KPMG MAKINSON COWELL

UK dividends

The way back?

June 2020

UK dividends – the way back?

Introduction

When the COVID-19 crisis struck, for those significantly impacted, corporate survival was uppermost in the minds of these companies and their shareholders. Companies moved to increase liquidity and strengthen their balance sheets, while institutions promised not to take up management time and facilitated faster and cheaper equity capital raising by relaxing the pre-emption guidelines.

Three months on, over £11bn of new equity for the FTSE 350 has been raised, most companies have survived and institutions are now looking further ahead. Next to come under the microscope will be the December year end companies as they report interim results.

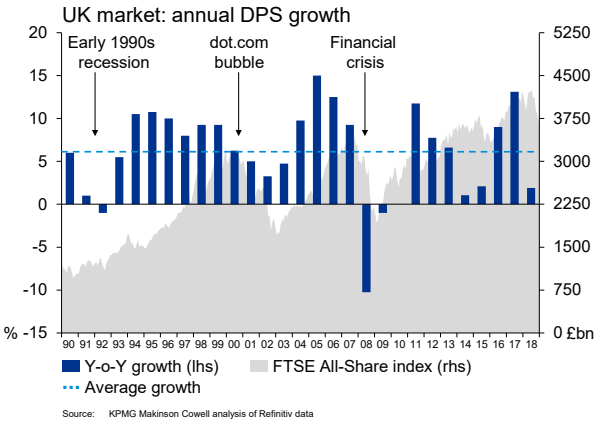
Institutions will be looking at the trading performance for the first half and in particular the second quarter, if it is disclosed, because this is the first period wholly affected by COVID-19. They will be looking at balance sheets and statements on liquidity. And they will also be looking at outlook statements and what is said about dividends.

Dividends are an indicator of prospects as well as a payment to shareholders based on past performance. Many of the 2019 final dividends were passed or suspended in the drive to improve liquidity and institutions took a benign view. However, we suspect this brief honeymoon is coming to an end. Investors will expect clearer guidance on what Boards are planning and the logic behind these decisions.

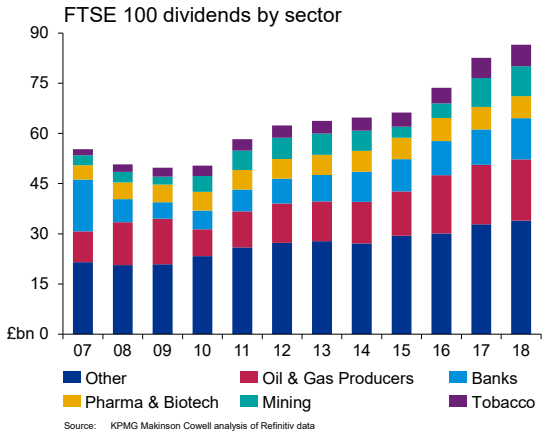
In this paper we set out how dividends for the UK market have evolved over recent decades, the actions companies have taken with respect to dividends in response to COVID-19 and the current range of sell-side expectations for distributions in the short term.

Dividend trends

With few exceptions, dividends for UK PLC have grown steadily over the last 30 years, averaging an increase of 6% per annum on a weighted basis, though this has slowed more recently. Taking the period since the financial crisis, growth has averaged 4%. The median annual growth rate for the current constituents of the FTSE 100 has averaged more than 7% per annum over that period. In the UK, a small number of companies with very large capitalisations exert significant influence on overall market growth rates. Over the past decade, the top ten largest payers in the FTSE 100 have accounted for 56% of the total dividends paid and, these companies have tended to grow dividends at a slower rate than the majority of index constituents.



Over the last 30 years, three interruptions to the long-term dividend growth trend stand out; the early 1990s recession, the dot.com bubble and the global financial crisis. The early 1990s recession saw growth reduce from 6% in 1990 to -1% in 1992, before rebounding strongly over the next few years. The dot.com bubble, at the turn of the following decade, also saw dividend growth slow, declining from 9% in 1999 to 3% in 2002, though growth accelerated sharply over the middle of the decade.



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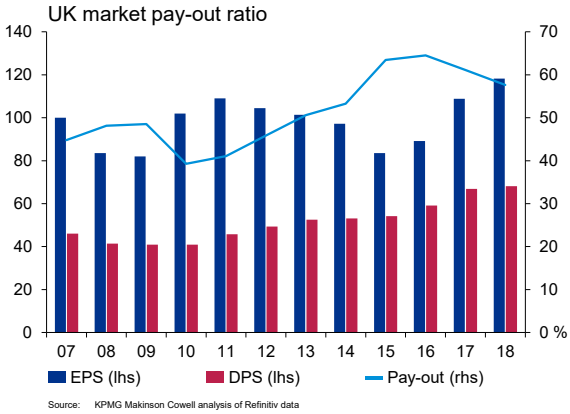
The most recent significant interruption came in response to the global financial crisis, which resulted in large dividend cuts across the market but amongst the banks in particular. Heading into the GFC, UK banks accounted for 28% of total FTSE 100 dividends in respect of 2007 but that had decreased to 10% two years later. The decline in bank dividends was partly offset by increased distributions from oil & gas producers.

Despite the cuts to some dividend payments, the pay-out ratio for the market remained within its long-run average range of 45-50% up until 2009. It touched a low in 2010 as earnings rebounded, however, over the following years the market's pay-out ratio increased steadily to peak at c.65% in 2016, as companies continued to grow dividends while earnings declined. Pay-out reduced over the next two years to 58% though still remained elevated compared with historic levels.



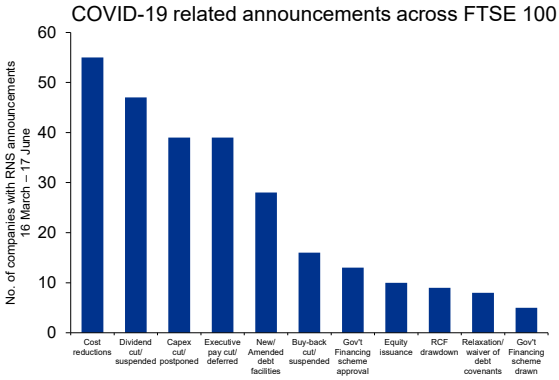
Source: KPMG Makinson Cowell analysis of Refinitiv data

Response to COVID-19

As a result of COVID-19 and the unprecedented measures taken by governments, central banks and regulators, some companies have come under intense pressure to reduce cash costs and ensure they have enough liquidity to survive, as the measures taken to tackle the virus have heavily impacted their ability to operate.

Many companies quickly sought to reassure investors, confirming the strength of balance sheets and detailing the actions leadership were taking to adapt businesses. Common themes in regulatory announcements included the extension and draw down of RCFs, the relaxation or waiving of debt covenants and the accessing of government support schemes in relation to the balance sheet. Whilst on the cost side, there was much talk about managing down overheads and other variable costs, as well as reducing salaries and incentives, cutting discretionary spend and cutting or postponing non-essential capital expenditure programmes. In the face of so much uncertainty, it is unsurprising that dividends were also high on the agenda as an area to preserve cash.

The following chart illustrates the number of FTSE 100 companies that have issued a regulatory statement commenting on the actions noted above, as well as some others, such as charitable actions, buy-back programmes and equity issuance.



Source: KPMG Makinson Cowell analysis of regulatory announcements

The COVID-19 pandemic began to unfold as we entered the annual full-year results season for December year-end reporters. Initially, many commentators considered the virus to be geographically isolated to Asia and, as such, would have a relatively concentrated impact, particularly to supply chains. Against this backdrop, many companies proceeded to declare final dividends in respect of 31 December 2019. As the scale of the pandemic and the associated response became apparent, companies began to look to preserve cash and many of those final dividends were subsequently cancelled or deferred. In addition, many companies announced a suspension or cut to future dividends at least until visibility improved. Since the 16 March,

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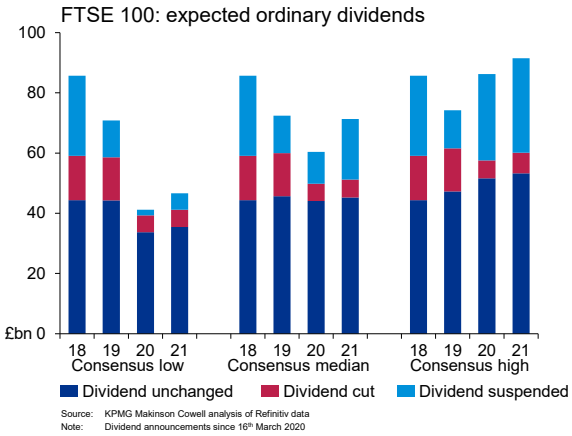
41 FTSE 100 companies have omitted at least one dividend and 6 have announced a cut.

Current sell-side dividend expectations

Given the significant actions taken by companies to preserve cash and the vast uncertainty in how quickly the global economy will recover, there is an unsurprisingly large range of sell-side estimates for dividend payments in respect of the 2020 and 2021 financial years.

The following chart illustrates the aggregate amount of ordinary dividends paid by the current constituents of the FTSE 100, in respect of the financial year ended nearest to 31 December 2018, and the amounts expected to be paid in respect of the next three financial years ended closest to 31 December 2021. The analysis reflects three models, the first takes the most pessimistic sell-side forecasts for each company, the second the median and the third the most optimistic. Companies are grouped into three categories: those that have an unchanged dividend policy, those that have cut their dividend and those that have suspended at least one dividend payment since 16 March 2020.

The forecasts do not necessarily reflect investors' expectations and should be treated with caution. However, the differences between the three cases are stark, with low, median and high, broadly reflecting three distinct economic outlooks, an 'L', 'U' and 'V' shaped recovery respectively. We think most attention should be paid to the consensus median forecasts which obviously exclude individual sell-side outliers.



Consensus low takes the most pessimistic sell-side dividend forecasts for each constituent. On this basis, dividends in respect of 2021 are expected to total £47bn, almost half the 2018 total. The analysis suggests an initial 17% decline in 2019, followed by a larger more significant contraction of 42% in 2020. Aggregate dividends then rebound by 13% in 2021.

Consensus median illustrates the market outcome assuming the mid-range view of dividend expectations are used for each constituent. In 2021, dividends of £71bn are expected to be paid across the market, similar to that paid in 2019 and a decline of 17% on the 2018 total. Dividends are then expected to bounce back strongly in 2021, growing at 18%, after declining in 2020. Just over half of the FTSE 100 are expected to declare dividends in respect of 2021 that are in excess of those declared in respect of 2018. Of the 53 companies that have left their dividend unchanged, 11 are expected to announce a dividend cut and all but one of the 41 companies that have announced dividend suspensions are forecast to return to paying some form of dividend by 2021.

Consensus high is based on the most optimistic sell-side dividend forecasts for each FTSE 100 constituent. In 2021, dividends of £92bn are expected to be paid across the market, an increase of 7% on the total in respect of 2018. Total dividends are expected to rebound immediately from the decline in 2019, with dividends declared in respect of 2020 slightly above those declared in 2018. This rebound is largely driven by the expectation of a quick reinstatement of suspended dividends. 86 of the FTSE 100 are expected to declare dividends in respect of 2021 that are in excess of those declared in respect of 2018.

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