A slower spin

Summary
- Due to the economic ramifications of the coronavirus pandemic, 45 per cent of UK companies have already cut or cancelled their dividend payments, with an estimated £25.4 billion of dividend cuts occurring this year.
- Pension funds that rely on dividends to fund cashflow needs are likely to suffer most from this suspension.
- Investors are encouraged not to be too concerned, as these dividend cuts are mainly a result of external factors, not due to weaknesses within the companies.

A significant number of companies have cut, suspended, or cancelled their dividend payments in response to the coronavirus pandemic. Laura Blows explores what this means for pension fund investors

If money makes the world go round, it is companies' dividend payments that do the spinning. These payments to equity holders have a significant role in generating wealth growth for pension funds, Isas and beyond.

Last year saw dividends paid by British companies hit an all-time high of £110 billion – an increase of 10.7 per cent on 2018, according to GraniteShares founder and CEO, Will Rhind. There will be no such highs this year; the economic impact of the coronavirus pandemic has made sure of that.

"Dividend payments have been cut across the globe as companies look to protect the strength of their balance sheets and provide some respite to negative cashflow issues," Redington senior vice president, manager research, Oliver Wayne, says.

Costs

According to Link Groups' *UK Dividend Monitor Q1 2020,* 45 per cent of UK companies have already scrapped payouts to shareholders, and ETF provider GraniteShares' review of dividend announcements from UK listed companies for the period 19 March to 20 April 2020 finds that 92 per cent involved cancelling or suspending payments.

Link predicts £25.4 billion of dividend cuts will definitely occur this year, equivalent to one third of the dividends Link had expected (before the crisis struck) UK plc to pay between April and December. It reckons that a further £23.9 billion in dividends are also at risk, but £31.1 billion are likely to be safe.

In a best-case scenario, Link expects dividends to fall 27 per cent to £71.9 billion in 2020, and in the worst scenario, to fall by 51 per cent to £48 billion. It places its 'realistic' upper bound at a 32 per cent fall to £67.3 billion, and realistic lower bound at 39 per cent to £60 billion.

Reasons

The reasons for suspending dividend payments or cancelling buybacks are varied. For instance, Link states that the biggest dividend cuts will come from banks, slashing by £13.6 billion. However, this is largely due to regulatory pressure. For example, following a letter from the Prudential Regulatory Authority (PRA), large UK banks have suspended dividends and share buybacks to the end of 2020 and cancelled any outstanding dividends from 2019.

Aviva's statement when announcing its decision to withdraw planned dividend payments bears this out. It said: "The board has taken this decision in the wake of the unprecedented challenges Covid-19 presents for businesses, households and customers, and the adverse and highly uncertain impact on the global economy. Regulatory authorities, including EIOPA, the PRA and supervisors of other Aviva subsidiaries, have responded by publicly urging restraint on dividend payments by insurers to shareholders. In light of the significant uncertainties presented by Covid-19, the board agrees with our regulators that it is prudent to suspend dividend payments at this time."

The Investment Association has also lent its weight, writing a letter on behalf of the UK's investment management industry to the chairs of all FTSE 350 companies.

"Dividends are an important income stream for many savers, pensioners and institutional investors, including pension funds and charities," the letter says. "Shareholders ask companies to take into account the suitability and sustainability of a dividend payment in light of current uncertainties. Shareholders expect companies who do decide to suspend dividend payments to restart them as soon as it is prudent to do so. Ultimately, shareholders expect companies to be transparent about their approach to dividends, particularly, if they are seeking additional capital."

Even companies deciding to continue paying dividends is not without controversy at this time. For instance, Tesco pledged to pay a £900 million total dividend, despite receiving £585 million in tax relief, generating criticism. Shell recently announced that it would still pay a dividend at 16c per share, from a previous level of 47c. This is a reduction in its divided for the first time since the Second World War, generating some concern from those adhering to the 'never sell Shell' adage.

The impact of Covid-19 on supermarkets' financial performance is yet to be played out, but other retail arms, such as high-street shops, along with travel and energy companies (due to oil price falls) are having to stop dividend payments in response to reduced revenues.

With many firms also postponing pension deficit recovery contributions *[see page 30]*, "they could hardly then pay dividends", Buck head of knowledge resource centre, Gary Crockford, says.

"Many companies are taking a defensive stance and while hoping for the best are preparing for the worst, and suspending payments such as dividends and deficit recovery contributions is part of the bigger picture of ensuring they have sufficient cashflow to weather the storm," he adds.

Past experience

However, this not the first time there's been a dividend storm. Crockford states that dividend cuts occurred following the global financial crisis (GFC) in 2008. "However, current dynamics are quite different to the GFC and we would not be surprised to see more cuts to dividends this time round," he warns.

"In sterling terms, aggregated broker estimates suggest that dividends paid out by FTSE All Share companies may fall 21.6 per cent year-on-year as a result of Covid-19 related dividend cuts," Stamford Associates head of manager research, Duncan Burden, says. "This compares to an approximate fall of 21.7 per cent between 2008 and 2009 as a result of the GFC."

Concern

So if we have (somewhat) been in this scenario before, just how concerned should pension fund investors really be?

For Crockford, the level of concern will depend on whether money is simply being retained within a strong business or if the dividends that would have been paid are lost as a result of the company ultimately folding.

"For pension schemes, the implications *[of dividends not being paid]* will be different depending on whether dividends are purely reinvested, or are used to meet scheme cash needs, such as paying pensions. In the latter case, cashflow contingency planning will be important to allay concerns," he adds.

Wayne agrees that funds with 'hard' yield requirements will be most materially impacted, as they are forced to search for income in an increasingly narrow range of companies.

Those pension schemes that rely on dividends for cashflow could simply be compensated for by selling down some of the equity holdings, Crockford suggests.

"However, even allowing for the recent rally in equity markets, the heightened volatility of the markets leaves us feeling nervous over using equity allocations as a source of funding. We would be looking to cover any shortfall in cashflow needs from low volatile assets that have seen limited drawdowns," he recommends.

Burden warns that some companies will have welcomed the opportunity to cut their dividend, having already been over-distributing from a position of balance sheet weakness before the advent of the Covid-19 crisis. In such instances, dividend suspension acts as a capital preservative and may position management to allocate capital more productively as the crisis relents.

"The challenge will be to distinguish true stock selection errors, where dividends were arguably already at risk, from those companies that have been a victim of improbable circumstance."

Despite this, investors with genuinely long-term horizons should not overestimate the significance of shorter-term cuts to dividends, Burden states.

"The cuts do not necessarily reflect lasting impacts on companies' business models," he says. "In several cases, dividend cuts or suspensions are anticipated to be transient, to allow companies to bridge a period of depressed earnings without overstretching their balance sheets. In this sense, we would not be surprised to see truly long-term investors, who seek fundamentally resilient, unleveraged businesses to look beyond dividend cuts in the near term."

His colleague, Stamford Associates senior investment consultant, Stuart Grant, agrees.

"Trustees should remember that the adoption of a carefully considered and robust investment strategy populated with talented investment management professionals should be able to weather the inevitable pitfalls that beset a long-term investment journey," he says. "If they have done this, they shouldn't be unduly concerned."

In fact, if the Covid-19 crisis is short and sharp, "we may look back on this moment as a historic buying opportunity", Link Group *UK Dividend Monitor* author and Global Corporate Markets CEO, Susan Ring, says.

It may have slowed down for now, but it seems dividend payments are expected to return to full speed once the threat of coronavirus diminishes and the world starts turning again.

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