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YOUR INVESTMENT CONSULTANTS

INVESTMENT BASICS

SHARES

What is a share?

A share can be defined as the interest of a shareholder in a company. The company's capital is divided into a number of equal shares.

When you buy shares you become a joint-owner of the company along with all the other shareholders.

Shareholders "own" a part of the assets of the company and part of the stream of cash those assets generate. As the company acquires more assets and the stream of cash it generates gets larger, the value of the business increases. This increase in the value of the business is what drives up the value of the stock in that business.

Because they own a part of the business, shareholders get one vote per share of stock to elect the board of directors. The board is a group of individuals who oversee major decisions made by the company. Boards decide how the money the company makes is spent. Decisions on whether a company will invest in itself, buy other companies, pay a dividend, or repurchase stock are all the purview of the board of directors.

However, one must note that although a shareholder is a part-owner of a company, he does not own any of the company's assets – the company, as a separate legal entity, owns its own assets.

Types of Shares

Ordinary Shares: Every company has ordinary shares. The ordinary shareholders are the true owners of the company who are entitled to the balance of the income of the company after all expenses have been paid. If the company goes into liquidation (this is the legal process by which the business of the company is ended) the ordinary shareholders are entitled to the balance of the assets, if any, after all debts have been repaid. Ordinary shares are also called equity shares or equities. In the United States, ordinary shares are referred to as common stock.

Preference Shares: Companies sometimes also issue another class of shares, preference shares. Preference shares receive dividends in priority to equity shares. The dividend however is fixed every year and is expressed as a percentage, for example 5%. In the case of liquidation, the shares are also entitled to repayment in priority to equity shares.

Why invest in shares?

A shareholder has the right to share in the profits of the company by way of a cash payment, called a dividend. Dividends are usually paid twice a year. The amount of dividend depends on the level of profits, so if profits increase from one year to the next, then so should the dividend. Shares therefore offer the possibility of an increasing income, or income growth, to the investor. However, there is also a risk – if the profits fall then so will the dividend, and if the company makes a loss, then it may not be able to pay a dividend at all.

As the company grows, so should the value of the shares thus offering the prospect of capital growth. However, shares can fall in value and if the company fails and becomes insolvent, the shares become worthless. Therefore, when a company is doing well, its share price may go up and the value of your investment rises but if the company is not doing so well, its share price can go down and the value of your investment then falls. Share values are also affected by the overall level of confidence in the local economy and the international economic climate.

Investors therefore invest in shares for capital growth and dividend income.

Share Registration

Nowadays shares are issued in registered form, meaning that the company issuing the shares maintains a record or register of the current shareholders. The person who actually owns the shares is described as the beneficial owner, because they are entitled to the benefits of ownership. However, the shares may be registered either:

- In the name of the beneficial owner; or
- In the name of a nominee company

Nominee companies are operated by investment and stockbroking companies to hold shares owned by their clients. The principal advantage to a shareholder of having their shares held by a nominee company is that of administrative ease.

In Malta, and in various other countries, shares are de-materialised meaning that there is no certificate of ownership. In this case, investors' shareholdings of each individual company are recorded in accounts at the Central Securities Depository housed within the Malta Stock Exchange. When a share is sold, the Depository updates its records to reflect the change in ownership.

Dividends

A dividend is a payment to shareholders out of the profits of the company. The frequency with which companies pay dividends varies: some company pay a dividend once a year, some pay two. If more than one dividend is paid, then the earlier dividend is called the interim dividend and the last dividend is called a final dividend. Normally, companies declare an interim dividend on announcement of their half-year results and the final dividend is proposed for authorisation by shareholders at the Annual General Meeting once the full-year results are approved. Once a dividend is declared, the company also announces the cut-off date which determines which shareholders will be entitled to the declared dividend. Up until that date, the shares are said to be trading cum-dividend and investors purchasing the shares will be entitled to the forthcoming dividend. After this date has elapsed, the shares go ex-dividend, meaning that it is being offered for sale without the dividend. If the current owner sells an 'ex div' share, he will keep the dividend payment. But again, the price of the share will reflect this - it will have dropped from its 'cum dividend' price. Therefore, when a share begins trading 'ex-dividend', the share price usually falls by the amount of the next dividend payment.

A dividend is usually paid to a shareholder as a payment by cheque or directly credit to his bank account. Dividends are normally paid net of 35% tax. Occasionally companies pay a dividend in the form of new shares in the company. Such a dividend is called a scrip dividend.

Share Issues

A new issue of shares can be divided into two categories:

1. Primary issues: this is an issue of shares when a company is first admitted to an exchange. Such an issue is usually described as an Initial Public Offering (IPO). An IPO might be of new shares created by the company, or it could be existing shares being sold by the existing shareholders or it could be a combination of the two.
2. Secondary issues: a secondary issue is an issue of new shares by a company which is already listed. A large shareholder like the Government may wish to dispose of a stake in a company which is already listed and that sale would be classified as a secondary issue. Other examples are rights issues and scrip issues.

How do I purchase and sell shares?

Shares listed on the Malta Stock Exchange are transacted via a licensed stockbroker. Shares are traded on every business day between 10:45 am and 12:30 noon. For further information on how to deal, refer to the live trading section within the site menu or click here.

The process is fairly simple as noted hereunder:

- The investor sends the stockbroker written instructions (by letter, fax or email) clearly indicating security required, price at which he/she would wish to trade and MSE account number (if available) apart from the standard personal details;
- When buying shares, the stockbroker must receive funds for the investment up-front either by means of a cheque or bank draft or directly in his clients' account via Internet banking;
- The stockbroker will then effect the trade at the best possible price (if the request so demands) or place the order in the market at the price established by the client;
- On execution, the stockbroker sends you a trade confirmation showing transaction details and claiming amount due or advising amount to be settled. In the case of a sale, payment is remitted to client within three working days from trade date.
- The investor will then receive confirmation of this transaction from the Central Securities Depository of the Malta Stock Exchange through the appropriate registration advice.

What is a scrip issue?

A scrip issue (also referred to as a bonus issue or capitalization issue) is an issue of new shares to existing shareholders in proportion to their existing holdings, example the Bank of Valletta plc 1 for 5 bonus share issue in January 2003 and the 1 for 1 bonus share issue in January 2006. The shareholder does not pay for these new shares which are said to be fully issued paid up. The company does not raise any additional capital from a scrip issue, but their reason for making a scrip issue is usually to reduce the share price. Why should the company want to reduce the share price? The company and its shareholders wish the share price to increase, but when the share price becomes a little too high it becomes more difficult to buy and sell – it is becoming less liquid. In order to improve the liquidity of the shares the company makes a scrip issue. As a result, there are more shares available, but at a lower price.

What is a share split?

A share split is another way of reducing the share price. The company simply divides each share into a number of shares each with a smaller nominal value. The latest share split in Malta was carried out by HSBC Bank Malta plc in March 2005. At the time the split was on a 2 for 1 basis.

What is a rights issue?

In a rights issue existing shareholders are offered a new issue of shares in proportion to their existing holdings in the company. Unlike a scrip issue, a rights issue raises funds for the company and it increases the net assets of the company. Rights issues are normally offered at a discount to the market price of the share and this usually has an effect on the share price. A shareholder is not obliged to take up a new issue of shares. The shareholder can sell the entitlement to subscribe to someone else.