



Course of Study for Beginning Investors
Class 3 Estimating Future Growth

Defining Dividend Yields & Returns




Carol Theine
 PRESIDENT,
 PUGET SOUND CHAPTER



SSG Section 5 Total Return Analysis (or 5-year Potential)

Two Factors:
Dividends
Price Appreciation

5 TOTAL RETURN ANALYSIS **Toolkit 6**

A CURRENT YIELD
 Present Full Year's Dividend \$ 0.640 ÷ Current Price of Stock \$ 27.060 = 2.4 % Present Yield or % Returned on Purchase Price

B AVERAGE YIELD - USING FORECAST HIGH P/E
 Avg. % Payout 26.9 ÷ Forecast High P/E 15.0 = Avg. Yield 1.8

AVERAGE YIELD - USING FORECAST AVERAGE P/E
 Avg. % Payout 26.9 ÷ Forecast Avg P/E 12.5 = Avg. Yield 2.2

C % COMPOUND ANNUAL TOTAL RETURN - USING FORECAST HIGH P/E
 Average Yield 1.8 % + Annual Appreciation 13.2 % = Compound Annual Total Return 14.9 %

D % PROJECTED AVERAGE RETURN - USING FORECAST AVERAGE P/E
 Average Yield 2.2 % + Annual Appreciation 9.1 % = Projected Average Total Return 11.3 %

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5 5-YEAR POTENTIAL **BetterInvesting Online SSG**

This combines price appreciation with dividend yield to get an estimate of total return. It provides a standard for comparing income and growth stocks.

A Present Full Year's Dividend \$ 0.640 ÷ Present Price of Stock 27.06 = 0.02 = 2.37 % Present Yield


B AVERAGE YIELD - USING FORECAST HIGH P/E
 Avg. % Payout = $\frac{26.88}{15.00} = 1.79\%$
 Forecast High PE = 15.00

AVERAGE YIELD - USING FORECAST AVERAGE P/E
 Avg. % Payout = $\frac{26.88}{12.50} = 2.15\%$
 Forecast Average PE = 12.50

C COMPOUND ANNUAL RETURN - USING FORECAST HIGH P/E
 Annualized Appreciation 13.18 %
 Average Yield 1.79 %
 Annualized Rate of Return 14.97 %

COMPOUND ANNUAL RETURN - USING FORECAST AVG P/E
 Annualized Appreciation 9.13 %
 Average Yield 2.15 %
 Annualized Rate of Return 11.28 %


3



Dividend Yield

= $\frac{\text{Dividend}}{\text{Price}}$


4



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Many Dividend Yields

- **Section 3 – High Yield for each Year**
- **Section 5 – Current Yield**
- **Section 5 – Average Potential Yield – Using Forecast High P/E**
- **Section 5 – Average Potential Yield – Using Forecast Low P/E**

5 


Section 3 - % High Yield

= Dividend ÷ Low Price

Fiscal Year	High Price	Low Price	EPS	High P/E	Low P/E	Dividend	% Payout	% High Yield
1 2006	28.4	21.5	1.20	23.7	17.9	0.340	28.3	1.6

.34 ÷ 21.5 = .0158 = 1.6%

We could look at % Low Yield -- the dividend of .34 divided by high price of 28.4 resulting in a low dividend yield of 1.2%.

6 

5A – Current Yield


MSFT

A CURRENT YIELD
 Present Full Year's Dividend \$ 0.640 ÷ Current Price of Stock \$ 27.060 = 2.4 % Present Yield

Present Full Year Dividend –

- Most recent company dividend announcement applied to a full year.
- MSFT increased dividend last quarter to \$.16 share (up from \$.13) .

.16 x 4 = .64

7 

5A – Current Yield


MSFT

A CURRENT YIELD
 Present Full Year's Dividend \$ 0.640 ÷ Current Price of Stock \$ 27.060 = 2.4 % Present Yield

Microsoft Corporation (NasdaqGS: MSFT)
 After Hours: 27.05 ↓ 0.01 (0.04%) 7:59PM EST

Last Trade:	27.06	Day's Range:	26.99 - 27.21
Trade Time:	Feb 18	52wk Range:	22.73 - 31.58
Change:	↓ 0.15 (0.55%)	Volume:	68,672,855
Prev Close:	27.21	Avg Vol (3m):	57,297,800
Open:	27.18	Market Cap:	227.37B
Bid:	27.05 x 100	P/E (ttm):	11.55
Ask:	27.15 x 500	EPS (ttm):	2.34
1y Target Est:	33.38	Div & Yield:	<u>0.64 (2.40%)</u>

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8 

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5A – Current Yield

MSFT

A CURRENT YIELD
 Present Full Year's Dividend \$ 0.640 ÷ Current Price of Stock \$ 27.060 = 2.4 % Present Yield

**Current Yield uses
 Current Dividend and
 Current Stock Price**


Usefulness of this number?

9 

5B: Average *Potential* Yield – Using Forecast High P/E

$$\text{Yield} = \frac{\text{Average \% Payout}}{\text{Forecast High P/E}}$$

$$\text{Yield} = \frac{\text{Dividend EPS}}{\text{Price EPS}}$$


10 

5B: Average *Potential* Yield – Using Forecast High P/E

$$\text{Yield} = \frac{\text{Average \% Payout}}{\text{Forecast High P/E}}$$


Average % Payout is a Judgment Item

- If a company paid a special one-time dividend, you might exclude it. (In FY 2005, MSFT paid a one-time \$3/share dividend.)
- Recently banks and other companies CUT dividends.

11 

Examine % Payout SSG Section 3

GE		WFC	
Fiscal Year	% Payout	Fiscal Year	% Payout
2006	51.8	2005	44.4
2007	52.3	2006	43.4
2008	69.7	2007	49.6
2009	59.2	2008	185.7
2010	40.0	2009	28.0
AVERAGE	54.6	AVERAGE	70.2

12 


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Toolkit 6: % Payout

- **% Payout is a judgment item that *never changes* automatically.**
- **Even if the Section 3 data changes (outliers or new FY data), the % Payout in section 5 must be updated manually.**


B AVERAGE YIELD USING FORECAST HIGH P/E
 Avg. % Payout 41.3 / 70.2 + Forecast High P/E 15.0 = Avg. Yield 4.7

13




BI Online SSG: % Payout

- **Recalculates average after outliers.**
- **But you must click “Calculate Yield” after the new average is shown or you type your own number.**



14




5B: Average Potential Yield – Using Forecast High P/E

$$\text{Yield} = \frac{\text{Average \% Payout}}{\text{Forecast High P/E}}$$

Forecast High P/E = Your Judgment Projection in 4A

15



5B: Average Potential Yield – Using Forecast High P/E

$$\text{Yield} = \frac{\text{Average \% Payout}}{\text{Forecast High P/E}}$$


= $\frac{26.88\%}{15.00}$ = 1.79%

3 PRICE, PRICE

	Fiscal Year	% Payout
1	2006	28.3
2	2007	27.5
3	2008	23.0
4	2009	30.9
5	2010	24.8
6	AVERAGE	26.9

4 EVALUATING REWARD and RISK over the next 5 years
 A FUTURE HIGH PRICE ANALYSIS -- NEXT 5 YEARS
 Selected High P/E 19.7 X Estimated High Earn 15.0

16



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5B: Average *Potential* Yield— Using Forecast Average P/E

Yield = $\frac{\text{Average \% Payout}}{\text{Forecast Average P/E}}$

= $\frac{27.00\%}{12.500}$

= 2.15%

**Forecast Average P/E =
(Your High P/E + Your Low P/E) ÷ 2**

4 EVALUATING REWARD and RISK over the next 5 years

A FUTURE HIGH PRICE ANALYSIS – NEXT 5 YEARS
 Selected High P/E $\frac{19.7}{15.0}$ X Estm

B FUTURE LOW PRICE ANALYSIS – NEXT 5 YEARS
 (a) Sel. Low P/E $\frac{13.5}{10.0}$

17

5B – Why Two Different Yields?

Next step is to calculate returns –

**Yield
+ Price Appreciation
Potential Return**

**Two different returns presented
using different P/E assumptions for
dividend yield and price appreciation.**

18

5C & 5D - Returns

5 TOTAL RETURN ANALYSIS

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 Avg. % Payout 26.9 ÷ Forecast High P/E 15.0 = Avg. Yield 1.8

AVERAGE YIELD - USING FORECAST AVERAGE P/E
 Avg. % Payout 26.9 ÷ Forecast Avg P/E 12.5 = Avg. Yield 2.2

C % COMPOUND ANNUAL TOTAL RETURN - USING FORECAST HIGH P/E
 Average Yield 1.8 % + Annual Appreciation 13.2 % = Compound Annual Total Return 14.9 %

D % PROJECTED AVERAGE RETURN - USING FORECAST AVERAGE P/E
 Average Yield 2.2 % + Annual Appreciation 9.1 % = Projected Average Total Return 11.3 %

The yields calculated in 5B are used in 5C & 5D.

19

5C – Annual Price Appreciation – High P/E

$$\text{Potential Annual Price Appreciation} = \left(\left(\frac{\text{High Stock Price Forecast}}{\text{Present Stock Price}} \right)^{1/5} - 1 \right) \times 100$$

$$= \left(\left(\frac{50.25}{27.060} \right)^{1/5} - 1 \right) \times 100$$

$$= 13.18\%$$

4 EVALUATING REWARD and RISK over the next 5 years

A FUTURE HIGH PRICE ANALYSIS – NEXT 5 YEARS
 Selected High P/E $\frac{19.7}{15.0}$ X Estimated High Earnings/Share 3.35 = Forecast High Price \$ 50.2

B FUTURE LOW PRICE ANALYSIS – NEXT 5 YEARS
 (a) Sel. Low P/E $\frac{13.5}{10.0}$ X Estimated Low Earnings/Share 2.10 2.35 = \$ 23.5

20

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5C –Compound Annual Total Return


C % COMPOUND ANNUAL TOTAL RETURN - USING FORECAST HIGH P/E
 Average Yield 1.8 % + Annual Appreciation 13.2 % = Compound Annual Total Return 14.9 %

If the company performs as well as you expect, and you sell the stock at the forecast high price, this will be your financial return.

REMINDER: Two judgments impact your high price:

- 1) EPS growth rate in Section 1
- 2) High P/E selected in Section 4

21



5D – Annual Price Appreciation – Average P/E

$$\begin{aligned} \text{Potential Annual Price Appreciation} &= \left(\left(\frac{\text{Stock Price Forecast}}{\text{Present Stock Price}} \right)^{1/5} - 1 \right) \times 100 \\ &= \left(\left(\frac{41.88}{27.060} \right)^{1/5} - 1 \right) \times 100 \\ &= 9.13\% \end{aligned}$$

4 EVALUATING REWARD and RISK over the next 5 years


A FUTURE HIGH PRICE ANALYSIS – NEXT 5 YEARS
 Selected High P/E 19.7 X Estimated High Earnings/Share 3.35 = Forecast High Price \$ 50.2

B FUTURE LOW PRICE ANALYSIS – NEXT 5 YEARS
 (a) Sel. Low P/E 13.3 X Estimated Low Earnings/Share 2.10 = \$ 23.5

Average Forecasted P/E is 12.5

12.5 x 3.35 = 41.88

22



5D – Projected Average Return (PAR)– Using Average P/E


D % PROJECTED AVERAGE RETURN - USING FORECAST AVERAGE P/E
 Average Yield 2.2 % + Annual Appreciation 9.1 % = Projected Average Total Return 11.3 %

If the company performs as well as you expect, and you sell the stock at the average P/E, this will be your financial return.

REMINDER: Judgments impacting your stock price:

- 1) EPS growth rate in Section 1
- 2) High and LOW P/E selected in Section 4


23



Which is better? Total Return or PAR

- **Total Return (High P/E) is more optimistic.**
- **PAR (Average P/E) is more conservative and some would say “realistic”.**

24



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15% Return Goal?

- **Not every stock in your portfolio needs to have 15%.**
- **Goal is a PORTFOLIO goal of 15% to double your money in 5 years.**
- **Is 15% realistic in all economic cycles? No.**

25



Questions?

Email:
ctheine@puget.betterinvesting.net

26



What is the difference between simple and compounded return?

A simple return assumes you make money only on the initial investment each year.

A compounded return accounts for reinvestment of the profits.

