Business Standard

Coal India dividend: Quick gains unlikely for new investors

There will be market adjustment, affecting arbitrage opportunities; focus on fundamentals and a longer horizon

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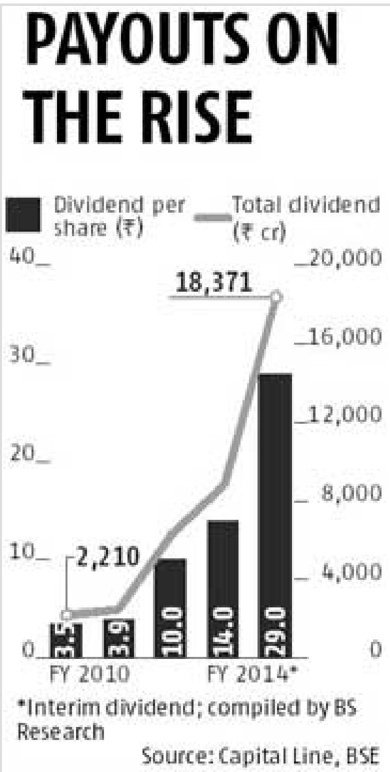
If you are thinking of making a quick gain by buying the Coal India Ltd (CIL) stock now, think again. Though the dividend yield works out to an attractive 9.83 per cent at the current price of Rs 295, it will not lead to any gain for investors once the stock goes ex-dividend.

First, stock prices of companies adjust immediately after a stock goes ex-dividend. Theoretically, the CIL stock should correct by Rs 29. The stock's ex-dividend date is 17 January, by when the stock should correct to Rs 266.

Vikas Gupta, executive vice-president, Arthveda Fund Management, says, "The market adjusts for what a company gives back to investors. The correction in the CIL stock could be a little higher than Rs 29, as there could be some overselling."



The Income Tax (I-T) Department doesn't allow dividend stripping, or buying the stock now, pocketing the dividend and booking losses on investments once a stock goes ex-dividend. Investors either have to hold the stock for three months before it goes ex-dividend or three months after the stock goes ex-dividend, to benefit from the huge tax payouts, and for dividend stripping not to apply. The losses will be ignored by the I-T department.

Also, futures and options prices will be adjusted to factor in the huge dividend payout, according to a National Stock Exchange (NSE) circular. The circular says the complete value of the dividend (Rs 29) will be deducted from all cum-dividend option strike prices on the ex-dividend date. In other words, on an options strike price of, say, Rs 290, the new strike price will be Rs 261 on the ex-dividend day. The futures price will also be adjusted by Rs 29 on the ex-dividend date.

As all the prices — the current market price and the futures and options contract prices — will be adjusted once the stock goes ex-dividend, arbitrage opportunities will not be available. All the positions in futures and options — the short or long positions on the NSE — will not be impacted.

Experts say investors looking to buy CIL shares should look at the fundamentals and assess whether the company is likely to record gains, rather than just play for stock dividends. "Other than the dividend, there's no other positive announcement. But over a two-three-year horizon, the stock looks extremely undervalued," says Gupta.