Dividends and Ex-Dates

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In the July/August 2006 column "Yield Ahead" we looked at yield calculations for preferred shares and performed a simple calculation. The information that was required to calculate yields can be reviewed in Table 1. In this column we'll look more carefully at the question "Include First Dividend?"

Table 1 - Information Required to Calculate Yield with Sources
A convenient calculator is at http://www.telusplanet.net/public/kbetty/ytc.xls

Current Price	www.tsx.com
Call Price	www.prefinfo.com
Settlement Date	Three business days following the trade
Call Date	www.prefinfo.com
Quarterly Dividend	www.prefinfo.com
Cycle	Company news via www.tsx.com
Paydate	Company news via www.tsx.com
Include First Dividend?	Company news via www.tsx.com
Don't Forget to Check!	
Credit Rating	www.dbrs.com
Prospectus	www.sedar.com

While this question may seem trivial, it's highly important and a wrong answer can cost money. If you buy in the middle of September, will you get the dividend to be paid at the end of September? The answer to this question requires an understanding of the concept of dividend ex-dates, which can generally be read or calculated from the information provided by the company dividend announcement.

Before we start delving into those intricacies, I'll announce that I have started a new website, www.prefinfo.com, to publish basic information regarding the more commonly traded preferred share issues and hopefully save readers of this column a little time. Note, however, that this collection of information should not be regarded as eliminating the need for investors to look at prospectuses for themselves! The intent of providing this information is to make comparisons more convenient for small investors and perhaps to reduce the amount of paper that must be shuffled through.

Back to work. There are three dates required to specify the timing of dividends: the ex-date (more formally referred to as the "ex-dividend date"), the record date and the paydate.

The paydate is the easiest to understand. That's when you actually get the money that you've earned by owning the shares and thereby, however indirectly, lent the company some money.

The record date is the date on which the company determines who is entitled to receive the declared dividend in proportion to their shareholdings. It should be noted that determination of ownership is made at the end of the day, which will be important when we consider the ex-dividend date.

Back in the old days before computers, this was an intensely manual process. The transfer agent (responsible for issuing stock certificates and re-registering them when submitted for changes by the new owner after a trade) had to close their books, examine their ledgers and cut a cheque for the correct amount to each registered certificate holder. The process could take as much as a month. Much of the process has been automated. Many companies will simply issue a single certificate to the Canadian Depositary for Securities, ("CDS", http://www.cds.ca on the web) and let the question of who actually owns the shares be handled by the brokerages and custody agents from their records.

Some companies find it practical to pay out the funds on the same day of determination (e.g., Split Yield Corporation, ticker symbols YLD.PR.A and YLD.PR.B) while many others have a very short period between the two dates (e.g., Thirty Five Split Corp, symbols TFS.PR.A). Other companies, lacking the technology and efficiency required for such breathtaking speed, take a month to prepare the cheques (e.g, Royal Bank, with many issues of preferreds), presumably because it's so difficult to find a good quill pen when you need one nowadays.

There are no rules of thumb that can give an idea of the length of time that may be expected between record date and paydate for a particular issue. Therefore, investors need to check the ex-date for the next dividend even if that dividend is not expected until two months after the record date. For example, the TransCanada Pipelines issue trading as TCA.PR.Y on the Toronto exchange had for its most recent dividend an ex-date of June 28, a record date of June 30 and a paydate of August 1. So, even a full month in between record date and paydate is not sufficient time to be sure that the "first dividend" after purchase should be included.

The most important date to know when making a decision about a trade is the ex-date.

As we understand from the above, the people who actually own the shares at the close of business on the record date are the ones who are entitled to the dividend. But ownership doesn't change hands immediately. Just because you've executed a trade on the stock exchange doesn't mean that you actually own the shares—the same way that signing a contract to buy a house doesn't mean you get the keys that minute and can move in that evening. There's settlement to worry about.

As explained in Table 2, "Settlement Times", trades on the Toronto Stock Exchange, settle on a T+3 basis (you can get special settlement on the terms market, but that's an extremely laborious process). If you buy the shares on the first of the month, you will own them at the close of business on the fourth of the month, assuming that those days and all intervening days are business days. When I'm calculating settlement dates, I think of Table 3, "Calculating Settlement Dates".

So, we know how to calculate the settlement date. And we know that if our settlement date is on or prior to the record date for the particular dividend, we will receive that dividend. These are good things to know.

Years of experience have convinced market participants that it is most convenient to think in terms of not receiving the dividend. For this reason, the ex-date has been defined: the ex-date is the first day of trading on which the purchaser of the stock does not receive the dividend because the trade will settle after the record date.

Knowing this definition and knowing how to calculate settlement dates, we can then create Table 4, "Calculating the Ex-Date".

Table 2 - Settlement Times

Ownership can't change hands immediately. Securities need to be received and the cash paid over and, for the benefit of the half-dozen or so people in North America who insist on keeping all their stock certificates themselves instead of delegating custody to their brokers, time must be allowed for everything to get itself into place. In days gone by, prior to computerization, this process took five days ("T+5") but thanks to the miracles of modern technology, the time was shortened to a mere three days ("T+3") in June 1995.The acronyms above, T+5 and T+3, are a shorthand method of expressing the delay between the "Trade Date" (the date the buyer and seller agree to the trade by executing it on a stock exchange) and the "Value Date" (or "Settlement Date"), the date that the securities, the money and, importantly for our purposes, actual ownership of the securities changes hands. There was at one time a push for the North American standard to change to T+1 but this has lost its impetus. Shorter periods between trade and settlement are desirable because there's less time for the contracting parties to go bankrupt. The worst-case scenario for this type of risk was achieved by the Herstatt Bank in 1974, which failed after receiving payment for trades but before delivering anything in return!

In a nutshell—if we purchase the stock three business days prior to the record date, we'll get that first dividend, because the trade will settle on that third day and the company will work out who gets the dividend after the close of business on the record date. If we purchase it on the ex-date or afterwards, we won't. (See Table 5 also.)

Preferred shares are not like bonds, which accrue interest daily and have their accrued interest calculated and paid as part of each trade. If you buy on the day before the ex-date, you'll get those three-months worth of dividends—wait until the next day and you'll get nothing.

In the last column I suggested that readers set up a yield calculation on the calculation spreadsheet and look at the difference in yield that results when exactly the same trade is set to receive or not receive the first dividend … and I'll suggest it again! Have a look—the difference is quite substantial, isn't it?

Table 3 - Calculating Settlement Dates (T+3 Settlement)

If the trade takes place on	The settlement date will be
Monday and Tuesday	Three calendar days after the trade
Wednesday, Thursday, Friday before a normal weekend	Five calendar days after the trade (there's two days added for the weekend)
On any of the three days prior to a long weekend	Six calendar days after the trade (an extra one because the holiday is skipped)
Anywhere near Christmas and New Year's	Take a deep breath and work it out carefully.

The more money-grubbing readers of this article may, by now, have decided that buying on the day before the ex-date and selling on the ex-date should be an easy way to make money. After all, you'll be holding the stock for one day and getting ninety days of dividends! Unfortunately, there's not much that's free in this wicked world and the trading price of the stock should be expected to, and generally will, fall on the ex-date by an amount approximating the dividend that has become payable. There are very often a few poor souls, however, who have either forgotten, miscalculated, or simply don't know about ex-dates and buy shares at the opening for the same price as they were trading the day prior. Perhaps they entered a "Good 'Til Cancelled" (GTC) order without accounting for the next dividend. Don't fall into that trap!

Table 4 - Calculating the Ex-Date (T+3 Settlement)

If the record date is	The ex-date is
Monday or Tuesday	Four calendar days prior (2 days standard + 2 days for the weekend)
Wednesday, Thursday or Friday	Two calendar days prior (2 days standard)
On either of the two days following a long weekend	Five calendar days prior (2 days standard + 2 days for the weekend + 1 day for the holiday)

Table 5 - Examples of Record Date / ex-Date calculation

Record Date	Ex-Date	Rule followed
Friday, September 29	Wednesday, September 27	All days are business days, there fore two calendar days prior.
Monday, September 18	Thursday, September 14	Intervening weekend, therefore four calendar days prior.
Wednesday, September 6	Friday, September 1	Intervening long weekend, there fore five calendar days prior.

Don't despair if all the above has you afraid that you'll be performing complex calculations for an hour before executing a trade. You'll get used to it! Just be careful, since even professionals can miscalculate. On April 4, 2006, Mulvihill Structured Products issued a press release stating that their PIC.PR.A issue would pay a dividend on April 28, with record date April 17 and ex-date April 13. Well, a very quick glance at the calendar says that's all right … the record date, April 17, was a Monday, so the ex-date should have been four calendar days prior, April 13.

A more careful look at the calendar, though, shows that April 14 was Good Friday—a banking holiday that means we must add a day to the periods. The record date of April 17, since it immediately followed a long weekend, implied that the ex-date was five calendar days earlier, not four … April 12! Mulvihill issued a press release on April 12 that "clarified" just what date the ex-date was.

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