

Capita UK Dividend Monitor

Issue 22 - January 2015



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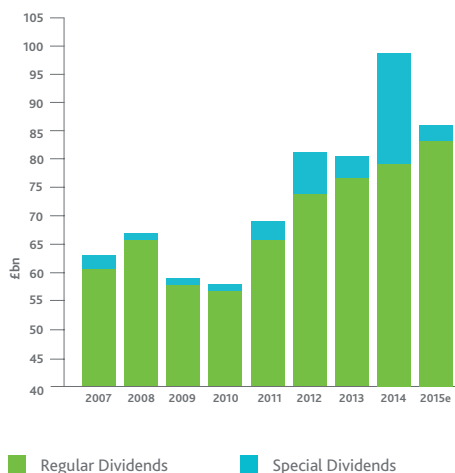
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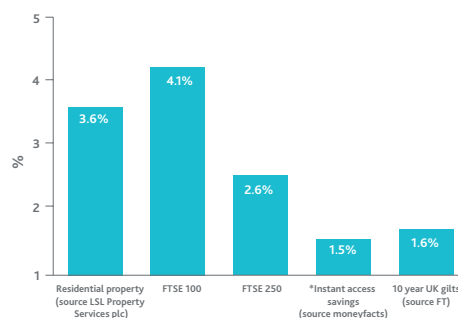
Executive summary

- UK headline dividends reach £97.4bn, up 21.0%, slightly exceeding Capita 2014 forecast
- Underlying dividends (ex special) rise just 1.4%, the weakest rate of growth since 2010
- Sterling's strength in the first part of the year knocks £3.5bn off the full year total, but investors begin to feel the benefit of sterling strength in Q4
- Resurgent UK consumer drives strong results for consumer services companies, boosting dividends from retailers and travel firms
- Supermarkets buck the trend, with Tesco slashing dividends, and worse to come in 2015
- Tesco fell to 19th place in 2014 UK dividend rankings, from 13th in 2013
- Investors in construction, support services, estate agents, and general insurers were all among the winners
- Commodities did worst, with mining cutting by 8% and oils by 1%, with the strong pound making a big impact
- The UK's top 100 firms grew underlying dividends just 0.7%, while the midcaps raced ahead ten times faster
- Headline Q4 dividends shrank slightly, owing to lower special payments, but underlying dividends grew 4.0%, half of which was due to the falling pound
- 12 month prospective yield on equities steady at 3.9% while bond yields collapse to 1.6%
- Outlook – sharply lower oil prices, weaker world economic outlook, dollar strength and the Tesco factor all affect our forecast for 2015
- USD strength will boost payouts 3.6%, based on the current exchange rate, low oil prices are also a net positive; Tesco's cancellation and Vodafone's being a smaller company will reduce the total by approximately £1.4bn
- We raise our headline forecast to £86.1bn but reduce our underlying forecast to £83.6bn.

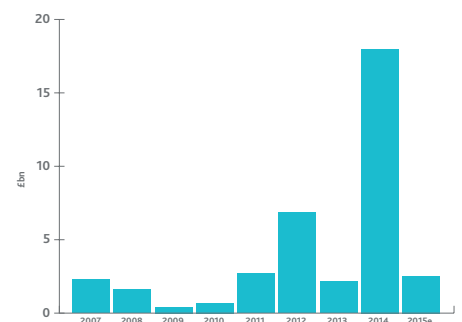
UK dividends



UK Income January 2015



Special dividends



Introduction



The UK stock market ended the year against a backdrop of plunging oil prices, deflation in the eurozone, renewed recession in Japan, concerns over Chinese economic growth, and geopolitical uncertainty. It's hardly surprising, therefore, that volatility in share prices marked the beginning of 2015. Despite all this, the UK economy is holding up well though corporate earnings are still patchy. It is the US economy, however, that has climbed to the top of the G7 growth league, and its currency has soared as a result. The US dollar is now at its highest level against the

pound in eighteen months, which is starting to reverse the heavy drag on UK dividends caused when the pound peaked in mid 2014.

The quarterly Capita Asset Services UK Dividend Monitor analyses the latest trends in total gross UK dividend payments (before 10% withholding tax), sector performance and the biggest companies, and updates the forecast for the full year.

With grateful thanks to **Exchange Data International** for providing the raw data feeds.

Signs of life for UK dividends after a lacklustre 2014, as the pound begins to fall

UK companies paid out a headline £97.4bn (gross) to their shareholders in 2014, £240m, or 0.2% ahead of our £97.1bn forecast. This was an all-time record for the UK, up 21.0% compared to 2013, though this headline total is not representative of the underlying picture. Special dividends for the year totalled £18.3bn, of which the vast majority was down to the big Vodafone special paid in the first quarter, a world record £15.9bn for a single payment. The remaining special dividends were slightly ahead of our forecast at 3% of the underlying total payout. With so many of our big companies reporting in foreign currencies, as we have discussed through the year, the strength of sterling knocked £3.5bn off headline dividends. This currency effect accounts for almost the entire difference between our initial January 2014 forecast (£101.1bn), and the eventual outcome. We steadily downgraded our expectations through the year as the currency climbed.

Underlying dividends, which exclude special payments, were £79.1bn, in line with our £79.2bn forecast, and rose just 1.4% year on year, a real terms decline. This was a very weak rate of growth by historical standards, with only 2009 and 2010 performing worse, due to the global recession and the effect of BP's dividend cancellation respectively. Various factors explain the poor showing, not least among them the sluggish profit growth at UK plc; investors rolled with regular

profit warning punches from a range of industries, with the supermarket groups the most high profile to succumb. Without the drag of the strong pound, underlying dividends would have been about £2.5bn higher, and would therefore have risen 4.6%, a modest but creditable growth rate, and comfortably ahead of inflation.

The fourth quarter saw dividends shrink slightly at the headline level (down 0.4% on year to £15.2bn) due to lower special dividends. This was in line with the weakness in the third quarter. However, at the underlying level, where dividends rose 4.0%, it was the fastest increase since Q3 2013. It was entirely due to the sharp rise in the US dollar in the quarter, which has begun quickly to reverse some of the negative effects of the strong pound earlier last year. Between October and December, the pound lost 4.0% of its value against the dollar, extending losses that began in Q3, but which did not occur in time to boost Q3 payouts. It gained against the euro, though fewer companies declare payments in the single currency. With the three largest payers in the quarter reporting results in US dollars (HSBC, Shell, BP), this currency effect added £310m to the quarter's total from these three companies alone, and therefore entirely explains the outperformance relative to our forecast. Indeed, the stronger dollar accounted for about half the growth in the quarter in sterling terms.

UK headline dividends reach £97.4bn, slightly beating forecast

But underlying dividends rise just 1.4%, the weakest since 2010

Strong sterling knocks £3.5bn off the full year, but this is set to reverse

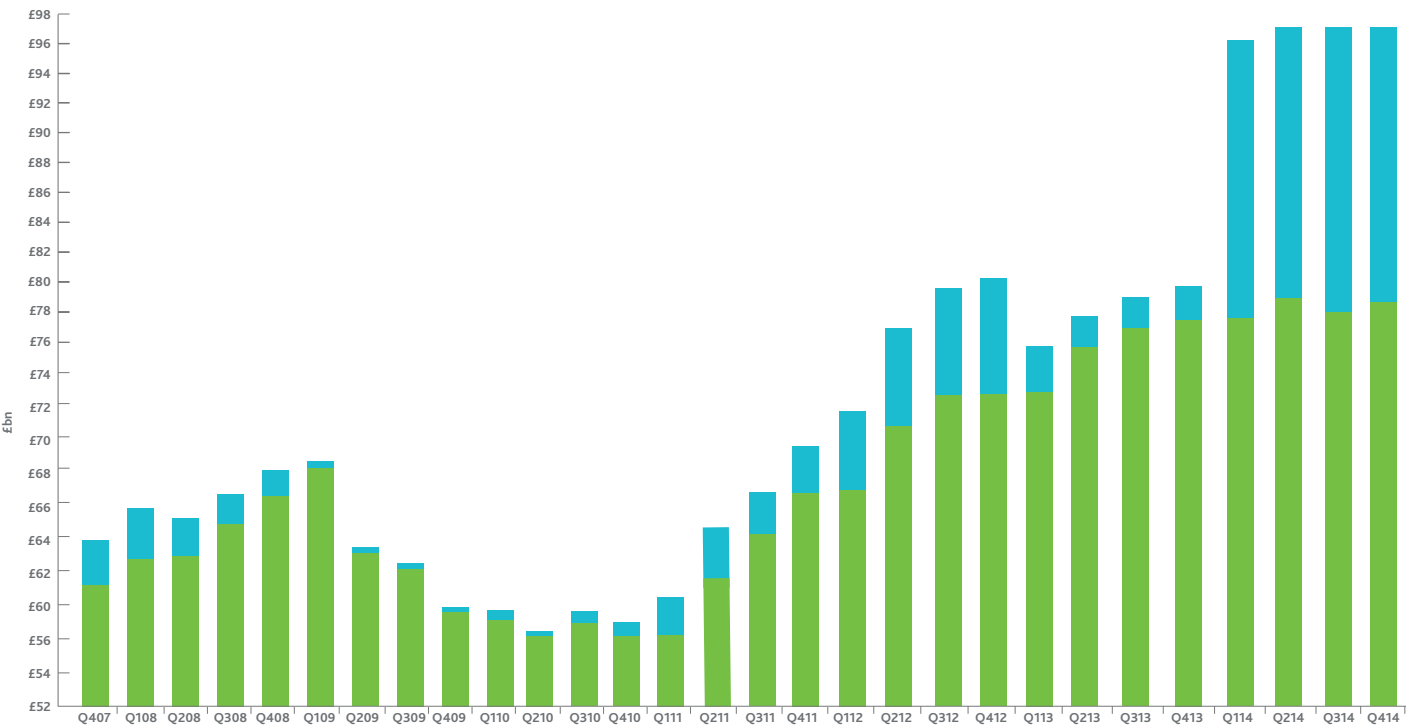
Surging dollar boosts Q4 payouts

Dividends Paid £bn	2007	2008	yoy	2009	yoy	2010	yoy	2011	yoy	2012	yoy	2013	yoy	2014	yoy	2015e	yoy
H1	£33.0	£35.3	6.9%	£31.1	-11.9%	£29.5	-5.3%	£35.1	19.0%	£42.8	21.9%	£39.8	-7.0%	£56.7	42.6%		
H2	£30.5	£33.2	8.7%	£28.5	-14.0%	£29.2	2.3%	£34.7	18.7%	£38.7	11.7%	£40.7	5.1%	£40.7	0.0%		
Full Year	£63.6	£68.5	7.8%	£59.7	-12.9%	£58.7	-1.7%	£69.7	18.9%	£81.5	16.9%	£80.5	-1.3%	£97.4	21.0%	£86.1	-11.6%
Q4	£13.2	£14.2	7.2%	£11.1	-21.8%	£10.4	-6.5%	£12.9	24.9%	£14.7	13.5%	£15.3	4.0%	£15.2	-0.4%		

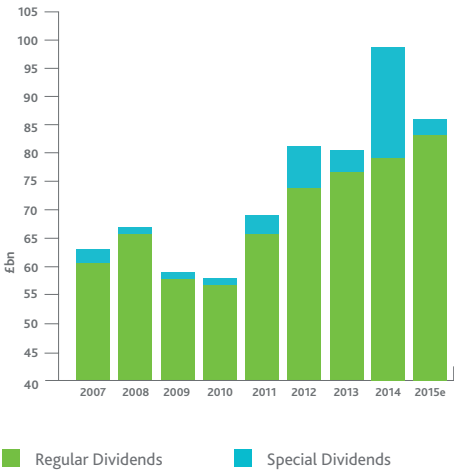
Growth in quarterly dividends - year on year



Rolling twelve month dividends

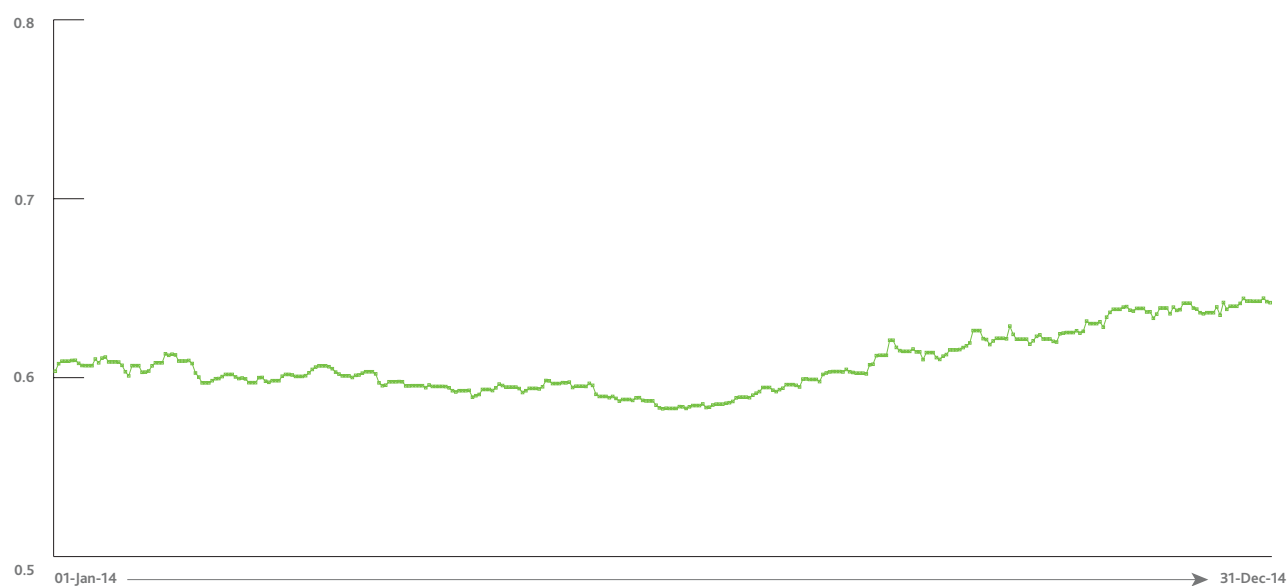


UK dividends



Regular Dividends Special Dividends

USD / Sterling Exchange Rate



Sectors and companies

For the full year, the strongest sector grouping was consumer services, where general retailers and travel firms offset sharply lower dividends from the struggling supermarket sector. Strong consumer spending is helping companies grow their earnings and return more cash to their shareholders. The supermarkets will continue to buck this positive trend in 2015. With their price war intensifying, the profits left over for shareholders are shrinking fast. Tesco has cancelled its final dividend, costing investors over £900m in 2015. As the UK's 19th largest dividend payer in 2014 (down from 13th in 2013), this will make a measurable dent in our forecast. Even if it pays an interim later in the year, it is unlikely to make it into the UK's top 300 payers in 2015.

Industrials did very well too, boosted by a strong performance from support services, transportation (thanks to the inaugural Royal Mail dividend), construction, and electronics.

Utilities also returned to growth after two years of declines.

The big financials sector saw banks deliver an increase of just 1%, but estate agents and general insurers boosted the overall total.

The worst result came from commodity groupings. Mining firms slashed their payouts 8%, while the oil and gas producers cut theirs 1%. For both this was mainly due to the strength of the pound, though far smaller special dividends exacerbated the trend for the miners.

The year's largest payer was of course Vodafone, distributing £20bn in total. Shell, HSBC, BP, and Glaxosmithkline made up the top five. The top 15 stocks made up 63% of UK Plc dividends, though excluding the Vodafone special payment, they made up a smaller share than of late, mainly because dividend growth has been slowest at the UK's largest firms.

Defensive firms showed dramatic growth at the headline level. However, stripping out the Vodafone effect, cyclically sensitive companies grew their dividends faster than the more defensive ones. This is to be expected in a period of economic growth.

In Q4, HSBC makes two interim payments, and so is the largest payer overall for the period (£2.6bn). Along with Shell and BP, these three companies accounted for three fifths (£6.1bn) of the total in the quarter. These companies report in US dollars and have seen their sterling dividends held back significantly over the last year.

Consumer spending boosts retailers and travel firms

Supermarkets buck the trend, with Tesco slashing dividends, and worse to come in 2015

Winners: construction, support services, estate agents, general insurers

Losers: commodities and mining

Dividends - top companies

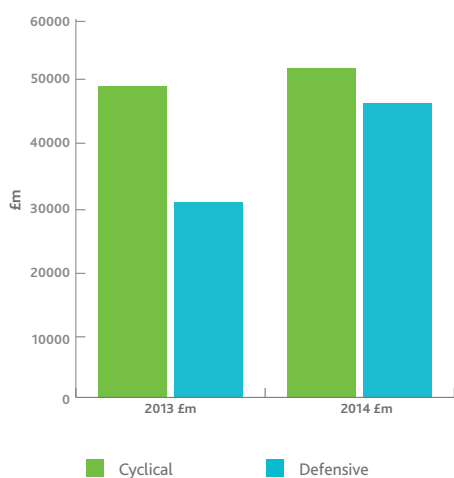
Rank	2007	2008	2009	2010	2011	2012	2013	2014
1	HSBC Holdings plc	HSBC Holdings plc	BP plc	Royal Dutch Shell Plc	Royal Dutch Shell Plc	Royal Dutch Shell Plc	Royal Dutch Shell Plc	Vodafone Group plc
2	Royal Dutch Shell Plc	BP plc	Royal Dutch Shell Plc	Vodafone Group plc	Vodafone Group plc	Vodafone Group plc	HSBC Holdings plc	Royal Dutch Shell Plc
3	BP plc	Royal Dutch Shell Plc	HSBC Holdings plc	HSBC Holdings plc	HSBC Holdings plc	HSBC Holdings plc	Vodafone Group plc	HSBC Holdings plc
4	Vodafone Group plc	Vodafone Group plc	Vodafone Group plc	Glaxosmithkline plc	Glaxosmithkline plc	BP plc	BP plc	BP plc
5	Glaxosmithkline plc	Glaxosmithkline plc	Glaxosmithkline plc	Astrazeneca plc	BP plc	Glaxosmithkline plc	Glaxosmithkline plc	Glaxosmithkline plc
Subtotal £bn	£21.7	£25.6	£27.7	£22.5	£25.9	£30.2	£29.0	£43.5
	34%	37%	46%	38%	37%	37%	36%	45%
6	Barclays plc	Barclays plc	Astrazeneca plc	British American Tobacco	British American Tobacco	British American Tobacco	British American Tobacco	British American Tobacco
7	Lloyds Banking Group plc	Lloyds Banking Group plc	British American Tobacco	BP plc	Astrazeneca plc	Astrazeneca plc	Astrazeneca plc	Astrazeneca plc
8	HBOS	British American Tobacco	BHP Billiton plc	BHP Billiton plc	International Power plc	Cairn Energy	Rio Tinto plc	Rio Tinto plc
9	Astrazeneca plc	Astrazeneca plc	Tesco plc	Tesco plc	BHP Billiton plc	BHP Billiton plc	BHP Billiton plc	National Grid Plc
10	BT Group	BT Group	Diageo plc	National Grid Plc	National Grid Plc	Rio Tinto plc	National Grid Plc	BHP Billiton plc
11	British American Tobacco	Reed Elsevier Plc	National Grid Plc	Standard Chartered plc	Tesco plc	National Grid Plc	Standard Chartered plc	Diageo plc
12	Aviva Plc	Aviva Plc	Unilever plc	Diageo plc	Rio Tinto plc	Old Mutual plc	Glencore plc	Standard Chartered plc
13	Diageo plc	Tesco plc	Standard Chartered plc	Unilever plc	Standard Chartered plc	Tesco plc	Tesco plc	Glencore plc
14	Tesco plc	Anglo American plc	Aviva Plc	Rio Tinto plc	Diageo plc	Standard Chartered plc	Diageo plc	Unilever plc
15	Royal Bank of Scotland Group plc	Diageo plc	Reckitt Benckiser Group Plc	Imperial Tobacco Group plc	Unilever plc	Diageo plc	Unilever plc	Imperial Tobacco Group plc
Sub Total £bn	£13.8	£14.4	£12.1	£12.8	£15.8	£17.6	£17.4	£17.6
Grand Total £bn	£35.5	£40.0	£39.7	£35.2	£41.6	£47.8	£46.4	£61.1
	56%	58%	67%	60%	60%	59%	58%	63%

Dividends - by industry

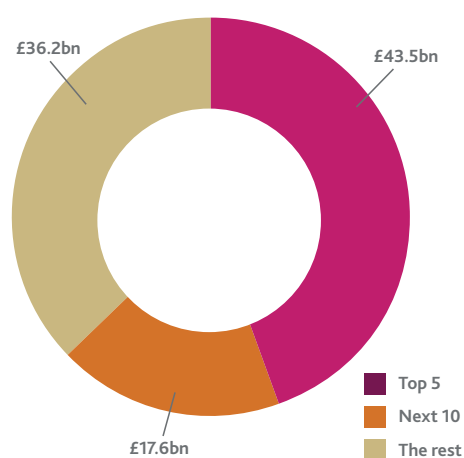
Dividends by Industry £m	2007	2008	change yoy	2009	change yoy	2010	change yoy	2011	change yoy	2012	change yoy	2013	change yoy	2014	change yoy
Basic Materials	£1,943	£4,079	110%	£2,821	-31%	£3,766	33%	£6,416	70%	£7,421	16%	£7,729	4%	£7,349	-5%
Consumer Goods	£3,650	£6,766	85%	£6,835	1%	£7,712	13%	£8,555	11%	£9,209	8%	£10,001	9%	£10,581	6%
Consumer Services	£2,081	£8,004	285%	£5,207	-35%	£5,619	8%	£6,791	21%	£7,389	9%	£7,761	5%	£8,629	11%
Financials	£6,441	£18,977	195%	£11,312	-40%	£11,803	4%	£13,238	12%	£16,656	26%	£16,830	1%	£17,460	4%
Health Care	£3,584	£4,858	36%	£5,841	20%	£6,232	7%	£6,669	7%	£7,058	6%	£6,956	-1%	£7,047	1%
Industrials	£1,498	£3,847	157%	£3,149	-18%	£3,550	13%	£4,068	15%	£5,044	24%	£5,394	7%	£5,783	7%
Oil and Gas	£8,290	£12,403	50%	£15,640	26%	£10,217	-35%	£11,748	15%	£15,371	31%	£14,212	-8%	£14,153	0%
Technology	£213	£533	150%	£328	-38%	£424	29%	£487	15%	£515	6%	£654	27%	£620	-5%
Telecomm-unications	£2,104	£6,096	190%	£5,446	-11%	£5,937	9%	£6,279	6%	£8,592	37%	£6,733	-22%	£21,391	218%
Utilities	£1,329	£2,947	122%	£3,096	5%	£3,416	10%	£5,494	61%	£4,243	-23%	£4,185	-1%	£4,366	4%
Total	£63,565	£68,508	8%	£59,676	-13%	£58,677	-2%	£69,744	19%	£81,498	17%	£80,455	-1%	£97,377	21%

2013 v 2014

Cyclical v Defensive



Q4 2014



Cyclical v defensive sectors



Sub-sector	2013 £m	2014 £m	2014 v 2013
Mobile Telecommunications	£5,666	£20,153	256%
Oil & Gas Producers	£13,860	£13,781	-1%
Banks	£8,743	£8,852	1%
Pharmaceuticals & Biotechnology	£6,756	£6,835	1%
Mining	£7,239	£6,695	-8%
Tobacco	£4,110	£4,305	5%
Life Insurance	£3,419	£3,488	2%
Gas, Water & Multiutilities	£3,196	£3,324	4%
Beverages	£2,553	£2,642	3%
Travel & Leisure	£2,028	£2,630	30%
Media	£2,471	£2,552	3%
Support Services	£2,193	£2,421	10%
Financial Services	£1,931	£2,170	12%
Food & Drug Retailers	£2,062	£1,831	-11%
Food Producers	£1,747	£1,804	3%
General Retailers	£1,200	£1,615	35%
Aerospace & defense	£1,428	£1,516	6%
Household Goods & Home Construction	£1,220	£1,434	18%
Nonlife Insurance	£1,129	£1,242	10%
Real Estate Investment Trusts	£1,276	£1,239	-3%
Fixed Line Telecommunications	£1,068	£1,238	16%
Electricity	£990	£1,042	5%
Industrial Engineering	£583	£527	-9%
General Industrials	£604	£513	-15%
Real Estate Investment & Services	£333	£468	41%
Software & Computer Services	£501	£451	-10%
Chemicals	£355	£430	21%
Oil Equipment, Services & Distribution	£351	£370	5%
Construction & Materials	£258	£297	15%
Industrial Transportation	£113	£263	134%
Electronic & Electrical Equipment	£216	£246	14%
Personal Goods	£191	£212	11%
Health Care Equipment & Services	£200	£211	6%
Technology Hardware & Equipment	£152	£169	11%
Automobiles & Parts	£135	£148	10%
Forestry & Paper	£92	£132	42%
Industrial Metals & Mining	£43	£93	118%
Leisure Goods	£45	£37	-19%
Alternative Energy	£1	£1	12%

FTSE 100 v FTSE 250

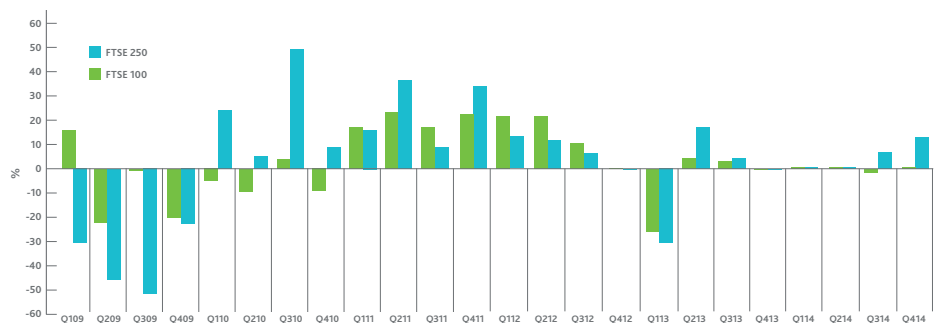
For the full year 2014, the FTSE 100 paid a headline £87.7bn to its shareholders, a 22.8% increase on 2013, mainly thanks to the big special dividend from Vodafone. Underlying dividends from the big caps rose just 0.7% to £70.0bn, with over half that meagre growth due to the recovery in the US dollar in the final quarter alone. The main reason for the weakness was the fact that the pound was very strong in the first half of the year, and due to the other factors we have discussed above. In the fourth quarter the large caps raised their payouts 4.3% on an underlying basis, the fastest rate of growth in more than a year. Headline growth in Q4 was just 0.2%.

The FTSE 250's firms increased their payouts a much stronger 8.0% at the headline level in 2014, to a total £8.3bn, with slightly slower underlying growth meaning a total £7.7bn. They are less exposed to the world economy and to the exchange rate, and so have been able to grow their dividends faster than their larger counterparts.

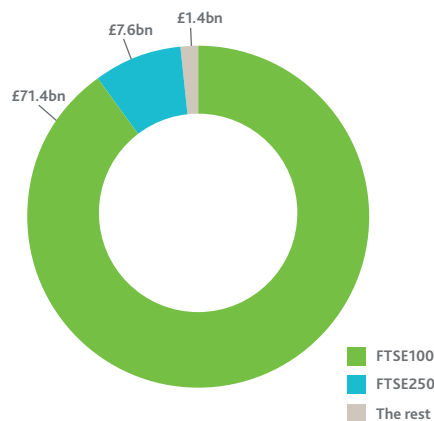
Small caps saw just 1.5% growth.

With the FTSE 100 representing 89% of underlying dividends in 2014 (90% of headline), the impact of rapid growth among the mid-caps is limited on the overall total.

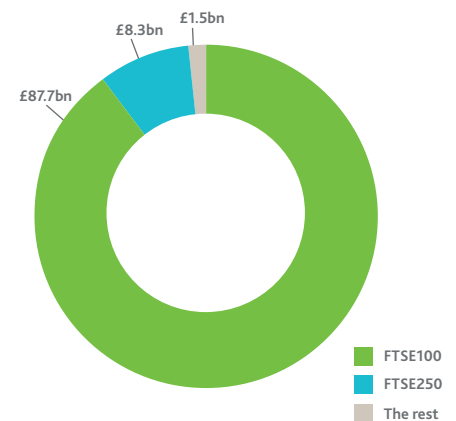
FTSE100 v FTSE250 - annual growth per quarter



2013 £bn



2014 £bn



The UK's top 100 firms grew underlying dividends just 0.7% in 2014

Midcaps raced ahead ten times faster

Yield

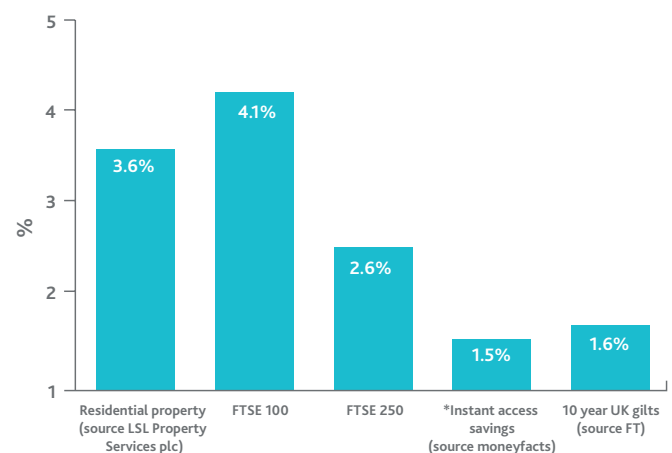
Equity yield steady at 3.9% while bond yields collapse to 1.6%

Equity yields have moved very little since our last report. Based on our forecast for the next twelve months (see Outlook), the prospective yield on the UK market is still 3.9%. The FTSE 100 will yield 4.0% (down from 4.1%), while the FTSE 250 will yield 2.6%, up from 2.5% last quarter.

Since our last report, cash and property have seen almost no change in their yields. Government bond yields have shown a dramatic change however. The UK 10 year benchmark yield is now 1.60%, down from 2.45% at the end of September. This is a major move that takes the government's funding cost down to levels not seen since the historic lows in mid 2012, and is almost half the level of this time last year. It reflects a flight to safety by investors concerned about trends in the world economy and markets, and moderating expectations for inflation in the UK.

The sharp decline in bond yields in particular once again increases the attractiveness of equities for income investors who are prepared to look beyond the volatility in share prices. With fixed income yielding less than inflation, it offers poor value to investors.

UK Income January 2015



Outlook

USD strength and weak oil will boost dividends

We issued our preliminary forecast for 2015 in October. At that time we pencilled in headline dividends of £85.8bn, down on 2014 because Vodafone will obviously not repeat its big special. We said that underlying dividends would be £83.7bn.

Since then a number of things have changed. There is much greater pessimism about the world economy, the oil price is much lower, the US dollar is much stronger, and Tesco has cancelled its 2015 final dividend.

We do not think the weaker oil price will lead to a cut in payouts from Shell and BP, two of the powerhouses of UK dividends. In 2009, when the oil price was last at this level, Shell continued to increase its US dollar dominated payout, while BP held its one flat. Unless the oil prices crashes a lot further, we expect them to at least hold their US dollar payouts steady. Lower oil prices will be a positive for many other firms. A weaker world economy will drag on the ability of the UK market's highly international list of firms to deliver strong earnings growth. The impact on dividends is always more muted than the impact on profits, and we expect that to be the same this year. The currency effect is a positive

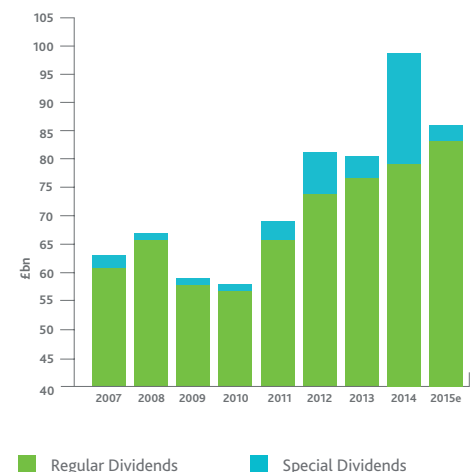
Tesco's cancellation and Vodafone's being a smaller company will reduce total by almost £1.4bn

one. 40% of UK dividends are from companies that report in US dollars. At the time of writing, the dollar was approximately 8% stronger against the pound than its average for the whole of 2014. We do not attempt to forecast currencies, but rather base our forecast on the continuation of the prevailing exchange rates. All other things being equal, if the current level of the dollar is sustained, it will at least add 3 percentage points to the UK's dividend growth rate for 2015.

In the light of all of these factors, we have increased our forecast for headline dividends to £86.1bn (with a slightly higher run rate of special dividends), but the Tesco effect means our underlying forecast is slightly lower, at £83.6bn, an increase of 5.7% compared to 2014. This allows for the fact that Vodafone, formerly a top 3 UK payer is now a much smaller company and is likely to drop to fifth place in the rankings in 2015, and for the £900m cost of the Tesco final dividend cancellation; we had expected Tesco to pay £220m. Stripping out these two factors, we think growth can top 7% in 2015. As ever, we will keep our forecast under review as new information comes to light.

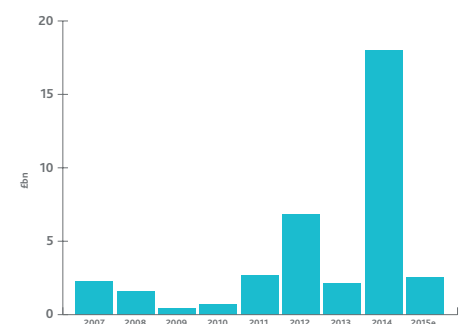
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UK dividends

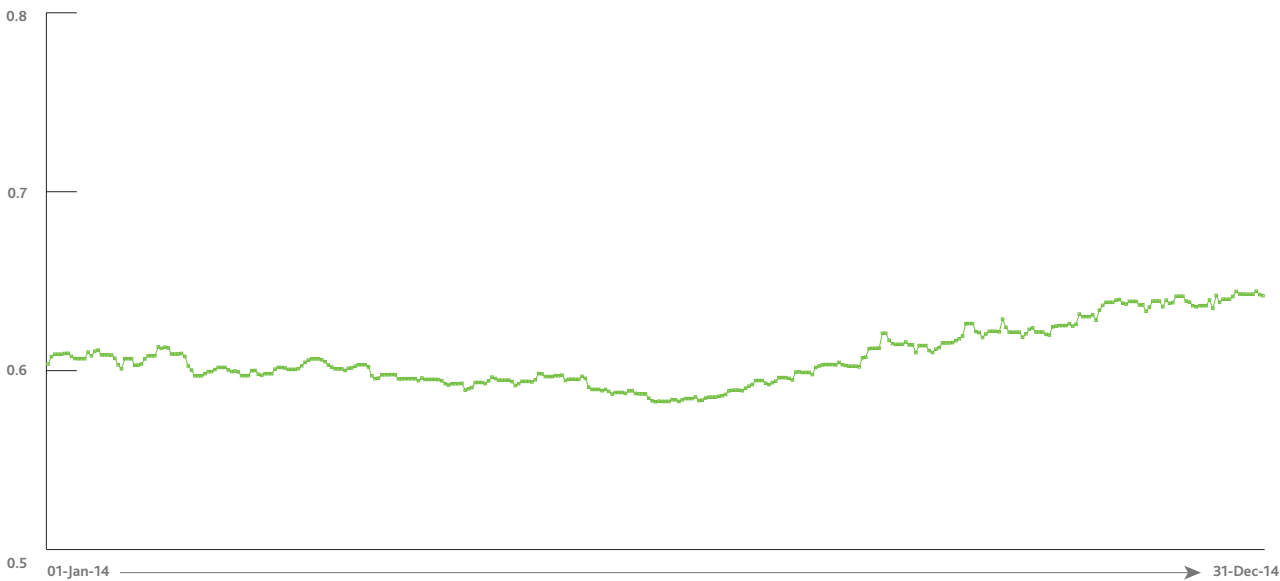


■ Regular Dividends ■ Special Dividends

Special dividends



USD / Sterling Exchange Rate



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