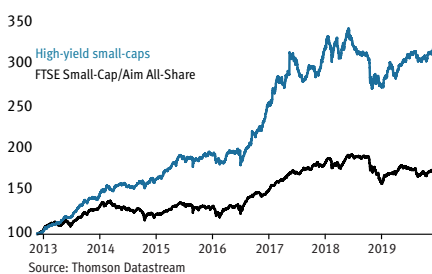




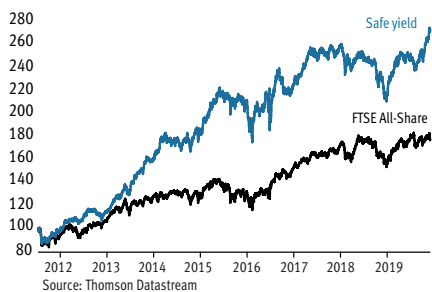
# AlphaScreens: Finding dividend diamonds

*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:

■ Debate is raging whether lockdowns are vital to slow coronavirus or if they are just short term gain (in terms of stopping health services being overwhelmed – the number of deaths is still horrific), for the sake of long-term pain and prolonging the economic damage and ultimately suffering a higher number of deaths.

■ Germany has announced strict new measures, which will presumably be material for the top-ranking company on our dividend yield screen this month, **Sirius Real Estate (SRE)**, which is focussed on German commercial property. A reminder the virus trumps stock screens.

■ Of the largest companies, miners **Rio Tinto (RIO)** and **BHP Group (BHP)** have enticing dividend yields, as does defence and aerospace business **BAE Systems (BA)**, but investors should take note of the tests they fail, especially with the worsening economic backdrop.

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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(-)	Cur	Test failed	Special dividend	Tests passed (out of 8)
Sirius Real Estate	SRE	£769m	74p	13	4.2%	8.2%	18.6%	-6.8%	335m	EUR	na	NO	8
Polymetal Int'l	POLY	£7,870m	1,668p	8	3.9%	79.2%	26.2%	-12.2%	1,398m	USD	na	NO	8
Temple Bar IT	TMPL	£463m	692p	-	7.4%	-	-	-5.6%	103m	GBP	/FwdEPSGrth/	NO	7
Ferrexpo	FXPO	£1,069m	182p	4	8.6%	2.4%	-26.3%	-1.6%	141m	USD	/FwdEPSGrth/	NO	7
Severfield	SFR	£164m	53p	9	5.4%	-29.5%	24.9%	-7.6%	-5m	GBP	/FwdEPSGrth/	NO	7
S&U	SUS	£203m	1,673p	11	6.5%	-49.3%	33.9%	3.6%	109m	GBP	/FwdEPSGrth/	NO	7
Apax Global Alpha	APAX	£786m	160p	-	6.0%	-	-	2.8%	-31m	EUR	/FwdEPSGrth/	NO	7
IG Group Holdings	IGG	£2,788m	753p	13	5.7%	-11.0%	-4.2%	1.5%	-498m	GBP	/FwdEPSGrth/	NO	7
CMC Markets	CMCX	£933m	321p	10	4.7%	57.3%	-54.0%	-1.5%	-89m	GBP	/FwdEPSGrth/	NO	7
Investec	INVP	£1,055m	152p	5	7.3%	45.8%	26.9%	-5.8%	5,102m	GBP	/DivGrth/IntCov/	NO	6
Centamin	CEY	£1,419m	123p	11	7.6%	64.9%	6.4%	-40.8%	-260m	USD	/EPSGrth/DivCov/	NO	6
City of London Inv.	CLIG	£200m	394p	9	7.6%	49.0%	11.0%	-4.4%	-13m	GBP	/EPSGrth/DivCov/	NO	6
Rio Tinto	RIO	£53,184m	4,266p	9	7.0%	3.1%	-3.7%	-10.5%	6,352m	USD	/FwdEPSGrth/DivCov/	NO	6
BAE Systems	BA	£13,307m	414p	9	5.6%	-6.5%	14.8%	-14.6%	3,386m	GBP	/FwdEPSGrth/DivGrth/	NO	6
BHP Group	BHP	£31,516m	1,492p	10	6.3%	20.3%	-11.8%	-13.2%	10,995m	USD	/FwdEPSGrth/DivCov/	NO	6
Berkeley Group	BKG	£5,015m	4,001p	12	5.2%	2.1%	5.8%	-14.8%	-1,136m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
CLS Holdings	CLI	£786m	193p	16	3.8%	-1.8%	5.8%	-0.7%	719m	GBP	/FwdEPSGrth/IntCov/	NO	6
Moneysupermarket.com	MONY	£1,299m	242p	16	4.8%	-28.5%	20.5%	-21.3%	-8m	GBP	/FwdEPSGrth/DivCov/	NO	6
Stock Spirits	STCK	£428m	214p	12	3.7%	45.3%	2.7%	-4.7%	38m	EUR	/DivGrth/EPSGrth/	NO	6
Wm Morrison Supermarkets	MRW	£3,993m	166p	11	4.2%	7.0%	5.6%	-11.1%	2,785m	GBP	/EPSGrth/IntCov/	NO	6
Hargreaves Lansdown	HL	£6,512m	1,373p	26	4.0%	-9.3%	-3.2%	-20.8%	-443m	GBP	/FwdEPSGrth/DivCov/	NO	6
RM	RM	£145m	173p	11	4.6%	-60.5%	55.3%	-21.4%	20m	GBP	/FwdEPSGrth/DivCov/	NO	6
Morgan Sindall	MGNS	£512m	1,110p	8	5.3%	-42.8%	64.1%	2.6%	-91m	GBP	/FwdEPSGrth/DivCov/	NO	6

Source: FactSet, 29 October 2020

**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(-)	Cur	Test failed	Special dividend	Tests passed (out of 8)
Temple Bar IT GBP	TMPL	£463m	692p	-	7.4%	-	-	-5.6%	103m	GBP	/FwdEPSGrth/	NO	7
S&U	SUS	£203m	1,673p	11	6.5%	-49.3%	33.9%	3.6%	109m	GBP	/FwdEPSGrth/	NO	7
City of London Inv.	CLIG	£200m	394p	9	7.6%	49.0%	11.0%	-4.4%	-13m	GBP	/EPSGrth/DivCov/	NO	6

Source: FactSet, 29 October 2020

Continued on the next page

### 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(-)	Cur	Test failed	Special dividend	Tests passed (out of 8)
Belvoir Group	BLV	£45m	128p	8	4.2%	14.0%	6.1%	-1.5%	6m	GBP	/DivGrth/	NO	7
Pan African Resources	PAF	£372m	19p	4	3.4%	199.9%	-3.9%	-26.6%	53m	USD	/FwdEPSGrth/	NO	7
K3 Capital Group	K3C	£103m	150p	11	5.0%	-6.8%	40.4%	8.3%	-7m	GBP	/FwdEPSGrth/	NO	7
Polar Capital Holdings	POLR	£500m	508p	11	6.5%	12.0%	10.6%	2.6%	-141m	GBP	/DivCov/	NO	7
Tatton Asset Mgmt	TAM	£154m	272p	19	3.5%	9.3%	18.5%	-4.2%	-12m	GBP	/DivGrth/	NO	7
Anglo Asian Mining	AAZ	£126m	110p	-	6.4%	-	-	-27.6%	-21m	USD	/FwdEPSGrth/DivGrth/	NO	6
NWF Group	NWF	£98m	200p	11	3.5%	-15.8%	4.6%	1.0%	39m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Somero Enterprises, Inc.	SOM	£132m	235p	13	8.3%	-36.2%	-	0.4%	-22m	USD	/FwdEPSGrth/DivCov/	NO	6
STM Group	STM	£15m	26p	5	5.0%	-50.4%	89.3%	-1.9%	-15m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Trans-Siberian Gold	TSG	£105m	96p	5	8.3%	108.8%	33.2%	-5.9%	7m	USD	/DivGrth/DivCov/	NO	6
Jarvis Securities	JIM	£87m	793p	-	4.0%	-	-	22.9%	-3m	GBP	/FwdEPSGrth/DivCov/	NO	6

Source: FactSet, 29 October 2020

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