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Australia's High Dividend Yield Has a Catch

By LESLIE P. NORTON

The trouble with dividends Down Under.

Emerging Markets

DIVIDENDS WILL BE A HUGE PART OF RETURNS in Asia this year, and the highest major-market yield is Australia's 6.8%, according to Bloomberg.

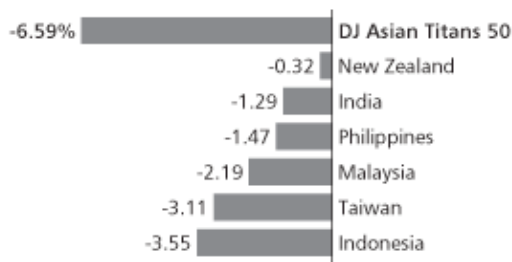
Don't break out the champagne. Australian payouts are often matched by a capital increase in the form of a "fully underwritten dividend-reinvestment plan," or DRP. Companies around the world regularly allow investors to take annual dividends in shares. But issuing new shares to pay for a current dividend is unique. Australian companies often give the new shares to a bank, which then sells them at big discounts. (For some nice explanations, see www.intelligentinvestor.com.au.)

As stocks languish, underwritten DRPs increase. That raises the hackles of some big investors. "Cash gets tight, and they issue shares to pay the dividend. It's really picked up in intensity over the course of the last six months," says Vincent McBride, manager of [Lord Abbett International Dividend Income fund](#) (ticker: LIDAX). "You can't see this or touch it. The investment banks, who underwrite these share issues, take no notice of this in their research. You think you're buying a stock with a 6% yield, but in reality, there was a stock offering to pay that dividend. If they can't afford to pay it, they shouldn't." Echoes Don Gimbel of Carret & Co.: "I personally would rather see a company cut their dividend a little bit to preserve cash."

The sell-side, says McBride, doesn't flag the share issues because it is doing the underwriting. Culprits this year include such Standard & Poor's ASX 200 members as [Australia & New Zealand Banking](#) (ANZ.Australia), [Billabong International](#) (BBG.Australia), and [Westpac Banking](#) (WBC.Australia). Citigroup reckons DRP capital raisings in Australia amounted to A\$15 billion (US\$10 billion) in the past 12 months, equal to nearly 2% of the market.

Still, the discounts are narrowing. Graham Harman, a Citi strategist in Sydney, calls fully underwritten DRPs

Asia



"harmless." You can buy Australian banks yielding 8.5%, says Harman. If dividends are cut by 30%, "that's still well ahead of Treasury notes." And Australian stocks yielded 6% or more only five times previously in the past 50 years.

However attractive, such fat yields seem bound to get slimmer. Says Tanya Branwhite, a Macquarie strategist in Sydney: "Rather than signaling value, this continues to highlight the risk of further dividend cuts."

RECENTLY, AFTER THE [Satyam Computer](#) (SAY) blowup,

David Riedel pored over the financials for a number of Indian companies. The proprietor of San Francisco-based Riedel Research, an independent equity-research service focused on emerging markets, Riedel cast his eye on **Geodesic Information Systems** (GEOD.India), which offers instant messaging and other e-business systems over a variety of platforms. It has posted an impressive level of revenue growth. For the year ended March '08, it earned 16.9 rupees a share on revenue of 3.3 billion rupees (US\$68 million). The stock traded last week at 61 rupees, down 71% over 12 months, for a market cap of 562 billion rupees.

The future for IM seems bright -- Geodesic sees mobile-carrier IM revenue rising to US\$12 billion next year from an estimated US\$8 billion in 2009.

But Riedel sees a number of red flags in the company's financials. One, IM revenue estimates vary, and Riedel cites a Radicati Group estimate that global enterprise IM revenue will be just US\$295 million in 2011. Geodesic's revenue seems to be a disproportionate share of that, which suggests an "overstated" market share given the high level of competition.

Two, says Riedel, Geodesic's costs are out of line. He sees staff and software-development costs accounting for 31.4% of revenue at Geodesic, compared to 40% to 50% for [Infosys](#) and i-flex solutions, now called Oracle Financial Services. Marketing costs also seem low -- at 2.8% of revenue in a competitive industry -- says Riedel. Those costs are 5.5% at Infosys and 11.3% at Oracle Financial. Three, Geodesic raised US\$125 million last year for acquisitions, but hasn't announced a significant one yet. And four, it changed its auditor last year.

Geodesic spokeswoman Navita Sharma retorts that Geodesic's offerings are much wider and deeper than IM. She maintains that development costs are in line with industry standards. Any discrepancies can be accounted for by Geodesic's lower overhead -- it had just 400 employees in '08. Marketing expenses, while on the rise, are on the low end because Geodesic spreads costs to partners like system integrators and Websites. Geodesic is seeking acquisitions. And the new auditor, she maintains, "is one of the most respected...in India." Given "challenging" conditions, she says, Geodesic is "reinventing new business models to suit the current environment."

In this environment, continued jitters will loom large, so don't expect the questions and answers to end there.

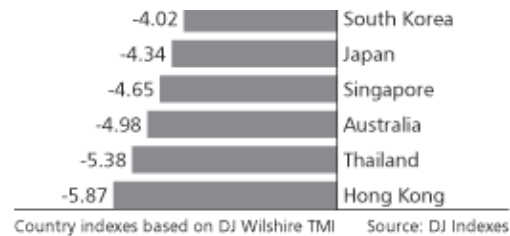
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Red Rules: Stock prices throughout Asia ended up on the negative side of the ledger.