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# Dividend Barometer

April 2024

# What is the Dividend Barometer?

Much of the UK equity income conversation is focused on a narrow set of large companies. This overlooks businesses outside the FTSE 100 with strong dividend cover and a track record of growing dividend distributions. The barometer is a report, compiled by the Quoted companies team at Octopus Investments, which champions the lesser-known dividend credentials of small and mid-cap income stocks.

> ***Barometer (n.)** something that can show how a particular situation is developing, or how people's opinions on a particular matter are changing.*

# Headlines

**Large cap laggards –** FTSE 100 forecast to continue to pay out a total cash dividend in 2025 below pre-Covid levels.

**Smaller companies to outperform –** FTSE Small cap and FTSE 250 ex-IT both set to exceed the FTSE 100 by dividend yield.

**A critical sector –** the financial sector is the largest dividend payer across all indices. But the exposure to specific subsectors varies by index.

**AIM dividend yield is due to progress and benefit from excellent cover.**

## Support for UK businesses

As we are in an election year, it is reassuring that both this Government and a potential Labour government are aligned on some important points of policy.

Both have voiced strong support for investing in UK businesses, and in particular small companies with high growth potential.

To this end, the Government continued to recognise the role retail investors play in boosting the economy, following on from the 10-year extension of support for the Enterprise Investment Scheme and Venture Capital Trusts. This was through their recent announcement of an incremental allowance of £5,000, that will be available for those who want to invest in the new British ISA, which is currently going through the consultation process.

As inflationary pressure is easing, and policy measures are creating a supportive environment for businesses and investors, there is cause to be optimistic.

And as we demonstrate in this edition of the Dividend Barometer, those who take a multi-cap approach to UK equity income investing can benefit from exciting growth potential and growing, high-quality dividends away from the more traditional dividend stalwarts, which arguably have less upside potential.

## Large caps continue to offer only modest cover

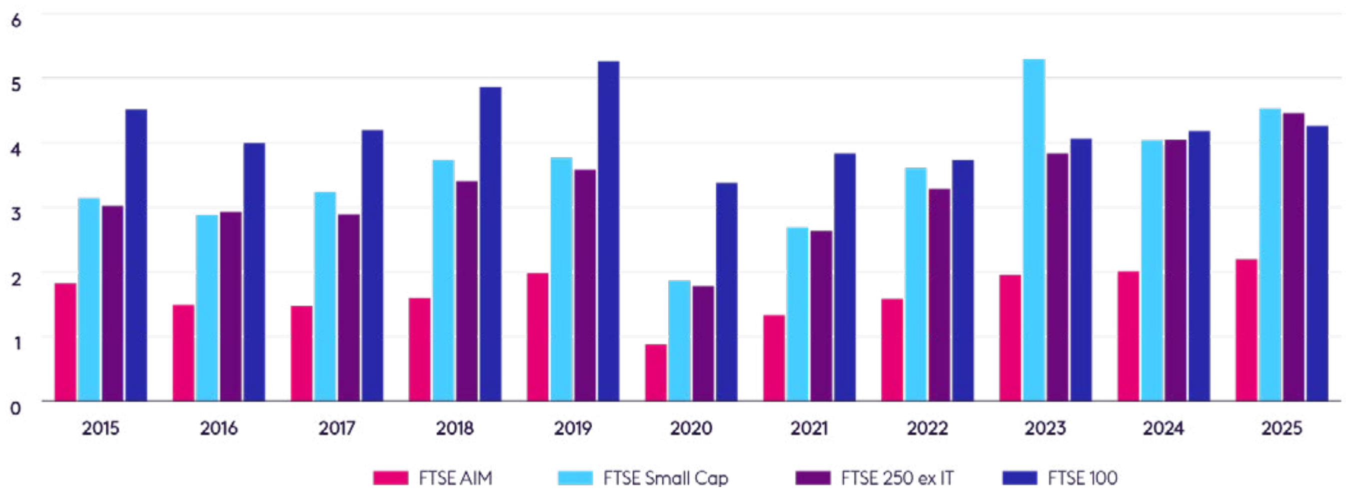
Dividend cover is a critical consideration for an investor. Poor levels of cover mean the potential for cuts to payouts is higher and the scope for dividend growth is lower.

While dividend cover for much of the FTSE 100 has recovered to what we consider a true base level of 2x, we suggest investors should still proceed with caution. Many funds taking a traditional approach to income investing will be packed with these larger cap FTSE 100 stocks exhibiting limited cover.

Importantly, the dividend yield for the FTSE Small Cap, and FTSE 250 ex-IT are both due to exceed the FTSE 100 for 2025 based on current forecasts. Both indices are also expected to benefit from better than FTSE 100 dividend cover.

For AIM, the dividend yield is due to progress to over 2% in 2024 and continues to benefit from excellent dividend cover of 3.3x.

**Dividend Yield By Index (%)**




**Past performance is not a reliable indicator of future results.** Source: Octopus Investments/Factset to 29/02/2023.

## Long term growth in dividends

For AIM, the overall cash dividend is forecast to continue to grow faster than larger peers, with the index forecast to deliver cash dividend growth over the 10 years to 2025 of over 82%, this compares to the FTSE which has delivered much more pedestrian growth of c22% over the same period.

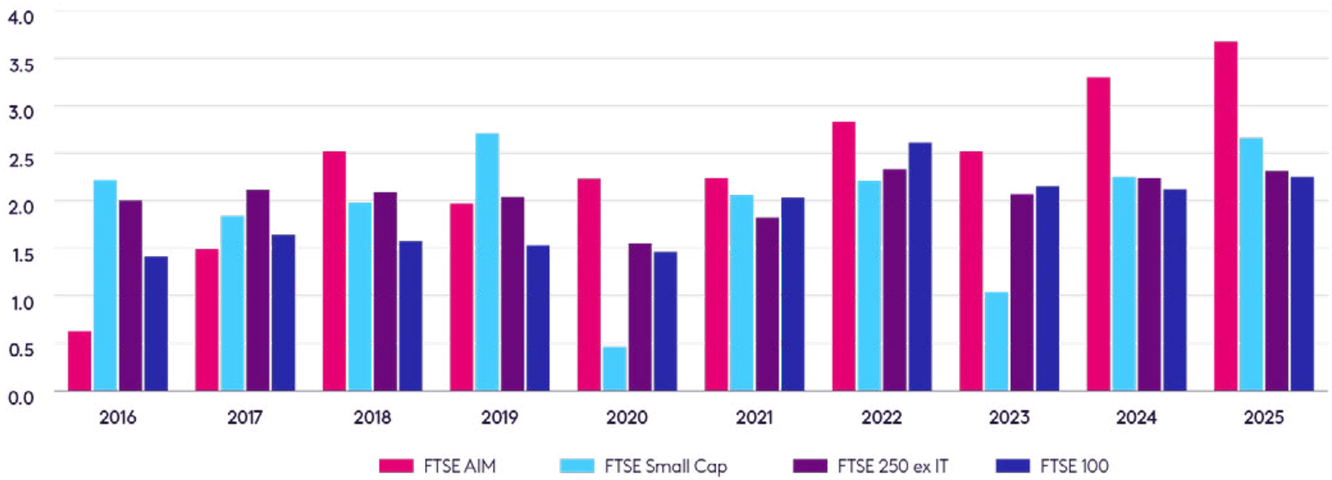
## Attractive dividend growth in small and mid cap

Underpinning the differences in dividend cover and growth, we're seeing a disparity between the recovery of large cap stocks versus smaller companies following the impact of Covid-19 and a more challenging economy in recent years.

For the FTSE 100, the total cash dividend forecast to be paid out in 2025 will remain at almost 11% below pre-Covid levels (2018).

Dividends outside the FTSE 100 are showing resilience and a more exciting growth trajectory, with combined dividends ex-FTSE 100 expected to progress comfortably above pre-Covid levels by 2025.

### Dividend Cover By Index (x)

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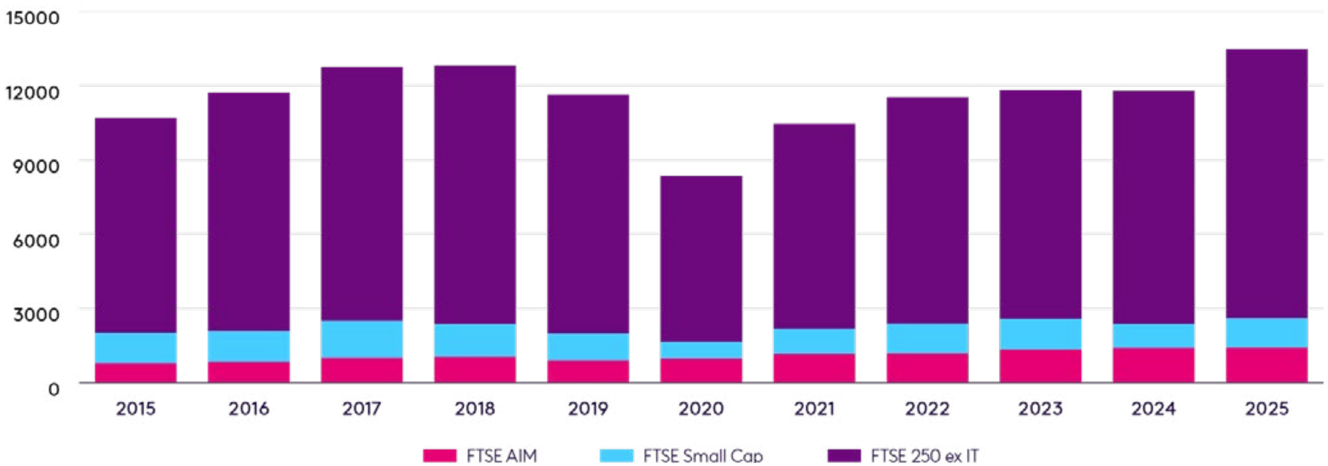
### Overall Cash Payments By Index (£m)

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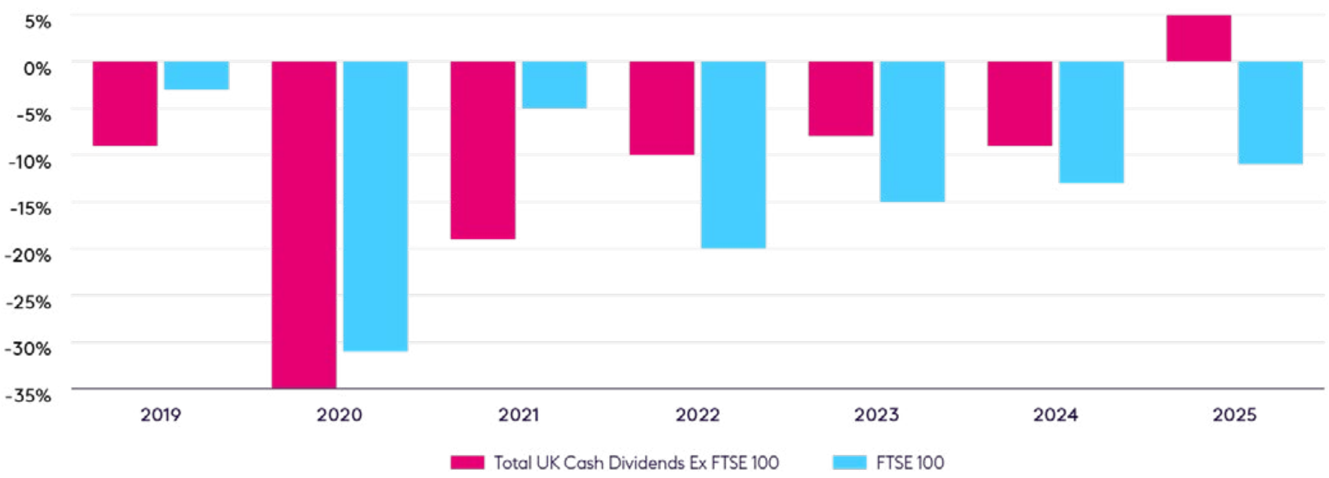
## Diversification can mitigate concentration risk

On dividend concentration, the FTSE 100 remains the most concentrated index by far, with the top ten largest payers accounting for the 57% of all dividends due to be paid in 2024. For the FTSE 100, traditional income sectors such as banks, tobacco, and mining continue to dominate payouts. For the FTSE 250 ex IT, the top 10 account for 22%. And for the FTSE Small Cap ex-IT it is 33%. For the FTSE AIM All Share it is 36%.

### Dividends vs Pre Pandemic Levels (2018)

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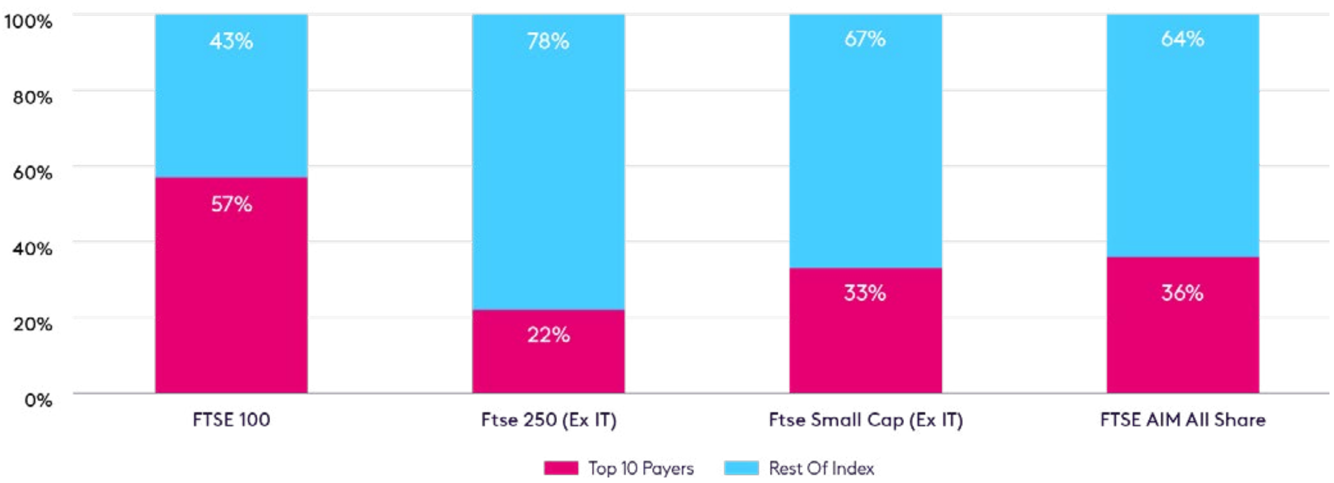
### Dividend Concentration By Index 2024

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## A closer look at the biggest paying sector

The financial sector is the largest payer across all indices – accounting for 29% of the FTSE 100, 44% of the FTSE 250 exIT, 42% of the FTSE Small Cap ex-IT, and 21% of the FTSE AIM Index. However, the specific subsectors vary significantly by index.

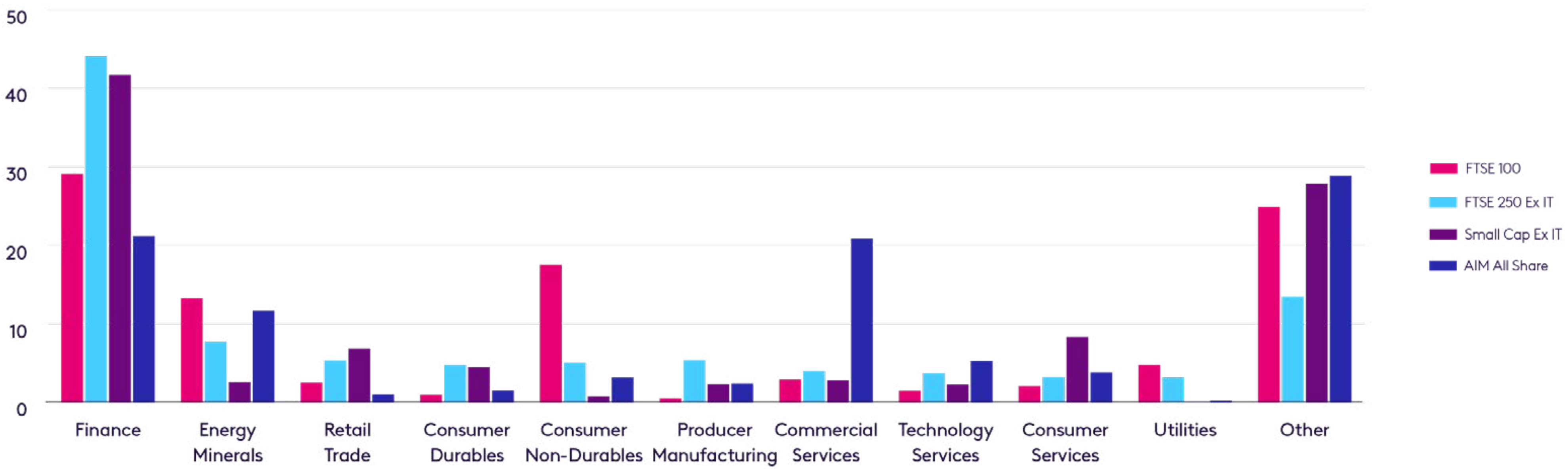
Within the FTSE 100, the large financial services stalwarts of HSBC, Lloyds, Barclays, Nat West and Legal & General make up more than 73% of the expected Finance sector payouts. But in other indices there is a much wider spread of sub-sectors, often with very different growth dynamics.

Within the FTSE 250, the top five expected payers in the sector are Abrdn, Investec, Direct Line Insurance, Hargreaves Lansdown, and British Land, accounting for 24% of the overall expected Finance sector payouts.

Within the FTSE Small Cap IT, the largest expected payers are Liontrust Asset Management, Chesnara, Pollen Street Capital, CLS Holdings, and Paypoint, accounting for c46% of the total Finance sector expected payouts.

Within FTSE AIM, the top five payers in the sector are Greencoat Renewables, Polar Capital, Impax Asset Management, Burford Capital, and Mortgage Advice Bureau. These five names account for 64% of total finance sector dividend payouts.

**Dividends Paid By Sector (%)**

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# Dividend diamonds

## We highlight two stocks held in our portfolio with great prospects and strong performance:

### Kitwave

**A leading independent wholesale business.**

**Sector:** Consumer Services
**Index:** FTSE AIM Index

Since listing in 2021, Kitwave has delivered fantastic dividend performance. From its first full year dividend in October 2022 of 20p, the stock is expected to generate growth of over 50% in dividend payouts in the financial year to October 2025.

In the latest update for the full year to end October 2023, the group delivered revenue growth of 20% in the year, and profit growth of 40%.

Despite this performance, the stock remains attractively valued. It is trading on a price/earnings multiple of 11.4x and is expected to deliver an attractive dividend yield of c4%.

### Galliford Try

**A leading UK construction group.**

**Sector:** Industrial Services
**Index:** FTSE Small Cap Index

Since the group reset earnings in 2021 under the tenure of the current management, the business has seen excellent progress in profits and dividends over the period.

Payouts are expected to climb from the 4.7p per share paid in the year to June 2021 to 14.66p in the year to June 2024.

Considering the fantastic operational and dividend performance, the stock remains attractively valued around an 11x price/earnings multiple and is expected to deliver a dividend yield of c5.8% this year.

These companies are for illustrative purposes only and are not an investment recommendation.

## Looking ahead

Since launching the Dividend Barometer a year ago, it has been reassuring to see the trends that we highlighted hold true. We continue to see a maturing of dividend dynamics away from the FTSE 100, and we continue to see better income growth from the indices focused on smaller companies.

We continue to encourage investors to look outside the FTSE 100 for income, where there remains scope for material capital returns from many of these stocks, especially as interest rates normalise and appetite for smaller companies improves.

Rather than being limited by many of the constraints experienced by more traditional equity income funds which are largely focused on the top FTSE 100 dividend payers, we look across the entire market cap spectrum for some of the more exciting dividend-paying companies with faster growth. These companies are capable of sustaining a growing dividend, underpinned by ongoing profit growth.

**Discrete 1-year performance % return to February 2024**

| | 2024 | 2023 | 2022 | 2021 | 2020 |
|---|---|---|---|---|---|
| **FTSE 100 TR GBP** | 0.8 | 9.6 | 19.2 | 1.4 | -2.7 |
| **FTSE 250 TR** | -0.9 | -2.8 | 2.9 | 10.2 | 3.8 |
| **FTSE AIM TR** | -12.6 | -16.1 | -11.3 | 39.3 | -4.4 |
| **FTSE Small Cap TR** | 0.5 | -2.9 | 8.9 | 23.3 | 2.7 |
| **Kitwave** | 30.3 | 52.9 | 0.7 | n/a | n/a |
| **Galliford Try** | 37.1 | -0.2 | 28.4 | -11.7 | -79.1 |

**Past performance is not a reliable indicator of future results.** Source: Lipper to 29/02/2024. Returns are based on published dealing prices, single price mid to mid with net income reinvested, net of fees, in sterling.

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**Risks to bear in mind**

The value of an investment can fall or rise and you may not get back the full amount you invest. Smaller company shares are also likely to fall and rise in value more than shares in larger, more established companies listed on the main market of the London Stock Exchange. They may also be harder to sell.