Linear technology

Technology

Linear Technology payout policy, unlike many competitors in the Semiconductor Industry, has a relatively large portion in dividends. Linear has provided steady dividends since 1992 in a gradually increasing rate in small amounts. Why do firms pay dividends? Can dividends raise the value of firms? To answer these questions, let's assume that Linear pays out its entire cash balance as a special dividend. For the detailed reference and information, the appendix attached at the end can be reviewed. There would be two different kinds of approaches to this example.

The first approach would be adopting the assumptions of M and adjusting Liner's situations to it. In conclusion with M&M, the value of the firm will remain steady regardless of the dividend policy. We can simulate two symmetric firms that only vary in the dividend payout ratio. If there is a difference in firm values or share prices between these firms, investors would not let it be and Just do their households. Investors in the market would reveal the opportunity of arbitrage. Therefore, the value of two symmetric firms should be the exactly the same.

To sum up, there would be no change in value, earnings or PEPS. The stock price would Just decline Just as the amount of dividend payout. However, if we peel the onion of assumptions, things get different. On the other hand, by taking the second approach and sticking to the fact that dividend policies can affect the value of the firm, we can compare new result with the prior result. As the cost of capital is lower than Liner's Return on Equity, Liner's stock is a growth stock. Being a growth stock means the company earns more than what its shareholders request for their investment.

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On this condition, paying out entire cash balance will possibly lower Liner's future earnings, PEPS, stock price and TTS company value, as the company has lesser amount of cash in its hands for future investment after paying dividend. But Linear has paid out constant dividends in spite of the results above. The reasons are as follows. Linear believes that offering dividends appeals to potential investors who not only focus on the growth of the firm but also have interests in definite incomes. Some shareholders may prefer dividends now rather than uncertain income of the future.

They also thought that providing dividends can give a signal which represents stability of business as supported by 1 See M. H. Miller, F. Modeling: Dividend Policy, growth and the Valuation of Shares dividend signaling hypothesis. It can also make it easier to get more money by getting into debts. And other numerous studies assert the fact that firms with more favorable inside information optimally pay higher dividends and receive appropriately higher prices for their stock 2. 2. What's the best option between dividends and repurchase? Linear is powering through stock repurchase in the recent fiscal years.

There are two major reasons explaining this increasing amount stock repurchase. Liner's employee compensation is mostly based on stock options ND profit sharing. In order to counterbalance the exercise of stock options, Linear is buying back stock. Another reason is the lack of profitable investment opportunities. But the practical reasons exist. Stock repurchases are discretionary compared to dividends. Additionally, stock repurchase

doesn't affect the value of the shareholders. Go back to the example mentioned above. If the company pays out b repurchasing shares, the two approaches do not show a difference.

Since the firm's stocks are growth stocks, the cash used to repurchase stocks lacks the opportunity a generating high cash flows. Accordingly, the market price would result in decreased future earnings, PEPS, and the firm value of Linear. The number of outstanding share instead of the price, will decrease. While the price of stock would increase Just as the amount of cash paid out to repurchase the outstanding stocks. It is important that both cases, earnings and earnings per share before the payment are not affected. 3. About the dividend rate Firms Judge the rate of dividend initiations by earnings.

However, simply put, if dividend rate changes depending on the change of earnings, the fluctuation of dividend will increase. This would not be good. Because cutting dividends means uncertain future cash flows. If a company cuts dividend rate, shareholders will need higher opportunity costs of capital, as a result stock prices will go down. Thus, Lineal has retained constantly increasing dividend rates in small amounts. Under the theoretical assumptions such as M, there is no difference whether firms pay out dividends or not. And if the cost of capital is lower than a firm's ROE, n dividend can raise a firm's value.