S&P 500 average of 57% and trailing only the industrials sector average of 72%.

Reflecting revenue growth constraints from changing consumer eating and drinking habits, rising international market risks (particularly in highly inflationary emerging markets), and more limited merger and acquisition (M&A) opportunities, the average firm continues to shift capital allocation strategies toward dividends and share repurchases from capital expenditures (CAPEX) and M&A. As a result, cash from operations allocated to dividend and buybacks increased by 7.5% to 68.7% in 2014 from 61.2% in 2005.

Regarding dividend yield, consumer staples typically has one of the highest yields. As of Oct. 9, 2015, the consumer staples dividend yield of 2.6% exceeded the S&P 500 Index average of 2.2% and was surpassed only by the telecommunication services (5.4%), utilities (3.8%), and energy (3.3%) sectors. However, in the past 10-years, the percentage of cash flow from operations (cash flow from operations) allocated toward dividends has risen by only 1.6% to 37.4% in 2014 from 35.8% in 2005, while the percentage deployed toward buybacks has risen 5.9% to 31.3% in 2014 from 25.4% in 2005. Given top-line challenges related to portfolio repositioning efforts in the face of shifting consumer preferences, we believe buybacks have become more attractive than dividend payments to consumer staples management teams as a tool to boost earnings per share (EPS) growth.

Industry and company observations

The absence of significant growth opportunities in the sector, combined with a low interest rate environment, increases the attractiveness of debt-funded dividends and share repurchases to boost shareholder value. For example, Costco Wholesale Corp. twice accessed debt markets to help fund special dividends. In February 2015, the company cited favorable access to credit markets and its ability to maintain a conservative capital structure in issuing $1.0 billion in notes, along with existing cash, to help fund a special cash dividend of approximately $2.2 billion, or $5.00 per share, paid to shareholders as of Feb. 9, 2015. This followed a $3.0 billion note issuance in December 2012 that helped fund a special $7.00 per share dividend to shareholders on Dec. 10, 2012.

The presence of activist investors in the consumer staples sector also supports debt-funded share repurchases, in our view, as we believe limited M&A opportunities are currently available. Sysco Corp. announced a $2.0 billion note offering at the end of September 2015 to fund a $1.5 billion accelerated share repurchase (ASR) program and share repurchases. The ASR should be completed by March 2016. The announced debt offering follows the election of two new members to its board of directors in August 2015 from activist investor Nelson Peltz's Trian Fund Management L.P. The decision to increase share repurchases was made after the Federal Trade Commission blocked the company's attempt to acquire U.S. Foods. With strong cash flows, limited growth opportunities, and activist investors, we look for Sysco to continue to pursue share repurchases.

Anticipated future actions and trends

We believe management teams will remain focused on supporting EPS growth through multi-year cost-cutting and restructuring efforts while utilizing cash flow for share repurchases. With low interest rates supporting the attractiveness of debt financing, we expect boards and management teams to continue approving the redirection of cash flow toward share repurchase and dividend programs rather than toward debt repayments or CAPEX boosts. Further, we believe activist investor activity in the sector will support the maintenance of debt leverage levels as a source of capital.

The attractiveness of high dividend yields in the consumer staples sector may be hurt as the Federal Reserve looks to boost interest rates. However, we expect the pace of interest rate increases to be slow. Also, as progress is made on portfolio repositioning strategies, thereby providing increased revenue growth (and EPS) support, we expect management teams in the sector to increasingly look to reallocate capital toward dividend payments from buybacks in the intermediate term (2017-2020).

We do not see a strong case for increased use of capital toward CAPEX and M&A. Although we expect research and development programs to receive capital support, their spending levels will remain a small percentage of overall cash deployment in the consumer staples sector.

Growth in capital spending programs will remain limited, in our view, as near-term growth opportunities are restricted by slowing macroeconomic growth in international markets and as firms continue to slowly reposition product portfolios due to changing consumer desires.

Lastly, due to the presence of highly consolidated subindustries within the sector, M&A may be viewed as a source of cash, through asset divestitures, as much as a use of cash through industry consolidation.

Table 2

Consumer Staples Buybacks And Dividends--Top Company Contributors (2012-2014)

Company	Buybacks (mil. $)	Dividends (mil. $)	Total (mil. $)
The Procter & Gamble Co.	18,504	20,170	38,674
Philip Morris International Inc.	16,321	17,159	33,480
Wal-Mart Stores Inc.	15,298	17,685	32,983
The Coca-Cola Co.	13,553	14,914	28,467

Source: S&P Capital IQ.

--Joseph Agnese, S&P Capital IQ Equity Analyst

Energy

Historical sector data and analysis

The energy markets experienced a secular upcycle between 2005 and 2014 with one brief interlude in 2008-2009. Therefore, improving earnings power characterized this period as crude oil prices gradually rose and sustained themselves at high levels. Improved earnings came with stronger cash flows, which afforded the latitude to increase returns to shareholders--via both dividends and buybacks.

Indeed, total cash from operations for S&P 500 energy companies grew by 60% to $222 billion in 2014 from $139 billion in 2005. This has enabled dividend and buyback growth, which rose by 128% and 47%, respectively. Interestingly, by 2014, total allocations by S&P 500 energy companies to buybacks and dividends had adjusted to roughly a 50/50 split--$43 billion for the former versus $41 billion for the latter. In comparison, in 2005, buybacks totaled $29 billion whereas dividends were a mere $18 billion. Thus, at a sector level, dividends as a share of total returns to shareholders have grown from 38% to 49%. Relative to cash from operations, total returns to shareholders have grown as well to 38% in 2014 from 34% in 2005.

However, on an equal-weighted basis, dividends in 2014 comprised 62% of total returns to shareholders. The discrepancy between weighted and unweighted results indicates that many companies (11 of the 40 energy names in the S&P 500) eschewed buybacks completely in 2014, including such companies as ConocoPhillips and Williams Cos. (They each last repurchased shares in 2012 and 2008, respectively.)

Industry and company observations

We have seen various return strategies from some of the largest energy companies in the past 10 years. Exxon Mobil, for example, increased its dividend payments by an average of 5% per year during this time. With buybacks, however, the company has reduced its exposure with buybacks down 4% per year on average. Exxon Mobil's buybacks hit a high water mark of $35 billion in 2008 when crude oil prices peaked slightly above $145 per barrel, before declining precipitously. We note that the company tends to treat buybacks as a safety valve for excess free cash flows after CAPEX and dividends have been addressed, and as a result, buybacks tend to be higher in strong cash flow years and weaker in poor cash flow years. However, the company's buybacks have largely resulted in significant reductions in its diluted share count. Based on average share prices in each of the past 10 years, we estimate that Exxon Mobil repurchased about 3.0 million shares between 2005 and 2014, and its diluted share count dropped by 2.1 million shares (to 4.2 million shares in 2014 from 6.3 million shares in 2005). The estimated repurchase of 3.0 million shares over this timeframe was partially offset by other factors that elevated share counts, such as exercises of stock options. Nonetheless, the fact that the share count fell by about 70% of the estimated number of shares repurchased, suggests that Exxon Mobil had a low level of such offsetting factors relative to other energy companies from other factors (e.g., options exercises), in our view.

In contrast, rival supermajor oil company Chevron Corp. saw faster growth in both dividends and buybacks (9% and 6% compound annual growth rates [CAGRs] respectively), yet Chevron's diluted share count dropped only about 224 million shares, roughly half of the 443 million shares that we estimate the company repurchased during the study period. Chevron's buybacks also peaked in 2008 but then adjusted to zero in 2009 and minimal levels in 2010 before rising significantly starting in 2011.

In the aftermath of weak crude oil prices in late 2008 and early 2009, many companies slashed buybacks to adjust to weak cash flows. As a result, in general, we think energy companies are less focused on being opportunistic with buybacks when share prices are cheap and more focused on managing their cash flow picture. In 2009, overall cash flows in the sector fell 35% versus 2008 and in fact dropped to be about equal with the 2005 level.

Anticipated future actions and trends

This is an unusual time in the oil patch as the market is trying to assess whether the days of $90 oil will return or whether a new normal in the $50-$60 range will likely persevere. We believe the latter. As a result, we think cash flows will be challenged and likely return to levels last seen in 2005 or 2006. With weaker cash flows, and presumably weaker earnings, we think dividend payout ratios will rise. We would not discount the possibility for dividend cuts in the short term but see any such cuts likely happening at smaller firms rather than larger ones. Given lower incentives for organic growth, we think the industry will respond in the short term via either decelerating growth or outright cutbacks in capital spending--in contrast to strong CAPEX spending seen for most of the past 10 years. Any such declines in capital spending, in turn, should filter through the value chain, adversely affecting oil services providers.

Some of that reduced organic investment may get plowed back into acquisitions. We view the oil and gas exploration and production space as highly fragmented with wide disparities in free cash flow generation and dominated for the most part by larger firms. Thus, we see this subindustry as ripe for consolidation. Some of the anticipated decline in organic growth may also go toward enhanced buybacks, helping to provide a boost to EPS (or, perhaps, limiting the decline in EPS that comes from subdued pricing). In the longer term, we think the industry will have to revamp its organic capital spending levels higher as long periods of reduced oil and gas development can lead to rapid declines in production.

With growing dividends and weaker cash flows, and presumably weaker earnings, we think dividend payout ratios will rise. We would not discount the possibility for dividend cuts but see any such cuts likely happening at smaller firms rather than larger ones. Instead, at larger energy firms, difficult payout ratios may manifest via decelerating capital spending growth. Much of the past decade has seen rapid increases in upstream CAPEX, and aside from U.S. unconventional shale plays, the industry has not delivered substantial production growth. As a result, we think the industry may be moving toward a lower-growth phase where spending levels are choked back, which should filter through the value chain.

Table 3

Energy Buybacks And Dividends--Top Company Contributors (2012-2014)

Company	Buybacks (mil. $)	Dividends (mil. $)	Total (mil. $)
Exxon Mobil Corp.	50,249	32,535	82,784
Chevron Corp.	13,048	22,246	35,294
ConocoPhillips	5,098	10,137	15,235
Schlumberger Ltd.	8,246	5,008	13,254

Source: S&P Capital IQ.

--Stewart Glickman, CFA, S&P Capital IQ Equity Analyst

Financials

Historical sector data and analysis

Financial sector stocks paid out more than $61 billion in common stock dividends last year, far more than any other S&P 500 sector. However, the sector paid out a relatively stingy 31% of profits, lower than all but one other sector. The dichotomy is due to Federal Reserve constraints on bank dividend payouts, capped at 30% of normalized profits, as well as a number of other factors, including a desire of many management teams to retain some financial flexibility because profits in many areas of this sector can fluctuate. Although payout ratios at REITs typically hover around 100%, the non-REIT financials paid out 26% of 2014 generally accepted accounting principles (GAAP) profits as dividends. This was below the 37% dividend payout figure for the S&P 500 in 2014 mainly because of Federal Reserve guidelines, which discourage aggressive dividend payout ratios for large banks, and capital building activities as Basel III phased in.

Industry and company observations

Common stock buybacks in the past 10 years have outweighed dividends, both for financials and for the S&P 500. Companies can get more aggressive with buybacks because they can be easily dialed back as share prices rise, bank capital requirements increase, or profits slip. In the past 4.5 years, S&P 500 financial companies have spent $277 billion buying back their common stock, well above the $228 billion spent in that time on common stock dividends.

Common stock buybacks haven't achieved much for shareholders of some financial firms as share counts rose slightly, on average, for the sector, led by REITs and large non-REITs, such as American International Group Inc., Morgan Stanley, Metlife, Zions Bancorporation, and Capital One Financial Corp. Share counts at major banks have barely fallen. Wells Fargo & Co. has spent nearly $26 billion in common stock repurchases in the past 4.5 years, while its common shares outstanding have fallen less than 1% in that time span. JPMorgan Chase & Co. spent $23 billion, and its share count fell 5.7%.

Notable exceptions have been Legg Mason Inc. (share count down 28% since 2010), The Goldman Sachs Group Inc. (-21%), Discover Bank (-19%), State Street Corp. (- 16%), American Express Co. (-15%), and Blackrock Inc. (-12%). Insurance companies have also done well for common stockholders with 11% median decreases in share counts since 2010, led by The Travelers Cos. Inc. (-33%), Chubb Corp. (-28%), and Unum Group and Allstate Corp. (both -23%).

Preferred stock buybacks by financial companies have totaled $205 billion in the past 10 years, skewed upward by large Troubled Asset Relief Program (TARP) repayments, which peaked at $139 billion in 2009.

Combining common stock buybacks and dividends (ignoring TARP repayments), the financial sector has paid out the most, in terms of dollars, at $505 billion in the last 4.5 years. But that's been 61% of GAAP earnings over that time span, below the 85% ratio for the S&P 500, which has been driven by nearly 100% in health care and consumer sectors.

Another way of looking at payouts is to estimate when they will break the all-time records, set in 2007, of $65 billion in dividends and $103 billion in common stock buybacks. For dividends, 2015 will be that year, but common stock buybacks, at $44 billion in the first half of 2015, will fall short of 2007's lofty mark.

Anticipated future actions and trends

Going forward, we expect dividend payouts for financial sector non-REITs to stay in a 26%-30% range indefinitely and the total financials sector to stay at a 31% dividend payout ratio. For full-year 2015, S&P Capital IQ consensus views project a 14% increase in financial sector GAAP profits versus a decrease for the entire S&P 500. Based on these inputs, we expect cash dividends for financial stocks to rise 12%, well above most other sectors.

Table 4

Financials Buybacks And Dividends--Top Company Contributors (2012-2014)

Company	Buybacks (mil. $)	Dividends (mil. $)	Total (mil. $)
Wells Fargo & Co.	18,688	20,570	39,258
JPMorgan Chase & Co.	13,002	18,240	31,242
The Goldman Sachs Group Inc.	16,284	3,842	20,126
American International Group Inc.	18,499	1,006	19,505

Source: S&P Capital IQ

--Erik Oja, Cathy Seifert, and Kenneth M. Leon, S&P Capital IQ Equity Analysts

Health Care

Historical sector data and analysis

The health care sector has been active the past 10 years in capital deployment strategies regarding dividends and buybacks. However, not all of the subindustries have been active participants. From 2005-2014, the sector paid out $286.8 billion in dividends and repurchased $502.0 billion in stock. Further, the sector generated $1.2 trillion in cash flow from operations. Therefore, shareholder friendly dividend and buyback activity equated to 64.8% of total cash flow from operations earned.

On an absolute dollar basis, total dividends paid increased each year except for 2009 and 2011. The sector has increased its dividend payout 7.4% on a compound annual basis during this time period. The biggest increase came in 2010 with a 30.2% increase, following the 6.5% decline in 2009.

The health care sector has also been active in share buybacks. During this time period, the sector repurchased some $502 billion shares, the fourth most, based on dollar value, out of the 10 sectors. Pfizer and Johnson and Johnson were the two most active companies during this time period, repurchasing $66.7 billion and $54.8 billion, respectively.

Industry and company observations

Historically, the pharmaceutical industry has been the largest and most consistent payer of dividends. It paid $229.4 billion in dividends, or 80% of the total dividends paid, from 2005 to 2014. Pfizer Inc. has been the biggest payer of dividends, paying approximately $70 billion, Pfizer and Johnson & Johnson followed with $60.7 billion. However, in recent years, the biotechnology industry has begun to mature and generate consistent cash flow, enabling some biotech companies, such as Amgen Inc. in 2011 and Gilead Sciences Inc. in 2015, to start paying dividends with current dividend yields of 2.2% and 1.75%, respectively.

Biotech has been increasingly active in repurchasing shares during the past five years. Both Amgen and Gilead Sciences have been the most active and have repurchased $35.6 billion and $20.9 billion, respectively, over this time five-year period. However, Gilead has been the most active in the past two years with $9.3 billion shares repurchased.

Anticipated future actions and trends

We expect these trends to continue in the next several years, and we anticipate that more biotech companies will engage in similar capital deployment activities in the future as their businesses mature and they begin generating steady cash flows. Although we do not anticipate biotech to overtake the pharmaceutical industry, we believe firms such as Gilead will still actively engage in dividends and buybacks. In early 2015, Gilead announced a $15 billion repurchase program, and the company generated $12.8 billion in cash from operations in 2014, which, in our view, is sufficient to fund its capital deployment plans.

Table 5

Health Care Buybacks And Dividends--Top Company Contributors (2012-2014)

Company	Buybacks (mil. $)	Dividends (mil. $)	Total (mil. $)
Pfizer Inc.	29,518	19,723	49,241
Johnson & Johnson	23,581	21,668	45,249
Merck & Co. Inc.	16,810	15,443	32,253
UnitedHealth Group Inc.	10,262	3,238	13,500

Source: S&P Capital IQ

--Jeffrey Loo, CFA, S&P Capital IQ Equity Analyst

Industrials

Historical sector data and analysis

S&P 500 industrials sector stocks paid out more than $39 billion in common stock dividends last year, in the middle of the pack among all S&P 500 sectors, and they paid out a relatively low 36% of profits, the fourth-lowest. In 2014, S&P 500 financial companies spent $71 billion on buybacks, close to double what they spent on dividends. In the past 10 years, S&P 500 industrial companies spent $412 billion on buybacks versus $293 billion on common stock dividends.

Industry and company observations

For industrial companies in the S&P 500, from 2010 through the first half of 2015, share counts declined 4.0%, on average, led by large buybacks from heavy-duty industrial names, such as Illinois Tool Works Inc. (share count down 26%) Ingersoll-Rand PLC (21%), Deere & Co. (21%), and 3M Co. (11%). The defense area has also been active in share repurchases with lowered share counts from Northrup-Grumman Corp. (down 34%), L-3 Communications Holdings (27%), Raytheon Co. (20%), and Rockwell Collins Inc. (16%). We think defense companies, facing weak revenue outlooks but having strong cash flows, are deploying that cash to support EPS by buying back stock.

Notable exceptions have been in the airline industry, only just starting to buy back stock in the past couple of years due to improving cash flows, and the rail subindustry.

Looking at common stock buybacks and dividends added together, the industrials sector has paid out $705 million in total from 2005 through 2014, in the middle of the pack among all S&P sectors. That represented 90% of GAAP profits over that time period, also in the middle. In 2014, dividends and buybacks together accounted for 101% of total GAAP profits. Although dividends in 2014 represented 36% of profits versus 37% for the 10-year average, buybacks rose to 64% from the 10-year average of 53%.

Looking at buyback efficiency, you can see some trends. For example, a company like 3M bought back 301 million shares from 2005-2014 but saw its share count only decline by 135 million, equating to a buyback efficiency of 45% (share count decline of 135 million divided by repurchase of 301 million shares).The most efficient large buybacks were done by Masco Corp. and Paccar Inc., which each had an efficiency of 90%, followed by Illinois Tool Works at 76%. It is notable the General Electric Co. (GE) had a low efficiency rating. From 2005-2014 GE bought back 2.1 billion shares of common stock but saw its share count decline by 322 million shares for an efficiency score of just 15%. Other notable companies with low scores include Fluor Corp. (14%), FedEx Inc. (20%), and The Boeing Co. (29%).

Anticipated future actions and trends

Dividend payouts as a percentage of profits have been stable during the past 10 years 36% and 37% of profits, and we expect dividend payouts to stay in this range with increased dollar amounts likely driven by profit growth over time.

We think many industrial companies have been able to lower share counts through aggressive repurchases in the past few years, and we expect this to continue in the next few years at least. The amount of buybacks as a percentage of total profits has been rising, to 64% in 2014 from 53% in 2005, and we expect that to continue to rise over time.

Table 6

Industrials Buybacks And Dividends--Top Company Contributors (2012-2014)

Company	Buybacks (mil. $)	Dividends (mil. $)	Total (mil. $)
General Electric Co.	17,691	23,861	41,552
3M Co.	13,068	5,581	18,649
United Parcel Service Inc.	8,154	6,756	14,910
The Boeing Co.	8,802	4,904	13,706

Source: S&P Capital IQ.

--Jim Corridore, S&P Capital IQ Equity Analyst

Information Technology

Historical sector data and analysis

Information technology (IT) is the largest sector within the S&P 500 and recently accounted for 20% of the index's market capitalization. Not surprisingly, technology also has more non-operating cash and investments than any other sector. (We note the financials sector has considerable cash and investments owned by depositors).

We believe this reflects the following characteristics of the sector:

- Overall size;
- Business models that generate notable cash flows;
- A historical focus on relatively conservative cash allocations after the dot-com bubble burst;
- The pace and magnitude of change; and
- Changing client/consumer/user tastes.

The dollar amount of buybacks more than doubled in the past 10 years to $156 billion in 2014 from $76 billion in 2005, and the dollar amount of dividends increased nearly five-fold to $54 billion from $11 billion.

Technology accounted for 20%-30% of S&P 500 buybacks throughout the past 10 years. We believe that much of this activity was intended to offset dilution related to stock-based compensation (e.g. stock options). For 2012, 2013, and 2014, technology accounted for 20%, 26%, and 28% of stock repurchases, and we believe this more recent trend reflects strong operating cash flows, increased comfort with more aggressive capital allocations, and shareholders (including activists) increasingly calling for or demanding expanded actions. We also believe that IT companies perhaps provided more stock-based compensation, given a rising stock market and more competition for employees. This has led to greater indicated buyback activity.

Technology's contributions to S&P 500 dividends have risen dramatically and steadily, to 15% in 2014 from 6% in 2005. In the past decade, we believe the investing public, including shareholders and managements, has become more comfortable with the concept of technology companies--traditionally thought of as investing for growth--initiating and increasing dividends. We think this growing comfort acknowledges key companies maturing and the importance of dividends for investors, especially given the current low interest rate environment and uncertain backdrop for investment returns.

Industry and company observations

Two IT companies essentially bookmark the decade from 2003 to 2012. Microsoft Corp. initiated a dividend in 2003 and paid a special dividend in 2004, which was a strong statement as the company and the technology sector were emerging from a multi-year downdraft following the dot-com bubble burst. Then in 2012, Apple Inc. announced plans to spend $45 billion over three years on a new dividend and stock repurchase program, again a few years after a major economic downturn. Microsoft's moves caused investors to wonder about the company's growth profile and perhaps led to fewer dividend actions from technology companies. Apple's actions were favorably received, and we think they contributed to new and expanded buybacks and dividends across the sector.

From 2005 to 2014, just about all of the technology companies in the S&P 500 bought back stock, and three-quarters of them paid dividends. Companies in the technology hardware, storage, and peripherals industry all bought back at least $3 billion in stock during the indicated period, led by Apple ($73 billion), Hewlett-Packard Co. ($65 billion), and EMC Corp. ($17 billion).

As for dividends, more than half of the S&P 500 semiconductors and semiconductor equipment industry, despite the cyclical nature of the businesses, recently yielded 2.6% or more (versus 1.6% for the technology sector and 2.2% for the S&P 500). Interestingly, none of the companies in the internet software and services industry has paid dividends despite what we see as substantial cash balances, financial flexibility, and past buyback actions.

Anticipated future actions and trends

Given what we see as strong cash balances, considerable financial flexibility, and greater acceptance of notable buyback and dividend activity, we see more S&P 500 technology companies buying back more stock and initiating and increasing dividends. Five years ago, the S&P 500 and S&P 500 technology sector yielded 2.0% and 0.9%, respectively. Now, they are 2.2% and 1.7%. Within five years, we see parity between yields of the technology sector and the broader market.

Notably, we believe that Alphabet Inc. (formerly Google Inc.), which does not currently have a repurchase plan or dividend in place, will announce a substantial new capital allocation program within the next year or so to utilize the $68 billion the company had in cash and short-term investments as of June.

Additionally, we see at least one other company--besides Alphabet within the S&P 500 internet software and services industry (including Akamai Technologies Inc., eBay Inc., Facebook Inc. VeriSign Inc., and Yahoo Inc.)--initiating a dividend by the end of next year. In particular, we are focused on the slower growth companies in this group that have been engaged in divestiture activity in the past couple of years--eBay, VeriSign, and Yahoo.

Table 7

Information Technology Buybacks And Dividends--Top Company Contributors (2012-2014)

Company	Buybacks (mil. $)	Dividends (mil. $)	Total (mil. $)
Apple Inc.	72,890	26,979	99,869
International Business Machines Corp.	39,533	12,096	51,629
Microsoft Corp.	19,762	24,549	44,311
Oracle Corp.	28,979	5,279	34,258

Source: S&P Capital IQ.

--Scott Kessler, S&P Capital IQ Equity Analyst

Materials

Historical sector data and analysis

Historically, dividends and share repurchases have played an equally important role in returning cash to shareholders in the materials sector. In the past 10 years, the median percentage of cash returned to shareholders as a percentage of cash flow from operations in the materials sector was 45%, 23% from dividends and 22% from share buybacks.

Although the dividend payout ratio (i.e. dividends/cash flow from operations) has remained relatively stable within a narrow range (17%-25%), share buyback activity as a percentage of cash flow from operations has been much more volatile since 2005, ranging from a low of 4% in 2010 to a high of 57% in 2014. We note that this recent spike in buybacks is due mostly to E. I. du Pont de Nemours and Company (DuPont) and The Dow Chemical Co. increasing return to shareholders by spinning off companies per activist pressure. 2014 also marks the peak of the dividend payout ratio in 10 years at 25%.

Industry and company observations

During the past 10 years, specialty chemicals and fertilizers and agricultural chemicals companies have returned the most cash to shareholders with more than 150% of cash flow from operations on average for both. On the other hand, both the commodity chemicals and the gold subindustries have returned on average less than 10% of cash flow from operations in dividends and buybacks.

CF Industries Inc., Sherwin-Williams Co., and DuPont , all of which have been returning on average over 70% of cash flow from operations to shareholders in the form of dividends and share repurchases, have been returning more cash than the sector as a whole.

In terms of dividend growth, CF Industries (five-year CAGR of 40%), WestRock Co. (29%), The Mosaic Co. (16%), and International Paper Co. (14%) all stand out.

The companies that have been the most effective in reducing diluted shares outstanding have been Sherwin-Williams and Ball Corp.; both companies have effectively reduced their share count by more than 33% since 2005. Both companies have exhibited relatively strong growth in free cash flow during the past decade. Also, both companies have exhibited a lower dividend yield, allowing a higher proportion of free cash to go toward buybacks. The current dividend yields for both companies are around 1.0% versus the materials industry average yield of 2.2%.

Anticipated future actions and trends

We forecast that dividends will continue to trend in the 22%-25% range of cash flow from operations for the materials sector. Although we think long-term trends will have buybacks fall back down to 20-25% of cash flow from operations, we note several large companies in the materials sector with robust buyback programs. We expect this trend to continue into 2016 as companies are both opportunistically buying their shares and supporting their EPS metrics by reducing share counts.

We also note that both Dow Chemical and DuPont, for example, have been under pressure from activist investors (Trian Fund Management L.P. for DuPont and Daniel Loeb's Third Point LLC for Dow Chemical Co.) to improve shareholder returns by breaking up the companies. Both companies have large authorizations for share buybacks, and they are partially funding the share repurchases from spinning off certain segments of the business.

Table 8

Materials Buybacks And Dividends--Top Company Contributors (2012-2014)

Company	Buybacks (mil. $)	Dividends (mil. $)	Total (mil. $)
Monsanto Co.	8,879	2,425	11,304
LyondellBasell Industries N.V.	7,737	3,363	11,100
The Dow Chemical Co.	4,500	5,549	10,049
E. I. du Pont de Nemours and Co.	3,400	4,951	8,351

Source: S&P Capital IQ.

--Mathew Miller, CFA, S&P Capital IQ Equity Analyst

Telecommunications Services

Historical sector data and analysis

Our analysis of the telecommunication services sector illustrates that companies heavily favor returning excess cash flow to shareholders in the form of a recurring dividend rather than through share repurchases. In 2014, roughly 89% of cash returned to shareholders was via dividends rather than buybacks compared with 76% in 2005. This percentage shift toward dividends and away from share repurchases was the second most pronounced of the 10 sectors, only behind utilities.

Despite the favorable dividend trends, a lower percentage of total cash flow from operations was returned to investors via combined dividends and buybacks in 2014 (30.5%) than in 2005 (32.9%). The 2014 figure was once again the second lowest among the 10 sectors (utilities the lowest), which we attribute to the telecom arena's capital-intensive business.

Industry and company observations

The telecom industry has historically been known for its ability to generate a steady stream of cash flow and thus has always leaned toward the dividend approach. Dividends paid in 2014 reached roughly $19 billion, an all-time high for the sector. As of Oct. 9, 2015, the S&P 500 telecom sector boasted the most attractive dividend yield of the 10 sectors at 5.4%.

AT&T Inc. and Verizon Communications Inc., the two largest U.S. telecom providers, both raised their dividends every year since 2006, even during the severe 2008-2009 economic downturn when many companies across corporate America were slashing or eliminating dividends. Verizon has increased its dividend per share to $2.16 in 2014 from $1.62 in 2005 (compounded annual growth rate of 3.25%), and AT&T's per share dividend has risen to $1.85 from $1.30 (compounded annual growth rate of 4.0%) during this timeframe.

Smaller rural wireline providers have had less success in maintaining dividends. Frontier Communications Corp. cut its per share annual dividend to $0.75 from $1.00 after the 2010 acquisition of Verizon assets and then to $0.40 in February 2012 to focus on reducing debt leverage. In early 2015, Frontier increased the dividend to $0.42 per share from $0.40. CenturyLink Inc., in early 2013, lowered its annual dividend by 26% to $2.16 from $2.90. We believe the change in the dividend policy was largely driven by CenturyLink's expectation of using up its net operating losses and desire to maintain at least a 60% dividend coverage ratio. Management decided to take the pain of reducing the dividend in early 2013 and replace it with a repurchase plan for two years.

Share repurchases have been the less popular tool for telecom service providers. AT&T was aggressive in 2012-2013, repurchasing more than $25 billion during that period. However, acquisitions as of late have tempered buybacks for AT&T (we note more than $75 billion in completed acquisitions since the start of 2014). In the first half of 2015, Verizon completed a $5 billion accelerated share repurchase program, reducing its share count by 101.6 million. This occurred after Verizon announced in February to sell $10.5 billion in wireline assets to Frontier and 165 towers to American Tower for $5 billion.

Anticipated future actions and trends

Going forward, we expect the major trends within the telecom sector to remain relatively unchanged with the focus still on supporting attractive dividend yields. AT&T and Verizon both have yields greater than 5%, and CenturyLink and Frontier possess dividend yields of more than 8%.

We believe that share repurchases will be elusive for the major telecom providers through at least 2016. AT&T recently completed its acquisition of DIRECTV in July 2015, and Verizon bought Vodafone Group PLC's 45% stake in Verizon in early 2014 to give it full ownership. Although both transactions increase free cash flow generation for the acquirers, we expect the companies' focus in the intermediate term to be on reducing high debt levels.

Of the telecom sector members, only Level 3 Communications Inc. has refrained from any sort of dividend/share repurchase program for investors. Our belief is that recent/future cash flow growth makes the company well-positioned to eventually return excess cash generated to shareholders via one of these methods.

Table 9

Telecommunication Services Buybacks And Dividends--Top Company Contributors (2012-2014)

Company	Buybacks (mil. $)	Dividends (mil. $)	Total (mil. $)
AT&T Inc.	27,397	29,489	56,886
Verizon Communications Inc.	153	18,969	19,122
CenturyLink Inc.	2,273	4,340	6,613
Frontier Communications Corp.	0	1,200	1,200

Source: S&P Capital.

--Angelo Zino, CFA, S&P Capital IQ Equity Analyst

Utilities

Historical sector data and analysis

Dividends have historically been important to the utilities sector, providing notable cash returns to shareholders. The sector has high capital intensity but generates significant amounts of cash from its regulated operations. As a result, utility companies typically have paid out more than 50% of their earnings in the form of dividends. Currently, utility companies in the S&P 500 have an average dividend payout ratio of 62%.

In 2005, utility sector dividends held an 80.4% share of total utility dividends and repurchases within the S&P 500. That figure has risen to 94.7% in 2014. In 2005, some utility companies had sizable unregulated operations. Wary of increasing their dividends to reflect rising earnings of more risky, unregulated businesses, utilities used share repurchases to deploy excess cash. After the spate of mergers in the late 1990s and early 2000s when many utility companies used shares as a currency, and they also used share repurchases to reduce share counts in the following years., utilities used share repurchases to deploy excess cash. With many companies selling or spinning off unregulated subsidiaries in recent years, utility companies have shifted toward a more regulated and steady earnings stream. Following some larger unregulated separations, the involved companies used the proceeds to repurchase shares.

Industry and company observations

During the past 10 years, four utilities companies in the S&P 500 had what we consider strong dividend growth, each having a CAGR for dividends of more than 9% over the years. However, most of these companies (CenterPoint Energy Inc., Sempra Energy, and WEC Energy Group Inc.) cut their dividends between 2000 and 2002, which allowed them to achieve double-digit growth rates. Eversource Energy cut dividend in 1997. NextEra Energy Inc., with a dividend CAGR of 7.9% during the same period, cut its dividend in 1994, and Dominion Energy, with a CAGR of 6.1%, froze its dividend for 10 years until 2004. However, the data does not indicate that dividend cuts or long-term dividend freezes will lead to healthy long-term dividend growth during the period after the cut or freeze. Of the 29 utilities companies in the S&P 500, two independent power producers didn't start paying a dividend until recently. Of the remaining 27 utility companies, 14 cut their dividend at least once since 1995, and two more temporarily suspended their dividend during that period. One additional company did both during that time period. Also, 21 utilities have had a frozen dividend during at least a two-year period since 1999. Only Consolidated Edison Inc. and NextEra Energy did not cut or freeze their dividends during the past 20 years, and only Consolidated Edison has what we consider a consistent dividend record for the past 30 years.

Anticipated future actions and trends

Going forward, we see dividends' share of total repurchases and dividends continuing to trend above 90%. However, we believe that completion of a $1.5 billion accelerated repurchase program by Duke Energy Corp. in 2015 could lead to a reduction this year in the ratio to slightly below 90% in 2015. In our view, using share repurchases to deploy cash isn't as attractive in the sector as is using dividends due to investor interest in dividends. Dividends represent cash returns on shareholder investments in a capital-intensive industry that traditionally was widely held by individual investors. In addition, we believe that there will be few opportunities for companies to sell or spin off large portions of their businesses that would generate cash in sufficient levels to make meaningful share repurchases within the sector.

We also believe that most utilities have dividend payout ratios that would allow those companies to sustain their dividends at least at current levels. However, we think that a large majority of utility companies within the S&P 500 are likely to continue to pursue dividend increases and that the average annual increase in the next several years will range from 4.5%-6.0%, above the 10-year average.

Table 10

Utilities Buybacks And Dividends--Top Company Contributors (2012-2014)

Company	Buybacks (mil. $)	Dividends (mil. $)	Total (mil. $)
Duke Energy Corp.	0	6,174	6,174
Southern Co.	455	5,321	5,776
Exelon Corp.	0	4,030	4,030
Dominion Resources Inc.	0	3,909	3,909
Source: S&P Capital IQ.			

--Christopher B. Muir, S&P Capital IQ Equity Analyst