

What next for investors seeking dividends?

Like most investment managers we like to buy shares in companies that are growing their profits and distribute some of this to their shareholders by way of dividends.

The covid-19 pandemic has seen many companies cut or cancel dividends, in order to preserve cash in these greatly uncertain times. Generally though, share prices do not respond well to dividend

reductions and in particular when a dividend is cancelled altogether as shareholders are no longer 'paid to wait', as it were.

'Sure of Shell' no longer

One notable case is Royal Dutch Shell which recently cut its dividend for the first time since the Second World War. Its shares fell sharply on the news as most analysts anticipated it would maintain its dividend come what may.

With one of the longest track records of dividend payment, it was perceived that management would do everything in its power to maintain the dividend – even increasing debt to pay it (clearly unsustainable long term) in the belief that oil prices would recover sufficiently to pay back the debt.

Indeed, this is the path that rival BP took only 24 hours before the Shell announcement. It maintained

its dividend by increasing borrowings and the shares rose.

Which all begs the question – what should we as investors do? Sell Shell in order to buy higher yielding BP shares? As with many things in investment, the answer is not a simple one.

Shell's management has taken early and decisive action by removing the millstone of the largest dividend in the UK from around their necks.

By cutting the dividend payout by two-thirds, a lower, more sustainable dividend, allows the company to retain more cash, which aids its credit rating, making borrowings cheaper and allowing further investment in the business as it looks to diversify away from oil production into more renewable forms of energy.

If successful, it is fair to assume that the dividend will rise again from these levels; in which case the shares will have been a shrewd investment at such depressed prices.

A counter-intuitive move

BP, on the other hand, still carries the millstone of a large dividend and is banking on a recovery in oil prices to maintain this level.

It may be proved correct, but we cannot be certain; and, given Shell has cut its dividend already, it makes it somewhat easier and less surprising

if BP eventually follows suit. It may appear counter intuitive, but selling BP in order to buy Shell, which has underperformed, may well be the wiser move.

Dividend dependability

Given the importance of dividends, those companies that are able to maintain their dividends, no matter what the economic conditions, are likely to be highly sought after.

Companies such as Reckitt Benckiser, Unilever, GlaxoSmithKline and AstraZeneca have all had a 'good' crisis. All provide food or healthcare products that have seen demand unaffected, or in some instances, increase as a result of the pandemic.

Unilever, for example, may have seen lower ice cream sales than anticipated as people are forced to stay at home; but it has seen sales of hygiene products such as soap and cleaning products soar.

Whilst these types of companies may lag behind a market recovery when it comes, their earnings and dividend dependability make them core holdings in our and many other investors' portfolios.

It is not solely in the oil sector, as with BP and Shell, where companies have acted differently in relation to dividend pay outs as a result of the pandemic.

Insurance companies such as Aviva, RSA and Direct Line all cancelled their dividends (following the lead of the banks) after pressure from the Prudential Regulation Authority to conserve capital.

Legal & General and Phoenix however, both paid their dividends and confirmed they had sufficient regulatory capital even after the pay out. Both shares reacted positively to the news.

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