AFS Dividend Review Week 40, 2019

The Week Ahead

Ex-dividend dates:
7 October: Air Liquide (1 for 10 bonus share issue)
11 October: BBVA

Events:
9 October: LVMH, Takeaway results

What to watch:
AXA – The Axa 2021 dividend future offers decent upside to the last traded level of EUR 1.365. Let's first look at the 2019 dividend though. Axa pays out between 50% and 60% of adjusted net income as annual dividend. Underlying net income was up 7% in the first half of this year compared to the same period in 2018. This is in line with Axa's mid-term guidance of annual underlying earnings growth between 3% and 7%. I assume the same 7% increase holds for the second half of the year, which leads to underlying earnings of EUR 6.6 billion over 2019. After adding net realized capital gains of EUR 300 million, equal to last year, I expect adjusted net income to be around EUR 6.9 billion. This implies a dividend of EUR 1.42 per share over 2019 at a 50% payout ratio, at the bottom end of the payout range, while last year's 52% payout ratio would lead to a EUR 1.49 per share dividend. The 2020 dividend future last traded close to these estimates at EUR 1.40.

A 3% underlying net income increase next year and EUR 300 million in realized net capital gains would lead to adjusted net income of EUR 7.1 billion. Applying a 50% payout ratio leads to a dividend of EUR 1.47 per share. Pushing the payout ratio to the mid-point of the 50% to 60% range would yield a 2020 dividend of EUR 1.60 per share. As a result, there's at least 7.7% upside to the last traded level of the 2021 Axa dividend future and potentially 17% if the payout ratio is boosted.

Axa can afford to push its payout ratio towards the middle of its payout range. The Solvency II ratio currently stands at 190%, within the 170% to 220% target range. Furthermore, it still has a 38.9% stake in US-listed subsidiary Axa Equitable Holdings worth EUR 3.65 billion, which it wants to fully sell as soon as possible. The proceeds share sales will be used to cut the debt to total capital ratio from 30.2% to within its 25% to 28% target range. As a 9% stake is locked up in a mandatory convertible bond that matures in May 2021, the remaining EUR 2.8 billion stake lowers the debt ratio to approximately 26.5%. The debt target can thus be reached without jeopardizing the Solvency II position. Furthermore, annual capital generation of 15 to 20 percentage points is sufficient to maintain the Solvency II level above 170%, after deducting the 12 percentage point impact of the dividend payment and even when interest rates decline some more. As a rule of thumb, Axa's Solvency II ratio decreases approximately 13 points for every 50 bps interest rate decrease. As a result, Axa will be able to further increase its payout ratio within its target range, which could suggest a 2020 dividend above the current market consensus.

ALLIANZ – could raise its 2019 outlook and announce a new share buyback when it presents its Q3 results next month. Allianz currently expects operational profit between EUR 11 billion and EUR 12 billion, a EUR 500 million bandwidth around last year's level of EUR 11.5 billion. Operating profit was EUR 6.1 billion in the first half of the year, more than half of the top end of the outlook range. Furthermore, Allianz has proven to be quite conservative in its annual outlook as operating profit has ended up close to the top end of the full-year guidance range in each of the past four years. Operating profit generally is a tad lower in the second half of the year compared to the first six months. Still, operating profit in the second half of 2019 equal to the EUR 5.7 billion reported in the second half of last year takes the full year number to EUR 11.8 billion, at the high end of the guidance range. Assuming non-operating items of EUR 1 billion, in line with the last two years, and applying last year's net tax rate of 25.9% yields net income of EUR 8 billion.

Allianz's Solvency II ratio was 213% after Q2, in the top half of its 180% to 220% target range. It uses excess capital for buybacks if it doesn't see any suitable acquisition targets. The insurer has repurchased EUR 3 billion in shares in both 2017 and 2018 and EUR 1.5 billion in shares so far this year. As a rule of thumb, every EUR 1 billion in share repurchases cuts the Solvency II ratio by 3%. Furthermore, it generates approximately 10 percentage points of capital a year after dividends and taxes. As a result, the impact of an additional EUR 1.5 billion in share repurchases can be completely offset by the capital generated in the second half of 2019. Such a share buyback would cut the number of outstanding shares by 1.7%.

Allianz pays out an annual dividend equal to 50% of net income. Based on estimated net income of EUR 8 billion and after lowering the number of outstanding shares by 1.7%, the dividend over 2019 would end up at EUR 9.60 per share. This exactly matches the last traded level of the 2020 dividend future. The 2019 dividend would end up around EUR 9.45 per share absent of a buyback.

Confirmed Dividends

BBVA – will pay out an interim dividend of EUR 0.10 per share with 11 October as ex-dividend date.

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