

AlphaScreens: finding dividend diamonds

23 May 2022

Large cap yields in tougher times

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.

- Recessionary fears are mounting and the tide of cheap money that flooded financial markets in the pandemic is receding as central banks tighten monetary policy to combat inflation. It's no surprise therefore that earnings per share (eps) at private equity investment company **3i Group (III)** is expected to have halved year-on-year by the end of its current fiscal year. The climate both for earnings of its holding companies and for would-be disposals is worsening compared to last year. Still, aside from the current year expected eps growth 3i passes all our income tests and the median estimate is for a 4.1 per cent dividend yield from the current share price for the year ahead.
- Other companies still ranking well on our large cap screen include tobacco sin stocks **Imperial Brands (IMB)** and **British American Tobacco (BATS)**, which could have good defensive properties in a stagflationary period despite the longer term outlook being one of secular headwinds.
- Housebuilders **Barratt Developments (BDEV)** and **Taylor Wimpey (TW)** both have juicy trailing dividend yields, but how house prices and land values fare in a potential stagflationary environment, and with interest rates set to rise more quickly, will be crucial to the industry's prospects and for dividends.
- **Royal Mail Group (RMG)** is looking ahead to tougher times after its brief renaissance in the parcel boom of the pandemic. The share price has come off since the turn of the year and the old problems of industrial relations strife are resurfacing over plans to be more competitive. The dividend yield remains attractive even excluding special payments. Analysts' expectations for the forward yield suggest they aren't too worried about the ordinary dividend at this stage and possibly the higher forward yield can be taken as a sign the jitters over the short-term have been fully punished by the share price falls this year.
- As in the last few months, Russian-linked miner **Polymetal (POLY)** remains one to be wary of despite the fat yield.

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).

May Alpha dividend yield screen results are below:

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

Name	Share price Ticker (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	Special div paid (inc specials)	Trailing DY
3i Group	III	1221.5	11888	5.8	3.8%	4.1%	-50.4%	16.1%	-7%	-	7 /Fwd EPS grwth/	-	3.8%
Imperial Brands	IMB	1790.5	17017	6.6	7.8%	8.1%	5.0%	6.8%	1%	-9521.0	7 /FC DPS grwth/	-	7.8%
Barratt Developments	BDEV	488.9	4999	6.1	6.8%	8.3%	9.4%	1.5%	-19%	32.6	7 /Trail EPS grwth/	-	6.8%
Taylor Wimpey	TW	127.25	4540	6.5	6.7%	7.3%	5.4%	7.9%	-14%	-114.1	7 /Trail EPS grwth/	-	6.7%
BAE Systems	BA	748.6	23626	14.3	3.4%	3.6%	7.7%	6.7%	25%	-5585.0	7 /FC DPS grwth/	-	3.4%
Polymetal Int'l	POLY	241.5	1144	1.5	13.5%	5.6%	-11.9%	-4.1%	-79%	-368.4	6 /Fwd EPS grwth/FC DPS grwth/	-	13.5%
Royal Mail	RMG	315.4	3016	6.6	5.3%	6.6%	-21.7%	14.5%	-25%	-1150.0	6 /Fwd EPS grwth/Trail EPS grwth/	YES	11.6%
Kingfisher	KGF	246.8	4977	8.7	5.0%	5.0%	-19.1%	3.0%	-24%	-2293.0	6 /Fwd EPS grwth/FC DPS grwth/	-	5.0%
Anglo American	AAL	3523.5	47130	6.9	6.1%	6.5%	0.8%	-17.1%	0%	-1098.6	6 /Fwd EPS grwth/FC DPS grwth/	YES	8.8%
Tritax Big Box REIT	BBOX	202	3775	25.8	3.3%	3.5%	-8.7%	11.2%	-11%	-	6 /Fwd EPS grwth/Interest cov/	-	3.3%
Intermediate Capital	ICP	1396	4056	10.9	4.1%	5.4%	-9.8%	-10.6%	-20%	-	6 /Fwd EPS grwth/FC DPS grwth/	-	4.1%
Rio Tinto	RIO	5449	68073	6.2	10.6%	11.4%	-0.5%	-25.7%	-4%	1964.6	6 /Fwd EPS grwth/FC DPS grwth/	YES	13.9%
Schroders Non Voting	SDRC	2375	7725	10.3	5.1%	5.2%	-6.5%	7.1%	19%	-	6 /Fwd EPS grwth/FC DPS grwth/	-	5.1%
Schroders	SDR	2824	7725	12.2	4.3%	4.4%	-6.7%	7.2%	-13%	-	6 /Fwd EPS grwth/FC DPS grwth/	-	4.3%
British American Tobacco	BATS	3430.5	77875	9.4	7.9%	6.8%	7.5%	9.4%	1%	-11879.0	6 /Trail EPS grwth/Div Cov/	-	7.9%
Smurfit Kappa	SKG	3096	8056	10.5	4.2%	3.7%	26.0%	4.7%	-24%	-1643.9	6 /Trail EPS grwth/FC DPS grwth/	-	4.2%
WPP	WPP	960.6	10546	9.9	3.2%	4.1%	18.1%	12.4%	-19%	-12602.5	6 /Trail DY/Trail EPS grwth/	-	3.2%
St. James's Place	STJ	1235	6708	15.2	4.2%	4.9%	5.6%	11.3%	-19%	-	6 /Div Cov/Interest cov/	-	4.2%

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

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

Name	Share price Ticker (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	Trailing DY
Ferrexpo	FXPO	171	1007	2.9	22.6%	14.7%	-43.4%	-27.2%	-38.1%	-44.9	7 /Fwd EPS grwth/	-
TBC Bank	TBCG	1320	728	3.1	7.2%	10.2%	20.7%	11.2%	-12.0%	-	7 /Interest cov/	-
Bellway	BWY	2283	2819	5.5	5.6%	6.4%	18.4%	0.1%	-22.2%	-611.8	7 /Trail EPS grwth/	-
IG Group	IGG	711	3068	8.0	6.1%	7.2%	-9.5%	-1.6%	-8.6%	-	7 /Fwd EPS grwth/	-
Vistry	VTY	834	1854	5.9	7.2%	8.8%	12.0%	2.9%	-17.3%	-590.2	7 /FC DPS grwth/	-
Synthomer	SYNT	309	1444	7.8	9.7%	5.1%	-49.1%	10.9%	3.7%	-58.2	7 /Fwd EPS grwth/	-
Crest Nicholson	CRST	243.2	625	5.9	5.6%	6.8%	16.8%	6.8%	-22.8%	-114.3	7 /Trail EPS grwth/	-
Man	EMG	236.1	3138	9.1	4.6%	5.2%	-12.3%	5.9%	23.1%	-	7 /Fwd EPS grwth/	-
Pets At Home	PETS	279	1395	12.0	3.5%	4.3%	60.6%	4.9%	-25.8%	-195.2	7 /Trail EPS grwth/	-
Bodycote	BOY	628.5	1203	13.9	3.2%	3.4%	18.8%	16.2%	-18.1%	-223.7	7 /Trail EPS grwth/	-
RHI Magnesita NV	RHIM	2424	1139	5.7	5.3%	6.0%	9.2%	9.3%	-24.1%	-525.6	6 /FCF +ve/FC DPS grwth/	-
OSB	OSB	511	2273	5.9	5.1%	5.7%	-3.3%	9.6%	-3.0%	-	6 /Fwd EPS grwth/Interest cov/	-
Paragon Banking	PAG	468.2	1137	7.2	5.6%	5.6%	3.9%	9.0%	-14.9%	-	6 /Interest cov/FCF +ve/	-
Ashmore	ASHM	223	1589	11.4	7.6%	7.6%	-37.7%	-9.6%	-18.0%	-	6 /Fwd EPS grwth/FC DPS grwth/	-
Grafton	GFTU	877	2084	10.5	3.5%	3.6%	-9.3%	-3.1%	-18.3%	266.0	6 /Fwd EPS grwth/FC DPS grwth/	-
Vesuvius	VSVS	344.6	935	7.7	6.2%	6.3%	20.0%	13.8%	-18.1%	-353.9	6 /Trail EPS grwth/FC DPS grwth/	-
Travis Perkins	TPK	1145	2406	9.8	3.3%	3.8%	8.8%	3.7%	-18.2%	-565.4	6 /Trail EPS grwth/FC DPS grwth/	-
Morgan Sindall	MGNS	1892	878	8.5	4.9%	5.3%	0.2%	5.1%	-11.0%	-658.3	6 /Fwd EPS grwth/FC DPS grwth/	-
Sirius Real Estate Ltd	SRE	113.8	1334	14.4	3.0%	3.8%	57.8%	4.9%	-9.8%	-	6 /Trail DY/Trail EPS grwth/	-
Centamin	CEY	83.46	965	10.0	8.3%	5.4%	23.2%	10.6%	-12.3%	93.9	6 /Div Cov/FC DPS grwth/	-
Rathbones	RAT	2045	1274	12.6	4.0%	4.2%	-3.3%	1.6%	14.6%	-	6 /Fwd EPS grwth/FC DPS grwth/	-
Liontrust Asset Mgmt	LIO	1050	682	8.9	5.5%	6.6%	4.4%	7.9%	-31.5%	-	6 /Trail EPS grwth/Div Cov/	-
Contour Global	GLO	256	1679	24.2	5.1%	6.3%	61.2%	1.5%	39.6%	-626.2	6 /Div Cov/Interest cov/	-
Telecom Plus	TEP	1622	1282	22.2	3.5%	3.9%	5.8%	18.6%	10.0%	-127.6	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	Ticker	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
SThree	STEM	360	481	10.2	3.1%	3.4%	8.6%	10.8%	-24.1%	-160.9	8	na
TBC Bank	TBCG	1320	728	3.1	7.2%	10.2%	20.7%	11.2%	-12.0%	-	7	/Interest cov/
Duke Royalty	DUKE	36	130	10.6	5.9%	8.4%	18.5%	16.3%	-11.6%	-	7	/Trail EPS grwth/
Luceco	LUCE	128	206	7.6	6.3%	4.9%	-21.3%	19.7%	-49.2%	-63.3	7	/Fwd EPS grwth/
S&U	SUS	2220	270	8.2	5.7%	6.1%	-15.1%	7.4%	-14.6%	-	7	/Fwd EPS grwth/
Mission	TMG	62	56	8.3	3.9%	4.3%	9.2%	14.1%	0.8%	-32.3	7	/Trail EPS grwth/
Springfield Properties	SPR	133	157	6.9	4.5%	5.5%	14.6%	18.6%	-11.7%	-71.5	7	/FCF +ve/
Forterra	FORT	239	530	10.3	4.2%	5.3%	25.6%	13.9%	-4.6%	-49.3	7	/Trail EPS grwth/
Morgan Adv. Materials	MGAM	292	833	9.6	3.1%	3.4%	10.7%	5.3%	-6.0%	-100.5	7	/FC DPS grwth/
RBG Holdings	RBGP	99	94	9.5	5.1%	6.5%	13.8%	18.1%	-21.2%	-11.5	7	/FC DPS grwth/
Argentex	AGFX	77	87	8.0	3.6%	3.7%	25.4%	25.7%	-4.0%	-	7	/Trail EPS grwth/
Watkin Jones	WJG	227	581	11.0	3.6%	4.6%	5.4%	31.9%	-6.2%	26.8	7	/Trail EPS grwth/
Cake Box	CBOX	195	78	11.9	3.2%	4.1%	48.5%	12.9%	17.5%	0.2	7	/Trail EPS grwth/
Breedon	BREE	68	1145	10.5	2.4%	3.3%	29.9%	1.0%	-22.7%	-195.2	7	/Trail DY/
MTI Wireless Edge	MWE	64	57	19.0	3.3%	3.9%	5.8%	7.3%	15.3%	0.0	7	/Div Cov/
Mortgage Advice Bureau	MAB1	940	536	18.0	3.0%	4.2%	20.6%	45.1%	-21.3%	-	7	/Div Cov/

Sources: FactSet, NSCI plus Aim, Investors' Chronicle

A tighter set of ideas

We now screen from 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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