Investors' Chronicle | Alpha

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AlphaScreens: finding dividend diamonds

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Dividend discipline and long-term success

One of the less talked about benefits of dividends is that paying them helps encourage discipline by company management. When there is a commitment to return capital to shareholders then it helps foster a culture of only investing in the best and most profitable projects versus making additional distributions. In a virtuous circle, those good investments by management help grow earnings and hence future dividends, along with capital gains as multiples track rising earnings.

- Pharmaceutical company **GSK (GSK)** tops our latest large cap dividend yield screen and as a firm that has undergone considerable changes in its recent history, hopefully it can be a case in point for a business where paying shareholders instils discipline. Having spun-out its consumer goods business into **Haleon (HLN)**, the focus has already been sharpened towards pharmaceutical research and in May, GSK sold down further shares of the holding it retained in Haleon's stock. One of the major drags on GSK's share price has continued to be litigation risk thanks to claims made in North America relating to alleged side effects to heartburn drug Zantac, although it is noteworthy that a Canadian court recently threw out a case. On the drug development front, there has been encouragement from the phase III trials of a meningitis vaccine candidate. Although the share price has negative momentum, the strategy appears to be coming together and this may be a decent entry point for income investors.

- Another company where management has had a clear impact is advertising agency business **WPP (WPP)**, which earned plaudits last year for its progress on cost rationalisation. The business has been expanding in key areas through acquisitions focussed on achieving a bigger footprint in the areas of data-driven influencer marketing and in specialist areas such as healthcare. The company has grabbed most headlines, however, for its partnership with **Nvidia (US:NVDA)**, to help in the development of AI solutions for clients. The clear focus on growth and adapting to the rapidly changing media landscape will cheer long-term investors, as must another positive quarter in Jan-Mar 2023, defying expectations of a cyclical advertising downturn. Income investors, especially, may be wary of the £1.4bn increase in net debt in the last quarter, driven largely by the acquisitions. The current strong business momentum could still run into difficulties given wider economic uncertainty and if earnings face headwinds, interest expense trumps paying dividends.

Alpha UK large-cap dividends

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	Median NTM Fwd DY	Fwd EPS grwth current FY	Fwd EPS grwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 11)
GSK	GSK	1348	55184	8.9	4.3%	4.3%	6.0%	5.5%	-5%	-14933.0	8
Smurfit Kappa	SKG	2872	7471	10.1	4.3%	4.5%	-25.9%	-4.7%	-10%	-1986.5	8
Anglo American	AAL	2300	30758	7.4	7.3%	5.5%	-23.0%	-5.6%	-23%	-1699.2	8
British Am. Tobacco	BATS	2558	57195	6.5	11.3%	9.8%	3.5%	6.4%	-18%	-13828.0	8
WPP	WPP	864	9289	8.2	4.6%	4.9%	3.6%	8.1%	-16%	-15216.8	8
Glencore	GLEN	417	52001	7.5	8.5%	9.6%	-47.7%	-8.2%	-19%	-41728.3	7
Shell	SHEL	2248	152631	6.7	4.0%	4.2%	-23.4%	-1.6%	-12%	-67391.3	7
Legal & General	LGEN	229	13667	6.5	8.5%	9.1%	-7.3%	11.4%	-11%	-	7
Rio Tinto	RIO	4886	61122	8.3	8.3%	7.5%	-10.0%	-8.5%	-18%	-2218.0	7
Imperial Brands	IMB	1717	15719	5.7	7.0%	8.7%	8.3%	8.4%	-15%	-9289.0	7
Unilever	ULVR	4018	101146	17.7	3.7%	3.8%	-3.1%	7.9%	-3%	-17448.3	7
Barclays	BARC	153	23732	4.4	4.8%	6.1%	9.4%	6.8%	-12%	-	7
NatWest	NWG	263	23644	5.5	12.1%	7.1%	36.4%	10.0%	-10%	-	7
National Grid	NG	1056	38824	15.0	5.3%	5.5%	0.4%	2.1%	4%	-6362.0	6
BP	BP	461	80955	5.9	4.5%	4.7%	-34.6%	-2.2%	-16%	-57565.1	6
Lloyds	LLOY	45	29266	5.8	5.4%	6.5%	4.4%	5.5%	-14%	-	6

Sources: FactSet, Investors' Chronicle

UK large-cap shares, steady income tests failed summary

Company	Test failed 1	Test failed 2	Test failed 3	Test failed 4	Test failed 5
GSK	Dividend cut in past five years	Past dividend per share growth	FC DPS grwth below median		
Smurfit Kappa	Dividend cut in past five years	FC earnings per share growth	FC DPS grwth below median		
Anglo American	Dividend cut in past five years	FC earnings per share growth	FC DPS grwth below median		
Brit. Am. Tobacco	FC earnings per share growth	Dividend cover	FC DPS grwth below median		
WPP	Dividend cut in past five years	Past EPS growth	Interest cover		
Glencore	Dividend cut in past five years	FC EPS growth	Past EPS growth	FC DPS grwth below median	
Shell	Dividend cut in past five years	FC EPS growth	Past EPS growth	FC DPS grwth below median	
Legal & General	FC earnings per share growth	Past DPS growth	Interest cover	FC DPS grwth below median	
Rio Tinto	Dividend cut in past five years	FC EPS growth	Dividend cover	FC DPS grwth below median	
Imperial Brands	Dividend cut in past five years	Past DPS growth	Dividend cover	FC DPS grwth below median	
Unilever	Dividend cut in past five years	FC EPS growth	Past DPS growth	FC DPS grwth below median	
Barclays	Dividend cut in past five years	Dividend cover	Interest cover (irrelevant for banks)	Free cash flow (irrelevant for banks)	
NatWest	Dividend cut in past five years	Dividend cover	Interest cover (irrelevant for banks)	Free cash flow (irrelevant for banks)	
National Grid	FC dividend cover	FC EPS growth	Past DPS growth	Interest cover	FC DPS grwth below median
BP	Dividend cut in past five years	FC EPS growth	Past DPS growth	Past EPS growth	FC DPS grwth below median
Lloyds	Dividend cut in past five years	FC EPS growth	Dividend cover	Interest cover (irrelevant for banks)	Free cash flow (irrelevant for banks)

Sources: FactSet, Investors' Chronicle

Alpha UK mid-cap dividends

Name	Ticker	Share price (p)	Mkt cap £mn	Fwd 12-mth PE	Trailing 12-mth DY	Median NTM Fwd DY	Fwd EPS grwth current FY	Fwd EPS grwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 11)	Tests failed
Drax	DRX	554	2213	4.7	3.8%	4.3%	30.7%	16.9%	-12%	-2369.6	10	/Div Cov/
Spirent Comms	SPT	179	1070	14.3	3.5%	3.6%	-23.5%	8.2%	-17%	16.0	9	/Fwd EPS grwth/FC DPS grwth/
Rathbones	RAT	2000	1269	14.5	4.2%	4.4%	51.6%	20.5%	-5%	-	9	/Div Cov/FC DPS grwth/
Bridgepoint	BPT	220	1785	13.5	3.6%	4.0%	22.6%	-8.2%	-12%	-	8	/Trail DPS Grwth/Fwd EPS grwth/FC DPS grwth/

Sources: FactSet, Investors' Chronicle

Alpha UK small-cap dividends

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	Median NTM Fwd DY	Fwd EPS grwth current FY	Fwd EPS grwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 11)	Tests failed
DWF	DWF	59	200	4.7	8.3%	10.8%	1.8%	12.3%	-19%	-101.0	9	/Trail DPS grwth/Trail EPS grwth/
Severfield	SFR	63	196	7.2	5.0%	5.7%	13.9%	5.8%	4%	-123.3	9	/Trail DPS grwth/Trail EPS grwth/
Keller	KLR	668	486	6.1	5.6%	6.1%	5.6%	8.0%	-18%	-623.9	8	/Trail DPS grwth/FCF +ve/FC DPS grwth/
Foresight	FSG	411	478	10.7	3.5%	5.6%	8.7%	17.0%	0%	-	8	/Trail DPS grwth/Trail EPS grwth/FC DPS grwth/

Sources: FactSet, Investors' Chronicle

Alpha UK Aim company dividends

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	Median NTM Fwd DY	Fwd EPS grwth current FY	Fwd EPS grwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 11)	Tests failed
Kitwave	KITW	258	181	9.8	3.6%	4.4%	29.6%	3.3%	8%	-78.3	8	/Trail DPS grwth/Trail EPS grwth/FC DPS grwth/

Sources: FactSet, Investors' Chronicle

Investors' Chronicle Alpha dividend screen methodology (11 tests)

Compulsory

- Trailing 12-month dividend yield at least 3 per cent
- Dividend yield on forecast current year dividends per share of at least 3.5 per cent

Other tests

- No decrease in year-on-year dividend per share growth rate in last five years
- Forecast DPS to be less than 0.8 times forecast EPS for next three years
- Forecast compound annual growth rate (CAGR) for EPS to be above 5 per cent over current unreported and next financial years, with positive growth expected in both years.
- Last three years' EPS CAGR above 5 per cent
- Last three years' DPS CAGR above 5 per cent
- Dividend cover (trailing one year EPS divided by trailing one year DPS) of at least 1.5 times.
- Interest cover (trailing one year operating profit divided by trailing one year interest expense) of at least 5 times.
- Positive free cash flow on a trailing 12-month basis.
- Forecast DPS growth between forecast for current unreported year and forecast for the next two financial years after that, above median.

Mid-cap, small-cap and Aim companies

For mid-cap companies we exclude any companies that fail the dividend cut test. For smaller and Aim-listed companies we do the same and also make the forecast EPS growth test compulsory.

The results are more likely to be cyclical value stocks further down the market capitalisation scale.

Screened indices

We screen an equities universe inspired by the Numis family of UK indices (although we do not copy their methodology exactly).

Investors' Chronicle UK screening cut-offs:

Large Cap: The top 80 per cent of the UK main market's market capitalisation.

Mid cap: The next 15 per cent of UK main market capitalisation (80th to 95th percentile)

Small Cap: The bottom five per cent of the main market by capitalisation with a £35mn lower cut-off.

Aim: We cut off the Alternative market by excluding all companies below £35mn market cap.

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