

DIVIDENDS IN AGGLOMERATION



OVERVIEW:

One of the most common concerns when contemplating going from being a small private company to joining a public agglomeration is the question of dividends.

Typically, although a small business will choose to keep their profits to a minimum, those profits are distributed to the owner as dividends in a more tax efficient manner than receiving a bigger salary.

In an agglomeration the profits of each subsidiary are accounted for at the holding group level. Dividends are then paid to all shareholders of the public company proportionally to the number of shares you own. So what does this actually mean for you in real terms?

We'll divide it into 'What you control' and 'What you don't'.

What you control

PRIVATE COMPANY

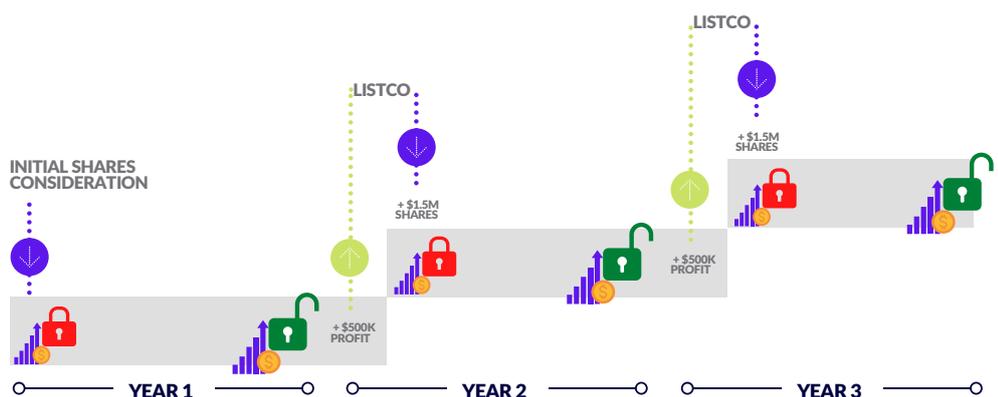
It's the end of the financial year and your accountant congratulates you on another bumper year. You have made an extra \$500k in EBIT (Earnings Before Interest & Tax). However, you have been in business long enough to know that it's not time to pick out the new summer house just yet.

Firstly, there is not that much cash in the bank, secondly even as the cash comes in, of that \$500k in extra EBIT, on average you are probably only going to be able to take out around half of that in cash for your personal use.

PUBLIC AGGLOMERATION

Let's say you have been in the PLC for a year and the group CFO congratulates you on the extra \$500k in EBIT you bought in this year. You are immediately awarded 3x that, or \$1.5m in stock in the PLC at the current share price. Now that \$1.5m worth of stock is locked up for 12 months, but on the day it was issued your shares from the previous year become unlocked.

This means that your company has made an extra \$500k profit but that you could actually sell \$1m worth of your previous stock, bank that money in your personal account (purchase the summer house) and still have \$500k more shares in your brokerage account than you did a week ago.





What you can't control

GROUP PROFITABILITY

Outside of your control is how the other companies in the group perform and where the price of the stock is on a given day. However, agglomerations are also dividend paying organisations. That means that as long as the group overall is profitable, as well as your bonus shares, you will also receive dividend payments on all shares you own (including those that are locked up). This means that even in years when you make no profit in your own company, or even a loss, as a shareholder of the holding company you will still receive dividends payments.

SHARE PRICE

On a day to day basis, share prices can fluctuate wildly, but over the long term as long as the holding company's fundamentals go up (revenue, profit, free cash flow) the valuation of the company and thus the share price will go up. It has been said that the stock market is a device to 'transfer wealth from the impatient to the patient'. If you are able to sit on your bonus shares you could easily find that they are worth 2 or 3x or more what they were when they were issued.

