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Dividend with that

By: Claude Solnik April 6, 2015 0

Nathan's Famous stockholders recently had a big payday when the firm shelled out $116 million to pay a $25-per-share special dividend as of March 20.

While most shareholders must hope and wait for their stocks to rise, Nathan's shareholders cashed in without selling a single share. It was Christmas and New Year's all at once – but at a price.

The Jericho-based firm borrowed $130 million to make the distribution, creating possibly the biggest payout in the hotdog firm's history. While Nathan's action was remarkable in scale, other companies are pumping money out to shareholders even if they aren't always paying out of profits.

Shareholders are hitting big paydays in the form of special dividends, as companies pay out of earnings or borrow to distribute cash taxed at lower-than-ordinary rates, if at all.

Dividends paid out of profits are taxed at between 20 and 23.8 percent, still below the ordinary tax rate for most people. Dividends paid out of borrowing, classified as returns on capital, aren't subject to any tax.

Much of the Nathan's dividend won't be taxed because it's being paid for by borrowing rather than earnings. Melville-based Park Electrochemical is paying a $2.50 dividend, also exceeding earnings, so portions won't be taxed.

“In the tax world, this is a corporate distribution,” said Tom Butler, Jericho-based Grassi & Co.’s partner in charge of tax services. “If they don’t have earning and profits, it’s not taxable to the shareholder.”

The Nathan’s payout will mean big money to key insiders and investors. Executive Chairman Howard Lorber, who owns nearly 1 million shares, was slated to reap a $25 million payday from the distribution. Mario Gabelli’s GAMCO Investors fund would get $16 million.

“People might be taking money out,” said Eric Altstadter, partner in charge of EisnerAmper’s Syosset office. “But it’s going straight through to everyone.”

Special dividends or distributions aren’t as common as standard dividends, but they are becoming more common, as shareholders take money out of companies.

“One-time dividends have become increasingly popular even among companies that do not pay a regular dividend,” according to Dividend.com. “Instead of trying to expand their operations with risky capital investments, they are instead choosing to distribute the profits to shareholders.”

Others agreed that firms often are returning cash to investors through distributions, although payouts often result from bigger earnings as the economy improves.

“We do see more and bigger dividends,” said Joseph Perry, partner in charge of tax and business services at Manhattan-based Marcum with large Melville operations. “As they reduce cash and expenses, they have more cash. They have to do something with the cash.”

Companies that borrow to pay distributions, however, pay a price. Nathan’s is paying 10 percent annual interest – a junk bond rate.

“If there aren’t earnings, the company has to have the cash to do so. Or they might have to borrow,” said Craig Rubin, a partner at Melville-based Nussbaum Yates Berg Klein & Wolpow. “If you have a company that doesn’t have accumulated profits, they might not be in a position to pay out a distribution.”

Some of the world’s best known companies have borrowed to pay big bucks to shareholders. Apple in February announced it was borrowing $6.5 billion to pay dividends and buy stock, even though it was earning billions.

If Apple used profits from global sales to pay the dividend, it would have had to pay U.S. income taxes on that money. Borrowing lets Apple avoid those taxes.

“To get the cash for dividends, they could have repatriated offshore money,” Perry said. “Instead, they floated bonds to bring the cash to the United States.”

As the economy improves, firms’ prospects often improve, making big dividends more likely. Nathan’s recently signed a more lucrative licensing agreement, boosting future earnings.

“There’s some anticipation in the marketplace that the economy will do well,” said Thomas Conoscenti, an economist based in Coram. “I think good dividends show me the company is doing well, even if it was borrowed money.”

Altstadter said dividends can show shareholders that executives are “upbeat on their future prospects.”

“They’re saying they think they can make that up based on operations earlier,” he said. “They’re giving off confidence.”

While distributing money might seem like a quick way of tapping funds, shares often drop after dividends. Nathan's shares fell roughly $25 the day after the dividend was paid as the firm accumulated debt, driving down earnings.

"Stock prices typically go down. In general, the dividend is priced into the stock," Butler said. "Normally, there's a decrease in the value of the stock."

Even if special dividends provide money upfront, they can lead to higher taxes when shareholders sell stock. The dividend is subtracted from the cost basis of a stock, increasing capital gains, if any, when stock is sold.

"It's almost as if a company is saying I'm better giving it back to you, because you'll do better with it than investing it in the company," Perry said of decisions to distribute large amounts of cash.

While dividends put money in shareholders' pockets, some companies use cash to buy back stock. Melville-based Henry Schein last December approved buying back up to $300 million of company shares, after buying back $289.5 million under the previous buyback.

"Some companies would rather have a buyback. If you have fewer shares, you can have an increase in earnings per share," Rubin said. "A buyback shows management is confident in its stock. It also could think the stock is undervalued."