



Reap Rich Dividends in Weak Markets, too

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A high-dividend-yield stock assures steady income, underlines company's soundness

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It is raining dividends for equity investors. As companies typically announce dividends in July, a chunk of investors starts realigning portfolios based on the dividend yield. Eight mutual fund schemes that build their portfolio to benefit from high-dividend-yield stocks recognise the importance of this strategy. Investors' sudden interest in the dividend-yield strategy during volatile market is another indication of the relevance of the theme.

"Stock prices of companies that consistently distribute at least 20% of profits as dividends and that are available at attractive dividend yields will find support early in a falling market," says Kartik Mehta, assistant vice-president - institutional research, Sushil Financial services. But, before you go choosing stocks on your own or invest in one such fund, it is better to know how it works.

DIVIDEND YIELD

For beginners, a dividend is the cash paid out by a company to its equity shareholders. It is expressed as a percentage of face value. For example, when a company with a stock having a face value of ₹10 announces a 50% dividend, it means the shareholder is entitled to get ₹5 for each stock held. The dividend of a company is not dependent on the price of the stock.

To arrive at the dividend yield of a stock, you just have to divide the dividend amount per share in rupees by the stock price. For example, if you get ₹5 as dividend for every share held, and if the stock is quoting at ₹200, the dividend yield is 2.5%. The higher the dividend yield of a stock, the better it is. A good dividend yield becomes a



High-Dividend-Yield Stocks Show Resilience

When The Markets Are Down, These Stocks Find Support Quite Fast And Prevent Capital Erosion



A high-dividend-payout ratio is seen as an investor-friendly measure of a company's management



High-dividend-paying companies are low on capital expenditure



High-dividend-paying companies have high cash flow and low borrowings



In a weak market, prices of high-dividend-yield stocks find support earlier than the rest

TOP-10 DIVIDEND-YIELD STOCKS

COMPANY NAME	DIVIDEND PER SHARE*	DIV YLD(%)	CMP
HCL Infosystems	7.50	9.15	81.95
Ashok Leyland	2.00	7.92	25.25
Sasken Comm.Tec.	7.00	6.46	108.40
Indiabulls Fin.	10.00	5.84	171.15
Bajaj Holdings	35.00	4.59	762.15
SRF	14.00	4.48	312.45
Finolex Inds.	3.00	4.37	68.60
ElectroSt.Cast.	1.25	4.25	29.40
Andhra Bank	5.50	4.12	133.60
Corporation Bank	20.00	4.10	488.25

As on August 5, 2011

SOURCE ETIG

MUTUAL FUNDS THAT BET ON DIVIDEND YIELDS

SCHEME NAME	RATING	6 MONTHS	1 YR	3 YR	5 YR
Birla Sunlife Dividend Yield Plus	★★★★★	3.7	-0.01	22.91	18.82
BNP Paribas Dividend Yield	★★★★★	6.16	2.15	17.85	14.57
Escorts High Yield	★★★★★	-1.93	0.66	11.7	NA
ING Dividend Yield	★★★★★	1.89	-0.79	18.91	19.09
Principal Dividend Yield	★★★★★	-1.03	-4.33	8.98	9.21
Tata Dividend Yield	★★★★★	3.69	4.89	16.91	17.94
Tempelton Equity Income	★★★★★	-9.19	0.1	9.37	14.87
UTI Dividend Yield	★★★★★	1.03	1.66	17.27	19.35
S&P CNX Nifty	NA	-1.19	-2.49	6.65	10.91
Equity Funds: Multi Cap Category	NA	-1.01	-5.11	9.82	13.27

* In %; Growth options of all schemes considered; Returns for more than one year are annualised; Returns as on August 5, 2011; NA = Not available

SOURCE Value Research



regular source of income for investors. What's more, the downside of such stocks is also capped.

WHY IT IS IMPORTANT

A company rewards shareholders in multiple ways — through dividends, bonus shares, stock splits, rights shares issued at attractive prices, share buyback, etc. Bonus and stock splits are looked at as just another book-keeping entry and there is no cash transfer. But dividend is the only way shareholders, especially those who believe in the old adage 'sales are vanity, profit is sanity and cash is reality', get to enjoy a cash flow.

There is a little scope for manipulation when it comes to dividend payments to shareholders. A high-dividend payout, thus, reinforces in the minds of the investing public the belief that the busi-

ness is doing well. It also enhances the image of the management as being shareholder-friendly.

High dividends are generally paid by companies that have minimum capital expenditure requirement. "These businesses generate high cash flows and generally have low leverage, which makes them perform well in times of uncertainty and in times when the interest rates are high," explains Ramanathan K, CIO - single manager investments, ING Investment Management. A strong balance sheet with least borrowings and high cash balance enables a company to look at inorganic growth in bad times, when businesses quote at attractive valuations. As there is minimum borrowing on books, the company can also raise fresh funds easily to facilitate such opportunities.

A WORD OF CAUTION

A regular income and downside protection is something growth investors will get if they invest in a high-dividend-yield stock. But that does not mean all the stocks offering high dividend yields can be lapped up. Investors have to look at the consistency of the dividends over anything else.

"If a company has declared a special dividend, the dividend yield goes up. But a dividend may not be sustainable," points out Kartik Mehta. It is better to look at only the dividends announced in the normal course of a business. Companies announce special dividends if there is an asset sale or a special occasion such as a golden jubilee of the company.

Dividend yield numbers are distorted due to business cycles also. A cyclical business typically an-

nounces higher dividends at the peak of the cycle, which may push up the dividend yield. But, investors entering the stock at that level may suffer capital erosion, since the business would be entering the downcycle.

Similarly one has to account for change in the ownership of a company. When ownership changes, the new owners may not necessarily continue with the business plans of the previous owners. If the new owners decide to take up new investments, dividends may get curtailed to that extent. In such cases, it makes sense to read the fine print of the company's dividend policy. A change in business strategy, if it influences the dividend-payout strategy, gets mentioned in the company's annual report.

Then there are stagnant busi-

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nesses. "Never buy a stock just because it offers good dividend yield. If the business is not expected to grow, you may not get what you seek when you invest in the stock market — capital appreciation," says an analyst with a mutual fund. As complications increase, there will be many investors who prefer to seek professional help.

THE MUTUAL FUND ROUTE

There are also mutual fund schemes that invest keeping dividend yield as the core investment strategy. "Dividend-yield funds are conventionally suited for investors looking for decent capital appreciation in rising markets and cushion from downfall in falling markets," says Dhruv Raj Chatrjee, senior research analyst, Morningstar India. Numbers support the fact that these schemes do well in bear markets. In 2008, when the markets were in the bear phase, the average returns posted by dividend-yield funds was a loss of 49.02%. Over the same time, the average returns posted by diversified equity funds stood at a loss of 55.66%. A point to note is that in 2008, the BSE Sensex had lost 52.45%. But an investor has to be careful while investing in these schemes. Barring Templeton India Equity Income Fund and UTI Dividend Yield Fund, most dividend-yield schemes have decent exposure to mid- and small-sized companies. This makes them riskier than their large-cap counterparts. Of course, such mid-cap-oriented schemes tend to deliver stellar returns when markets rebound.

"You must have two to three years of investment horizon to see good risk-adjusted returns in a dividend-yield fund," says Ramanathan of ING.

When markets are weak, dividend-yield funds make good investment candidates for equity investors.

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