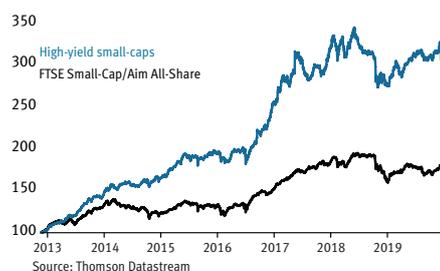




# AlphaScreens: Finding dividend diamonds

*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*

## High-yield small-caps



## Safe yields (large-caps)



### Algy Hall's view:

Investors neglect dividends at their peril. Over the 25 years to the end of 2019, the average annual return from the FTSE All-Share based on share price alone stood at 4.15 per cent, compared with a 7.4 per cent total return once dividends are factored in. And the benefit of reinvesting dividends over the long term makes the difference even more pronounced, with the 25-year cumulative total return from the FTSE All-Share standing at 497 per cent, compared with 176 per cent ignoring dividends. As well as providing income, a good yield can suggest a company has attractive qualities that could support share price performance, and a robust dividend record can indicate a company in good financial health with a strong and stable business.

### Foreword by Alpha Editor:

- For the second month running, no FTSE All-Share companies pass all eight of our quality high-yielder tests designed for larger companies. There is a real risk of falling into value traps just looking at dividend yield, but even some of our quality tests are rendered less effective thanks to the severity of the coronavirus crisis, so investors should ask themselves further questions.
- **Sirius Real Estate (SRE)**, a Reit focussed on commercial property and flexible workspace in Germany, only fails our beta test, but beware profits are coming under pressure thanks to coronavirus lockdown.
- Several recruiters rank highly, but these should be avoided for now, as we are on the precipice of a major recession.
- Of the very large companies that rank highly, questions to ask include whether the Bank of England's monetary policy response to coronavirus will hurt insurer **Aviva's (AV.)** product profitability and therefore its dividend policy? Will miner **Rio Tinto (RIO)** be able to maintain its bumper payout? For how long can tobacco giant **Imperial Brands (IMB)** support a poorly covered dividend?

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### **Large-cap dividend diamonds criteria**

Our large-cap screen is tilted towards companies that show signs of having stable prospects associated with dividend staying power. To help assess this, we use a measure of historic share price volatility against the wider market called beta. Betas of below one indicate that a stock has been less sensitive to market movements and suggest it could boast some defensive qualities. The large-cap Alpha dividend yield screen is conducted on all FTSE All-Share stocks using the following criteria:

- A dividend yield higher than the median (mid-rank) average of all dividend-paying shares screened.
- Dividend covered at least twice by earnings.
- Earnings growth forecast in each of the next two financial years (ie dividend cover is not expected to dramatically fall).
- Operating cash conversion of 100 per cent or more (ie earnings are being tuned into cash with which to pay dividends).
- Interest payments covered at least five times by operating profits (ie interest payments on borrowings are not likely to be a significant threat to maintaining dividend cover).
- Return on equity of 12.5 per cent or more (i.e. an indicator that the business may be of decent quality [if the interest cover test is also met, it suggests high returns on equity are not overly dependent on high debt levels]).
- A beta of 0.75 or lower.
- No dividend cut in the past three years.

Not many stocks pass such a stringent list of criteria. The ones that pass all the tests are listed at the top of the table, followed by those failing one test, then those failing two tests as detailed in the 'Tests passed' column. All stocks must pass the dividend yield test to feature in the table that follows. Special dividends are included in the yield calculation used by the screen, and where a special dividend has been paid, it is highlighted in the table's 'Special dividend' column. While the primary ranking of the stocks is based on the number of tests they pass, inside each of these groupings, stocks are ordered according to their attractiveness based on a combination of dividend yield and dividend cover.

### **Small-cap dividend diamonds criteria**

The small-cap Alpha dividend yield screen is more growth-focused than our large-cap screen, and is conducted separately on the FTSE All-Small and FTSE Aim All-Share indices, with the results presented in two separate tables. While the screen's dividend yield test is more aggressive than the one used by our large-cap screen, the lower average yields from small-caps mean little difference in the absolute level of yield both screens require. The screen uses the following criteria:

- A dividend yield among the top third of all dividend-paying shares screened.
- Dividend covered at least one-and-a-half times by earnings.
- Earnings growth forecast in each of the next two financial years and average growth of 5 per cent or more (ie rising earnings to support dividend growth and maintain or improve dividend cover).
- Positive free cash flow (ie a weak test that earnings are turned into cash with which to pay dividends).
- Interest payments covered at least five times by operating profits (ie interest payments on borrowings are not likely to be a significant threat to maintaining dividend cover).
- A three-year compound annual dividend growth rate of 5 per cent or more.
- A three-year compound annual earnings growth rate of 5 per cent or more.
- A market capitalisation of more than £10m (ie not severely illiquid).

Not many stocks pass such a stringent list of criteria. The ones that pass all the tests are listed at the top of the table that follows, followed by those failing one test, then those failing two tests as detailed in the 'Tests passed' column. All stocks must pass the dividend yield test to feature in the table. Special dividends are included in the yield calculation used by the screen, and where a special dividend has been paid this highlighted in the table's 'Special dividend' column. While the primary ranking of the stocks is based on the number of tests they pass, inside each of these groupings, stocks are ordered according their attractiveness based on a combination of dividend yield and dividend cover.

*Stock screen methodology formulated and explained by Algy Hall*

**Large-cap dividend diamonds selection (passing at least 6 out of 8 tests)**

Name	TIDM	Market cap	Price	Fwd NTM PE	Dividend yield	EPS grth FY+1	EPS grth FY+2	3-month momentum	Net cash/debt (-)	Currency	Test Failed	Special dividend	Tests passed (out of 8)
Sirius Real Estate	LSE:SRE	£631m	61p	13	5.1%	8.4%	10.9%	-32.5%	-278m	EUR	/Beta	NO	7
Forterra	LSE:FORT	£330m	166p	7	6.9%	-8.7%	8.0%	-53.6%	-57m	GBP	/EPSGrth/	NO	7
Robert Walters	LSE:RWA	£225m	313p	11	5.0%	-40.0%	43.0%	-44.9%	10m	GBP	/EPSGrth/	NO	7
Reach	LSE:RCH	£267m	90p	3	7.3%	-16.5%	5.4%	-35.1%	20m	GBP	/EPSGrth/CashConv/	NO	6
Hays	LSE:HAS	£1,544m	92p	11	10.2%	-30.4%	-7.7%	-48.7%	-215m	GBP	/EPSGrth/Beta	YES	6
PageGroup	LSE:PAGE	£889m	280p	12	9.4%	-25.1%	28.1%	-46.3%	-31m	GBP	/EPSGrth/Beta	YES	6
The Law Debenture Corp.	LSE:LWDB	£532m	450p	-	5.8%	-	-	-30.1%	-44m	GBP	/EPSGrth/CashConv/	NO	6
Aviva	LSE:AV	£9,159m	234p	4	13.2%	-11.8%	10.0%	-44.3%	9,913m	GBP	/EPSGrth/Beta	NO	6
JPMorgan Claverhouse IT	LSE:JCH	£293m	512p	-	5.7%	-	-	-33.9%	-41m	GBP	/EPSGrth/CashConv/	NO	6
Hollywood Bowl	LSE:BOWL	£221m	147p	16	8.1%	-35.5%	53.6%	-46.2%	-2m	GBP	/EPSGrth/Beta	YES	6
Norcros	LSE:NXR	£101m	125p	4	6.7%	-5.0%	13.2%	-54.7%	-71m	GBP	/EPSGrth/Beta	NO	6
JPMorgan Global Grth & Inc.	LSE:JGGI	£381m	273p	-	4.8%	-	-	-21.8%	7m	GBP	/EPSGrth/CashConv/	NO	6
S&U	LSE:SUS	£181m	1,493p	6	7.9%	3.8%	9.2%	-28.2%	-126m	GBP	/IntCov/CashConv/	NO	6
STV Group	LSE:STVG	£116m	297p	6	7.1%	13.6%	8.1%	-28.3%	-50m	GBP	/RoE/CashConv/	NO	6
Vivo Energy	LSE:VVO	£778m	65p	7	4.7%	-0.1%	19.5%	-46.7%	-208m	USD	/DivGrth/EPSGrth/	NO	6
Morgan Advanced Materials	LSE:MGAM	£508m	179p	8	6.2%	-17.5%	8.8%	-42.7%	-221m	GBP	/DivGrth/EPSGrth/	NO	6
Rio Tinto	LSE:RIO	£63,016m	3,761p	9	9.3%	-20.9%	-18.3%	-16.5%	-3,476m	USD	/DivCov/EPSGrth/	YES	6
Mondi	LSE:MNDI	£5,930m	1,224p	10	6.0%	-20.6%	11.7%	-30.8%	-2,202m	EUR	/EPSGrth/Beta	NO	6
Wm Morrison	LSE:MRW	£4,440m	186p	14	4.7%	4.3%	4.5%	-6.7%	-2,459m	GBP	/IntCov/RoE/	YES	6
Imperial Brands	LSE:IMB	£14,665m	1,564p	6	13.2%	-4.1%	3.9%	-18.7%	-11,350m	GBP	/DivCov/EPSGrth/	NO	6
Clipper Logistics	LSE:CLG	£167m	164p	10	5.9%	20.0%	7.9%	-42.7%	-250m	GBP	/DivCov/IntCov/	NO	6
Vitec	LSE:VTC	£293m	644p	13	6.1%	-37.2%	49.7%	-41.5%	-96m	GBP	/DivCov/EPSGrth/	NO	6

Source: S&amp;P Capital IQ, 6 April 2020

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**FTSE All-Small dividend diamonds selection (passing at least 6 out of 8 tests)**

Name	TIDM	Market cap	Price	Fwd NTM PE	Dividend yield	EPS grth FY+1	EPS grth FY+2	3-month momentum	Net cash/debt (-)	Currency	Test failed	Special dividend	Tests passed (out of 8)
STV	LSE:STVG	£116m	297p	6	7.1%	13.6%	8.1%	-28.3%	-50m	GBP	na	NO	8
Reach	LSE:RCH	£267m	90p	3	7.3%	-16.5%	5.4%	-35.1%	20m	GBP	/FwdEPSGrth/	NO	7
UP Global Sourcing	LSE:UPGS	£32m	41p	5	9.9%	3.0%	5.2%	-55.2%	-14m	GBP	/FwdEPSGrth/	NO	7
Hollywood Bowl	LSE:BOWL	£221m	147p	16	8.1%	-35.5%	53.6%	-46.2%	-2m	GBP	/FwdEPSGrth/	YES	7
City of London Investment	LSE:CLIG	£77m	310p	8	8.7%	13.8%	1.1%	-27.9%	11m	GBP	/DivCov/	NO	7
BlackRock Latin Am. IT	LSE:BRLA	£102m	261p	-	10.9%	-	-	-47.1%	-25m	USD	/FwdEPSGrth/EPGrth/	NO	6
Norcros	LSE:NXR	£101m	125p	4	6.7%	-5.0%	13.2%	-54.7%	-71m	GBP	/FwdEPSGrth/EPGrth/	NO	6
S&U	LSE:SUS	£181m	1,493p	6	7.9%	3.8%	9.2%	-28.2%	-126m	GBP	/IntCov/FCF/	NO	6
SThree	LSE:STEM	£264m	206p	11	7.4%	-40.4%	16.4%	-43.5%	11m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Record	LSE:REC	£58m	30p	11	10.1%	-10.8%	-10.9%	-24.1%	22m	GBP	/FwdEPSGrth/DivCov/	YES	6
GCP Asset Backed Inc. Fund	LSE:GABI	£331m	75p	-	8.6%	-	-	-31.2%	453m	GBP	/FwdEPSGrth/DivCov/	NO	6

Source: S&P Capital IQ, 6 April 2020

**Aim dividend diamonds selection (passing at least 6 out of 8 tests)**

Name	TIDM	Market cap	Price	Fwd NTM PE	Dividend yield	EPS grth FY+1	EPS grth FY+2	3-month momentum	Net cash/debt (-)	Currency	Test failed	Special dividend	Tests passed (out of 8)
STM	AIM:STM	£14m	24p	4	8.5%	6.1%	6.5%	-2.1%	15m	GBP	na	NO	8
Finsbury Food	AIM:FIF	£76m	60p	6	5.9%	6.7%	2.9%	-39.9%	-44m	GBP	/FwdEPSGrth/	NO	7
MTI Wireless Edge	AIM:MWE	£24m	28p	-	5.9%	-	-	-32.1%	7m	USD	/FwdEPSGrth/	NO	7
Polar Capital	AIM:POLR	£341m	366p	10	9.0%	-21.3%	-20.0%	-34.6%	120m	GBP	/FwdEPSGrth/	NO	7
Watkin Jones	AIM:WJG	£360m	142p	8	5.9%	6.2%	5.4%	-42.3%	77m	GBP	/EPGrth/	NO	7
Trans-Siberian Gold	AIM:TSG	£53m	61p	-	11.1%	-	-	-29.5%	-10m	USD	/FwdEPSGrth/DivGrth/	YES	6
RTC	AIM:RTC	£6m	39p	-	10.7%	-	-	-35.0%	-6m	GBP	/FwdEPSGrth/MktCap/	NO	6
Wynnstay	AIM:WYN	£40m	203p	6	6.9%	0.3%	5.9%	-35.0%	4m	GBP	/FwdEPSGrth/EPGrth/	NO	6
ULS Technology	AIM:ULS	£25m	39p	7	6.5%	-17.4%	-	-42.5%	-5m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Vianet Group	AIM:VNET	£22m	77p	7	7.4%	31.3%	-10.1%	-52.0%	-1m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Rotala	AIM:ROL	£14m	27p	-	10.0%	-	-	-50.9%	-35m	GBP	/FwdEPSGrth/IntCov/	NO	6
Somero Enterprises	AIM:SOM	£101m	180p	6	8.5%	-5.0%	2.7%	-35.4%	22m	USD	/FwdEPSGrth/DivCov/	NO	6
Highland Gold Mining	AIM:HGM	£747m	205p	8	6.0%	91.6%	-1.5%	1.9%	-217m	USD	/FwdEPSGrth/DivCov/	NO	6
Frenkel Topping	AIM:FEN	£17m	24p	-	5.4%	-	-	-33.3%	1m	GBP	/FwdEPSGrth/DivCov/	NO	6

Source: S&P Capital IQ, 6 April 2020

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