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# THE EFFECTS OF DIFFERENT POLICIES ON CORPORATE PROFITS DISTRIBUTED FREE CASH FLOWS AND PROFITABILITY (CASE STUDY)

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**Resumen**: Las empresas que benefician a sus acciones aumentan a largo plazo de forma estable y segura y se consideran estabilizadas. Además, la larga historia de los pagos de dividendos para generar flujo de caja suficiente evidencia. Por lo general, el dividendo se basa en la volatilidad de los beneficios ajustados. Si la proporción de dividendos fijos empresariales igual al 50% y una tasa de interés temporal no sube, la sociedad gestora puede pagar dividendos en la misma cantidad de años atrás. Por último, la ventaja es que el exceso de dividendos de capital en proyectos de inversión de negocios rentables desde el exterior. Puede evitar el problema del flujo de caja libre (es decir, la inversión no rentable debido al excedente de activos líquidos) a través del aumento de los pagos de dividendos. Las empresas que tienen deudas excesivas de sus flujos de efectivo libre principalmente para pagar sus deudas financieras. Por lo tanto, los beneficios (debido a los pagos de intereses más bajos) aumenta, es más estable (más alto que el patrimonio) y el flujo de caja es más estable.

**Palabras clave:** Participación en resultados, toma de acciones, sociedades anónimas, flujo de caja libre, valoración, dividendos, acciones propias

**Abstract:** Businesses that benefit their shares rise in long-term stable and secure and are considered stabilized. In addition, the long history of dividend payments to generate cash flow sufficient evidence. Usually, the dividend is based on adjusted earnings volatility. If the ratio of business fixed dividend equal to 50% and a temporary interest rate does not rise, the management company may pay dividends in the same amount of years ago. Finally, the advantage is that excess capital dividends on investment projects profitable business from the outside. You can prevent the problem of free cash flow (that is, investment unprofitable due to surplus liquid assets) through increased dividend payments. Businesses that have excessive debts of his free cash flows primarily to repay their financial debts. Thus, profits (due to lower interest payments) increases, is more stable (higher than equity) and cash flow is more stable.

**Keywords**: Profit sharing, take stock, joint stock companies, free cash flow, valuation, dividends, treasury shares

## 1. INTRODUCTION

Excellent businesses produce excess returns, more money than funds that invest every year to competitiveness. At best, company investment opportunities to invest their surplus capital is moving. If that attractive for investment opportunities not available, remaining free cash flow to pay debt, acquisition of other companies, dividends or buy back shares to return capital to shareholders consumption. Also, in some cases, keep or reinvest profits to build up cash-backed capital in the future may be a good decision. Especially in most companies, the choice between payment of dividends or buy back stock is very important.

## 2. CASH DIVIDENDS PAID

Payment of dividends is one of the distribution of profits. Dividends are usually paid at regular intervals and the amount is often determined on the basis of profits available for that period. In America, usually quarterly dividend payments, while the majority of European companies pay dividends annually or every two years.

Depending on the industry and type of business, the rate of dividend payments are very different. Growing businesses that need to grow their surplus income often they ignore the distribution of dividends. In contrast, the rate of growth is low established businesses often pay a large part of their profits to shareholders, because there is little worthwhile investment opportunities. Businesses in mature markets such as the telecommunications market in the world with the highest proportion of profit distribution. This ratio is somewhat higher than the net profit. Usually equal to the total share dividend distribution ratio of profit to net profit or dividend per share of earnings per share. Because the dividend is meant outflow of capital, it is recommended that the ratio of interest payments is calculated using operating cash flow, especially because cash flow is not necessarily equal to net profit. [1]

The ratio of interest payments= Dividend per share/Operating cash flow per share [1]

The financial press often when calculating payout ratio of earnings per share in the denominator of this expression is used. As previously mentioned, this way of dividend distribution is consistent with the economic nature and so false. Fast-growing businesses, while profitable in this area are the exception rather than the rule, but. Even when reporting earnings, high investment on working capital and fixed assets often results in negative cash flow. In this case, dividends can only be paid the necessary materials company or by taking additional loans.

The optimum ratio of interest payments depends on various factors. In practice, the dividend shall be paid only if the business does not have a good opportunity for investment. The reason for this is that the investor must pay taxes on the dividends and the reinvestment of dividends received by shareholders encounter problems. Dividend yield attractiveness in terms of dividend payments measures.

Take stock dividend yield= Dividend per share/ Share price [2]

The ratio of dividends paid to the current share price. For example, meant paying dividend yields 5 percent to $ 5 per share at a price of $ 100 per share. Because this amount on the payment date will be out of business, the share price is reduced to the amount paid. So, by buying stock on the day prior to the dividend payment be achieved profit without risk. [2]

### 2.1. Dividend policy of the Company Bezek Telecommunication

Bezek, the largest telecommunications service provider in Israel, with net income increasing payment rates to 100% of their dividend payment made significant changes in policy. In addition, the company plans a special dividend payment for the period 2009 to 2013 that was more than 100% of net income. At first glance, it seems that the policy interest payments on the company's financial stability and its future plans for growth at risk. It is worth noting that Bezek your interest expenses as "cash flows from financing" is classified. This expenditure should be classified as operating cash outflows and hence cash flow from operating activities as mentioned in Table 1.

Table 1. Some states Bezek financial statement [3]

| Bezek telecommunications company | | | |
|---|---|---|---|
| By millions ILS | 2012 | 2011 | 2010 |
| Annual profit | 1864 | 2061 | 2442 |

| | | | |
|---|---|---|---|
| Wear and tear | 1436 | 1395 | 1409 |
| Other non-cash items | 714 | (270) | (155) |
| Interest payments | (464) | (377) | (237) |
| Net flow from operating activities (a) | 3550 | 2809 | 3459 |
| Net capital expenditure (b) | (1235) | (1637) | (1489) |
| Free cash flow (c) | 2315 | 1172 | 1970 |
| Dividends paid | (3071) | (3155) | (3733) |

Using the formula payout ratio of operating cash flow is used, it can be shown that Bezek, on average, more than 101% of its operating cash flow in the form of dividend payments. With an overview it is clear that this approach is not sustainable strategy to pay dividends. If the company does not invest enough, the annual free cash flow is normal and expected dividends to be determined. Between 2010 and 2012, Bezek paid almost 200 percent of its free cash flow. It is clear that the use of cash reserves or borrow possible. With a glimpse of the above cash flow statements and changes to interest payments, immediately see that Bezek is borrowed. As a result of this, the implementation of Bezek in 2012 to 235 percent. This figure is very high and the current and potential investors should consider it. However, Bezek in the short and medium term ability to repay its debt, as the company acquires a new form of operating profit more than 3 billion, half a billion, while interest payments by the company's new shape.

For a definitive assessment of the accuracy of this extreme policy on dividends, in addition to purely financial aspects of the operational developments as well. The question that needs asking is that Bezek financial resources to maintain its dominant position in the market that it is better to invest in dividend paying or not? The question in assessing any company's dividend policy is fundamental, because it can always be achieved in two ways: the high free cash flow: Operating cash flow increased or reduced capital expenditure. By artificially reducing capital expenditure, the company is slowly but surely weaken and deteriorate contemporary. According to the annual report, Bezek, we can calculate the rate of depreciation of assets. In 2012, the total cost of property, plant and equipment 20 052 million Bezek new form is equal to that of a new form of 13 976 million has been amortized. The company is close to the 69.7% depreciation of assets is very high and hence disturbing. It can be concluded that the company pays very high dividends and are likely the result of insufficient investment in the asset base. Two other factors also confirmed this conclusion. First, the company is losing to inexpensive domestic arena, and second, the rate of depreciation of assets, the company is relatively poor compared to European and American competitors. Therefore, to maximize shareholder value is more plausible that a more moderate policy on dividends is to be applied in accordance with changes in cash flow.

## 3. POLITICS REDEEM THE SHARES (TREASURY STOCK)

The second form of share repurchases important is the distribution of profits. When a company buys shares on the open market cancel the shares or to acquire the Company's treasury shares. Especially when the shares will be canceled, reducing the number of outstanding shares will increase the share of each shareholder in the company. The following brief example illustrates the impact of share repurchases shareholders 10 shares and price per share is now $ 20. Purchase one share of the company and so the owner of the business will be 10%. If management decides that a share buyback from the market and it does not void a share of only 9 remain in the hands of shareholders. The amount of your assets in the company increases to 1 of 9. This amount is equivalent to 11.1% of the total value of the company. Share price does not change, because the redeemed shares is meant outflows. Money has been withdrawn from the company (business value dropped), but the total capital of the company increased share of investment, because fewer shares remain in the hands of shareholders. Hence, redeemed shares increases the size of the contribution of each individual. The following example shows this process.

$ 100 cash ⟷ $ 100 Equity
$ 100 Equi ⟷ $ 10 per share (10 shares) [3]

Now $ 100 in cash and equity is $ 100. According to the shareholders 10 shares in the ratio of price to book value 1, the value of each share is $ 10. If the shares to be redeemed at a price of $ 10, cash assets and equity decreased to $ 90.

$ 90 cash ⟷ $ 90 Equity
$ 90 Equi ⟷ $ 90 per share (10 shares) [4]

However, the value of each of the nine remaining share equal to $ 10. Redemption of shares is effective when the share price slightly purchased. For example, if the company's stock price over the carrying amount of the purchase price of share only when the company change the current shareholders' equity, which is less than before the profit obtained. This suggests that the mere use of excess capital for share repurchases shows.

For various reasons, effectively redeem the shares of profit distribution. First, this type of distribution (indirect) profits are usually not taxed, and the second is that management can create value through the intelligent redemptions. For example, if the actual value is much less than the actual stock, management must use excess capital for share buybacks. Assume that the stock is trading at a price of $ 5, but after a comprehensive analysis it is determined that shareholder value is $ 10. In this way, bought shares worth 1 dollar 50 cents. Unlike dividends, stock repurchases does not mean that investors are struggling reinvestment. So, share repurchases will increase the proportion of equity in the business. For redemption, shareholders.

As many as bonus stock options to manage their businesses, negative incentives to redeem the shares. Especially in Anglo-Saxon countries, the repurchase program is to enhance the share price in the short term extreme use. Moreover, assuming that corporate profits remain stable, according to redeem the share price business has doubled in five years.

However, this impact is not always pleasant to shareholders because profits have to be redeemed. Redeem the shares without regard to price and value of the stock is not sustainable fiscal policy goals, such capital can be invested more effectively elsewhere. Another mistake is stock repurchase program that shares be redeemed with the help of loans. Especially in America, with the help of loan stock redeemable in the years before the financial crisis of 2009-2008 led to important figures of the balance sheet is reduced. The following case studies and increase shareholder value while reducing its value as a result of redemptions last show.

### 3.1- Redemption of shares in the company policy Yum! Brands

Yum! Brands is one of the largest fast food in the world with brands such as Taco Bell and Pizza Hut is. Regardless of the company's aggressive policy development lead Yum! Brands due to lower than the average figures for the balance sheet and at the same time it is very good operational development. While the company's free cash flow averaging $ 700 million per year stems, before the financial crisis a year more than $ 1.8 billion was divided between the shareholders. A large part of this sum was distributed through share repurchases. The price earnings ratio of 17 to 20 were redeemed. Presumably, these purchases were not so cheap. Because it reduces the equity shares will, despite high annual net profit, on 2008/12/31 equity was negative. Management does not act in the interest of shareholders. Share repurchases by the high prices until it is done through loans is expensive and reduces profits. Investing more branches or new brands can create more value. However, since 2009, the business has suspended share repurchases and dividend distribution for improved balance sheet ratios is not important. However, this method has not been distributed to the survival Brands Yum! With difficulty, because the business model and strong cash flows can be considered. In terms of maximizing shareholder value if they keep more of the profit is likely to be more shareholder value. [4]

### 3.1. Policy review redeem the shares in Daimler

Unlike Yum! Brands, some businesses may redeem shares (at least partially) not using free cash flow. Because they have little free cash flow or no flow do not have. In recent times, some expensive business activities in the capital market. During the economic boom, when stock prices higher, some businesses own shares in accordance with good conditions in terms of income are redeemed. During the recession, when the stock price is cheaper, increased investment should be spent on lack of capital and lack of liquidity pressures. Especially due to the capital increase at low prices, stock redemption period had a negative impact on shareholders. The capital increase is in stark contrast to redeem the shares. Company emit new shares and therefore likely to reduce the share of existing shareholders. The capital increase, the new share issue, should be done when the stock is expensive because of the current shareholders effectively sell part of their participation. Moreover, the capital increase is one of the most successful acquisitions in new economic history is made. Group Dyalmr negative example in the case of profit distribution policies. Between 2007 and 2009, Daimler shares worth a total of $ 7.7 billion were redeemed by the group. Most of the shares were bought at the peak of the stock market in 2007 and 2008, K usually stock assessment is favorable.

When during the financial crisis, the business was struggling with financial difficulties, the increase in capital stock was more at very low prices. By issuing new shares, $ 3.7 billion was injected into this group. The first company buys its shares at high prices and overrides, and then shortly publish new shares at low prices. Table 2 shows the evolution of the outstanding shares of Daimler.

Table 2: Daimler share repurchases between the years 2007 and 2009 [5]

| Daimler Company | |
|---|---|
| 2007 | 1047 |
| 2008 | 927 |
| 2009 | 1024 |

The business between the years 2007 and 2009 could amount to 2.2 percent of the outstanding shares and 7.7 billion euros was spent. At the end of 2009, the Daimler Group was worth $ 38 billion. Redemption volume in 2008-2007, the team was able to place 20% of the outstanding shares 2 percent a few years ago, right after the financial crisis to buy. It is interesting to note that the global financial crisis in 2009-2008 or Modigliani-Miller theory spending more marked over the years. In the popular version of this model, often touted to be the cost of capital by increasing debt, for example through share repurchases using loans decreased. This example shows how this approach can be costly and hurt the value of the company.

### 3.2. International Business Policy Review repurchase shares in the company Machines

Free cash flow and cash flow from financing Machines International Business (IBM) between 2010 and 2012 is presented in Table 3.

Table 3. International Business Machines some situations cash flow statement [6]

| International Business Machines | | | |
|---|---|---|---|
| Million dollars in America | 2012 | 2011 | 2010 |
| Operating cash flow | 19586 | 19846 | 19549 |
| Net capital expenditure | (4307) | (4059) | (3984) |
| Free cash flow | 15279 | 15787 | 15565 |
| Revenues derived from new debts | 12242 | 9996 | 8055 |
| Payments to liquidate the debt | (9549) | (8947) | (6522) |
| Short-term borrowings (repayments) | (441) | 1321 | 817 |
| Redemption of common shares | (11995) | (15046) | (15375) |
| Trading of the common shares etc. | 1540 | 2453 | 3774 |
| Dividends paid in cash | (3773) | (3473) | (3177) |

Total free cash flow between 2010 and 2012 International Business Machines about 46.4 billion dollars. The following items free cash flow represents cash flow from financing activities. Free cash flow is returned to shareholders. $ 46.4 billion in free cash flow the company is entered, and $ 44.8 billion in various forms has been paid to shareholders. Unlike the average price earnings ratio of 13.2 in the years 2010 to 2012, it does not seem that the company paid a large sum for the purchase of shares. This is good for long-term shareholders. The number of shares in 2009 from 1341 million to 1142 million in 2012 decreased. Investment three years ago the owner of 10% stake in the company had 11.7 percent of the company at the end of 2012 at its disposal. In addition, based on IBM Case Study In the previous chapter, it seems that the company is now well-planned development and has invested enough. IBM super successful reconstruction program is also proof of the same subject.

## 4. CONCLUSION:

About different options distribution of profits, the question arises as to which type of profit distribution policy is optimal? The answer to this question is related to the case. In summary, the following rules in this field is established:

When the stock price is attractive, redemption of preferred stock dividends. In addition to tax benefits, Bazkhrydshdh stock can be sold again later.

Especially during the economic boom that often relatively expensive stock, dividend distribution is reasonable. However, dividend payments are usually tax-efficient for shareholders. Despite the lack of suitable projects for investment, they can not distribute profits.

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