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BUYBACKS & DIVIDENDS
A Trillion Dollar Offer

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Strong macro numbers, exceptionally low interest rates and a healthy recovery in profits after the economic crisis have made several S&P500 companies financially stronger.

Ample cash reserves have increased their appetite for buybacks and dividends. Investors have welcomed both the payout strategies, with the buyback index significantly outperforming the benchmark over the past three years.

The generous trend of strong shareholder returns is expected to remain robust in 2015, given the confidence among companies to pursue their business plans, supported by significant cash and stable economic recovery.

Strong Rebound In Buybacks And Dividends After Financial Crisis

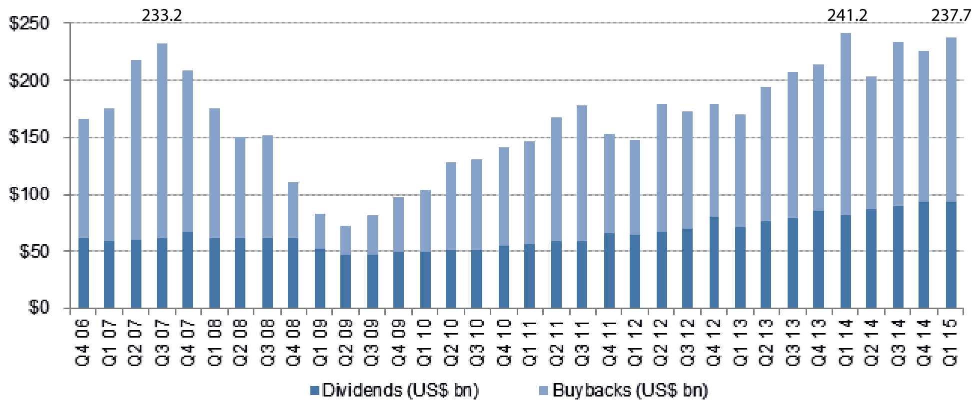
Buybacks and Dividends Touch US$ 904 bn

S&P 500 companies continue to increase their shareholders' payout, with strong rebound in buybacks as well as dividends since the financial crisis. Companies have spent nearly $2.3 trillion on buybacks since 2009, supporting the bull run in which the index has more than tripled during the period. In 2014, s&p 500 companies spent more than 90% of their earnings on buybacks and dividends.

In 2014, total expenditure on buybacks and dividends touched a record high of $903.7 bn, increasing from $787.4 bn in 2013. Buybacks represented a larger share of the total (61%), rising 16% Y-o-Y to $553.3 bn, little shy of its highest point in 2007 ($589.1 bn). However, this is higher than the low of $137.6 bn registered during the recession in 2009. On the other hand, dividends reached a record high of $350.4 bn in 2014 (up 12% Y-o-Y), indicating a healthy corporate America.

Buybacks for Q1'15 totaled $144.1 bn, up 8.7% from $132.6 bn in Q4'14, while dividends rose 0.8% to $93.6 bn, as cash-rich companies continue to reward stock investors. However, buyback participation slid marginally during the quarter, with fewer companies reducing their share count. In q1'15, 299 corporations reported buybacks, down from 308 in q4'14, although higher than 290 in q1'14.

S&P 500 Companies – Dividends and Buybacks (US$ bn)



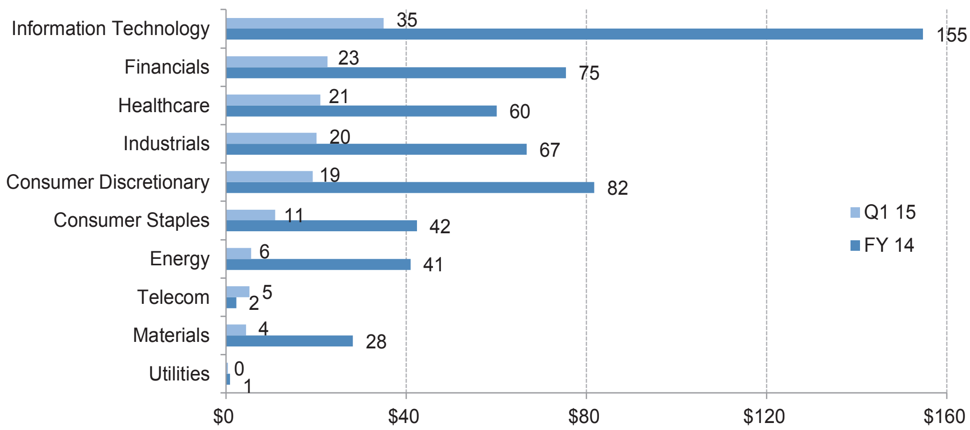
Source: S&P Dow Jones Indices, Aranca Research

Information Technology Leads The Pack

Among the sectors, Information Technology continued to lead in Q1'15, with buybacks as a percentage of the total in Q1'15 remaining at 24.3%, marginally up from 24.2% in Q4'14. Apple continued to dominate, with nearly $7.0 bn of buyback activity during the quarter. This reflects the cyclicity in the sector. Among other large contributors, Financials accounted for 15.6% of all the buybacks during the quarter, followed by Healthcare (14.5%), Industrials (14.0%), and Consumer Discretionary (13.3%, second best performer in Q4'14).

Five of the ten sectors witnessed a sequential percentage decline in spending on share repurchases, led by the Energy sector. The Telecom sector was a surprise, recording the largest percentage increase on buybacks. Verizon Communications joined the buyback market, spending $5 bn during the quarter after registering $92 mn in Q4'14. This resulted in a total sector spend of $5.2 bn in Q1'15.

S&P 500 Companies – Sectoral Buybacks (US$ bn)



Source:S&P Dow Jones Indices, Aranca Research

Some of the major spenders, which led to the increase in buyback expenditures in these sectors, are as follows:

Total Buybacks Over The Past Five Years

Information Technology

Apple Inc. ($79.9 bn)
Microsoft ($43.3 bn)
Intel ($34.9 bn)
Oracle ($34.2 bn)

Healthcare

Pfizer ($41.6 bn)
Johnson & Johnson ($29.4 bn)
Merck & Co. ($21.4 bn)
Gilead Sciences ($15.8 bn)

Consumer Discretionary

Comcast Corp. ($14.3 bn)
Twenty-First Century Fox ($13.9 bn)
General Motors ($12.7 bn)

Financials

JP Morgan Chase ($25.0 bn)
Wells Fargo ($23.7 bn)
American Intl. Group ($20.0 bn)

Shareholder Payout Remains Higher Than Business Investment

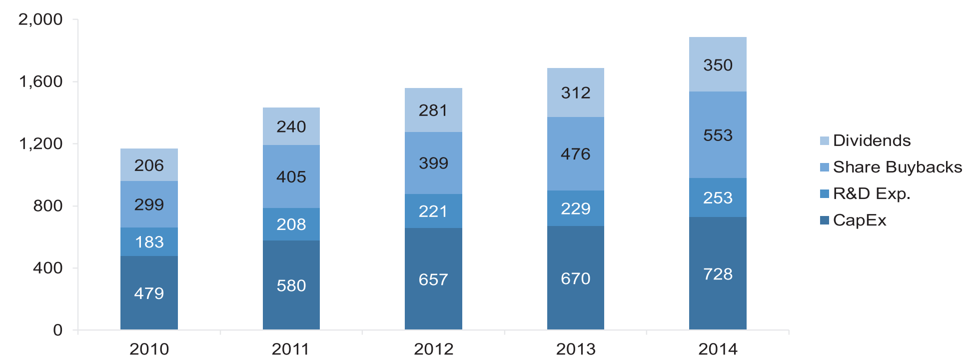
Are Increased Payouts Hampering Investment Opportunities?

As a contrarian, the question to be asked is whether corporate America is lacking investment opportunities that offer them higher returns on investment, which in turn is leading to increased investor payouts. In recent times, top managements have increased their engagement in financial engineering compared with business investments.

The right mix – Companies have not stopped or lowered their capex investments. In 2014, capital expenditures and R&D expenses by S&P 500 companies rose 8.6% and 10.4%, respectively. S&P 500 companies continue to follow a disciplined approach to capex and R&D expenses, along with several new product launches.

R&D expense in 2014 stood at US$ 31.9 per share, up from US$ 21.6 per share in 2009. It is about setting the right mix; cash governance could be through reinvestment in the company, mergers & acquisitions, repayment of debt, or returning value to shareholders through buybacks or dividends. In one of the recent earnings call, Apple's CEO Tim Cook stated that the buybacks reflect its strong confidence in what lies ahead; the company raised its dividend by 11% and boosted its buyback plan by $50 bn.

S&P 500 Companies – Capital Usage (US$ bn)



Source:S&P Dow Jones Indices, Bloomberg, Aranca Research

If a company has sufficient funds to ensure the operational and liquidity requirements of its business, effective cash management would directly or indirectly enhance shareholder value.

Is Undervaluation Leading to Higher Buybacks?

Buyback plans are believed to indicate that a company considers its stock to be undervalued. Several activist investors advised Apple to increase its share repurchase plan, stating that the company remains "dramatically undervalued" despite the rally and that raising buybacks helps increase shareholder value.

Since the start of the rally after the crisis, the increase in price-to-earnings multiples has been a major driver of stock gains. The S&P 500 index traded at a trailing P/E ratio of 12.6x in 2011 compared with the current multiple of 18.2x. The current P/E ratio still remains shy of a two decade long-term average of 19.5x. Overall, a company should have a good reason to believe its stock is undervalued. For a company, even after spending on capex and innovation, along with miniscule debt, still has billions of cash lying around – doing a buyback indeed makes sense.

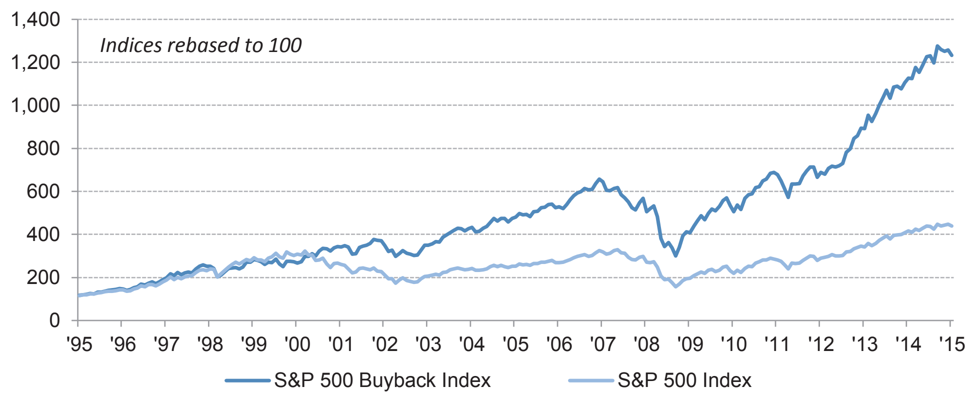
Companies With Largest Dollar Buyback Programs Outperform S&P 500

Since 1995, Buyback Index Yields Better Returns Than the Benchmark

From an investor's perspective, the key is to earn the highest return on every penny invested in stocks, be it from business growth or share buybacks. Since 1995, the S&P 500 buyback index has provided better returns than the benchmark S&P 500 index. Since 2009, the S&P 500 buyback index has been increasing at an annualized rate of 23%, while the benchmark S&P 500 index has advanced at 15%.

The question to be asked whether buybacks and dividends are driving the markets higher? Yes, to an extent; they act as an accelerator to sustain the rally. Historically, both these payout strategies have worked wonders for investors' total return, as investors continue to applaud repurchases. Furthermore, with expectations of buybacks and dividends reaching a new high in 2015, investors are likely to have sufficient runway this year which would help sustain the six-year bull run.

Buyback Index Compared With S&P 500 Index



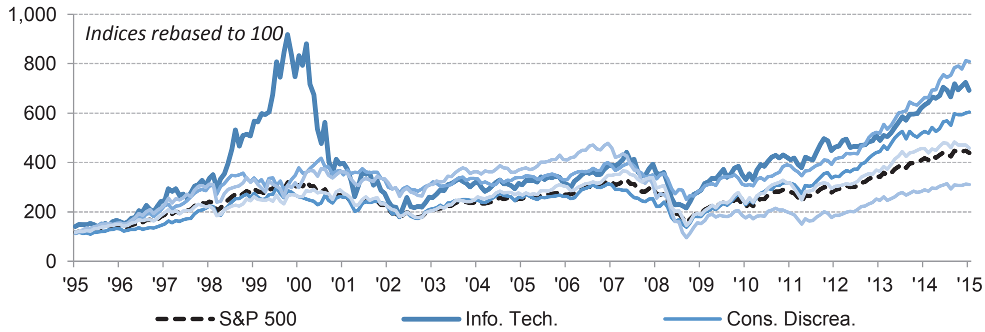
Source:Bloomberg, Aranca Research

Sectoral Indices Too Outperform the Benchmark

The sectors with largest buyback programs by dollar value have outperformed the S&P 500 index, except for Financials index, which was highly impacted by the financial crisis in 2008. The S&P 500 Healthcare index has been performing the best since 1995, beating the benchmark by 1.8 times, closely followed by the Information Technology index (1.6 times) and Consumer Discretionary (1.4 times); the Industrial index was at par with the S&P 500 index.

Sectoral indices for Utlities, Materials, and Telecommunications with lower buyback programs perfomed below the benchmark; Consumer Staples index was in line with the S&P 500 performance.

Sectoral Indices Compared With S&P 500 Index



Source:Bloomberg, Aranca Research

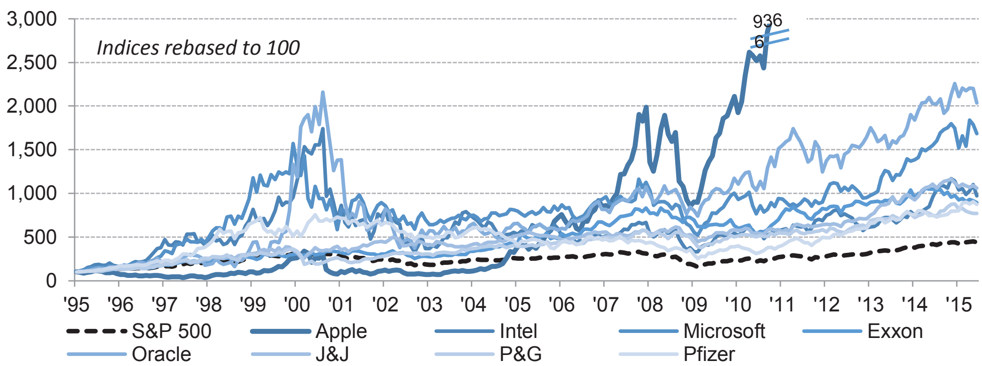
Of the non-financial companies on the index, currently Information Technology companies have the largest amount of available cash (US$ 784.7 bn) , which accounts for 45% of the total (US$ 1.73 trillion). Thereafter, Healthcare companies follow, with 17% (US$ 289.2 bn) of the total, and Industrials and Consumer Discreationary, with 14% and 10% share, respectively.

Top Buyback Stocks Continue the Winning Streak

Companies with the largest buyback programs by dollar value over the past five years too have outperformed the benchmark, with Apple being a multi-bagger. Buybacks allow companies to tweak the earnings per share (EPS) number, even with lower share count. Such level of buyback activity has been a tailwind for growth in earnings per share. Based on the S&P Q1 15 release, more than half of the S&P 500 issues reduced their share count, with 20% reducing it enough to benefit their Y-o-Y EPS by at least 4%. This has been an ongoing trend for the past five consecutive quarters and is a blessing, as EPS is the figure highly analyzed by investors.

For some technology companies, granting stock options to employees and buying back shares to offset this issuance has worked as an interesting strategy.

Top 8 Buyback Stocks Compared With S&P 500 Index



Source:Bloomberg, Aranca Research

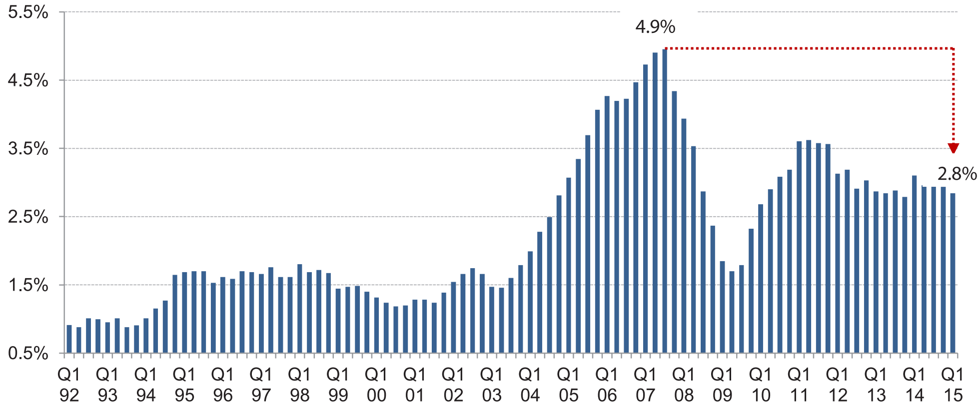
On Track To Cross US$ 1.0 Trillion By 2015

Buybacks & Dividends Remain Strong and Will Get Stronger

The plethora of share repurchases is expected to move at a robust pace in 2015, with investors acting as cheerleaders. This could be the third consecutive annual double-digit gain for buybacks and dividends and may end the year at a record high. Dividends in Q1 15 have already posted another record quarter, with the expenditure being US$ 93.6 bn; Expenditure on buybacks stood at US$ 144.1 bn, lower than US$ 172.0 bn in Q3 07.

In addition to the record high actual dollars spent on buybacks, what matters is the buyback yield (the amount spent on buybacks in relation to the size of the benchmark market). Currently, the buyback yield remains much lower at around 2.8% Compared with the late 2007/early 2008 high of nearly 5.0%. This supports the view that buybacks could go a long way in aiding the equity bull run.

Buybacks as Percentage of S&P 500 Market Cap



Source:Bloomberg, S&P Capital IQ, Aranca Research

Expected Growth In Earnings and Considerable Available Cash to Drive Investor Payout

Corporate America's performance in early 2015, along with the expected growth for full-year 2015, will continue to expand the capital return program to investors at an astounding figure of more than US$ 1.0 trillion. In 2015, EBITDA and EPS for S&P 500 companies are estimated to grow around 11.7% Y-o-Y and 4.6% Y-o-Y, respectively, based on the Bloomberg consensus estimates.

Currently, cash and cash equivalents on the balance sheet of non-financial companies on the index stand at US$ 1.73 trillion, up 30% from US$ 1.33 trillion in the end of 2014. This amount is equivalent to more than 98 weeks of estimated 2015 net income and 10% of the current market value of S&P 500 companies.

Shareholder payouts are a great financial engineering tool, but managements need to figure out the best utilization of its cash using balanced capital strategy.

Buyback and dividend activities are likely to hit record highs in 2015. The outperformance of sectors and stocks provides a glimpse of the future performance trend. However, this is not the whole and sole driver for the market nor an accurate indicator of future stock performance; but, this would certainly act as an acceletor to the bull run.

TOP 25

STOCKS TO WACH OUT FOR

Company	Sector	Remaining buybacks under Authorization	12-Month Buybacks	5-Year Buybacks	10-Year Buybacks
Exxon Mobil	Energy	~1 bn quarterly	11.1	84.7	219.1
Apple	Information Technology	50.0	34.0	79.9	80.2
Microsoft	Information Technology	21.9	11.3	43.3	123.7
Gilead Sciences	Healthcare	14.1	7.9	15.8	20.0
Pepsico	Consumer Staples	13.2	4.9	18.7	33.7
Merck & Co. Inc. (MRK)	Healthcare	11.0	7.6	20.3	26.5
Intel	Information Technology	10.9	11.0	34.1	61.1
CVS Health	Consumer Staples	9.8	5.2	17.5	26.2
Oracle	Information Technology	9.2	8.1	34.2	47.2
United Technologies	Industrials	9.1	4.2	9.6	19.5
QUALCOMM	Information Technology	9.1	6.2	15.2	20.8
Wells Fargo	Financials	9.0	11.0	23.7	37.5
The Boeing	Industrials	7.5	6.0	10.3	18.2
Mondelez International	Consumer Staples	6.9	2.7	4.0	7.9
Comcast Corporation	Consumer Discretionary	6.4	5.5	14.3	24.6
American International Group	Financials	6.3	5.4	20.0	27.0
EMC	Information Technology	6.1	4.0	9.7	17.3
Illinois Tool Works	Industrials	5.8	2.9	9.2	12.3
Pfizer	Healthcare	5.4	8.5	41.6	59.5
JPMorgan Chase	Financials	5.2	6.3	25.0	37.2
Procter & Gamble	Consumer Staples	5.0	4.8	30.4	74.0
LyondellBasell Industries N.V.	Materials	3.7	4.1	7.2	7.2
General Motors	Consumer Discretionary	3.0	2.1	12.3	12.3
Hewlett-Packard	Information Technology	2.7	4.7	25.9	64.9
Yahoo!	Information Technology	2.7	3.9	13.0	18.2
Top 25 Total		**$233.9**	**$183.4**	**$619.8**	**$1,096.2**
S&P 500 Total		**-**	**$538.1**	**$3,673.9**	**$4,041.2**
Top 25 % of S&P 500		**-**	**34.1%**	**16.9%**	**27.1%**

Remaining buyback amount under authorization as of August 07, 2015
Source: S&P Dow Jones Indices,SEC filings, Bloomberg, Aranca Research

Note: For some companies the share repurchase program does not have a stated dollar amount, and are based on number of shares. The same is calculated based on the prevailing market price to arrive at the dollar amount.

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