

Markit Dividends Forecasting Methodology

An outline of the processes used by Markit Dividends

- **Estimating dividend amounts**
- **Dividend payment schedule projections**
- **DIPs**

How are dividend amounts estimated?

The Team

Markit Dividend estimates are produced by a team of 25 multilingual analysts based in London, New York and Singapore.

Overview

Markit considers a number of different factors when forecasting dividends. In terms of estimated dividend amounts, Markit's main inputs are:

- Direct company guidance
- Fundamental analysis
- Peer group trends
- Historical patterns
- Consensus aggregate estimates

Direct Company Guidance

In stock exchange announcements, companies will often give guidance regarding their dividend policies, and in some cases companies will even provide the specific dividend amount which they intend to pay.

Dividend policies are often closely linked to earnings, whereby a company will aim to pay out a certain percentage of earnings as dividends. This is typically the base for many dividend estimates.

Additionally, analysts maintain lines of communication with companies within Markit's dividend coverage. Direct correspondence with investor relations departments or the company secretary allows Markit to gain further insight over dividend policies and projected

payouts. This is often a strong contributor to dividend estimates, particularly when companies announce a change in dividend policy.

However, with the recent economic downturn it is evident that many companies must revisit their established dividend policies, and therefore company guidance alone is insufficient.

Fundamental Analysis

Fundamental analysis allows Markit to look further into company performance. By examining the underlying metrics which drive dividend decisions, such as earnings, operating cash flow and net debt, a clearer picture over expected dividends can be obtained.

Markit also extensively monitors news flow, at both company and sector level, to ensure that any developments or underlying themes are incorporated into its dividend estimates.

In addition, information gleaned from company conference calls and discussions can often help to determine the importance which management teams at certain Groups place on dividends.

Industry & Peer Group Trends

In addition to individual company analysis, it is important to consider trends across markets as a whole and a company's peer group when estimating dividends. The monitoring of stock market movements, and the underlying drivers behind them, is supplemented by the study of PMI reports from Markit Economics.

Often, companies within similar fields will try to maintain a certain level of consistency against their rivals. This applies not just to targeting similar dividend policies. Increasingly there have been trends set by one company which are closely followed by others within the sector, such as the wave of dividend cuts in the house-building sector last year. Dividend yields across a sector can also signal potential dividend surprises.

Historical Patterns

In some cases, companies will not have a clearly-defined dividend policy but there will be clear patterns in the nature of their dividend payments.

Historical patterns are of some use, as they can often give indications of how companies' dividends have grown historically, in addition to how their dividend payout ratios have held up over time. In an environment where earnings are being squeezed, it is often useful to see how dividends have been declared during previous downwards earnings cycles.

Another useful aspect of analysing historical patterns is to see how dividends have been split by companies over previous financial years. As Markit provides dividend forecasts on discrete dividends (as opposed to aggregate full-year payouts) historical patterns are the most useful indicator of how a company will split its dividends in the absence of any direct guidance.

Consensus Aggregate Estimates

When forecasting dividends, it is beneficial to monitor consensus data. Given the volume of broker activity, it is often advantageous to observe not only any new estimates made by brokers, but also to look at the estimates of brokers who have strong track records of being accurate.

As consensus levels tend to factor in stale data which does not factor in more recent events, it is really only the examination of individual estimates that proves useful when assessing expected dividends. It is also increasingly noticeable that consensus averages (particularly in terms of forecasted EPS) tend to be far too optimistic during market downturns, and this must also be taken into account when forecasting distributions. Markit also monitors implied dividends within the options market as an indicator of potential dividend surprises.

Forecasting dividend payment schedules

Many companies tend to pay dividends based on a regularly recurring schedule. That being said, many other companies will have certain nuances, and it is also increasingly important to bear in mind any directives laid out by stock exchanges, which are responsible for imposing rules regarding the timing of dividend payments. Markit assesses the following when estimating dividend schedules:

- Direct company guidance

- Historical trends
- Stock exchange guidelines

Direct Company Guidance

Many companies will provide direct guidance regarding their dates. These are typically provided on investor relations web pages and within stock exchange announcements. Markit undertakes daily checks of these sources to ensure that its projected dividend dates are as accurate as possible.

Historical Trends

Many companies tend to pay dividends based on a relatively regular schedule. Whilst this should mean that the forecasting of dividend timetables is a simple task, this is not always the case.

Often, a company will have certain fairly established trends, whether it is that their final dividend always trades ex-dividend the week after it is announced or that its interim dividend is always paid on the 2nd Friday of July.

In the absence of explicit guidance on dates, monitoring trends allows Markit to predict dividend payment schedules. Additionally, whilst a company might be reticent to give out specific guidance on an ex-dividend date, they are much happier to comment on whether such hypotheses are valid or not.

However, historical trends are not sufficient. There are often instances where a company will have to amend its dividend schedules. The recent spate of rights issues has led many companies to amend their dividend payment schedules, in order for the ex-dividend date to fall before any rights are issued, whilst in other cases companies are seeking to amend the timing of their dividend cash flows for reporting purposes.

In order to model changes in dividend payment schedules, it is important to monitor company developments. Additionally, it is also important to be mindful of the proximity of ex-dividend dates to options expiry periods.

Stock Exchange Guidelines

Dividend schedules are also determined by stock exchanges. Most stock exchanges will issue dividend procedure guides so that companies will ensure that their dividend payments are consistent with their own guidelines. For example, in the UK ex-dividend dates

fall on Wednesdays with associated record dates being 2 business days afterwards.

Additionally, exchanges will also introduce other guidelines, such as the newly-introduced transparency directives on the LSE which require companies to report their results and dividends within 4 months of year-end. By monitoring these guidelines and assessing their implications on dividend schedules, Markit is able to more accurately forecast dividend timetables.

Dividend Index Points (DIPs)

Markit calculates Dividend Index Points for an index on an individual stock basis, taking into account the treatment of exceptional dividend types by each individual index provider, as detailed in the each index's

calculation methodology. For example, Markit will account for how a specific index handles both special cash dividends and capital returns and thus, if a special dividend causes a change to the divisor of the index, the special dividend is excluded. The functionality within the system also allows for varying proportions of the payment to be included/excluded where relevant.

Further, given the increased prevalence of stock dividends as a form of shareholder return in the past months, Markit will identify those stock dividends that have an impact on the DIPs for any of the indices for which the stock is a constituent.

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