PICK UP LOW RISK-HIGH RETURN STOCKS WHILE THE MARKETS ARE SLACK

WITH THE RECENT CORRECTION THAT TOOK PLACE IN THE STOCK MARKET, A NUMBER OF STOCKS ARE TRADING AT THEIR 52 WEEK LOWS. IT'S A GREAT TIME TO "BOTTOM FISHING" FOR SOME GOOD HIGH DIVIDEND YIELD STOCKS.

Regular dividend paying companies have always attracted an investor's attention. Apart from providing recurring income, high dividend yielding stocks are also amongst the safest bets, particularly when the markets nosedive. However, while many high yielding shares might come across as a 'paying' proposition, let us also scratch beneath the surface and ascertain what to look out for before investing in such companies.

WHAT IS 'DIVIDEND YIELD'?

Dividend yield is the dividend paid by the company (in Rs per share) divided by the Current Market Price (CMP) of its stock and is given in percentage terms. For instance, if the share price of a company is currently quoting at Rs 50 and the company declares a dividend of Rs 5 per share, then its dividend yield will be 10 per cent (Rs 5 divided by Rs 50, in percentage terms).

Accordingly, the higher a stock's CMP, the lower will be its dividend yield. And conversely, when prices are low, dividend yields shoot up.

HIGH YIELD STOCKS MAKE GOOD ROUGH WEATHER FRIENDS

Intrinsically sound high dividend yield stocks remain relatively attractive even in case the market falls. This is because your total return on an equity share comprises of both its capital appreciation and its dividend yield. For example, if a stock appreciates by 20 per cent during the year and its dividend yield is 5 per cent, then the total returns from the stock would amount to 25 per cent. Now, let's say the price of this stock starts dipping, you will face an actual loss only if the price falls below the sum of its appreciation since purchase and the dividend that has accrued.

Further, if the stock price falls considerably, there are good chances that buyers will emerge at lower levels, as the dividend yield will increase as the price falls. Thus, stable companies with good earnings visibility and a decent dividend paying history might be the best bets, especially in volatile markets. (Refer to table: "A few high dividend yield stocks traded on the Bombay Stock Exchange (BSE)")

However, if a company's profits are not sustained and it faces a slowdown in growth, then it is advisable to avoid such stocks even though the dividend yield looks attractive at present.

A few high dividend yield stocks traded on the Bombay Stock Exchange (BSE)

Company name	Dividend per share (in Rs)*	Current market price as on April 10, 2007 (in Rs)	Dividend yield (in per cent)
Tube Investments	4.70	58.50	8.03
Indian Card Clothing	12.50	169.00	7.35
Dwarikesh Sugar	6.00	77.9	7.70
Ador Welding	15.00	178.10	8.44
Aarti Industries	1.95	25.05	7.78
ONGC	45.00	867.45	5.19
GE Shipping	11.22	210.00	5.34
Shipping Corp	8.50	162.50	5.23

Note: Dividend per share is calculated on the basis of the respective face value of the share.

EVALUATE DIVIDEND PAYING STOCKS ON OTHER PARAMETERS TOO

It may be enticing to invest in stocks that sport mouth-watering dividend yields. However, merely going by a solid dividend yield could be misleading. Before investing in high yielding stocks, it is imperative that you evaluate the past record of dividends paid. Moreover, you should conduct the following checks before you are convinced of the stock's potential to deliver superior returns over the long term.

- ***Look out for extraordinary profits in the company's balance sheet***

You may come across companies that declare good dividends in the years in which they have made extra ordinary profits. It's only a sign that they may not be deploying a large part of these profits back into the business. In the case of such companies, the probability of receiving consistently high dividends is very low.

- ***Examine the historical dividend payout ratio alongside the potential earnings***

Dividend payout is the ratio of the dividend distributed to the Earnings Per Share (EPS) of the company. This ratio can give you a rough idea of the dividend the company is likely to distribute. Let's assume that the annual EPS of a company is Rs 20 and it has been consistently distributing 40 per cent of its total earnings as dividend. Assuming the same payout ratio of 40 per cent, the dividend payment of the company is likely to be Rs 8. In such cases, to gauge how much dividend will be distributed in the future, in addition to the dividend distribution ratio, you must have some idea of the earnings potential of the company.

- ***Does the company need cash?***

Generally, companies distribute dividend if they have surplus cash. At times, companies may need cash for specific purposes such as capital expenditures, expansions, takeovers or mergers, etc. In such circumstances, these companies may retain a large portion or the entire earnings, since internal accruals are the cheapest source of funds and the payout ratio may fall or the companies may not declare any dividend. So, a fall in the dividend payout ratio is not necessarily a bad sign. It must be seen in the context of the company's profits and fund deployment plans.

- ***Be wary of penny stocks that give high dividends***

Many stocks with a high dividend yield are either mid-caps or penny stocks that may offer low opportunity for capital appreciation. Worse still, in some cases, the risk of a capital loss could be high and therefore, it is imperative that you study the company's prospects carefully rather than be swayed by the impressive dividend that it pays.

DON'T JUST CHASE STOCKS THAT OFFER HIGH DIVIDENDS

Apart from high yielding stocks, there are others that can also offer a low risk – high return investment opportunity. At times, companies with high earnings may not necessarily make dividend payments and instead retain this surplus cash for future expansions and eventually give superior returns. So, do your homework properly if you hope to find those low risk – high return treasures. yM

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