Dividend Dashboard

AJ Bell Youinvest

Weak pound lifts FTSE 100 dividend prospects for 2017

This report shows:

- Which firms are forecast to pay the most generous dividends in 2017
- The firms in the dividend sweet spot
- The benefits of dividend reinvestment
- The danger zone where dividend cover looks thin

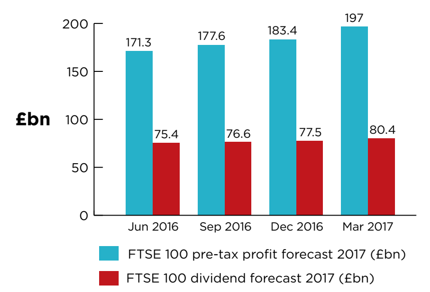
Dividend dashboard explained

Each quarter, AJ Bell takes the forecasts for the FTSE 100 companies from all the leading city analysts and aggregates them to provide the dividend outlook for each company. The data below relates to the outlook for 2017.

Healthy boost for 2017 dividend forecasts

Despite predictions of economic meltdown at the time of the Brexit vote, the FTSE 100 has since hit record highs and is still forecast to yield around 4% this year. That is largely because the real drivers of share prices are not politics but profit and cash flow and these have benefited from the fall in the value of sterling since the EU referendum. 75% of the FTSE 100 earnings come from overseas and so the weak pound provides a positive currency boost when those earnings are converted back into sterling.

As a result, consensus profit forecasts for the UK's leading index for 2017 have steadily increased from £171 billion at the time of the EU referendum, to £197 billion now. This has led to the consensus dividend forecasts for the FTSE 100 rising to just over £80 billion for 2017.



Just four sectors are forecast to contribute 67% of these total dividends, with oils, banks and insurance alone contributing 46% of forecast 2017 pay-outs:

Sector	Oil & Gas	Financials	Consumer Staples	Health Care	Total
Proportion of forecast dividends in 2017	24%	22%	12%	10%	**67%**

Dividend cover explained

Dividend cover is the amount of profit a firm makes divided by the dividend it pays out to shareholders.

The table below shows the dividend cover for a company making a profit of £100 and paying three different levels of dividend:

Dividend	Calculation	Dividend cover
£50	£100 divided by £50	2
£100	£100 divided by £100	1
£150	£100 divided by £150	0.67

What level of dividend cover to look for

Dividend cover of below 1.0 should ring alarm bells because it means the company is paying out more to shareholders than it makes in that year. This means it has to dip into cash reserves, sell assets or borrow money to maintain the payment. This is unlikely to be sustainable over the long term.

Dividend cover of around 1.5 is less than ideal because it means a company has less room for manoeuvre if profits fall in one year. It will then need to decide whether to reduce its dividend, stop reinvesting in the business or take on more debt.

Dividend cover of 2.0 or above is ideal because it means profit is double the amount the company is paying out to shareholders. This means it can continue to invest in the business and has scope to maintain its dividend payment in a bad year.

1

1.5

2

Dividends can combat rising inflation but cover looks thin in places

A 4% dividend yield looks very attractive, particularly when compared to the current 1.25% yield on 10 year UK Government bonds or the paltry returns from cash accounts. With inflation rising to 2.3% in February cash deposits are achieving a negative real return, whereas dividends continue to outpace inflation. However, equity investing entails higher risk so it is important to look for companies that pay sustainable dividends over the long term and this is where it is important to look at dividend cover and growth, as well as the headline yield.

Many of the stocks in the FTSE 100 that are forecast to pay the highest dividends have less than ideal dividend cover.

Half of the £80 billion of dividends from the FTSE 100 are forecast to be paid out by just 7 companies, but only one of these has dividend cover of more than 1.5 and two of them have less than 1.0:

	Forecast dividend yield in 2017	Forecast dividend cover in 2017
Royal Dutch Shell	15%	0.95x
HSBC	10%	1.35x
BP	8%	1.07x
GlaxoSmithKline	5%	1.43x
British American Tobacco	4%	1.60x
Vodafone	4%	0.63x
AstraZeneca	3%	1.06x
Average	**49%**	**1.15x**

Similarly, of the ten stocks that are forecast to have the highest dividend yield in 2017, none of them have dividend cover of more than 1.5 times and four of them are below 1.0:

	Forecast dividend yield in 2017	Forecast dividend cover in 2017
Direct Line	7.5%	1.09x
Royal Dutch Shell	7.1%	0.96x
Barratt Developments	7.0%	1.47x
Taylor Wimpey	7.0%	1.39x
BP	6.8%	0.91x
SSE	6.3%	1.31x
Legal and General	6.1%	1.43x
Vodafone	6.0%	0.52x
HSBC	6.0%	1.28x
Admiral Group	5.9%	0.95x
Average	**6.6%**	**1.13x**

Dividend danger zone

There are 25 FTSE 100 firms that are forecast to have dividend cover of less than 1.5 in 2017 and 20 of these are forecast to yield more than the 4% average for the index. The good news is some of these are utilities (such as National Grid, SSE and Severn Trent) where demand and cash flows are fairly predictable, while others, such as some of the house builders, have net cash balance sheets. The bad news is the majority of the 25 cannot rely upon either.

	Forecast dividend yield in 2017	Forecast dividend cover in 2017
Barratt Developments	7.0%	1.47x
Legal and General	6.1%	1.43x
National Grid	4.7%	1.41x
GlaxoSmithKline	4.8%	1.40x
Taylor Wimpey	7.0%	1.39x
Standard Life	5.7%	1.37x
AstraZeneca	4.6%	1.35x
Centrica	5.7%	1.33x
Land Securities	3.7%	1.31x
SSE	6.3%	1.31x
Severn Trent	3.6%	1.30x
Provident Financial	4.9%	1.29x
HSBC	6.0%	1.28x
Hammerson	4.4%	1.21x
British Land	4.1%	1.19x
United Utilities	4.1%	1.16x
Hargreaves Lansdown	2.9%	1.10x
Direct Line	7.5%	1.09x
INTU	5.0%	1.07x
St. James's Place	3.6%	1.06x
Royal Dutch Shell	7.1%	0.96x
Admiral Group	5.9%	0.95x
BP	6.8%	0.91x
Scottish Mortgage Inv. Trust	0.9%	0.63x
Vodafone	6.0%	0.52x

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Dividend growers

Another factor to consider when assessing the dividend potential of a stock is whether the dividend is expected to grow.

The FTSE 100 is forecast to grow its dividend payouts by £9.5 billion in 2017 compared to 2016 forecasts and almost two thirds of this is expected to come from just three sectors:

Sector	Proportion of forecast dividend growth in 2017
Mining	33%
Financials	26%
Oil & Gas	15%

Half of this growth is forecast to come from just seven firms:

	Dividend growth (millions)	Percentage of FTSE 100 total
Rio Tinto	£930	9.7%
Royal Dutch Shell	£870	9.1%
Glencore	£867	9.1%
BHP Billiton	£823	8.6%
Lloyds	£810	8.5%
BP	£557	5.8%
Anglo American	£259	5.7%
Total	**£4,856**	**50.8%**

The power of dividend reinvestment

The real power of dividends comes when you reinvest them so that you end up owning more shares in the same company and increase the amount of dividends you could receive in the future.

You can set up a dividend reinvestment plan via your broker or platform and they will then ensure the monies received are used to acquire more shares in the same quoted company.

By reinvesting dividends, you have mathematics on your side because you get to harness the power of compounding. Simple maths shows that reinvesting dividends provides stronger returns than not doing so providing you are able identify stocks where the dividend payments are safe and reliable.

Dividend reinvestment in action

An investor puts in one full year's ISA allowance of £15,240 and then makes no further contributions.

Assume that the FTSE All-Share generates the same compound annual growth rate that it has provided since inception in the early 1960s – 6.8% a year – and that it pays the same average annual dividend yield of 3.8% a year.

After subtracting 1% a year for platform administration and dealing fees, the initial £15,240 will be worth £81,129 after 30 years. £43,681 would also have been banked in cash dividends.

However, an investor who reinvests the dividends rather than banking them would have £231,577 after 30 years.

	6.8% compound annual capital return only	Dividends paid in cash (3.8% yield)	Investment value + cash dividends	6.8% compound annual capital return PLUS 3.8% dividend yield reinvested
Initial investment	£15,240	-	-	£15,240
After 10 years	£26,610	£7,538	£34,148	£37,747
After 20 years	£46,464	£20,700	£67,164	£93,496
After 30 years	£81,129	£43,681	£124,810	£231,577
After 40 years	£141,659	£83,809	£225,468	£573,585
After 50 years	£247,347	£153,874	£401,221	£1,420,696

Dividend sweet spot

14 FTSE 100 firms are set to yield in excess of 3% in 2017 that also have dividend cover of over 2.0, excluding special dividends. Investors should be aware that easyJet has announced a dividend cut within the last 12 months, as has Old Mutual.

	2017 forecast dividend growth	2017 forecast dividend cover	2017 forecast dividend yield
Next	0%	2.57x	3.9%
ITV	11%	2.01x	3.9%
EasyJet	-29%	2.02x	3.8%
International Cons. Airlines	10%	3.66x	3.7%
WPP	12%	2.01x	3.7%
RSA Insurance	36%	2.02x	3.7%
Kingfisher	6%	2.14x	3.4%
Babcock International	7%	2.86x	3.4%
Old Mutual	24%	2.81x	3.3%
3i	0%	2.97x	3.3%
Informa	5%	2.30x	3.2%
Smurfit Kappa	9%	2.48x	3.2%
Micro Focus	8%	2.10x	3.2%
Anglo American	100%	5.09x	3.1%