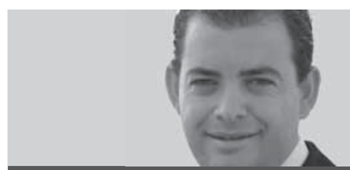
Stock Market Review



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Focusing on dividend growth

With interest rates near record lows and inflationary pressures increasing, many investors continue to face a challenge to generate sufficient income to cope with the rising cost of living. Meanwhile, local bond issuance has dried up and many international investment-grade bonds are no longer offering the returns they did several years ago. In view of this low interest rate environment, which now looks likely to remain so for the next two years especially in the US and UK, international and local equities producing attractive dividends are becoming good alternatives for income-oriented investors.

While in the past most investors viewed investing in equities mainly for capital appreciation, equities are now being seen in the context of the dividend return they can provide to shareholders.

The importance of an attractive income has always been the local investor's primary objective and companies need to understand that in order to attract increased attention and participation by the investing public, they have to adopt a generous dividend policy.

The expectations of slower economic growth in the next few years dampens capital growth prospects and in view of this, a leading international private wealth management institution advised investors in a recent note to its clients to increase their allocation to companies offering high dividend yields on their shares.

Although sentiment towards equities is currently weak due to the ongoing delays to iron out the eurozone sovereign debt crisis, the substantial drop in share prices especially over the summer months has led to an increase in dividend yields to more attractive levels. However, a careful selection process across international as well as local equities is crucial to identify companies offering sustainable and possibly also a growing dividend income stream, which would exceed inflation over time.

A commonly used indicator is a comparison of the dividend yield on shares with returns offered by 'safe' government bonds. For the first time in many years, the average dividend yield on the companies forming part of the S&P500 exceeds the interest yield on 10-year Treasuries. Likewise, the estimated dividend income of the shares within the FTSE100 produces a yield of 4.3 per cent compared to 2.5 per cent for 10-year UK gilts. The situation in Malta is similar with seven companies trading on historic dividend yields above the net yield of 3.74 per cent per annum on a 10-year Malta Government Stock.

In the US, five multinational companies in their respective industries have strong records of sustainable dividend growth over a long number of years. Procter & Gamble, which owns some of the leading consumer product brands, has increased dividends for each of the last 55 years, with the healthcare giant Johnson & Johnson growing its return to shareholders for 49 consecutive years.

Over the past 10 years, Johnson & Johnson has increased annual dividends by 13 per cent every year. Likewise, PepsiCo this year announced its 39th consecutive annual dividend increase and during the past 10 years, Pepsi has distributed over $48 billion to shareholders in the form of dividends and share buybacks as the company remains deeply committed to deliver strong returns to shareholders.

The oil and gas giant Exxon Mobil Corporation raised its dividends to shareholders for each of the past 29 years with software giant Microsoft Corporation growing its dividend distributions for the past six years. Shareholders of Microsoft however are placing increased pressure on the management team to distribute a larger part of their $52 billion cash pile.

In the UK, the companies within the FTSE100 offering the highest dividend yields (over five per cent in some cases) are all very familiar names such as Vodafone plc, Royal Dutch Shell, Glaxosmithkline plc and National Grid plc.

On the local stock market, although half of the companies have not paid a dividend to shareholders during the last financial year, seven other companies offer dividend yields above the return on Malta Government Stocks.

A company which has consistently ranked among the highest yielders in the league table is Plaza Centres plc. Since the Initial Public Offering in May 2000, the company increased dividends by 73 per cent from €0.0745 per share in 2001 to €0.1292 per share in 2009. Although the 2010 dividend was reduced by 10.4 per cent to €0.1157 per share, at the last traded price of €1.80, the historic yield amounts to 4.18 per cent per annum after tax.

Plaza's steady occupancy rate coupled with the increase in the rentable area as the complex expanded over the years, produced growing revenue and profitability levels enabling the company to improve its dividend levels. The fact that Malta's largest institutional investors rank amongst the top shareholders of Plaza could very well be as a result of the consistently attractive annual dividend.

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RS2 Software plc remains the company currently offering the highest dividend yield at 5.34 per cent per annum despite the sharp rebound in the company's share price in recent months. The June 2011 interim results published two months ago revealing a profit of €1.4 million during the first six months of the year indicates that the company should be in a position to at least maintain last year's distribution of a net dividend of €0.032 per share.

Meanwhile, the 23 per cent decline in BoV's share price since the start of 2011 helped the historic dividend yield increase to 5.2 per cent net (7.95 per cent pre-tax). However, after maintaining the interim dividend unchanged in May 2011, on October 28 the market will get to know whether the impact of the international sovereign debt crisis on the Bank's profitability levels will impinge on the overall final dividend payment which will be proposed for shareholders' approval.

The market response to the inability of a company to generate sustainable and attractive dividends for shareholders was very evident some months ago when Go plc slashed its annual dividend payment by 50 per cent. As a result, Go's share price dropped sharply and has continued to touch new all-time lows possibly because of the uncertainty surrounding future dividend streams as a result of the losses they are incurring on their Greek investment and the likely capital injection they will have to make as part of Forthnet's upcoming rights issue.

Investors' increased focus on companies with sustainable dividends is very likely behind the recent increase in trading activity in the equities of Maltapost plc and Malta International Airport plc. While the share price of the postal operator remained marginally unchanged ahead of the upcoming financial statements and dividend declaration, the renewed buying interest for MIA shares helped the equity to recover by 13 per cent from the summer low of €1.50.

Another company that has declared substantially higher dividends over recent years is Simonds Farsons Cisk plc. Shareholders of Farsons have seen their dividend income surge by 123 per cent since the year 2000, although the annual dividend was volatile in line with the changing profitability levels reflecting company specific and industry-wide developments.

The equity of Farsons is not generally looked upon as one producing an attractive dividend. However, on a historic yield of 3.64 per cent after tax, coupled with an improving operational performance, a robust balance sheet and a low level of leverage, this dividend could grow and be well sustained in future years.

Generally, local investors are looking more favourably towards investing in some of the large international companies offering sustainable and growing yields, although many will remain investing in local companies which they know better and are easier for them to follow.

As such, the local market needs to present more opportunities with a sustainable and attractive dividend as a main feature to satisfy the appetite of investors seeking a consistent return from their investment.

> **The local market needs to present more opportunities with a sustainable and attractive dividend as a main feature to satisfy the appetite of investors**

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