investors CHRONICLE alpha

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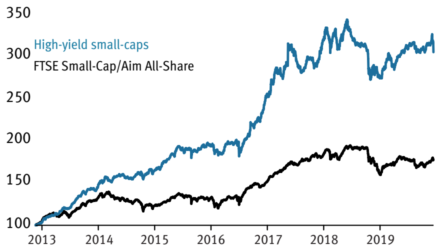
AlphaScreens: Finding dividend diamonds

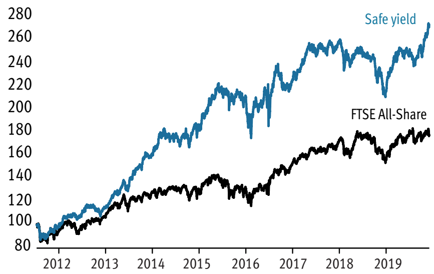
Dividends are an important source of returns and also a useful valuation measure that can be used to identify shares with the potential for capital growth. But it's important to screen out potential value traps when using yield as a guide

High-yield small-caps



Source: Thomson Datastream

Safe yields (large-caps)



Source: Thomson Datastream

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:

- With income hard to come by in 2020, the 8.8 per cent yield offered by iron ore pellet producer **Ferrexpo (FXPO)** leaps out on our dividend screen. The share price has defied concerns about some large shareholders this year, but this company is a reminder to do your homework before chasing dividends. It's reassuring that the company scores 7/8 on our screen.
- Online trading firms **IG Group (IGG)** and **CMC Markets (CMCX)** also offer attractive yields, and they both only fall short on our forward EPS growth target, although with volatility likely in financial markets for the remainder of 2020, they should have more time to make hay.
- Pharma giant **GlaxoSmithKline (GSK)** yields 5.6 per cent and passes 6/8 tests. Miners **Rio Tinto (RIO)**, which yields 6.2 per cent, and **BHP Group (BHP)**, on 5.6 per cent, pass 6/8.
- Defence and aerospace business **BAE Systems (BA.)** is another in the 6/8 club. Its dividend yield is 4.6 per cent. Investors might also want to consider what M&A strategies companies could consider next year. Rumours of an approach for **Rolls-Royce (RR.)** may make strategic sense, but income investors will want to think about the short-term impact on free cash flow and how that could affect the pay-out.

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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 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

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

Name	TIDM	Mkt 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	£812m	78p	14	4.0%	9.1%	18.6%	-3.8%	335m	EUR	na	NO	8
Temple Bar IT	TMPL	£483m	722p	-	7.1%	-	-	-6.2%	103m	GBP	/FwdEPSGrth/	NO	7
Ferrexpo	FXPO	£1,034m	176p	4	8.8%	3.4%	-29.6%	0.4%	141m	USD	/FwdEPSGrth/	NO	7
Severfield	SFR	£170m	55p	9	5.2%	-29.5%	24.9%	-9.5%	-5m	GBP	/FwdEPSGrth/	NO	7
S&U	SUS	£209m	1,720p	12	6.3%	-49.3%	33.9%	0.9%	109m	GBP	/FwdEPSGrth/	NO	7
Apax Global Alpha	APAX	£781m	159p	-	6.0%	-	-	12.9%	-31m	EUR	/FwdEPSGrth/	NO	7
IG Group Holdings	IGG	£2,946m	796p	14	5.4%	-11.0%	-4.2%	-7.8%	-498m	GBP	/FwdEPSGrth/	NO	7
CMC Markets	CMCX	£1,060m	365p	12	4.1%	44.7%	-54.9%	6.4%	-89m	GBP	/FwdEPSGrth/	NO	7
Investec	INVP	£1,117m	161p	6	6.9%	38.5%	30.8%	-3.4%	5,102m	GBP	/DivGrth/IntCov/	NO	6
Invesco Perpetual UK Sm Cos IT	IPU	£133m	392p	-	4.7%	-	-	-2.1%	-5m	GBP	/FwdEPSGrth/DivGrth/	NO	6
GlaxoSmithKline	GSK	£71,046m	1,416p	12	5.6%	-5.9%	1.0%	-12.4%	23,437m	GBP	/FwdEPSGrth/DivGrth/	NO	6
City of London Invest.ment	CLIG	£219m	433p	10	6.9%	47.1%	10.5%	9.9%	-13m	GBP	/EPSGrth/DivCov/	NO	6
Rio Tinto	RIO	£59,368m	4,762p	10	6.2%	2.4%	-5.7%	4.2%	6,352m	USD	/FwdEPSGrth/DivCov/	NO	6
BHP Group	BHP	£35,094m	1,662p	11	5.6%	15.0%	-10.2%	0.7%	10,995m	USD	/FwdEPSGrth/DivCov/	NO	6
BAE Systems	BA	£15,877m	494p	10	4.7%	-6.5%	14.5%	0.9%	3,386m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Centamin	CEY	£1,807m	156p	11	6.0%	71.0%	42.7%	-14.7%	-260m	USD	/EPSGrth/DivCov/	NO	6
Berkeley Group Holdings	BKG	£5,617m	4,468p	14	4.6%	-0.2%	8.0%	4.0%	-1,136m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Wm Morrison Supermarkets	MRW	£4,084m	170p	12	4.1%	6.8%	5.6%	-7.2%	2,785m	GBP	/EPSGrth/IntCov/	NO	6
Moneysupermarket.com	MONY	£1,447m	270p	17	4.3%	-23.9%	22.3%	-14.5%	-8m	GBP	/FwdEPSGrth/DivCov/	NO	6
RM	RM	£153m	182p	12	4.4%	-60.5%	55.3%	-29.5%	20m	GBP	/FwdEPSGrth/DivCov/	NO	6
Morgan Sindall	MGNS	£539m	1,170p	9	5.0%	-42.8%	64.1%	-5.6%	-91m	GBP	/FwdEPSGrth/DivCov/	NO	6
Robert Walters	RWA	£269m	353p	20	4.4%	-87.1%	253.7%	-15.1%	-47m	GBP	/FwdEPSGrth/DivCov/	NO	6

Source: FactSet

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

Name	TIDM	Mkt cap	Price	Fwd NTM PE	Dividend yield	EPS grth FY+1	EPS grth FY+2	3-mth momentum	Net cash/ debt(-)	Cur	Test failed	Special dividend	Tests passed (out of 8)
Temple Bar IT GBP	TMPL	£483m	722p	-	7.1%	-	-	-6.2%	103m	GBP	/FwdEPSGrth/	NO	7
S&U	SUS	£209m	1,720p	12	6.3%	-49.3%	33.9%	0.9%	109m	GBP	/FwdEPSGrth/	NO	7
Severfield	SFR	£170m	55p	9	5.2%	-29.5%	24.9%	-9.5%	-5m	GBP	/FwdEPSGrth/	NO	7
TClarke	CTO	£37m	87p	6	5.1%	-45.3%	57.1%	-12.9%	-3m	GBP	/FwdEPSGrth/	NO	7
Invesco Perpetual UK Sm. Cos IT	IPU	£133m	392p	-	4.7%	-	-	-2.1%	-5m	GBP	/FwdEPSGrth/DivGrth/	NO	6
City of London Investment	CLIG	£219m	433p	10	6.9%	47.1%	10.5%	9.9%	-13m	GBP	/EPSGrth/DivCov/	NO	6

Source: FactSet

Continued on the next page

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

Name	TIDM	Mkt 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)
Gamma Communications	GAMA	£1,583m	1,660p	31	0.7%	20.0%	11.2%	14.5%	-25m	GBP	na	NO	8
YouGov	YOU	£1,023m	950p	50	0.5%	6.6%	24.1%	25.0%	-26m	GBP	na	NO	8
Belvoir	BLV	£52m	148p	10	3.7%	14.0%	6.1%	24.5%	6m	GBP	/DivGrth/	NO	7
K3 Capital	K3C	£103m	151p	12	5.0%	-6.8%	40.4%	1.3%	-7m	GBP	/FwdEPSGrth/	NO	7
Polar Capital	POLR	£506m	514p	11	6.4%	5.1%	14.0%	5.5%	-141m	GBP	/DivCov/	NO	7
Pan African Resources	PAF	£469m	21p	4	3.1%	175.4%	-1.6%	14.1%	53m	USD	/FwdEPSGrth/	NO	7
Jarvis Securities	JIM	£81m	740p	14	4.3%	41.0%	2.8%	28.7%	-3m	GBP	/DivCov/	NO	7
Mattioli Woods	MTW	£183m	655p	15	3.1%	-15.6%	16.5%	-8.4%	-23m	GBP	/FwdEPSGrth/	NO	7
Tandem Group	TND	£23m	460p	-	1.3%	-	-	84.0%	-5m	GBP	/FwdEPSGrth/	NO	7
Tatton Asset Mgmt	TAM	£154m	272p	19	3.5%	9.2%	16.0%	-5.9%	-12m	GBP	/DivGrth/	NO	7
Caledonia Mining Corp	CMCL	£167m	1,363p	5	0.9%	47.9%	61.5%	4.8%	-9m	USD	/DivGrth/	NO	7
Arcontech	ARC	£26m	197p	23	1.3%	-2.3%	12.2%	19.4%	-5m	GBP	/FwdEPSGrth/	NO	7
Cake Box	CBOX	£64m	160p	16	1.0%	11.6%	34.3%	-2.1%	-2m	GBP	/DivGrth/	NO	7
Cohort	CHRT	£251m	612p	17	1.7%	-6.6%	9.8%	7.4%	12m	GBP	/FwdEPSGrth/	NO	7
Craneware	CRW	£376m	1,400p	29	1.9%	-5.0%	2.5%	-16.4%	-37m	USD	/FwdEPSGrth/	NO	7
Frenkel Topping	FEN	£53m	49p	22	2.8%	44.0%	27.8%	11.4%	-2m	GBP	/DivCov/	NO	7
Advanced Medical Sol	AMS	£452m	210p	26	0.7%	-50.1%	85.7%	-12.5%	-59m	GBP	/FwdEPSGrth/	NO	7
Judges Scientific	JDG	£314m	5,000p	28	1.0%	-31.0%	23.2%	-4.9%	8m	GBP	/FwdEPSGrth/	NO	7
Franchise Brands	FRAN	£102m	106p	23	0.9%	-7.7%	22.8%	8.7%	-3m	GBP	/FwdEPSGrth/	NO	7
Fevertree Drinks	FEVR	£2,532m	2,173p	46	0.7%	-33.0%	48.1%	-6.0%	-135m	GBP	/FwdEPSGrth/	NO	7
Anglo Asian Mining	AAZ	£143m	125p	-	5.7%	-	-	-10.1%	-21m	USD	/FwdEPSGrth/DivGrth/	NO	6
Sylvania Platinum	SLP	£168m	62p	4	2.6%	60.5%	-16.4%	53.1%	-45m	USD	/FwdEPSGrth/DivGrth/	NO	6
NWF Group	NWF	£91m	185p	11	3.7%	-15.8%	4.6%	-5.1%	39m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Somero Enterprises, Inc.	SOM	£141m	250p	14	7.8%	-35.7%	-	11.1%	-22m	USD	/FwdEPSGrth/DivCov/	NO	6
Croma Security Sol	CSSG	£10m	68p	-	2.7%	-	-	-4.3%	-1m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Trans-Siberian Gold	TSG	£116m	105p	6	7.7%	52.4%	83.1%	23.5%	7m	USD	/DivGrth/DivCov/	NO	6
STM	STM	£22m	37p	7	3.6%	-37.9%	77.1%	28.1%	-15m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Solid State	SOLI	£54m	633p	-	2.0%	-	-	15.1%	-2m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Manolete Partners	MANO	£119m	273p	9	1.3%	45.3%	36.6%	-47.1%	-26m	GBP	/DivGrth/FCF/	NO	6
EMIS	EMIS	£674m	1,064p	20	3.0%	-3.1%	6.7%	-3.4%	-37m	GBP	/FwdEPSGrth/DivCov/	NO	6
Brooks Macdonald	BRK	£265m	1,642p	11	3.2%	14.4%	15.7%	-0.2%	-43m	GBP	/EPSGrth/DivCov/	NO	6
Anpario	ANP	£93m	400p	21	2.1%	-3.3%	6.4%	12.7%	-13m	GBP	/FwdEPSGrth/IntCov/	NO	6
IG Design	IGR	£400m	415p	18	2.1%	-44.8%	100.7%	-16.0%	35m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Mind Gym	MIND	£102m	103p	-	0.9%	-	-	2.5%	-12m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Nucleus Financial	NUC	£98m	128p	26	0.8%	-49.8%	32.8%	-14.4%	-15m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Inspiration Healthcare	IHC	£46m	68p	14	0.3%	35.5%	-4.1%	2.6%	-6m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Alpha Financial Mrkts	AFM	£220m	208p	14	1.0%	1.5%	10.7%	10.9%	-18m	GBP	/DivGrth/EPSGrth/	NO	6
Alliance Pharma	APH	£388m	73p	14	0.7%	-4.8%	12.6%	-3.2%	55m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Best of the Best	BOTB	£162m	1,725p	-	0.2%	-	-	7.8%	-5m	GBP	/FwdEPSGrth/IntCov/	NO	6
Keystone Law	KEYS	£153m	490p	35	1.3%	-16.0%	15.1%	-1.5%	-5m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Tristel	TSTL	£232m	500p	39	1.2%	11.0%	3.3%	23.5%	0m	GBP	/DivGrth/EPSGrth/	NO	6
Clinigen	CLIN	£836m	629p	9	1.2%	-1.4%	24.8%	-21.6%	312m	GBP	/FwdEPSGrth/DivCov/	NO	6
Learning Tech	LTG	£930m	126p	29	0.6%	-14.0%	7.7%	-0.7%	-66m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
MTI Wireless Edge	MWE	£41m	47p	-	3.0%	-	-	36.8%	-6m	USD	/FwdEPSGrth/DivCov/	NO	6
AFH Financial	AFHP	£140m	325p	10	1.8%	-12.1%	12.9%	-6.3%	16m	GBP	/FwdEPSGrth/DivCov/	NO	6
Ramsdens	RFX	£35m	112p	7	2.4%	-26.1%	-	-25.6%	-2m	GBP	/FwdEPSGrth/DivCov/	NO	6
Alpha FX	AFX	£435m	1,085p	32	0.7%	5.7%	14.0%	53.9%	-113m	GBP	/DivGrth/DivCov/	NO	6

Source: FactSet