

AlphaScreens: finding dividend diamonds

24 January 2025

An Income list with a traditional feel

Our income screen flags a group of companies in sectors associated with high dividends, diversifying across these sectors, and taking advantage of gilt yields is a good way to build a stable income portfolio.

Income investors are facing a different set of challenges than a decade ago. In the 2010s, low interest rates and quantitative easing (QE) meant government bond yields were rock bottom and riskier high-yield corporate bonds or shares occupied more of portfolios. Now in the 2020s there are attractive yields on offer from UK government bonds (gilts), but the volatility in rates (due to stubborn inflation which also drags on real yields) means there has been significant price volatility in longer-dated gilts.

But, arguably, it is a better time overall to build an income portfolio: there should be some strategic bond fund and gilt fund exposure, but balanced out with dividend-paying stocks. Companies can increase the dividends they pay out if they do well, so are better at maintaining and growing a real yield.

The downside is that dividends can be cut, too, which is why it is important to diversify across a number of sectors. Our large-cap UK income screen gives plenty of ideas on companies that might have a place in the slice of an income portfolio that is invested in shares.

Top of the list is tobacco company **Imperial Brands (IMB)**. This may be a moral hazard for some investors and also this is undeniably an industry in secular decline (despite the rise of nicotine product alternatives - which in any case are coming under more regulatory scrutiny themselves). This means there is a risk of this dividend being cut in the future, but for now the fact that it is projected out to over 6 per cent for the next 12 months and the stock is on a valuation of only eight times next 12 months' earnings does give a margin of safety.

Next we have **SSE (SSE)**, which is structurally now more geared to growth - having cut the dividend in 2023 - but the energy distributor has rebalanced and refocused and could continue to build back the pay-out in future. The risk to this outlook is the ongoing massive capital investments being made towards the energy transition, which compete for cash.

Earnings growth which helps underpin dividend payments can be cyclical and frictional in industries like oil & gas and insurance which are well represented in our screen. The pay-outs are tempting but because of this uncertainty risk premium, it is important to

diversify sector exposure and lessen the chance of getting wrong-footed completely by any potential downturn in any specific business.

UK large-cap income shares (passing at least 6 out of 9* tests)

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd PE	LTM DY	NTM DY	Fwd EPS grwth FY	Fwd EPS grwth next FY	3-mth share price mom.	LTM net cash (£mn)	Tests passed (out of 9*)
Imperial Brands	IMB	2627	21909	7.9	5.8%	6.2%	6.8%	10.9%	14%	-10384	8
SSE	SSE	1584	17479	9.7	3.9%	4.3%	2.8%	0.2%	-16%	-4185	8
Shell	SHEL	2683	163328	8.8	4.0%	4.4%	-5.7%	-2.6%	6%	-35317	7
Tesco	TSCO	367	24707	12.6	3.4%	4.0%	13.9%	10.5%	4%	-16631	7
Severn Trent	SVT	2484	7457	16.0	4.8%	5.0%	27.8%	66.0%	-7%	238	7
BP	BP	424	68189	8.5	5.6%	6.3%	-29.5%	10.2%	5%	-31503	6
GSK	GSK	1364	56519	8.3	4.5%	4.6%	0.2%	5.5%	-6%	-18247	6
Intermediate Capital	ICG	2316	6731	13.9	3.4%	4.0%	-16.2%	29.9%	11%	-	6
Reckitt Benckiser	RKT	5072	34772	14.8	3.9%	4.2%	-2.3%	7.6%	2%	-6056	6
United Utilities	UU	983	6700	12.1	5.1%	5.4%	48.4%	78.4%	-8%	544	6
HSBC	HSBA	829	148072	8.2	5.8%	6.5%	14.8%	-3.0%	22%	-	5
Aviva	AV	512	13710	9.8	6.7%	7.5%	11.3%	15.8%	8%	-	5
Admiral	ADM	2678	8203	13.3	4.6%	6.8%	52.9%	17.2%	2%	-	5
Lloyds	LLOY	63	37910	8.9	4.6%	5.3%	-6.7%	-0.9%	1%	-	4
NatWest	NWG	430	34602	8.0	4.1%	5.1%	3.8%	7.9%	21%	-	4
Legal & General	LGEN	235	13867	10.2	8.8%	9.3%	49.0%	10.1%	5%	-	4

*Banks and insurers must pass 4 out of 7 tests on the large-cap screen
Source: FactSet and Investors' Chronicle

UK large-cap tests failed

Name	Ticker	Tests failed
Imperial Brands	IMB	/Cash conv/
SSE	SSE	/Div Cut/
Shell	SHEL	/EPS growth/ROE >12.5%/
Tesco	TSCO	/Div cover/Interest cover/
Severn Trent	SVT	/Div cover/Interest cover/
BP	BP	/EPS growth/Interest cover/ROE >12.5%/
GSK	GSK	/Div Cut/Cash conv/ROE >12.5%/
Intermediate Capital	ICG	/EPS growth/Cash conv/Beta < 0.9/
Reckitt Benckiser	RKT	/Div cover/EPS growth/Cash conv/
United Utilities	UU	/Div cover/Interest cover/ROE >12.5%/
HSBC	HSBA	/EPS growth/ROE >12.5%/Beta < 0.9/
Aviva	AV	/Div cover/Beta < 0.9/
Admiral	ADM	/Div Cut/Div cover/Beta < 0.9/
Lloyds	LLOY	/EPS growth/ROE >12.5%/Beta < 0.9/
NatWest	NWG	/Div Cut/Cash conv/ROE >12.5%/Beta < 0.9/
Legal & General	LGEN	/Div cover/ROE >12.5%/Beta < 0.9/

*Banks and insurers must pass 4 out of 7 tests on the large-cap screen

UK mid-cap income shares (passing at least 7 out of 9 tests)

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd PE	LTM DY	NTM DY	Fwd EPS grwth FY	Fwd EPS grwth next FY	3-yr EPS CAGR	3-mth share price mom.	LTM net cash (£mn)	Tests passed (out of 9)	Tests failed
ME Group	MEGP	207	778	13.1	3.8%	4.2%	8.6%	6.9%	-	-2%	-8	9	n/a
Mears Group	MER	353	320	9.2	4.0%	4.6%	54.0%	-19.6%	-	6%	-169	8	/EPS growth/
MITIE Group	MTO	115	1453	9.7	3.7%	3.9%	-3.1%	10.3%	-	-3%	-1080	8	/EPS growth/
IG Group	IGG	1006	3563	9.2	4.6%	4.8%	32.4%	7.6%	-7.6%	8%	-	8	/EPS growth/
Drax Group	DRX	615	2262	5.9	4.0%	4.7%	9.6%	-18.3%	-	-5%	-1675	7	/EPS growth/Beta < 0.9/
Lancashire Hldgs	LRE	650	1586	5.5	2.7%	12.5%	16.5%	6.8%	-	0%	-	7	/Interest cover/Beta < 0.9/
Keller Group	KLR	1378	1006	7.4	3.5%	3.6%	19.7%	1.5%	-	-16%	-613	7	/EPS growth/Beta < 0.9/
Wilmington	WIL	387	349	16.6	2.9%	3.0%	-2.4%	10.2%	-	1%	14	7	/fc DY < 3.5/EPS growth/
Galliford Try	GFRD	387	396	14.0	4.0%	4.2%	-1.4%	8.6%	72.9%	6%	-439	7	/EPS growth/Beta < 0.9/
Serco Group	SRP	150	1537	9.5	2.4%	3.0%	6.1%	-3.4%	-	-16%	-782	7	/fc DY < 3.5/EPS growth/
Computacenter	CCC	2086	2216	11.3	3.4%	3.6%	-3.7%	9.5%	-	-10%	-1443	7	/EPS growth/Beta < 0.9/
XPS Pensions	XPS	340	708	17.8	3.1%	3.5%	20.9%	5.5%	81.5%	-6%	-	7	/fc DY < 3.5/Beta < 0.9/
Morgan Sindall	MGNS	3730	1791	13.7	3.2%	3.4%	8.7%	0.7%	-	-6%	-956	7	/fc DY < 3.5/EPS growth/
Clarkson	CKN	4240	1305	15.1	2.5%	2.6%	3.4%	-1.1%	-	23%	25	7	/fc DY < 3.5/EPS growth/
QinetiQ Group	QQ	382	2134	11.0	2.2%	2.4%	5.4%	14.1%	4.2%	-17%	-411	7	/fc DY < 3.5/Beta < 0.9/

Source: FactSet and Investors' Chronicle

Small-cap high dividend yield shares below

UK small-cap DY shares (passing at least 8 out of 10 tests)

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd PE	DY	NTM DY	Fwd EPS grwth FY	Fwd EPS grwth next FY	3-yr EPS CAGR	3-mth share price mom.	LTM net cash (£mn)	Tests passed (out of 10)	Tests failed
Castings	CGS	272	118	13.3	6.8%	7.0%	-55.0%	22.6%	59.4%	-4%	-11	8	/EPS growth/ROE >12.5%/
Ultimate Products	ULTP	107	93	6.9	6.9%	7.4%	18.7%	13.4%	9.3%	-25%	-51	8	/EPS growth/Cash conv/

Source: FactSet and Investors' Chronicle

Aim-listed DY shares (passing at least 8 out of 10 tests)

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd PE	DY	NTM DY	Fwd EPS grwth FY	Fwd EPS grwth next FY	3-yr EPS CAGR	3-mth share price mom.	LTM net cash (£mn)	Tests passed (out of 10)	Tests failed
Nexteq	NXQ	72	43	17.7	4.6%	4.5%	-57.4%	-33.1%	-	-19%	15	9	/EPS growth/
Kitwave	KITW	287	231	8.6	3.9%	4.3%	13.2%	11.9%	-	-14%	-127	9	/Cash conv/
M.P.Evans	MPE	1015	530	8.6	4.7%	5.3%	52.6%	0.6%	-	12%	-13	9	/EPS growth/
FRP Advisory	FRP	139	355	12.5	3.7%	3.9%	7.1%	5.3%	14.9%	12%	-	9	/Cash conv/
Tristel	TSTL	395	188	22.8	3.4%	3.8%	6.1%	11.2%	20.3%	-1%	5	9	/Div cover/
Billington	BILN	490	63	8.8	4.1%	4.3%	-21.6%	-16.2%	-	1%	-6	8	/EPS growth/Interest cover/
Next 15	NFG	343	346	5.6	4.5%	4.5%	-10.5%	-16.8%	-	-16%	-190	8	/EPS growth/Cash conv/
Churchill China	CHH	585	64	10.0	6.2%	6.5%	-17.5%	0.2%	-	-32%	-3	8	/EPS growth/Cash conv/
NWF Group	NWF	154	76	7.9	5.3%	5.6%	-8.9%	18.3%	4.9%	2%	-91	8	/EPS growth/ROE >12.5%/
Wynnstay	WYN	285	66	11.0	6.1%	6.2%	-22.3%	10.0%	-	-9%	-61	8	/EPS growth/ROE >12.5%/
Ramsdens	RFX	233	74	8.6	4.8%	5.1%	5.0%	0.8%	180.7%	9%	-	8	/EPS growth/Cash conv/
Character	CCT	250	47	8.5	7.6%	7.6%	-1.2%	-	-23.0%	-5%	-20	8	/Div cover/EPS growth/
Midwich	MIDW	274	286	9.9	6.0%	6.3%	-28.2%	2.2%	-	3%	-286	8	/EPS growth/Interest cover/
Helios Underwriting	HUW	208	151	5.7	2.9%	9.4%	6.6%	66.3%	-	9%	-	8	/Cash conv/Interest cover/
Van Elle	VANL	42	45	8.0	2.9%	3.5%	20.6%	36.6%	-	2%	-29	8	/fc DY < 3.5/ROE >12.5%/
Alumasc	ALU	308	111	10.1	3.5%	3.6%	10.5%	6.8%	5.8%	19%	-18	8	/EPS growth/Cash conv/
Fonix	FNX	218	216	19.6	3.8%	4.8%	0.9%	3.7%	20.7%	-6%	-27	8	/Div cover/EPS growth/
Keystone Law	KEYS	532	168	19.2	3.5%	3.6%	0.6%	2.3%	20.8%	-3%	-14	8	/Div cover/EPS growth/
Mortgage Advice Bureau	MAB1	724	420	17.3	3.9%	4.4%	20.9%	16.3%	-	-5%	-	8	/Div cover/EPS growth/

Source: FactSet and Investors' Chronicle

Investors' Chronicle Alpha dividend screen methodology

Large-cap

Shares are ranked first on the number of tests passed and then on a composite of their rank amongst large caps for trailing dividend yield and dividend coverage. We tabulate companies that pass at least seven of the nine tests below.

- **Compulsory test** – the NTM dividend yield above 3.5 per cent. This is the yield of current share price to the next twelve months of dividends per share (DPS) forecast by analysts (we take the median of forecasts from FactSet).
- No DPS cut in either of the last two complete fiscal years. This shows consistency and commitment to the dividend.
- Trailing 12-month dividend yield above 3 per cent. Again, a slightly arbitrary figure and deliberately modest to not prejudice the screen towards cyclical value traps.
- Dividend cover above 1.6x. This is earnings per share divided by dividend per share. This figure is chosen because it's the inverse of DPS/EPS not being more than 80 per cent.
- Earnings per share growth forecast in the current (unreported) and next financial years. This is to reassure us of growing profits from which to maintain the pay-out ratio.
- Operating cash conversion above 100 per cent. This is cash from operations divided by operating profit (both figures for last full FY) and shows how much hard cash the business operations are generating from which to support making payments to shareholders.
- Interest coverage ratio of more than 5x. This is how many times EBIT (Earnings before interest and tax) covers interest expense. A high figure demonstrates a company isn't

over-leveraged and can support its debt.

- Return on equity (ROE) above 12.5 per cent. This is net income divided by ordinary shareholders' equity. It is a measure of quality. ROE can be inflated by leverage, so it is important to assess this with an eye on the previous interest cover test.
- Beta below 0.9 – this is a stability test. We don't want super volatile stocks amongst our large cap income shares.

Mid-cap

Ranked first on number of tests passed, then on a composite of their rank amongst mid-caps for trailing dividend yield and dividend coverage. We tabulate companies that pass at least seven of the nine tests below. For mid-caps it is also **compulsory that they are in the top 100 mid-cap companies based on the div yield and div cover ranking.**

Compulsory test. No cut in dividend per share in either of the last two financial years.

- **Compulsory test.** Must have a trailing DY over 2 per cent.
- Forecast DY above 3.5 per cent. This isn't compulsory for mid-caps because we don't want to exclude companies that may grow into being good dividend payers.
- Dividend cover above 1.6x.
- EPS growth forecast for current (unreported) and next financial years PLUS last full year EPS is higher than two years previously.
- Operating cash conversion above 100 per cent.
- Interest cover above 5x.
- ROE above 12.5 per cent.
- Beta below 0.9.

Small-cap and Aim:

Ranked first on the number of tests passed, then on a composite of their rank amongst small caps/Aim stocks for trailing dividend yield and dividend coverage. We tabulate companies that pass at least eight of the ten tests below. For small caps or Aim companies it is also compulsory that they are in the top 100 small-cap or Aim companies based on the div yield and div cover ranking.

- **Compulsory test.** No cut in dividend per share in either of the last two financial years.
- **Compulsory test.** Trailing dividend yield must be in the top 2/3 of companies that pay dividends. There is an argument for screening out the very highest dividend yields as a safety measure, but we leave this up to judgement interpreting the screen.

- **Compulsory test.** Trailing dividend yield must not be in the top five per cent of companies that pay dividends. This is to guard against value traps.
- Forecast DY above 3.5 per cent. This isn't compulsory for small caps because we don't want to exclude companies that may grow into being good dividend payers.
- Dividend cover above 1.6x.
- EPS growth forecast for current (unreported) and next financial years PLUS last full year EPS is higher than two years previously.
- Operating cash conversion above 100 per cent.
- Interest cover above 5x.
- ROE above 12.5 per cent.
- Free cash flow is positive.

Universe rules:

UK main market – we start with all companies with a market cap above £35mn, of these:

- Biggest 85 per cent go into the 'large cap' bucket.
- Those below the fifteenth percentile but bigger than £250mn go into 'mid cap'.
- Those between £35mn and £250mn go into small caps.

Aim market is run separately but we ignore companies below £35mn.

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ISSN 0261-3115.