

AlphaScreens: finding dividend diamonds

3 June 2021

Mining for yield

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:

- Mining shares have had a good 2021 so far. Commodities are seen as a hedge against inflation and as the world economy looks hopefully towards a recovery, there is rising demand for materials. This should bode well for income investors as even in bad times, miners tend to be committed to paying short-term rewards. Giants like **BHP Group (BHP)** and **Rio Tinto (RIO)** rank well on our dividend yield screen, as does the **Blackrock World Mining Trust (BRWM)**.
- Another old faithful for income investors is defence and aerospace business **BAE Systems (BA.)**, which also scores well. Its order backlog gives an element of visibility over future revenues and the geo-political tensions that exist between the west and both Russia and China, suggest that defence budgets may not be a casualty of post Covid-19 government spending reviews, as may have first been feared.
- With smaller companies, investors should think about dividend yield as a value indicator as much as the sign of a dependable long-run income stock. That said, the top three Aim companies look interesting. These are agricultural supply business **Wynnstay (WYN)**, **Warehouse Reit (WHR)** and **Smart Metering Systems (SMS)**. All are in industries with growth potential, but potential investors should dig into the capital structures of the latter two in particular, as they fail our interest cover test.

Dividends are crucial for UK investors

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.

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 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).
- 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).

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 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.

Stock screen and methodology by Algy Hall

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

Name	TIDM	Market cap	Price	Fwd NTM PE	Div 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)
Apax Global Alpha	APAX	£943m	192p	-	5.3%	-	-	-11.5%	-112m	EUR	/FwdEPSGrth/	NO	7
Polymetal Int'l	POLY	£8,188m	1,729p	10	5.4%	-1.5%	9.8%	20.2%	1,012m	USD	/FwdEPSGrth/	NO	7
Blackrock World Mining Trust	BRWM	£1,213m	662p	-	3.1%	-	-	11.4%	115m	GBP	/FwdEPSGrth/	NO	7
Impact Healthcare REIT	IHR	£387m	110p	15	5.7%	17.7%	11.6%	0.4%	66m	GBP	/DivCov/	NO	7
BAE Systems	BAE	£17,139m	531p	11	4.5%	2.9%	7.9%	7.2%	3,723m	GBP	/DivGrth/	NO	7
Carr's Group	CARR	£141m	151p	12	3.9%	2.1%	7.0%	17.1%	26m	GBP	/FwdEPSGrth/	NO	7
Smurfit Kappa	SKG	£9,840m	3,799p	16	4.6%	6.3%	15.8%	10.1%	2,126m	EUR	/DivCov/	NO	7
BHP Group	BHP	£46,318m	2,193p	9	5.1%	65.6%	3.5%	-7.0%	9,815m	USD	/DivCov/	NO	7
Stock Spirits	STCK	£547m	274p	14	3.1%	-4.4%	8.3%	4.4%	28m	EUR	/FwdEPSGrth/	NO	7
Morgan Sindall	MGNS	£1,057m	2,280p	12	2.7%	76.6%	0.5%	33.3%	-282m	GBP	/EPSGrth/	NO	7
Plus500	PLUS	£1,519m	1,500p	9	8.8%	-47.2%	-16.6%	15.1%	-429m	USD	/FwdEPSGrth/DivGrth/	NO	6
Majedie Investments	MAJE	£124m	233p	-	4.9%	-	-	-2.9%	16m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Lowland Investment	LWI	£380m	1,405p	-	4.3%	-	-	17.1%	26m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Schroder European REIT	SERE	£130m	97p	-	5.3%	-	-	9.1%	46m	EUR	/FwdEPSGrth/DivGrth/	NO	6
Ferrexpo	FXPO	£2,710m	460p	4	13.7%	68.1%	-22.8%	33.5%	-3m	USD	/FwdEPSGrth/DivCov/	NO	6
JPMorgan China Growth & Income	JCGI	£570m	693p	-	3.0%	-	-	-3.2%	-2m	GBP	/FwdEPSGrth/FCF/	NO	6
NB Private Equity Partners Ltd Class A NBPE	NBPE	£593m	1,360p	-	3.2%	-	-	15.7%	138m	USD	/FwdEPSGrth/DivGrth/	NO	6
TR Property IT Ord Shares Class GBP	TRY	£1,406m	443p	-	3.2%	-	-	19.1%	-	GBP	/FwdEPSGrth/FCF/	NO	6
3i Group	III	£12,218m	1,256p	6	3.1%	-0.5%	6.9%	10.6%	776m	GBP	/FwdEPSGrth/FCF/	NO	6
BB Healthcare Trust	BBH	£973m	182p	-	2.7%	-	-	-3.6%	-93m	GBP	/FwdEPSGrth/FCF/	NO	6
Rio Tinto	RIO	£78,671m	6,305p	8	5.4%	61.7%	-27.5%	-2.0%	565m	USD	/FwdEPSGrth/DivCov/	NO	6
JPMorgan Global Growth & Inc. GBP	JGGI	£643m	427p	-	3.1%	-	-	6.5%	21m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Centamin	CEY	£1,353m	117p	14	9.8%	-14.5%	2.5%	12.4%	-213m	USD	/FwdEPSGrth/DivCov/	NO	6
Devro	DVO	£347m	208p	12	7.4%	3.3%	5.9%	7.2%	110m	GBP	/FwdEPSGrth/DivCov/	NO	6
Henderson Int'l Income Trust GBP	HINT	£320m	163p	-	3.7%	-	-	4.6%	44m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Ultra Electronics	ULE	£1,479m	2,076p	16	4.6%	-1.4%	7.3%	6.5%	86m	GBP	/FwdEPSGrth/DivCov/	NO	6
City of London Investment	CLIG	£277m	546p	11	5.7%	58.6%	6.8%	5.0%	-16m	GBP	/EPSGrth/DivCov/	NO	6
Mondi	MNDI	£9,429m	1,942p	15	4.2%	4.8%	16.9%	8.6%	1,598m	EUR	/EPSGrth/DivCov/	NO	6
Schroders	SDR	£9,529m	3,576p	16	3.2%	6.7%	7.1%	1.0%	-3,000m	GBP	/DivGrth/EPSGrth/	NO	6
FDM Group (Holdings)	FDM	£1,077m	986p	30	4.7%	7.4%	13.2%	-3.9%	-45m	GBP	/EPSGrth/DivCov/	NO	6
DCC Plc	DCC	£6,023m	6,108p	15	2.6%	5.7%	4.0%	3.2%	302m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Hargreaves Lansdown	HL	£7,845m	1,654p	28	3.4%	13.0%	-11.2%	7.1%	-373m	GBP	/FwdEPSGrth/DivCov/	NO	6
Rathbone Brothers	RAT	£1,069m	1,826p	12	3.9%	15.1%	5.7%	16.5%	-1,726m	GBP	/EPSGrth/DivCov/	NO	6
RELX	REL	£35,766m	1,850p	20	2.5%	8.4%	13.7%	8.5%	7,035m	GBP	/EPSGrth/DivCov/	NO	6
Rotork	ROR	£3,033m	347p	27	2.9%	0.9%	8.3%	-7.0%	-178m	GBP	/FwdEPSGrth/DivCov/	NO	6
RHI Magnesita NV	RHIM	£2,177m	4,560p	11	2.9%	35.7%	15.2%	14.3%	519m	EUR	/EPSGrth/DivCov/	NO	6
HomeServe	HSV	£3,176m	945p	19	2.8%	14.1%	13.6%	-11.4%	514m	GBP	/EPSGrth/DivCov/	NO	6
Clarkson	CKN	£945m	3,105p	27	4.3%	5.1%	10.6%	21.8%	-148m	GBP	/EPSGrth/DivCov/	NO	6

Source: FactSet, 3 June 2021

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

Name	TIDM	Market cap	Price	FwdNTM PE	Div yield	EPSgrth FY+1	EPSgrth FY+2	3-month momentum	Net cash/debt (-)	Cur	Test failed	Special dividend	Tests passed (out of 8)
Impact Healthcare REIT	IHR	£387m	110p	15	5.7%	17.7%	11.6%	0.4%	66m	GBP	/DivCov/	NO	7
Carr's Group	CARR	£141m	151p	12	3.9%	2.1%	7.0%	17.1%	26m	GBP	/FwdEPSGrth/	NO	7
Premier Miton Global Ren. Trust GBP	PMGR	£29m	160p	3	6.4%	657.2%	53.4%	-1.2%	14m	GBP	/DivGrth/EPSGrth/	NO	6
Majedie Investments	MAJE	£124m	233p	-	4.9%	-	-	-2.9%	16m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Lowland Investment Co	LWI	£380m	1,405p	-	4.3%	-	-	17.1%	26m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Schroder European REIT	SERE	£130m	97p	-	5.3%	-	-	9.1%	46m	EUR	/FwdEPSGrth/DivGrth/	NO	6
Devro plc	DVO	£347m	208p	12	7.4%	3.3%	5.9%	7.2%	110m	GBP	/FwdEPSGrth/DivCov/	NO	6
City of London Investment	CLIG	£277m	546p	11	5.7%	58.6%	6.8%	5.0%	-16m	GBP	/EPSGrth/DivCov/	NO	6

Source: FactSet, 3 June 2021

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

Name	TIDM	Market cap	Price	FwdNTM PE	Div yield	EPSgrth FY+1	EPSgrth FY+2	3-month momentum	Net cash/debt (-)	Cur	Test failed	Special dividend	Tests passed (out of 8)
Wynnstay Group	WYN	£92m	457p	13	3.2%	22.6%	4.7%	-3.7%	-8m	GBP	na	NO	8
Warehouse REIT	WHR	£637m	150p	22	5.2%	28.9%	8.0%	20.5%	207m	GBP	/IntCov/	NO	7
Smart Metering Systems	SMS	£998m	880p	65	2.8%	34.9%	12.3%	26.6%	-37m	GBP	/IntCov/	NO	7
Caledonia Mining Corp.	CMCL	£125m	1,110p	5	2.5%	27.9%	36.1%	6.7%	-9m	USD	/FCF/	NO	7
Robinson	RBN	£25m	150p	10	5.7%	69.0%	7.0%	-4.8%	7m	GBP	/DivCov/	NO	7
Property Franchise	TPFG	£85m	264p	12	3.3%	35.8%	2.2%	37.1%	-9m	GBP	/EPSGrth/	NO	7
Jarvis Securities	JIM	£121m	272p	19	4.1%	7.8%	5.8%	21.7%	-4m	GBP	/DivCov/	NO	7
EMIS Group	EMIS	£758m	1,198p	22	2.7%	6.6%	6.5%	9.7%	-46m	GBP	/DivCov/	NO	7
Strix Group	KETL	£630m	305p	19	2.6%	7.1%	5.4%	18.7%	41m	GBP	/EPSGrth/	NO	7
Keystone Law	KEYS	£200m	640p	35	2.7%	13.6%	11.8%	7.6%	-6m	GBP	/DivCov/	NO	7
Pan African Resources	PAF	£418m	22p	5	3.2%	90.6%	18.8%	25.1%	62m	USD	/DivCov/	NO	7
H&T Group	HAT	£112m	280p	11	3.0%	-39.6%	75.3%	-5.7%	-14m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Anglo Asian Mining	AAZ	£178m	156p	-	3.8%	-	-	10.6%	-27m	USD	/FwdEPSGrth/DivGrth/	NO	6
STM Group	STM	£20m	34p	8	4.2%	29.6%	34.3%	11.7%	-	GBP	/DivGrth/EPSGrth/	NO	6
Belvoir Group	BLV	£87m	246p	12	4.3%	41.1%	-3.9%	48.5%	4m	GBP	/FwdEPSGrth/DivCov/	NO	6
Titon Holdings	TON	£15m	133p	15	2.6%	1323.1%	31.1%	24.4%	-4m	GBP	/DivGrth/EPSGrth/	NO	6
M.P. Evans Group	MPE	£403m	740p	19	3.0%	34.3%	13.6%	24.9%	57m	USD	/EPSGrth/DivCov/	NO	6

Source: FactSet, 3 June 2021

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