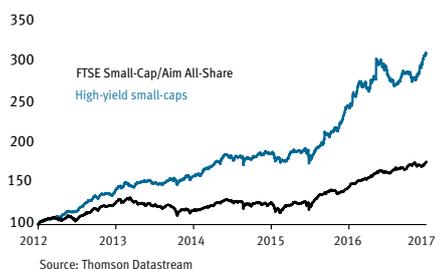




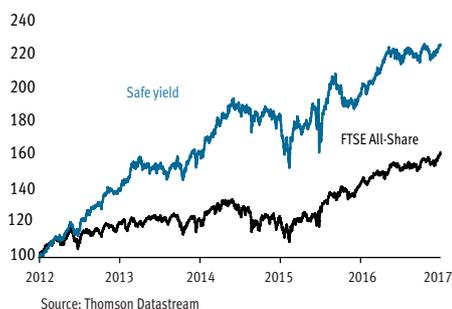
AlphaScreens: Finding dividend diamonds

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 2018, the average annual return from the FTSE All-Share based on share price alone stood at 3.2 per cent, compared with a 6.7 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 412 per cent, compared with 118 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:

- Blue-chips have struggled against our stringent dividend yield screen. Given the importance of dividends to long-term compound returns, or for those taking the scrip as part of their income, it is worth checking which tests have been failed to see whether old reliable income shares may come unstuck in future.
- Mining giant **Rio Tinto (RIO)** fails our dividend growth test, but it has also demonstrated its dedication to returning cash to shareholders via buybacks. It also fails the two-year EPS growth test, but this is a cyclical industry and a reminder for investors to diversify their income portfolio as payout levels may come under pressure in the future.
- Insurer **Prudential (PRU)** fails the current year forecast EPS test and the beta requirement (its share price has been too sensitive to wider market moves in the past year). Long-term, however, benefits of the de-merger of its UK business should find their way into shareholders' pockets.
- There are systematic reasons why companies may fail some of our tests. For example, **Target Healthcare REIT (THRL)** fails the dividend growth and dividend cover tests on our small-cap screen. As Reits must pay 90 per cent of their earnings out in dividends, dividend cover inevitably falls below our threshold.

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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	£835m	81p	19	3.7%	5.2%	12.6%	13.8%	-278m	EUR	na	NO	8
Norcros	LSE:NRX	£203m	253p	7	3.3%	8.6%	5.3%	16.9%	-71m	GBP	na	NO	8
Vp	LSE:VP	£355m	895p	9	3.4%	7.7%	4.2%	17.0%	-168m	GBP	na	NO	8
PageGroup	LSE:PAGE	£1,529m	481p	14	5.4%	3.7%	6.2%	10.5%	-57m	GBP	/Beta	YES	7
Apax Global Alpha	LSE:APAX	£842m	172p	-	4.9%	-	-	11.3%	116m	EUR	/EPSGrth/	NO	7
Hollywood Bowl	LSE:BOWL	£360m	240p	17	4.5%	12.7%	4.6%	9.5%	-5m	GBP	/DivGrth/	YES	7
Polymetal International	LSE:POLY	£5,478m	1,165p	12	3.4%	14.9%	20.9%	-1.4%	-1,736m	USD	/DivCov/	NO	7
Telecom Plus	LSE:TEP	£1,040m	1,330p	20	3.9%	9.4%	7.1%	11.8%	-41m	GBP	/DivCov/	NO	7
Barratt Developments	LSE:BDEV	£6,748m	667p	9	7.0%	-0.2%	0.9%	5.8%	758m	GBP	/EPSGrth/CashConv/	YES	6
Rio Tinto	LSE:RIO	£71,199m	4,202p	9	6.2%	21.3%	-13.1%	2.9%	-4,544m	USD	/DivGrth/EPSGrth/	NO	6
TBC Bank	LSE:TBCG	£684m	1,240p	5	4.2%	9.1%	8.4%	-0.6%	-3,016m	GEL	/IntCov/CashConv/	NO	6
SSE	LSE:SSE	£13,413m	1,300p	14	7.5%	15.0%	13.9%	12.3%	-9,936m	GBP	/DivCov/IntCov/	NO	6
PayPoint	LSE:PAY	£687m	1,016p	16	8.3%	2.7%	4.1%	13.6%	21m	GBP	/DivCov/DivGrth/	YES	6
S&U	LSE:SUS	£251m	2,080p	8	5.7%	5.6%	8.3%	-0.6%	-126m	GBP	/IntCov/CashConv/	NO	6
Bodycote	LSE:BOY	£1,653m	872p	17	4.5%	-7.2%	3.8%	23.8%	-112m	GBP	/EPSGrth/Beta	YES	6
Wincanton	LSE:WIN	£319m	258p	8	4.2%	3.8%	3.1%	15.4%	-139m	GBP	/RoE/CashConv/	NO	6
Countryside Properties	LSE:CSP	£1,769m	396p	9	4.1%	9.6%	7.2%	34.0%	78m	GBP	/CashConv/Beta	NO	6
GCP Student Living	LSE:DIGS	£774m	187p	30	3.4%	18.5%	10.8%	15.0%	-234m	GBP	/IntCov/CashConv/	NO	6
Mears	LSE:MER	£271m	245p	8	5.1%	1.0%	14.9%	-6.7%	-225m	GBP	/DivCov/IntCov/	NO	6
Mondi	LSE:MNDI	£8,122m	1,676p	12	4.2%	-9.4%	-6.7%	6.7%	-2,341m	EUR	/EPSGrth/Beta	NO	6
Morgan Sindall	LSE:MGNS	£639m	1,430p	9	3.7%	6.5%	4.5%	22.4%	58m	GBP	/CashConv/Beta	NO	6
Bovis Homes	LSE:BVS	£1,812m	1,225p	11	4.7%	9.1%	7.8%	18.7%	80m	GBP	/DivCov/Beta	NO	6
Headlam	LSE:HEAD	£381m	454p	12	5.5%	-10.1%	5.0%	10.1%	-14m	GBP	/DivCov/EPSGrth/	NO	6
Photo-Me International	LSE:PHTM	£332m	88p	10	9.6%	6.5%	3.6%	-12.0%	15m	GBP	/DivCov/DivGrth/	NO	6
SThree	LSE:STEM	£436m	341p	10	4.3%	8.6%	6.9%	30.3%	-8m	GBP	/DivGrth/CashConv/	NO	6
Prudential	LSE:PRU	£35,643m	1,377p	9	3.6%	-7.6%	6.2%	-0.1%	-10,891m	GBP	/EPSGrth/Beta	NO	6
Imperial Brands	LSE:IMB	£15,978m	1,703p	6	12.1%	-0.3%	4.6%	-19.2%	-11,350m	GBP	/DivCov/EPSGrth/	NO	6
MJ Gleeson	LSE:GLE	£435m	796p	12	4.3%	9.4%	9.6%	-2.0%	30m	GBP	/DivCov/CashConv/	NO	6
Severfield	LSE:SFR	£226m	74p	10	3.9%	13.3%	6.9%	19.4%	10m	GBP	/DivCov/RoE/	NO	6
Tate & Lyle	LSE:TATE	£3,407m	731p	14	4.0%	3.0%	2.2%	-0.5%	-433m	GBP	/DivCov/DivGrth/	NO	6
The Vitec Group	LSE:VTC	£460m	1,015p	12	3.6%	-6.5%	13.1%	-4.1%	-108m	GBP	/DivCov/EPSGrth/	NO	6
Ten Entertainment	LSE:TEG	£171m	263p	13	4.3%	19.6%	14.2%	11.9%	-10m	GBP	/DivCov/DivGrth/	NO	6

Source: S&P Capital IQ, 2 December 2019

Continued on the next page

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)
UP Global Sourcing	LSE:UPGS	£67m	85p	10	4.8%	3.0%	5.2%	19.7%	-14m	GBP	/FwdEPSGrth/	NO	7
STV	LSE:STVG	£154m	394p	8	5.1%	8.9%	12.9%	11.0%	-55m	GBP	/EPSGrth/	NO	7
BlackRock Lat Am IT	LSE:BRLA	£176m	448p	-	6.3%	-	-	0.4%	-25m	USD	/FwdEPSGrth/EPSGrth/	NO	6
Reach	LSE:RCH	£284m	96p	2	6.4%	1.5%	-5.9%	2.9%	-13m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
S&U	LSE:SUS	£251m	2,080p	8	5.7%	5.6%	8.3%	-0.6%	-126m	GBP	/IntCov/FCF/	NO	6
Record	LSE:REC	£81m	41p	16	7.3%	-24.3%	5.4%	33.5%	22m	GBP	/FwdEPSGrth/DivCov/	YES	6
Photo-Me Intl	LSE:PHTM	£332m	88p	10	9.6%	6.5%	3.6%	-12.0%	15m	GBP	/EPSGrth/DivCov/	NO	6
Headlam	LSE:HEAD	£381m	454p	12	5.5%	-10.1%	5.0%	10.1%	-14m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Target Healthcare REIT	LSE:THRL	£531m	116p	19	5.8%	22.2%	6.5%	-1.9%	-80m	GBP	/DivGrth/DivCov/	NO	6
Devro	LSE:DVO	£275m	165p	10	5.5%	9.9%	4.7%	-15.9%	-149m	GBP	/DivGrth/DivCov/	NO	6

Source: S&P Capital IQ, 2 December 2019

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	£15m	26p	4	7.7%	6.1%	6.5%	-38.0%	15m	GBP	na	NO	8
Finsbury Food	AIM:FIF	£106m	84p	9	4.2%	8.5%	3.1%	30.7%	-35m	GBP	na	NO	8
Gateley	AIM:GTLY	£198m	172p	12	4.7%	5.6%	7.1%	6.8%	-3m	GBP	na	NO	8
The Property Franchise Grp	AIM:TPFG	£49m	189p	13	4.5%	9.8%	4.3%	20.4%	3m	GBP	na	NO	8
The Character Group	AIM:CCT	£87m	406p	10	6.4%	-7.4%	0.0%	-0.5%	20m	GBP	/FwdEPSGrth/	NO	7
Billington	AIM:BILN	£38m	318p	9	4.1%	1.5%	3.7%	5.3%	8m	GBP	/FwdEPSGrth/	NO	7
M&C Saatchi	AIM:SAA	£141m	151p	8	7.3%	-14.5%	6.8%	-28.5%	-31m	GBP	/FwdEPSGrth/	NO	7
Somero Enterprises	AIM:SOM	£111m	197p	8	7.5%	-12.8%	0.8%	-29.5%	13m	USD	/FwdEPSGrth/	NO	7
Polar Capital	AIM:POLR	£509m	546p	13	6.0%	-26.7%	14.0%	7.8%	120m	GBP	/FwdEPSGrth/	NO	7
NWF	AIM:NWF	£77m	157p	10	4.2%	-2.1%	1.5%	-4.8%	-10m	GBP	/FwdEPSGrth/	NO	7
Highland Gold Mining	AIM:HGM	£664m	183p	8	7.3%	71.8%	2.1%	-22.3%	-217m	USD	/DivCov/	NO	7
Rotala	AIM:ROL	£26m	52p	7	5.2%	26.7%	9.1%	-8.0%	-35m	GBP	/IntCov/	NO	7
Frenkel Topping	AIM:FEN	£23m	33p	13	3.9%	73.3%	5.5%	3.8%	1m	GBP	/DivCov/	NO	7
Trans-Siberian	AIM:TSG	£60m	69p	-	9.3%	-	-	-43.5%	-10m	USD	/FwdEPSGrth/DivGrth/	YES	6
Northern Bear	AIM:NTBR	£13m	71p	-	5.7%	-	-	14.6%	-2m	GBP	/FwdEPSGrth/FCF/	YES	6
MS INTERNATIONAL	AIM:MSI	£30m	180p	-	4.6%	-	-	-12.2%	23m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Empresaria	AIM:EMR	£25m	51p	5	3.9%	-14.3%	18.4%	-17.7%	-31m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Shoe Zone	AIM:SHOE	£67m	135p	8	8.6%	-7.5%	0.4%	0.4%	3m	GBP	/FwdEPSGrth/IntCov/	NO	6
ULS Technology	AIM:ULS	£29m	45p	7	5.3%	-8.7%	-1.9%	-26.3%	-3m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Belvoir	AIM:BLV	£46m	125p	10	5.8%	6.4%	10.1%	13.1%	-10m	GBP	/DivGrth/FCF/	NO	6
Redde	AIM:REDD	£341m	111p	8	10.5%	6.2%	-0.5%	0.9%	-35m	GBP	/FwdEPSGrth/DivCov/	NO	6
ECO Animal Health	AIM:EAH	£147m	217p	14	5.1%	-35.7%	21.2%	-41.1%	16m	GBP	/FwdEPSGrth/FCF/	NO	6

Source: S&P Capital IQ, 2 December 2019

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