FE Trustnet News and Research

UK income investors set for £40bn windfall



By Jenna Voigt 30 Aug 2013

The most popular stock among UK income investors is poised to return an enormous special dividend to shareholders.

Vodafone could be set to pay £40bn to shareholders if it completes the planned sale of its stake in Verizon Wireless, according to Adrian Lowcock, senior investment manager at Hargreaves Lansdown.

The stock is one of the most-held in the IMA universe, and is hugely popular with UK equity income funds.

Many commentators have warned about the concentration risk this has caused, but investors who hold Vodafone either directly or through a fund could be about to have the last laugh.

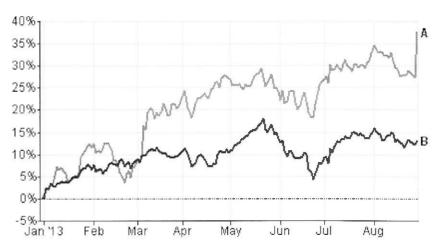
The risks of holding a large amount in one stock or in funds that hold the same stock are clear – if the bulk of someone's investments are in a very concentrated area, the chances of losing it all if something goes wrong are amplified significantly.

But sometimes – as in the case with Vodafone – making a gutsy bet literally pays dividends.

This week the multinational confirmed it was in talks to sell a 45 per cent stake in US mobile company Verizon Wireless.

The stock has had a strong year, picking up 37.64 per cent so far compared with 13.15 per cent from the FTSE 100, according to *FE Analytics*.

Year-to-date performance of stock vs index



- A VodafoneGrpPLC Ord USD0.11 3/7 TR in GB [37.64%]
- B FTSE -100 TR in GB [13.15%]

31/12/2012 - 29/08/2013 Data from FE 2013

Source: FE Analytics

However, it is in the last two days that shares have really shot up, gaining more than 8 per cent.

According to Lowcock, however, the greatest boost to investors from the potential \$130bn sale will be from the income.

He says the company is likely to pay out around £40bn as a special dividend, or 83p for each individual share.

This means investors who hold £5,000 in Vodafone shares could net roughly £2,000 in dividend payouts.

"The size of the transaction is huge and shareholders could be in line for a big payout. Vodafone has been a popular stock for fund managers," Lowcock said.

The majority of investors have exposure through funds rather than owning the equity directly, meaning UK portfolios are set to benefit massively from the windfall.

Among the portfolios in the IMA universe with the highest exposure to the telecommunications firm are <u>Legal & General Ethical</u>, <u>Scottish Widows UK All Share Tracker</u> and FF Global Telecommunications – all with more than 9 per cent of AUM in the stock.

A number of investment trusts also have a chunk in the telecommunications giant, with $\underline{Alastair\ Mundy's}$ four crown-rated $\underline{Temple}\ \underline{Bar\ Investment\ Trust}$ holding the most -6.8 per cent of AUM.



Funds with the highest exposure to Vodafone

Fund	% of AUM in stock
Legal&General Ethical	9.68
Scottish Widows UK All Share tracker	9.63
FF Global Telecommunications	9.4
RWC Income Opportunities	8.35
UBS UK Equity Income	7.44
Waverton UK	7.38
Temple Bar IT	6.8
JPM UK Managed Equity	6.64
Elite Charteris Premium Income	6.61
Standard Life UK Equity High Income	6.61

Source: FE Analytics

FE Alpha Managers <u>Adrian Frost</u> and <u>Adrian Gosden</u> also hold a significant chunk of the stock in their four crown-rated <u>Artemis</u> Income fund.

Overall, there are 363 funds in the IMA and AIC universes that hold Vodafone in their top-10.

Of the 100 funds in the IMA UK Equity Income sector, 52 hold it in their top 10

Initially, a chunk of change going straight into investors' pockets will undoubtedly feel like a good thing, but Lowcock says Vodafone's future prospects may not be as rosy.

"When looking at investing for income, it is important to focus on a stable income and the ability for that income to grow," he said.

"The US mobile market has proved a growth area for Vodafone over recent years, a contrast to more challenged operations in Europe, particularly southern Europe," he added.

"The chief executive officer, as of the group's mid-July first-quarter trading update, noted that 'regulation, competitive pressures and weak economies, particularly in southern Europe, continue to restrict revenue growth'."

"A sale of the Verizon Wireless stake would end a partnership of more than a decade, a relationship which has seen Verizon pay significant dividends to Vodafone."

He adds that Vodafone has a had a mixed track record when it comes to acquisitions, citing the failed purchase of Germany's Mannesmann – a move it had to painfully write down from its books later.

However, Lowcock says this extra cash on the balance sheet is a positive result of the sale, as the firm will be able to make acquisitions which, if they turn out well, could bolster current operations.

Another possibility is that the firm could pay out more cash to shareholders – increasing the dividend in the short-term.

"Concerns regarding increasing competition in the US mobile market currently persist," he added.

Given some of the concerns surrounding the sustainability of a growing dividend from Vodafone without its US arm, holding an investment trust could offer investors some additional security while still providing exposure to the stock.

Investment trusts have the ability to hold back dividends in the good times, thus allowing them to continue to pay a steady or growing dividend when times are more difficult – by using that stockpile of reserved income to shore up the dividend payout when markets are not performing as hoped.

Besides the Temple Bar IT, the <u>Dunedin Income Growth</u> trust, <u>BlackRock Income & Growth IT</u>, <u>JP Morgan Claverhouse IT</u>, Jupiter Dividend & Growth and the <u>Schroder Income Growth</u> trust all have more than 5 per cent of their portfolio in Vodafone.

Of these trusts, the Temple Bar IT and Dunedin Income Growth Trust have the strongest long-term track records, picking up 221.44 per cent and 151.26 per cent respectively over the last 10 years.

However, the JP Morgan Claverhouse and Jupiter Dividend & Growth IT have proven themselves over the last three years, making 40.19 per cent and 38.21 per cent respectively.

Of these trusts, the Dunedin and Claverhouse ITs have the highest yields – at 4 per cent for the former and 3.8 per cent for the latter.