

Orient Investment & Economic Research Center



The Impact of Dividends on the Share Price

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Research Paper

The Impact of Dividends on the Share Price



الشركة الشرقية للاستثمار (ش.م.ك.ع)
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Introduction

In the occasion of the declaration by the listed companies in the Kuwait Stock Exchange of their past year's financial results and hence the declaration of dividends, investors, usually, start to chat about such dividends and their impact on the pre- and post- AGM share prices.

However, along with such debates Orient Investment Company wishes to introduce the following research paper looking forward to be of benefit to investors in the market.

Different Types of Dividends

The decision to distribute a dividend is made by a company's board of directors. There is nothing requiring a company to pay a dividend, even if the company has paid dividends in the past. However, many investors view a steady dividend history as an important indicator of a good investment, so most companies are reluctant to reduce or stop their dividend payments.

Dividends can be paid in various forms, while the major two forms are cash and stock dividends.

The most welcomed distributions are cash dividends. This is money paid to stockholders, normally out of the company's current earnings or accumulated profits after undertaking adequate appropriations to the profits (e.g. Reserves, KFAS & NLST). Usually, dividends distributions are made at the end of the financial year after the financial results of the company are published to the public, while in other more developed countries; legislations allow companies to distribute interim dividends on a semi-annually or even quarterly basis. The stock dividend, the second most common dividend paying method, pays additional shares rather than cash. Companies usually decide on such dividends when they wish to give shareholders the opportunity to get part of the company's achieved profits but doesn't have the necessary cash available to pay every shareholder or there is a need for the available cash for the company's expansion plans



and at the same time the company does not have Treasury stock to meet the requirements of the dividend payout. So instead of paying cash, the company decides to issue new stocks as non-cash dividends.

There is however another, though uncommon, type of dividends, namely the property dividend. This type of allocation is a physical transfer of a tangible asset from the company to the investors. A good example is when a mother company decides to distribute to its shareholders stocks of a subsidiary company in which the mother company owns a certain stake.



The Important Dates of Dividends

Dividends are related to a set of critical dates that have impact, *inter alia*, on the share price in the stock market, these are:

Declaration date

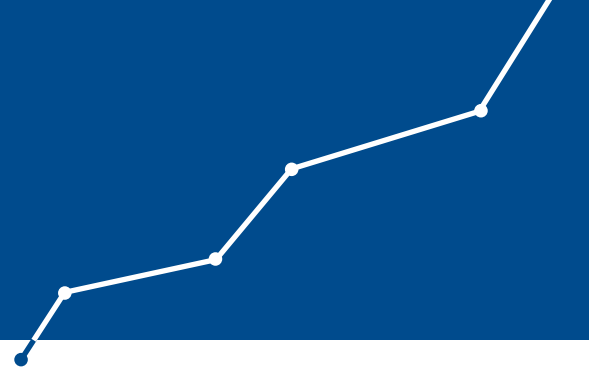
This is the date on which the board of directors announces to shareholders and the market as a whole that the company will pay dividends, and the dividends details are also specified. Naturally, such announcement has influence, positively or negatively on the share price depending on the quality of the declared dividends.

AGM announcement Date

This is the date on which the company announces the date of the AGM of the company which approves the proposed dividends by the board of directors. Usually, the market starts to interact with such announcement as the date of the AGM gets closer. Investors in the market tend to push the share price into certain levels taking into consideration the share price after the AGM, i.e. Ex-Div. share price.

AGM Date

This is the date on which the AGM of the company approves the proposed dividends by the board of directors. The importance of this date, as far as the share price is concerned, lies in being the last date in which the share is traded in the market Cum-Div. in connection to past financial year of the company. That is, only shareholders registered in the company's records are entitled to the dividends approved by the AGM.



First Day After AGM Date:

This is the first day in which the share is traded in the market after the AGM date, i.e. traded Ex-Div.. The share then starts its new cycle and interacts with the supply and demand mechanisms in the market accompanied by the actual performance of the company for the new year.

Dividends Payment Date

This is the date in which the company starts to pay dividends to the shareholders that are registered in its records on the date of the AGM.



Calculation of Ex-Div. Share Price

Impact of Cash Dividends on the share price

$$\text{Ex-Div Share Price} = \text{Cum-Div Share Price} - (C \times 100)$$

Where:

- (Ex-Div. Share Price) : is the price at which the share is traded first day after the AGM.
- (Cum-Div. Share Price) : is the price at which the share is traded on the AGM date.
- (C) : is the percentage cash dividends.

Example:

If a share is traded at a Cum-Div. price of 500 fils and the company has decided to pay cash dividends of 30% of its capital, the Ex-Div share price would be:

$$\text{Ex-Div Share Price} = 500 - (30\% \times 100)$$

$$\text{Ex-Div Share Price} = 470 \text{ fils}$$

Impact of bonus shares on the share price

$$\text{Ex-Div Share Price} = \text{Cum-Div Share Price} \div (1 + B)$$

Where:

- (Ex-Div. Share Price) : is the price at which the share is traded first day after the AGM.
- (Cum-Div. Share Price) : is the price at which the share is traded on the AGM date.
- (B) : is the percentage bonus shares.

Example:

If a share is traded at a Cum-Div. price of 500 fils and the company has decided to distribute bonus shares of 15% of its capital, the Ex-Div share price would be:

$$\text{Ex-Div Share Price} = 500 \div (1 + 15\%)$$

$$\text{Ex-Div Share Price} = 435 \text{ fils}$$

Impact of Capital Increase on the share price

Companies may tend to increase its capital at a price per share (proposed by the board of directors and approved by the AGM), usually at Par Value plus a Premium. The Ex-Div. share price is, then, calculated as follows:

$$\text{Ex-Div Share Price} = (\text{Cum-Div Share Price} + (Q \times I)) \div (1 + I)$$

Where:

(Ex-Div. Share Price) : is the price at which the share is traded first day after the AGM.

(Cum-Div. Share Price) : is the price at which the share is traded on the AGM date.

(Q) : is the share price for capital increase, i.e. Par Value + Premium.

(I) : is percentage increase in the share capital.

Example:

If a share is traded at a Cum-Div. price of 500 fils and the company has decided to increase its capital by 40% at a price per share of 245 fils (par value of 100 fils plus a premium of 145 fils), then the Ex-Div share price would be:

$$\text{Ex-Div Share Price} = (500 + (245 \times 40\%)) \div (1 + 40\%)$$

$$\text{Ex-Div Share Price} = 598 \div 1.4$$

$$\text{Ex-Div Share Price} = 427 \text{ fils}$$



Impact of Both types of Dividends & Capital Increase on the share price

A Company may, also, decide to pay cash dividends and distribute bonus shares and at the same time may decide to increase its capital. Having been approved in the same AGM, the impact of such dividends and capital increase would be calculated as follows:

$$\text{Ex-Div Share Price} = ((\text{Cum-Div Share Price} - (C \times 100)) + (Q \times I)) \div (1 + B + I)$$

Where:

- (Ex-Div. Share Price) : is the price at which the share is traded first day after the AGM.
- (Cum-Div. Share Price) : is the price at which the share is traded on the AGM date.
- (C) : is the percentage cash dividends.
- (B) : is the percentage bonus shares.
- (Q) : is the share price for capital increase, i.e. Par Value + Premium.
- (I) : is percentage increase in the share capital.

Example:

If a share is traded at a Cum-Div. price of 750 fils and the company has decided to pay cash dividends of 45%, distribute bonus shares of 20% and increase its capital by 60% at a price per share of 350 fils (par value of 100 fils plus a premium of 250 fils), then the Ex-Div share price would be:

$$\text{Ex-Div Share Price} = ((750 - (45\% \times 100)) + (350 \times 60\%)) \div (1 + 20\% + 60\%)$$

$$\text{Ex-Div Share Price} = (705 + 210) \div 1.8$$

$$\text{Ex-Div Share Price} = 508 \text{ fils}$$

This general formula can be used in all cases even if any type of

the dividends is missing or if there is no capital increase, hence by substituting zero in the non-existent variable would eliminate its effect for the purposes of the Ex-Div. calculation.

It should be noted however that due to the adoption of the price units in the Kuwait Stock Market, the resultant Ex-Div. share price of the above calculations may differ slightly from the Ex-Div. share price in the market on the first day after the AGM the share is traded, e.g. the above Ex-Div. share price of 508 fils would be traded at 510 fils.

Orient Investment Company, in an attempt to assist investors in calculating the Ex-Div share price, has offered on its website www.orient.com.kw a simple Ex-Div. share calculator for which the investor is asked to fill, in a user-friendly form, specific data concerning dividends and capital increase for a certain company.