2019 Mid-Term UK Dividend Report

Vodafone Cut Crimps Dividend Growth

Sterling dividend receipts rise 3% in H1, despite some notable dividend cuts.

Dividends from FTSE All Share Index constituents rose by 2.9% in the first half of 2019 versus the equivalent period a year ago, when measured in sterling on an "XD" basis. The growth was almost entirely due to the weakness of the pound versus the dollar as a reasonable underlying performance was offset by a number of high profile dividend cuts from companies including Vodafone, which knocked 2.5% off the overall growth on its own, and Marks & Spencer. In the first half of 2019 the pound was 6% lower on average against the US dollar than in the equivalent period in 2018. This has meant that £1.4bn of the £1.6bn increase in sterling dividends seen in H1 came from the stronger dollar. The underlying picture adjusted for this factor is therefore far less impressive with only modest real dividend growth being posted on average.

Currencies help flatter a modest underlying performance.

The average level of the dollar/pound exchange rate in H1 2019 was 1.30, a 6% decline versus the equivalent period in 2018. Although the pound strengthened by a little under 1% against the Euro over the same period, sterling dividend receipts have, nonetheless, received a helpful boost from the large number of dollar payers in the market.

Substantial special dividend payments.

Special dividends continue to be a major reward for UK investors. Already this year there have been £8.4bn of special payments made versus £6.8bn for the whole of 2018. Significant payments have come from Rio Tinto, BHP Group, Micro Focus International and Royal Bank of Scotland although the first three of these were, strictly speaking, repayments of capital after disposals. Strong balance sheets and a lack of investment opportunities would suggest that there is a good chance of 2019 registering a record total for special dividends.

Dividend concentration still a major concern.

The movement in the sterling exchange rate against the dollar has done nothing to improve the worrying concentration of total market dividends being paid by the very largest stocks. The dangers were amply illustrated by the Vodafone dividend cut, which reduced overall payments by 2.5% on its own. However, the cash flow cover of many of the larger dividends has improved in particular due the rise the oil price.

Real dividend growth still expected for 2019.

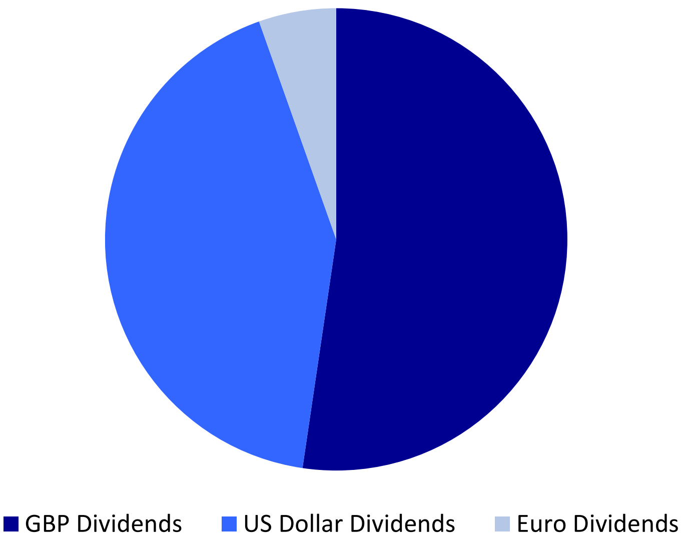
Despite the pressure from dividend cuts OLIM forecasts suggest that full year total market sterling dividend growth will be of the order of 3%-4% depending on movements in the currency markets over the remainder of the year. This represents another real increase in dividend payments for UK investors and provides a useful support for share prices despite the current political and economic uncertainty.

2019 H1 Dividend Performance

On an "XD" basis total FTSE All Share Index sterling ordinary dividends rose by 2.9% in the first half of 2019 over the equivalent period last year, building further on the impressive recovery in dividend payments seen since the financial crisis. Companies declared £55.8bn of dividends that went "XD" in the first six months of the year, up by £1.6bn from the £54.2bn that went "XD" in the equivalent period a year ago. However, this performance was not as impressive as it looks at first glance; of the £1.6bn increase in total market sterling dividends in the first half of the year, £1.4bn was due to the effect of the strengthening dollar on payments declared in that currency. Movement in the pound/Euro exchange rate actually reduced sterling payments marginally such that only £0.3bn of the increase, or less than a third, of the rise in sterling dividends was due to underlying dividend growth from FTSE All Share listed companies. This equated to underlying growth of barely 0.5%.

After being responsible for all of the sterling dividend growth recorded in 2016 following the devaluation of sterling in the aftermath of the Brexit referendum, currency movements are again dictating the overall growth in sterling payments to a large extent. Just under 11 % of FTSE All Share Index companies by number and well over a quarter of the stock market by market capitalisation declare non-sterling dividends, which accounted for 48 % of total dividends declared in the first half of 2019. The split of dividends paid by currency is shown in the chart below, which particularly illustrates the importance of the dollar dividend payers.

2019 H1 FTSE All Share Index Dividends Currency Split



Source: OLIM, Company RNS announcements

In the first half of 2019 sterling declared dividends accounted for 52.4 % of total receipts, US Dollar declared dividends 42.2 % and Euro declared dividends just 5.4 % , demonstrating just how important the US dollar/sterling exchange rate is for income investors. Unfortunately, the currency tailwind will abate in H2 as the average level of the pound against the dollar in H2 2018 was much closer to the current level. The proportion of dividends paid in Euros has fallen sharply due, in the main, to Vodafone's recent decision to reduce its final dividend.

The UK market's dividend base remains highly dependent on a small group of mega-cap stocks. The following table illustrates how this group is dominating payments.

Company	Total Dividends XD In H1 2019	% Of Total Market Dividends
Royal Dutch Shell	£5,966.1m	11.5 %
HSBC	£4,801.2m	9.2 %
BP	£3,213.5m	6.2 %
British American Tobacco	£2,328.2m	4.5 %
GlaxoSmithKline	£2,089.6m	4.0 %
AstraZeneca	£1,807.8m	3.5 %
Rio Tinto	£1,721.7m	3.3 %
Lloyds Banking Group	£1,523.3m	2.9 %
Glencore	£1,070.7m	2.1 %
National Grid	£1,066.5m	2.1 %
Vodafone	£985.1m	1.9 %
Imperial Brands	£925.5m	1.8 %
BHP Group	£882.4m	1.7 %
Prudential	£875.4m	1.7 %
Aviva	£812.4m	1.6 %
Unilever	£807.1m	1.6 %
Persimmon	£747.4m	1.4 %
Reckitt Benckiser	£709.2m	1.4 %
Legal & General	£704.6m	1.4 %
Barclays	£685.4m	1.3 %

Source: OLIM, Company RNS Announcements

The top five stocks now account for 35% of total market dividends, a small fall on the figure for the whole of 2016, the top ten account for 49% and the top twenty stocks account for very nearly two thirds of total market income. Income concentration is slightly down on last year in large part due to arithmetic effect of the Vodafone dividend cut, which has seen it fall 5 places down the contribution table.

Special Dividends

Special dividends remain a recurring feature of the UK stock market and emphasise how shareholder friendly most corporate boards are. Already this year there have been over £8.4bn of special payments made versus £6.8bn for the whole of 2018. Significant payments have come from Rio Tinto, BHP Group, Micro Focus International and Royal Bank of Scotland although the first three of these were, strictly speaking, repayments of capital after disposals. Strong balance sheets and a lack of investment opportunities would suggest that there is a good chance of 2019 registering a record total for special dividends. Included in the total are all special payments where there was an option to take the payment as income, including the popular B/C share schemes. So far in 2019, almost 40 companies have made special payments, the largest of which are listed in the table overleaf.

Company	2019 H1 Total Special Payments
Rio Tinto	£2,324.3m
BHP Group	£1,685.1m
Micro Focus International	£1,389.8m
Royal Bank of Scotland	£903.7m
InterContinental Hotels	£391.2m
Taylor Wimpey	£350.9m
Cineworld	£220.5m
SSP	£153.9m
Croda International	£151.6m
Direct Line Insurance	£114.1m
Redrow	£110.9m
Wm Morrison	£95.7m
Antofagasta	£72.5m
Victrex	£71.3m
Jupiter Fund Management	£52.2m
Admiral Group	£47.7m
Moneysupermarket.com	£40.0m
Bodycote	£38.3m
Ferrexpo	£29.8m
Ranger Direct Lending Fund	£23.3m

Source: OLIM, Company RNS Announcements

The table demonstrates the mix of special payments. The payments from Rio Tinto, BHP Group, Micro Focus and Intercontinental Hotels were effectively capital returns after disposals, with the remainder either relating to re-gearing of balance sheets after several years of cash accumulation (e.g. Cineworld, Croda, SSP), special payments in lieu of ordinary dividends (Antofagasta) or genuine special dividends (e.g. Admiral, Jupiter Fund Management, Wm Morrison, Victrex). In total there were £5.8bn of special payments that were really capital repayments relating to business or asset disposals, with the remainder falling into the various income categories. Given the strength of UK corporate balance sheets and the oft-quoted lack of investment opportunities, it seems likely that total special dividends in 2019 will be a record year for special payments.

Contribution Analysis of Total Dividend Growth and Dividend Cuts

Total UK sterling ordinary dividend receipts from FTSE All Share Index constituents grew by £1.6bn in the first half of 2019 on an "XD" basis over the same period a year previously. The top twenty contributors to this growth in ordinary dividends were as shown in the table overleaf.

Company	Contribution To H1 2019 Dividend Growth
Royal Bank of Scotland	£421.7m
Persimmon	£404.9m
Barclays	£344.1m
BP	£317.4m
HSBC	£300.4m
RELX	£289.1m
Royal Dutch Shell	£270.9m
Tesco	£206.1m
Burberry Group	£129.6m
Standard Chartered	£116.2m
Cineworld	£107.7m
Melrose	£93.8m
AstraZeneca	£89.8m
British American Tobacco	£89.6m
Imperial Brands	£86.8m
Micro Focus International	£75.1m
Informa	£73.9m
easyJet	£70.2m
Phoenix Group	£70.1m
Avast	£64.8m

Source: OLIM, Company RNS Announcements

The top twenty positive contributors to total dividend growth shown above actually contributed £3.6bn of total dividend growth more than double the total growth recorded. The list again emphasises the importance of currency movements to the overall growth picture given that companies such as Royal Dutch Shell are not actually increasing their dollar dividends but are nonetheless contributing to sterling dividend growth.

It is difficult to get an exact picture of the effect of dividend cuts on total market dividend growth as "XD" date movements can have a large effect on the H1 total given the number of stocks that traditionally have an end June or early July "XD" date. Nonetheless, there have been a number of notable dividend cuts from well-known companies including from Vodafone, Marks & Spencer, Intu Property and Saga. Fortunately, with the exception of Vodafone, which knocked £1.4bn of total dividends and reduced the overall dividend growth by 2.5% by itself, these did not have a particularly large negative impact on total market dividends, knocking less than £1bn off total market dividends in the current year. Of almost equal importance was the removal of Sky, Shire Pharmaceuticals, Old Mutual and GKN from the indices following takeovers, which together have removed almost £0.7bn from total market dividends in the first half of 2019 versus the same period a year ago.

Although there were a disappointing number of dividend cuts in H1 2019 their overall effect, excluding Vodafone, was small and this was outweighed by modest underlying dividend growth across the rest of the stock market and the strength of the dollar.

2019 Dividend Outlook

The outlook for dividend growth in 2019 is clouded by the economic impact of Brexit, although dividends would be protected at least to some extent by the large proportion of payments declared in either dollars or Euros. Nonetheless, the sustainability of dividend payments from some the major dividend paying companies remains in doubt, especially after the Vodafone cut which may provide a worrying precedent. Whilst the major oil company dividends look to be on a much sounder footing after the rise in the oil price, the same cannot be said for those of our leading pharmaceutical businesses. Doubts still hang over dividends at both the pharmaceutical majors, GlaxoSmithKline and AstraZeneca. Neither company is generating enough internal cash flow to pay their dividend liabilities and fund investment in their respective pipelines, which is causing debt to rise inexorably, although the underlying performance of GlaxoSmithKline has improved somewhat. Lastly, the level of yield offered by both the shares of BT and Centrica suggest doubts as to the sustainability of their dividends as well. Centrica's earnings are under great pressure whilst BT faces significant cash outflows to fund fibre investment, although both have reasonably strong balance sheets. SSE's dividend has finally succumbed to its weakening balance sheet and poor cash flow and will be reduced next year. Fortunately, trading conditions for HSBC have improved as US interest rates have risen, greatly helping the sustainability of its dividend, which had been viewed as at risk. Dividend growth amongst the very largest stocks is largely confined to miners and banks but even here slowing global economic growth suggests growth may be short-lived. At present, OLIM forecasts suggest that total market sterling dividend growth of around 3% in 2019, but the eventual outcome will of course be dependent to a large extent on the performance of the pound on the foreign exchanges over the last six months of the year. Unfortunately for income investors, most of the high-yielding stocks generating genuine dividend growth are to be found outside the FTSE 100, with some notable exceptions in the life assurance sector.

Conclusion

Dividend growth has been anaemic in the first half of 2019, in part due to Vodafone's decision to cut its dividend. Nonetheless, 3% growth is still ahead of inflation and would represent a further year of real dividend growth, building on the impressive record since the financial crisis. Since the low point in 2009 stock market dividends have almost doubled in value, growing at over twice the rate of inflation. Doubts still hang over the dividends of some of the market's largest income stocks but the companies involved are most likely to maintain payments at the expense of their balance sheets at least over the short-term. However, this is not a process that can continue indefinitely. OLIM forecasts suggest that, aided by currency movements, total market sterling dividends could grow by up to 3% in 2019, provided there are no more high profile dividend cuts This should provide a prop for share prices in the short-term given the historically high dividend yield on which the stock market is trading.

Important Information