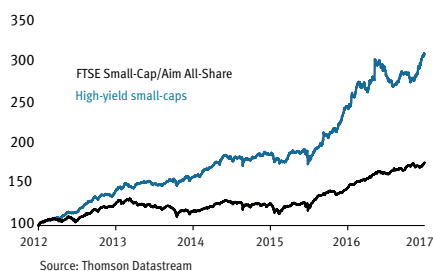




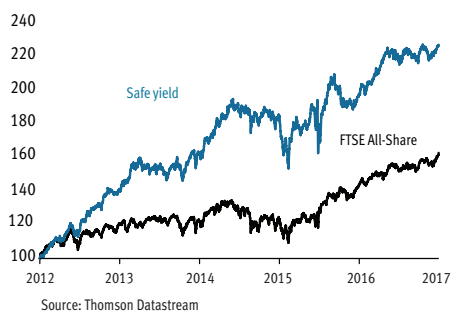
## AlphaScreens: Finding dividend diamonds

*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:

- It's a case of "as you were" at the top of our dividend yield rankings, with travel outlet concessions business **SSP (SSPG)**, home products company **Norcros (NXR)** and equipment renter **VP (VP.)** still the only FTSE All-Share companies to pass all the tests. When considering the sustainability of the yields on offer, it is noteworthy that SSP has paid specials in the past 12 months and that all three companies have negative net cash positions.
- Very few larger companies score well. Utility **SSE (SSE)** would have been a dividend stalwart for years. It yields 7.6 per cent, but the two tests it fails – dividend cover and interest cover – offer clues as to why investors should exercise a degree of caution.
- Insurer **Prudential (PRU)** also passes 6/8 tests. It fails the criteria of low market beta and EPS growth in each of the next two years. That said, this is a business with good long-term exposure to Asian markets and the de-merger of its UK business is expected to help it create longer-term value for shareholders.
- Aim-listed companies do best against our slightly tweaked small company tests. Yield is a sign of value with smaller companies and given some of our top-rankers are the sort of businesses that might suffer in a recession, these aren't shares to be bought as long-term income plays.

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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)
SSP	LSE:SSPG	£2,827m	636p	21	7.0%	9.9%	8.2%	-11.7%	-438m	GBP	na	YES	8
Norcros	LSE:NXR	£192m	239p	7	3.5%	8.3%	4.2%	10.6%	-35m	GBP	na	NO	8
Vp	LSE:VP	£337m	851p	9	3.5%	7.7%	4.2%	7.7%	-168m	GBP	na	NO	8
PageGroup	LSE:PAGE	£1,427m	449p	13	5.8%	4.4%	6.2%	1.9%	-57m	GBP	/Beta	YES	7
Apax Global Alpha	LSE:APAX	£820m	167p	-	5.1%	-	-	7.1%	116m	EUR	/EPSGrth/	NO	7
Sirius Real Estate	LSE:SRE	£762m	74p	17	4.0%	8.4%	9.4%	11.3%	-296m	EUR	/CashConv/	NO	7
Hollywood Bowl	LSE:BOWL	£356m	237p	16	4.6%	12.7%	4.6%	12.0%	-5m	GBP	/DivGrth/	YES	7
Barratt Developments	LSE:BDEV	£6,416m	634p	9	7.3%	-0.2%	0.9%	-0.8%	758m	GBP	/EPSGrth/CashConv/	YES	6
Bodycote	LSE:BOY	£1,391m	734p	14	5.3%	-6.6%	4.4%	3.0%	-112m	GBP	/EPSGrth/Beta	YES	6
SSE	LSE:SSE	£13,340m	1,291p	15	7.6%	16.3%	15.4%	16.9%	-9,343m	GBP	/DivCov/IntCov/	NO	6
Wincanton	LSE:WIN	£309m	250p	7	4.4%	3.5%	2.8%	7.8%	-19m	GBP	/RoE/CashConv/	NO	6
S&U	LSE:SUS	£256m	2,120p	8	5.6%	5.4%	8.8%	-4.5%	-126m	GBP	/IntCov/CashConv/	NO	6
Morgan Sindall	LSE:MGNS	£573m	1,282p	9	4.1%	3.1%	7.3%	16.3%	58m	GBP	/CashConv/Beta	NO	6
GCP Student Living	LSE:DIGS	£718m	174p	28	3.6%	18.5%	10.8%	6.6%	-234m	GBP	/IntCov/CashConv/	NO	6
SThree	LSE:STHR	£377m	288p	9	5.0%	8.8%	7.1%	5.4%	-8m	GBP	/DivGrth/CashConv/	NO	6
PayPoint	LSE:PAY	£619m	916p	14	7.6%	2.7%	4.0%	-8.7%	37m	GBP	/DivCov/DivGrth/	YES	6
Mondi	LSE:MNDI	£7,921m	1,634p	11	4.3%	-9.4%	-6.4%	2.0%	-2,341m	EUR	/EPSGrth/Beta	NO	6
Bovis Homes	LSE:BVS	£1,588m	1,181p	11	4.8%	8.1%	8.9%	10.7%	80m	GBP	/DivCov/Beta	NO	6
Mears	LSE:MER	£280m	253p	9	4.9%	1.0%	14.9%	-8.3%	-225m	GBP	/DivCov/IntCov/	NO	6
Photo-Me International	LSE:PHTM	£340m	90p	10	9.4%	6.5%	3.6%	-10.9%	15m	GBP	/DivCov/DivGrth/	NO	6
Headlam	LSE:HEAD	£411m	490p	13	5.1%	-10.1%	5.0%	8.4%	-14m	GBP	/DivCov/EPSGrth/	NO	6
Prudential	LSE:PRU	£35,150m	1,358p	9	3.6%	-3.1%	3.8%	-13.1%	-10,891m	GBP	/EPSGrth/Beta	NO	6
Speedy Hire	LSE:SDY	£277m	53p	10	3.7%	13.1%	9.5%	4.2%	-90m	GBP	/RoE/CashConv/	NO	6
Severfield	LSE:SFR	£237m	78p	10	3.6%	13.3%	6.9%	19.7%	25m	GBP	/RoE/CashConv/	NO	6
MJ Gleeson	LSE:GLE	£446m	818p	12	4.2%	9.4%	9.6%	-3.1%	30m	GBP	/DivCov/CashConv/	NO	6
Dunelm	LSE:DNLM	£1,604m	794p	15	3.5%	3.2%	5.4%	-11.7%	-25m	GBP	/DivCov/Beta	NO	6
Tate & Lyle	LSE:TATE	£3,147m	676p	13	4.4%	1.5%	3.2%	-9.2%	-307m	GBP	/DivCov/DivGrth/	NO	6
Clipper Logistics	LSE:CLG	£239m	235p	12	4.1%	40.7%	5.2%	-10.4%	-69m	GBP	/DivCov/Beta	NO	6
Ten Entertainment Group	LSE:TEG	£170m	262p	13	4.4%	19.7%	15.0%	9.6%	-10m	GBP	/DivCov/DivGrth/	NO	6
Telecom Plus	LSE:TEP	£943m	1,206p	19	4.3%	10.3%	6.8%	-11.5%	-37m	GBP	/DivCov/CashConv/	NO	6

Source: S&amp;P Capital IQ, 4 November 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)
SThree	LSE:STHR	£377m	288p	9	5.0%	8.8%	7.1%	5.4%	-8m	GBP	/DivGrth/	NO	7
STV	LSE:STVG	£152m	388p	8	5.2%	8.9%	12.9%	7.2%	-55m	GBP	/EPSGrth/	NO	7
BlackRock Latin Am IT	LSE:BRLA	£181m	462p	-	6.1%	-	-	-12.7%	-25m	USD	/FwdEPSGrth/EPSGrth/	NO	6
Reach	LSE:RCH	£292m	99p	3	6.2%	1.4%	-5.9%	8.2%	-13m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Record	LSE:REC	£76m	39p	16	7.7%	-25.6%	0.6%	20.9%	24m	GBP	/FwdEPSGrth/DivCov/	YES	6
S&U	LSE:SUS	£256m	2,120p	8	5.6%	5.4%	8.8%	-4.5%	-126m	GBP	/IntCov/FCF/	NO	6
Photo-Me Inti	LSE:PHTM	£340m	90p	10	9.4%	6.5%	3.6%	-10.9%	15m	GBP	/EPSGrth/DivCov/	NO	6
Target Healthcare REIT	LSE:THRL	£511m	112p	19	6.0%	22.2%	6.5%	0.9%	-80m	GBP	/DivGrth/DivCov/	NO	6
Headlam	LSE:HEAD	£411m	490p	13	5.1%	-10.1%	5.0%	8.4%	-14m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Devro plc	LSE:DVO	£262m	157p	10	5.7%	9.9%	4.7%	-24.2%	-149m	GBP	/DivGrth/DivCov/	NO	6

Source: S&amp;P Capital IQ, 4 November 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	£25m	42p	7	4.8%	6.1%	6.5%	-1.2%	15m	GBP	na	NO	8
Finsbury Food	AIM:FIF	£104m	82p	8	4.3%	8.5%	3.1%	21.3%	-35m	GBP	na	NO	8
The Property Franchise	AIM:TPFG	£39m	153p	10	5.5%	9.8%	4.3%	-15.5%	3m	GBP	na	NO	8
Gateley (Holdings)	AIM:GTLY	£186m	162p	12	5.0%	6.3%	7.0%	-2.5%	-3m	GBP	na	NO	8
Northern Bear	AIM:NTBR	£13m	72p	-	5.6%	-	-	5.0%	2m	GBP	/FwdEPSGrth/	YES	7
The Character Group	AIM:CCT	£82m	385p	9	6.8%	-7.4%	0.0%	-32.4%	20m	GBP	/FwdEPSGrth/	NO	7
Billington	AIM:BILN	£37m	308p	9	4.2%	1.5%	3.7%	-2.2%	8m	GBP	/FwdEPSGrth/	NO	7
Somero Enterprises	AIM:SOM	£113m	200p	8	7.3%	-12.8%	0.8%	-28.0%	13m	USD	/FwdEPSGrth/	NO	7
M&C Saatchi	AIM:SAA	£155m	169p	8	6.5%	-14.5%	6.8%	-49.9%	-31m	GBP	/FwdEPSGrth/	NO	7
Highland Gold Mining	AIM:HGM	£758m	208p	10	6.4%	71.8%	2.1%	-3.0%	-217m	USD	/DivCov/	NO	7
Rotala	AIM:ROL	£27m	54p	7	5.0%	26.7%	9.1%	-5.3%	-35m	GBP	/IntCov/	NO	7
Trans-Siberian Gold	AIM:TSG	£76m	88p	-	7.3%	-	-	0.8%	-10m	USD	/FwdEPSGrth/DivGrth/	YES	6
Empresaria	AIM:EMR	£24m	50p	4	4.0%	-14.5%	19.3%	-27.7%	-31m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
MS INTERNATIONAL	AIM:MSI	£32m	192p	-	4.3%	-	-	-4.3%	23m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Polar Capital	AIM:POLR	£465m	500p	13	6.6%	-23.7%	15.0%	-13.4%	147m	GBP	/FwdEPSGrth/IntCov/	NO	6
Shoe Zone	AIM:SHOE	£65m	130p	7	8.8%	-7.5%	0.4%	-36.6%	3m	GBP	/FwdEPSGrth/IntCov/	NO	6
ULS Technology	AIM:ULS	£32m	49p	8	4.9%	-8.7%	-1.9%	-25.3%	-3m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Belvoir	AIM:BLV	£43m	117p	9	6.2%	6.4%	10.1%	4.8%	-10m	GBP	/DivGrth/FCF/	NO	6
Redde	AIM:REDD	£334m	109p	8	10.7%	5.5%	1.8%	-7.9%	-35m	GBP	/FwdEPSGrth/DivCov/	NO	6
Inspired Energy	AIM:INSE	£102m	14p	8	4.6%	12.8%	12.2%	9.6%	-28m	GBP	/EPSGrth/DivCov/	NO	6

Source: S&amp;P Capital IQ, 4 November 2019

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