Investors' Chronicle | Alpha

Alpha Editor: James Norrington
Alpha Production Editor: Sameera Hai Baig

AlphaScreens: finding dividend diamonds

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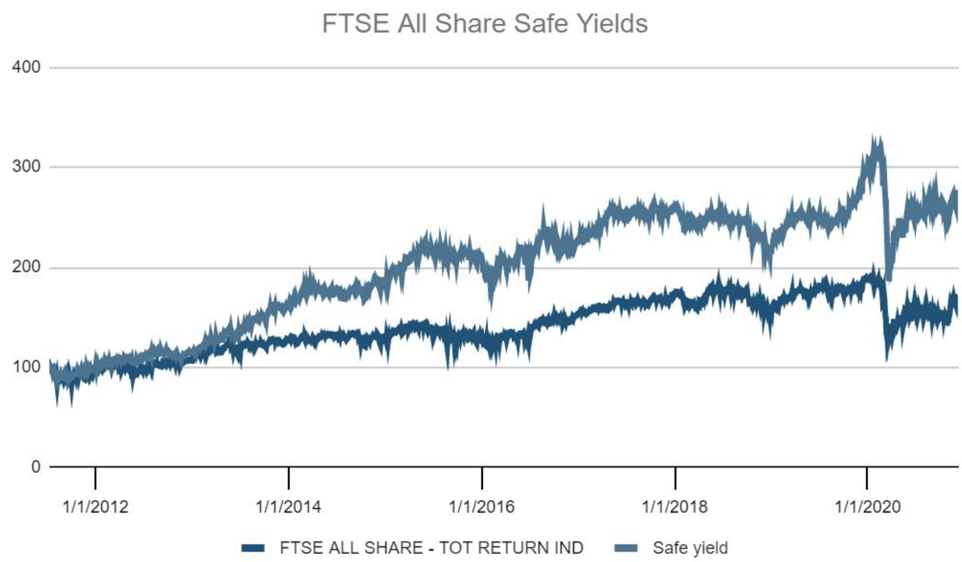
Trailing yield an old school value indicator

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

Comment by Alpha editor:

- Genuine large cap income stocks that score well against our safe yield tests are few and far between. Aerospace and defence company **BAE Systems (BA.)** only comes up short on our dividend growth test. Private equity and infrastructure focussed investment company **3i Group (III)** fails our eps growth test. Miner **Rio Tinto (RIO)** fails the same test, as well as the dividend cover requirement.

- Many of the other FTSE All Share constituents scoring at least 6/8 on the screen are mid-cap or small-cap companies. Here the dividend yield may be more an indication of value, rather than a sign of a cash cow stock to rely on for income over a longer time frame.



Source: Refinitiv, Investors' Chronicle

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 (i.e. dividend cover is not expected to dramatically fall).
- Operating cash conversion of 100 per cent or more (i.e. earnings are being tuned into cash with which to pay dividends).
- Interest payments covered at least five times by operating profits (i.e. 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. It 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 (i.e. rising earnings to support dividend growth and maintain or improve dividend cover).
- Positive free cash flow (i.e. a weak test that earnings are turned into cash with which to pay dividends).
- Interest payments covered at least five times by operating profits (i.e. 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 (i.e. not severely illiquid).

All stocks must pass the dividend yield test to feature in the tables. Special dividends are included in the yield calculation used by the screen, and where a special dividend has been paid this 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 their attractiveness based on a combination of dividend yield and dividend cover.

Stock screens and methodology by Algy Hall

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FTSE All-Share dividend diamonds (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)
Carr's	CARR	£121m	130p	10	3.7%	2.9%	7.8%	4.0%	33m	GBP	na	NO	8
CMC Markets	CMCX	£1,249m	430p	16	5.0%	90.3%	-56.8%	22.7%	-156m	GBP	/FwdEPSGrth/	NO	7
Apax Global Alpha	APAX	£1,063m	217p	-	4.7%	-	-	20.3%	-112m	EUR	/FwdEPSGrth/	NO	7
IG	IGG	£3,073m	830p	12	5.2%	22.9%	-20.4%	0.7%	-456m	GBP	/FwdEPSGrth/	NO	7
BAE Systems	BA	£16,164m	502p	10	4.7%	4.2%	7.6%	-0.1%	3,723m	GBP	/DivGrth/	NO	7
Severfield	SFR	£234m	76p	11	3.8%	-22.0%	18.3%	7.0%	-9m	GBP	/FwdEPSGrth/	NO	7
Smurfit Kappa	SKG	£8,791m	3,394p	16	5.1%	2.3%	15.4%	-0.5%	2,126m	EUR	/DivCov/	NO	7
Sirius Real Estate	SRE	£986m	94p	15	3.5%	29.5%	-1.2%	-1.2%	349m	EUR	/FwdEPSGrth/	NO	7
3i	III	£11,308m	1,162p	6	3.0%	683.8%	3.5%	2.6%	431m	GBP	/EPSGrth/	NO	7
Morgan Sindall	MGNS	£818m	1,764p	11	3.5%	52.9%	8.4%	27.8%	-282m	GBP	/EPSGrth/	NO	7
Grafton	GFTU	£2,411m	1,008p	16	2.7%	6.3%	10.3%	21.4%	355m	GBP	/EPSGrth/	NO	7
Liontrust Asset Mgmt	LIO	£801m	1,315p	15	2.7%	19.7%	35.0%	-2.6%	-94m	GBP	/DivCov/	NO	7
Plus500	PLUS	£1,342m	1,314p	9	10.0%	-53.5%	-16.4%	-10.2%	-429m	USD	/FwdEPSGrth/DivGrth/	NO	6
Schroder Euro. Real Estate IT	SERE	£124m	93p	-	5.6%	-	-	-9.2%	46m	EUR	/FwdEPSGrth/DivGrth/	NO	6
Ferrexpo	FXPO	£2,090m	355p	4	7.1%	13.3%	37.2%	29.3%	141m	USD	/DivGrth/EPSGrth/	NO	6
Polymetal International	POLY	£7,047m	1,494p	8	6.3%	8.3%	12.4%	-12.4%	-	USD	/IntCov/FCF/	NO	6
Blackrock World Mining	BRWM	£1,057m	596p	-	3.4%	-	-	18.7%	115m	GBP	/FwdEPSGrth/FCF/	NO	6
Rio Tinto	RIO	£71,679m	5,745p	8	5.9%	37.5%	-26.4%	3.6%	565m	USD	/FwdEPSGrth/DivCov/	NO	6
Devro	DVO	£313m	187p	11	8.2%	3.2%	6.8%	22.6%	110m	GBP	/FwdEPSGrth/DivCov/	NO	6
BB Healthcare Trust	BBH	£962m	188p	-	2.7%	-	-	5.6%	-93m	GBP	/FwdEPSGrth/FCF/	NO	6
Impact Healthcare REIT	IHR	£362m	114p	16	5.5%	16.6%	19.4%	4.1%	3m	GBP	/EPSGrth/DivCov/	NO	6
JPMorgan Global Grth & Inc.	JGGI	£602m	409p	-	3.2%	-	-	5.7%	21m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
City of London Investment	CLIG	£256m	506p	10	6.1%	60.5%	5.4%	21.9%	-16m	GBP	/EPSGrth/DivCov/	NO	6
3i Infrastructure	3IN	£2,590m	291p	-	3.3%	-	-	0.2%	-355m	GBP	/FwdEPSGrth/DivGrth/	NO	6
BHP	BHP	£46,033m	2,180p	11	5.1%	51.6%	-3.9%	9.6%	9,815m	USD	/FwdEPSGrth/DivCov/	NO	6
Ultra Electronics	ULE	£1,497m	2,104p	16	4.6%	-1.0%	5.8%	2.8%	86m	GBP	/FwdEPSGrth/DivCov/	NO	6
Berkeley	BKG	£5,266m	4,306p	13	2.7%	5.3%	4.5%	2.5%	-951m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Diverse Income Trust	DIVI	£392m	110p	-	3.4%	-	-	17.7%	-7m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Hargreaves Lansdown	HL	£7,243m	1,527p	28	3.6%	2.6%	-9.1%	4.4%	-373m	GBP	/FwdEPSGrth/DivCov/	NO	6
Rathbone Brothers	RAT	£940m	1,610p	12	4.5%	6.4%	7.9%	4.8%	-1,726m	GBP	/EPSGrth/DivCov/	NO	6
FDM	FDM	£1,142m	1,046p	33	4.4%	7.0%	13.0%	5.1%	-45m	GBP	/EPSGrth/DivCov/	NO	6
RELX	REL	£33,287m	1,723p	20	2.7%	7.0%	13.8%	-5.4%	7,035m	GBP	/EPSGrth/DivCov/	NO	6
Stock Spirits	STCK	£554m	277p	15	3.1%	-4.6%	7.6%	10.4%	21m	EUR	/FwdEPSGrth/DivCov/	NO	6
Rotork	ROR	£3,280m	375p	29	2.7%	1.0%	8.1%	26.8%	-178m	GBP	/FwdEPSGrth/DivCov/	NO	6
RHI Magnesita NV	RHIM	£1,986m	4,106p	11	3.2%	33.6%	15.1%	27.0%	519m	EUR	/EPSGrth/DivCov/	NO	6
Clarkson	CKN	£754m	2,480p	21	5.3%	9.4%	10.4%	-2.4%	-148m	GBP	/EPSGrth/DivCov/	NO	6
Goodwin	GDWN	£224m	2,980p	-	2.7%	-	-	-12.0%	32m	GBP	/FwdEPSGrth/DivCov/	NO	6
Mondi	MNDI	£8,963m	1,846p	15	4.3%	2.8%	12.9%	6.1%	1,608m	EUR	/EPSGrth/DivCov/	NO	6

Source: FactSet, 15 March 2021

FTSE All-Small dividend diamonds (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)
Schroder Euro. Real Estate IT	SERE	£124m	93p	-	5.6%	-	-	-9.2%	46m	EUR	/FwdEPSGrth/DivGrth/	NO	6
Devro	DVO	£313m	187p	11	8.2%	3.2%	6.8%	22.6%	110m	GBP	/FwdEPSGrth/DivCov/	NO	6
City of London Investment	CLIG	£256m	506p	10	6.1%	60.5%	5.4%	21.9%	-16m	GBP	/EPSGrth/DivCov/	NO	6
Impact Healthcare REIT	IHR	£362m	114p	16	5.5%	16.6%	19.4%	4.1%	3m	GBP	/EPSGrth/DivCov/	NO	6

Source: FactSet, 15 March 2021

Continued on the next page...

Aim dividend diamonds (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)
Wynnstay	WYN	£105m	526p	15	2.8%	22.6%	4.7%	63.1%	-8m	GBP	na	NO	8
Polar Capital	POLR	£664m	672p	11	5.1%	38.8%	7.4%	1.2%	-132m	GBP	/DivCov/	NO	7
Mattioli Woods	MTW	£194m	690p	14	2.9%	-12.3%	17.8%	-8.0%	-15m	GBP	/FwdEPSGrth/	NO	7
Jarvis Securities	JIM	£114m	261p	19	4.2%	7.8%	5.8%	34.6%	-4m	GBP	/DivCov/	NO	7
Pan African Resources	PAF	£348m	18p	4	3.8%	70.9%	54.4%	-14.9%	62m	USD	/DivCov/	NO	7
Anglo Asian Mining	AAZ	£164m	143p	8	4.9%	2.9%	21.0%	13.9%	-21m	USD	/DivGrth/EPSGrth/	NO	6
NWF	NWF	£107m	218p	12	3.2%	-15.6%	5.2%	5.3%	42m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Alumasc	ALU	£62m	171p	8	3.1%	150.9%	8.3%	49.3%	6m	GBP	/DivGrth/EPSGrth/	NO	6
Robinson	RBN	£26m	155p	11	3.5%	89.0%	4.3%	-3.1%	6m	GBP	/DivGrth/EPSGrth/	NO	6
Tatton Asset Management	TAM	£209m	361p	24	2.7%	8.1%	14.6%	32.7%	-13m	GBP	/DivGrth/DivCov/	NO	6
Brooks Macdonald	BRK	£331m	2,050p	13	2.7%	19.4%	15.0%	21.3%	-32m	GBP	/EPSGrth/DivCov/	NO	6
Begbies Traynor	BEG	£146m	115p	14	2.5%	9.4%	39.6%	27.2%	7m	GBP	/EPSGrth/DivCov/	NO	6

Source: FactSet, 15 March 2021

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