

Equity Strategy

The Dividend Hit Has Only Just Started

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The politics of dividend distribution will heavily influence how corporates navigate capital management decisions as a result of COVID-19. In an environment where workers are being made redundant or being paid only a proportion of wages, where government's are providing wage subsidies, and where supplier contractual relief is happening, distributions to shareholders will need to be carefully considered by boards. Consequently, even in a lower earnings environment, we expect pay-out ratios to fall from recent elevated levels. Investors will likely receive less income for the foreseeable future. While dividends are an instrument of wealth distribution rather than wealth creation, lower bond rates and changes to bank funding requirements mean lower term deposit rates, which means dividends (where possible) will be highly valued by yield thirsty investors, in our view. This theme is, therefore, supportive to those dividend payers with relative COVID-19 immunity – in particular, utilities (Contact, Genesis, Meridian, Mercury, Trustpower, Vector) and telcos (Chorus, Spark).

Pay-out ratios have been climbing; NZ high relative to other markets

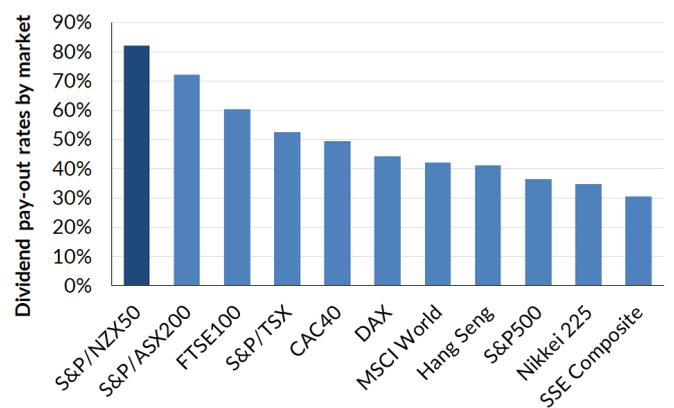
Over the past 10 years median pay-out ratios for the NZX50 have climbed from the low 70s to the low 80s. We accept that compositional changes have occurred but even taking into account new arrivals and share market departures, the same trend is visible. Pay-out ratios have increased but similar to what was observed through the GFC are now set to decline sharply.

Figure 1. Median divi pay-out ratio history for the S&P/NZX50



Source: Forsyth Barr analysis

Figure 2. NZ pay-out rates are very high versus other markets



Source: Bloomberg, Forsyth Barr analysis

Dividends on hold

The host of dividend suspensions in the February reporting season reflect cash preservation for companies exposed to COVID-19 challenges more than the politics, but sets the scene for further suspensions over the next 12 months. Separately, the RBNZ has said that locally incorporated banks cannot pay dividends on ordinary shares and should not redeem capital notes, to further support the stability of the banking financial system during this period of economic uncertainty. Moreover, last week the European Central Bank (ECB) called on banks across the euro zone to refrain from dividend payments and share buybacks.

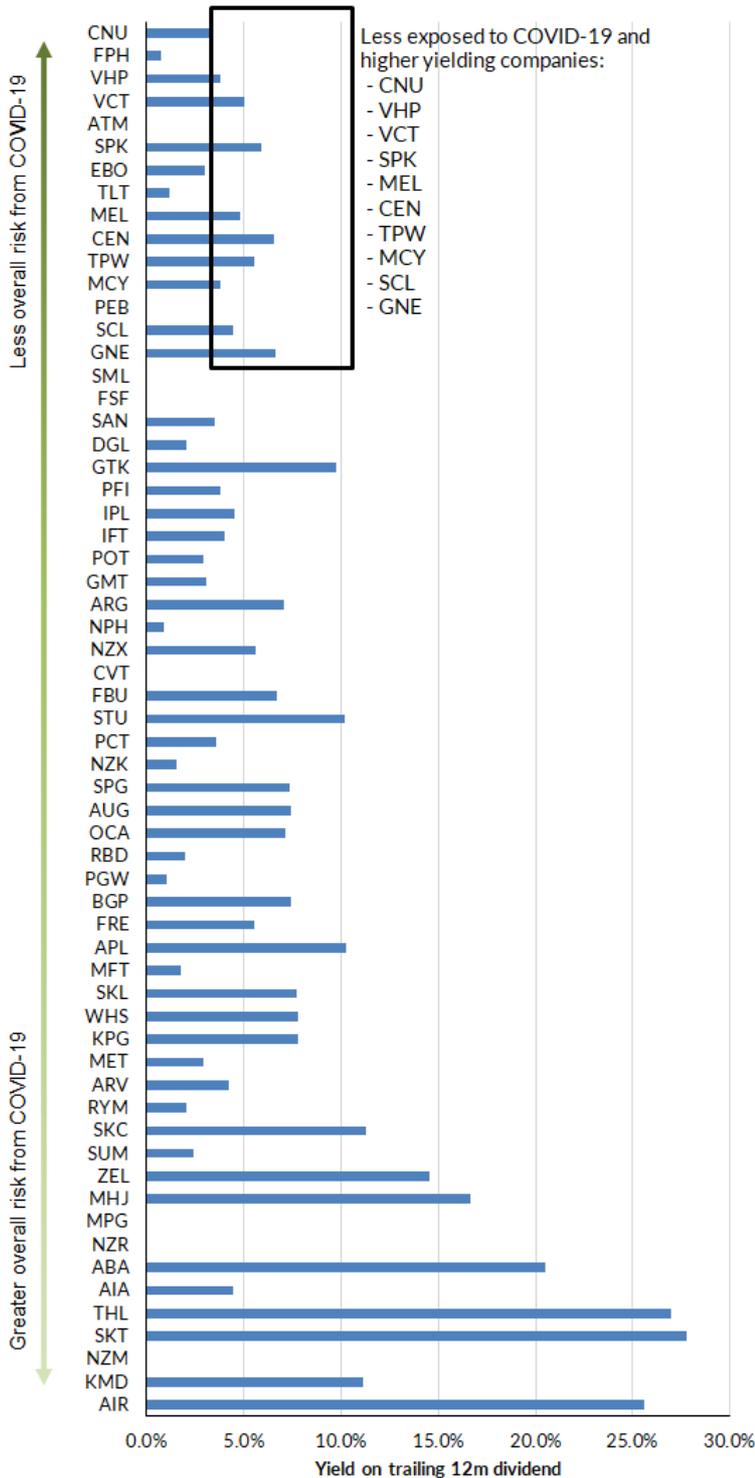
Good corporate citizenship will be a critical factor for navigating COVID-19

Companies that effectively balance the social good over shareholder distributions and profits will better navigate COVID-19 than those that don't, in our view. This may mean a greater impact than otherwise on near term profitability, but good corporate citizenship will likely have a longer lasting impact on labour productivity/retention, customer/brand loyalty and supplier relationships.

Dividend yield attractions

Further to our report *Equity Strategy: COVID-19 Winners, Losers, and Big Losers*, dated 24 March 2020, we apply the trailing 12 months dividend yield for all companies in our coverage universe as shown in Figure 3. Those less exposed to COVID-19 with higher yields include Chorus (CNU), Vital Healthcare (VHP), Vector (VCT), Spark (SPK), Meridian (MEL), Contact (CEN), Trustpower (TPW), Scales (SCL) and Genesis (GNE).

Figure 3. Screening our NZ universe for dividend yield and COVID-19 risks



Source: Eikon, Forsyth Barr analysis

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