

## AlphaScreens: finding dividend diamonds

3 March 2022

### Rethinking UK equity income

*Dividends are an important source of returns and also a useful valuation measure that can be used to identify shares with the potential for capital growth. But it's important to screen out potential value traps when using yield as a guide.*

- Our new UK large-cap income shares screen is topped by **Royal Mail (RMG)**, which has seen its share price fall by almost a quarter in the past three months. Touted as something of a recovery story towards the end of last year, some of the froth in that story has undoubtedly been blown away. The company is still expected to have grown earnings significantly in its current financial year, but analysts are more muted with their full-year 2023 projections. Nonetheless, thanks to the recent selling, the median forecast of dividend per share currently implies a next 12-month yield of around 6 per cent. Growth expectations don't point to a rising pay-out, but what is on offer is better value than it was.
- Like all companies in the defence industry, **BAE Systems (BA.)** is very much in the public conscience for reasons that we all wish it wasn't given the tragedy in Ukraine. Steady, if unspectacular, earnings growth is forecast which underpins consensus for a slightly progressive dividend. BAE is rated on slightly over 14 times forecast next twelve months' earnings, and the dividend yield of around 3.5 per cent looks reliable, albeit for now it fails our test to be among those companies forecast to raise the dividend quickly.
- **Barclays (BARC)**, and the positivity analysts display towards its dividend prospects, looks interesting for income investors. Although buying into banks for the dividend is a real balancing act of potential risk factors. On the one hand, there is the mixed blessing of rising interest rates. That's good in the sense it helps banks make an increased net interest margin on loan business, but not if the economy tips into recession and more loans go bad. On the other hand, we have to assume there will be spill-over into the financial sector from a new global sanctions regime against Russia, one of the world's biggest energy producers.
- The house-building sector is another that could suffer if the impact of sanctions and rate rises is to tip the UK into recession. Still, there have been some interesting results in recent days and unsurprisingly, several housebuilders are ranking well on our Large and Mid-Cap screens. Robin Hardy's [full Alpha analysis](#) of the income prospects for the sector was written before the recent flurry of results, but is worth revisiting.

- Our small-cap screen, which filters through companies listed on the main market and on Aim, is topped by **Cake Box (CBOX)**, which is almost a perfect warning that screens are the starting point not the end of investment research. The company's share price has tanked in recent months after some very adverse comments by a financial blogger. The company acknowledged some inconsistencies between its 2021 annual report and results announcements, but maintained there was no material read-through to doubt its reported financial statements.

Although there isn't evidence that the Cake Box situation is at all similar, episodes like the Patisserie Valerie fraud live long in the memory for investors, which explains the sell-off. Should this all blow over, Cake Box shares are very cheap, given analyst forecasts for its operating performance are pretty good. Still, playing the market for deep value is very different to income investing, so for the purpose of our report, this isn't a stock to buy right now.

## New approach to UK income shares

We've had a rethink about our Alpha dividend yield screens. Previously we were screening the FTSE All-Share index for large-cap companies and the FTSE All-Small Companies index and the FTSE Aim All-Share index for small-cap stocks.

This created a problem, however. The FTSE All-Share is a big index and includes many companies that aren't large cap. There is actually an overlap in some constituents of the All-Share and All-Small indices. This means the results we were getting from our All-Share screen, although the criteria were designed for larger companies, often showed-up small ones.

For income investors, the challenge is to build a portfolio of companies with reliable cash flows and resilient quality, a track record of sustaining and growing dividends; and reasonable growth prospects to keep that up. To that end, while there are some gems further down the market cap scale, the core holdings should be large cap.

With that in mind we have re-jigged our UK equity income screens and made the split between genuine large-cap, mid-cap and small-cap (including Aim) stocks, to focus on each group separately. We're now splitting the universe for our screens according to the methodology of the Numis index family.

As ever, all screens are meant as a source of ideas and not off-the-shelf portfolios (certainly some of this month's results warrant scrutiny). With that important caveat, these suggestions for further research should give investors a better idea of what the UK market has to offer in terms of core and satellite holdings that could help construct an income portfolio.

## UK dividend screens criteria

Given the disruption to UK dividends caused by the coronavirus pandemic, we have taken a much more forward-looking approach to dividends in our new screen. We've changed the compulsory test from having a 12-month trailing dividend yield above the median (many shares that could legitimately be classed as income plays would have failed that after coronavirus), to having a 12-month average forecast dividend yield above the median. We keep the trailing test as a flag, but companies that fail it can be included in the results.

We've also added a test for companies to have a three-year forecast dividend per share growth rate above the median. Finally, although we're maintaining the criteria for small companies to have a market cap above £10mn to be considered, we're now keeping most tests for small and large companies the same. This is because we're copying some of the income growth focus previously given to smaller companies to the large-cap screens and because the new large cap only screen already acts to give a more appropriate selection of bigger companies.

- Next 12 months' forecast dividend yield above the median average.
- Forecast dividend per share growth above the median.
- Forecast average earnings per share growth above 5 per cent for the next two years and earnings per share growth in both years.
- Trailing 12-month dividend yield above the median.
- Dividend per share smoothed-out average growth rate for the past three years above 5 per cent.
- Earnings per share smoothed-out average growth rate for the past three years above 5 per cent.
- Trailing dividends per share covered at least one-and-a-half times by trailing earnings per share.
- Operating profit/earnings before interest and taxation (EBIT) covers interest expense at least five times.
- Trailing 12-month free cash flow after lease obligations is positive.

Companies that pass the forward dividend yield test are ordered by the number of tests passed and then how they rank based on a combination of trailing dividend yield and dividend cover (keeping the nod to their historic income reliability as well as expectations).

## UK large-cap income (passing at least 6 out of 8 tests)

Name	Share price TIDM (last close)	Mkt cp (£mn)	Fwd 12- mth PE	Trailing 12- mth DY	NTM fwd DY (median est.)	Fwd EPS gwth cur FY	Fwd EPS gwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 8)	Tests failed	Special div paid	Last 12-mth DY (inc. spec)
Royal Mail	RMG	388	3745	6.3	4.3%	6.1%	15.4%	2.2%	-24%	-11500	8	na	9.5%
Barratt Dev.	BDEV	565	5779	7.1	5.9%	7.0%	10.4%	0.0%	-20%	32.6	7	/Trail EPS grwth/	5.9%
ITV	ITV	106	4251	6.9	3.1%	5.4%	39.5%	0.6%	-7%	-736.0	7	/Trail EPS grwth/	3.1%
Taylor Wimpey	TW	141	5154	7.4	5.9%	7.2%	168.2%	7.6%	-13%	-187.9	7	/Trail EPS grwth/	5.9%
BAE Systems	BA	746	23459	14.8	3.4%	3.5%	5.2%	6.1%	35%	-5585.0	7	/FC DPS grwth/	3.4%
Imperial Brands	IMB	1642	15601	6.5	8.5%	8.7%	0.3%	5.6%	5%	-9521.0	6	/Fwd EPS grwth/FC DPS grwth/	8.5%
Barclays	BARC	173	29029	6.2	3.5%	4.6%	-24.7%	6.3%	-9%	-	6	/Fwd EPS grwth/Interest cov/	3.5%
Aviva	AV	407	15123	8.8	7.0%	6.3%	12.4%	16.8%	3%	-	6	/Trail EPS grwth/Interest cov/	7.0%
Intermediate Cap.	ICP	1611	4679	12.4	3.6%	4.4%	-8.2%	-11.5%	-26%	-	6	/Fwd EPS grwth/FC DPS grwth/	3.6%
Rio Tinto	RIO	5919	73941	8.3	9.8%	8.5%	-24.0%	-23.1%	26%	1964.6	6	/Fwd EPS grwth/FC DPS grwth/	12.8%
Anglo American	AAL	3956	52908	9.6	7.8%	4.6%	-22.1%	-15.4%	39%	-1098.6	6	/Fwd EPS grwth/FC DPS grwth/	7.8%
Mondi	MNDI	1468	7128	10.3	3.6%	4.1%	5.8%	18.7%	-18%	-893.3	6	/Trail EPS grwth/FC DPS grwth/	3.6%
Glencore	GLEN	445	58666	7.3	3.8%	7.5%	23.2%	-26.6%	20%	-33541.3	6	/Fwd EPS grwth/FC DPS grwth/	3.8%
GlaxoSmithKline	GSK	1545	78545	12.9	5.2%	3.4%	4.7%	6.7%	0%	-19335.0	6	/Div Cov/FC DPS grwth/	5.2%
Hargreaves Lansdown	HL	1088	5158	20.0	4.7%	3.7%	-19.4%	11.5%	-18%	-	6	/Fwd EPS grwth/Div Cov/	4.7%
DS Smith	SMDS	320	4402	9.0	4.0%	5.0%	26.5%	19.9%	-13%	-1643.0	6	/Trail EPS grwth/Div Cov/	4.0%
WPP	WPP	1005	11474	11.0	3.1%	3.7%	14.4%	12.8%	-6%	-12602.5	6	/Trail EPS grwth/Interest cov/	3.1%
St. James's Place	STJ	1306	7059	16.0	4.0%	4.6%	8.6%	12.4%	-18%	-	6	/Div Cov/Interest cov/	4.0%
Coca-Cola HBCAG	CCH	1773	6486	12.8	0.0%	3.6%	5.7%	10.3%	-26%	-721.6	6	/Trail DY/Div Cov/	0.0%

Sources: FactSet, Numis Large-Cap index, Investors' Chronicle

## UK mid-cap income (passing at least 6 out of 8 tests)

Name	TIDM	Share price (last close)	Mkt cap (£mn)	12-mth Fwd PE	Trailing 12- mth DY	NTM fwd DY (median est)	Fwd EPS gwth cur FY	Fwd EPS gwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 8)	Tests failed
IG Group	IGG	765.5	3304	8.8	5.6%	6.3%	-15.7%	4.0%	-2.2%	-	7	/Fwd EPS grwth/
Vistry	VTY	945.6	2102	6.7	4.2%	7.6%	12.1%	3.1%	-14.9%	-625.4	7	/Trail EPS grwth/
Sirius Real Estate Ltd	SRE	122.8	1439	17.1	2.8%	3.3%	42.4%	6.6%	-10.9%	-	7	/Trail DY/
Pets At Home	PETS	363.2	1816	15.1	2.7%	3.4%	62.0%	9.3%	-22.6%	-195.2	7	/Trail DY/
Liontrust Asset Mgmt	LIO	135.6	831	10.7	4.3%	5.3%	43.2%	11.9%	-41.0%	-	7	/Div Cov/
Britvic	BVIC	817.5	2189	14.4	3.0%	3.5%	23.7%	8.4%	-8.0%	-493.7	7	/Trail EPS grwth/
Inchcape	INCH	709	2705	12.1	3.2%	3.3%	3.4%	14.0%	-16.3%	-1145.6	7	/Div Cov/
Drax	DRX	648	2587	9.8	2.9%	3.2%	189.4%	40.8%	7.8%	-1915.5	7	/Div Cov/
Redrow	RDW	544.8	1919	5.9	5.2%	5.7%	26.0%	0.3%	-17.8%	-607.0	6	/Trail EPS grwth/FC DPS grwth/
Bellway	BWY	2739	3381	6.7	4.3%	4.9%	13.4%	4.2%	-13.8%	-611.8	6	/Trail EPS grwth/FC DPS grwth/
Ashmore	ASHM	240.8	1716	11.2	7.0%	7.0%	-35.3%	-4.0%	-19.6%	-	6	/Fwd EPS grwth/FC DPS grwth/
Crest Nicholson	CRST	286.2	735	7.1	2.9%	5.6%	15.8%	7.9%	-12.5%	-114.3	6	/Trail DY/Trail EPS grwth/
Morgan Sindall	MGNS	2315	1074	10.5	4.0%	4.2%	0.6%	4.8%	-3.5%	-658.3	6	/Fwd EPS grwth/FC DPS grwth/
Centamin	CEY	103.85	1201	16.0	4.8%	5.0%	-18.2%	20.0%	9.3%	160.2	6	/Fwd EPS grwth/Trail EPS grwth/
Man	EMG	192.75	2632	9.1	4.2%	5.5%	-28.5%	14.5%	-12.6%	-	6	/Fwd EPS grwth/Trail EPS grwth/
Rathbones	RAT	1602	994	9.4	5.1%	5.3%	1.3%	5.2%	-15.7%	-	6	/Fwd EPS grwth/FC DPS grwth/
Dunelm	DNLM	1181	2396	14.4	11.8%	3.7%	29.7%	0.3%	-13.7%	-107.3	6	/Div Cov/FC DPS grwth/
Morgan Adv Materials	MGAM	293	836	10.1	2.3%	3.3%	34.4%	13.2%	-20.2%	-131.9	6	/Trail DY/Trail EPS grwth/
HomeServe	HSV	671	2257	12.3	4.0%	4.7%	14.6%	12.2%	-25.9%	-365.4	6	/Trail EPS grwth/Div Cov/

Sources: FactSet, Numis Mid-Cap index, Investors' Chronicle

Small-cap UK income shares below

## UK small-cap and Aim income (passing at least 7 out of 8 tests)

Name	TIDM	Share price (last close)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	NTM Fwd DY (median est)	Fwd EPS gwth cur FY	Fwd EPS gwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 8)	Tests failed
Cake Box	CBOX	145	58	9.2	4.3%	5.3%	44.3%	15.1%	-60.9%	0.2	8	na
Brooks Macdonald	BRK	2400	389	12.4	2.6%	3.4%	14.6%	13.4%	-12.7%	-	8	na
Duke Royalty Ltd	DUKE	39	140	12.1	5.5%	7.3%	7.5%	24.1%	-8.8%	-	7	/Trail EPS grwth/
Caledonia Mining Corp	CMCL	891	118	3.9	3.8%	4.9%	7.8%	47.7%	-8.1%	6.7	7	/Trail EPS grwth/
Norcros	NXR	277	224	7.9	4.1%	3.5%	9.0%	3.5%	-10.1%	-75.8	7	/FC DPS grwth/
STV	STVG	325	152	7.5	3.0%	4.0%	7.0%	10.2%	-8.5%	-18.9	7	/Trail EPS grwth/
Wincanton	WIN	361	450	8.9	3.2%	3.7%	13.8%	9.1%	5.6%	-330.2	7	/FCF +ve/
RBG	RBGP	115	110	10.5	4.3%	5.7%	18.6%	18.8%	-0.4%	8.0	7	/Trail EPS grwth/
Springfield Properties	SPR	141	166	7.6	4.2%	5.0%	14.6%	18.6%	-3.8%	-71.5	7	/FCF +ve/
Epwin	EPWN	100	144	10.6	2.8%	4.8%	90.1%	22.8%	-6.9%	-65.9	7	/Trail EPS grwth/
Watkin Jones	WJG	235	602	12.1	3.5%	4.2%	5.3%	31.9%	-5.8%	26.8	7	/Trail EPS grwth/
Forterra	FORT	226	512	9.9	2.7%	5.3%	161.9%	29.4%	-10.7%	-41.2	7	/Trail EPS grwth/
Liontrust Asset Mgmt	LIO	1356	831	10.7	4.3%	5.3%	43.2%	11.9%	-41.0%	-	7	/Div Cov/
Up Global Sourcing	UPGS	172	154	11.9	2.9%	4.2%	31.6%	6.8%	-4.4%	-39.3	7	/FC DPS grwth/

Sources: FactSet, NSCI plus Aim, Investors' Chronicle

## New indices, a tighter set of ideas

Going forward, we're switching to screening in an equities universe inspired by the Numis family of UK indices. The aim is to give investors a true overview of genuine large-cap, mid-cap and small-cap quality shares.

We will also be excluding investment trusts from results. The purpose of these screens is to highlight individual companies that are worth investigating further. Including closed-end funds in the universe skews the results and distracts from that objective. Investment trusts are given their own, far more detailed, analysis in the regular Alpha Investment Trust report.

## Breakdown of the Numis indices we have been inspired by:

**Numis Large-Cap** index (excluding investment companies/trusts): This includes the top 80 per cent of companies by market capitalisation that are listed on the UK main market. The lower size cut-off for 2022 is **£4.12bn** market cap.

**Numis Mid-Cap** index (excluding investment companies/trusts): This includes the 15 per cent of UK main market listed companies below the top 80 per cent, but above the bottom 5 per cent by market capitalisation. The upper size cut-off is **£4.12bn** and the lower cut-off is **£880mn** market cap.

**NSCI plus Aim**, version excluding investment trusts: This adds all Aim companies below the **£1.64bn** market cap cut-off to the NSCI (Numis Small Companies Index), which is the bottom 10 per cent of main market companies by market cap.

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