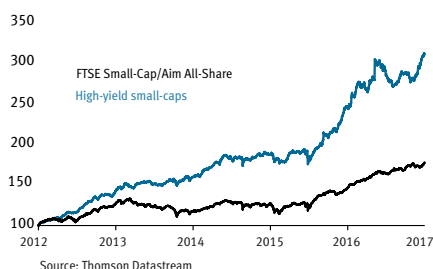




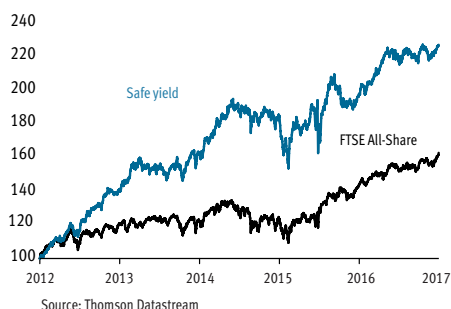
AlphaScreens: Finding dividend diamonds

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:

- The UK's FTSE 100 index is on an attractive trailing 12-month yield of around 5 per cent, but none of the blue-chips are passing all our dividend yield tests. Does this mean that the supposedly cheap FTSE 100 is a value trap? Our screen places great emphasis on dividend cover, earnings growth and operating cash conversion. The criteria may be strict but as global economic growth slows, investors should pay attention to these metrics when assessing income bargains.
- Smaller companies fair better on our FTSE All-Share screen, with the same companies as last month getting full marks. These are **SSP Group (SSPG)**, which operates food and beverage concessions at travel outlets, home consumer products company **Norcros (NXR)** and equipment rental business **VP (VP)**.
- The value factor has had some bad years on Aim, so dividend yield is a measure to be treated with caution. Our stringent dividend safety metrics do provide some reassurance, but as ever the screen results are a helpful starting point for further research before investing in riskier smaller companies.

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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

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	£2,726m	617p	21	7.2%	9.4%	8.4%	-9.5%	-438m	GBP	na	YES	8
Norcross	LSE:NRX	£181m	225p	7	3.7%	8.3%	3.4%	4.6%	-35m	GBP	na	NO	8
Vp	LSE:VP	£316m	797p	8	3.8%	7.7%	4.2%	-10.4%	-168m	GBP	na	NO	8
PageGroup	LSE:PAGE	£1,347m	424p	12	6.1%	9.3%	9.4%	-18.1%	-57m	GBP	/Beta	YES	7
Apax Global Alpha	LSE:APAX	£776m	158p	-	5.3%	-	-	5.2%	116m	EUR	/EPSGrth/	NO	7
Sirius Real Estate	LSE:SRE	£782m	76p	18	4.1%	5.3%	12.7%	8.5%	-296m	EUR	/CashConv/	NO	7
Hollywood Bowl	LSE:BOWL	£350m	233p	16	4.6%	10.1%	5.9%	4.9%	-5m	GBP	/DivGrth/	YES	7
Polymetal International	LSE:POLY	£5,372m	1,143p	11	3.6%	14.1%	20.0%	12.2%	-1,736m	USD	/DivCov/	NO	7
Intl Consolidated Airlines	LSE:IAG	£9,023m	455p	5	6.5%	-8.0%	2.1%	-0.4%	-4,819m	EUR	/EPSGrth/Beta	YES	6
Rio Tinto	LSE:RIO	£65,443m	4,036p	8	6.4%	23.6%	-11.3%	-15.1%	-4,544m	USD	/DivGrth/EPSGrth/	NO	6
Bodycote	LSE:BOY	£1,291m	681p	12	5.7%	-4.8%	5.9%	-19.0%	-112m	GBP	/EPSGrth/Beta	YES	6
Wincanton	LSE:WIN	£274m	222p	6	4.9%	3.5%	2.8%	-15.7%	-19m	GBP	/RoE/CashConv/	NO	6
SSE	LSE:SSE	£12,991m	1,253p	14	7.8%	17.5%	14.7%	9.0%	-9,343m	GBP	/DivCov/IntCov/	NO	6
Wm Morrison S'markets	LSE:MRW	£4,654m	195p	14	6.5%	3.6%	7.0%	-6.8%	-2,406m	GBP	/DivCov/RoE/	YES	6
Morgan Sindall	LSE:MGNS	£515m	1,152p	8	4.6%	3.1%	7.3%	-0.3%	58m	GBP	/CashConv/Beta	NO	6
Direct Line Insurance	LSE:DLG	£3,799m	278p	10	10.5%	-16.3%	-4.7%	-18.9%	660m	GBP	/DivCov/EPSGrth/	YES	6
Mondi	LSE:MNDI	£7,371m	1,521p	10	4.8%	-9.1%	0.2%	-14.5%	-2,341m	EUR	/EPSGrth/Beta	NO	6
PayPoint	LSE:PAY	£591m	875p	13	8.0%	2.7%	4.1%	-5.5%	37m	GBP	/DivCov/DivGrth/	YES	6
GCP Student Living	LSE:DIGS	£707m	171p	28	3.6%	18.5%	13.6%	3.3%	-234m	GBP	/IntCov/CashConv/	NO	6
Bovis Homes	LSE:BVS	£1,463m	1,088p	10	5.2%	8.1%	8.9%	5.5%	80m	GBP	/DivCov/Beta	NO	6
Forterra	LSE:FORT	£544m	278p	10	3.8%	5.1%	5.5%	-8.2%	-50m	GBP	/DivGrth/Beta	NO	6
Headlam	LSE:HEAD	£376m	448p	12	5.6%	-10.1%	5.0%	-4.6%	-14m	GBP	/DivCov/EPSGrth/	NO	6
Imperial Brands	LSE:IMB	£17,160m	1,821p	6	10.3%	2.2%	2.3%	-6.8%	-12,807m	GBP	/DivCov/CashConv/	NO	6
Mears	LSE:MER	£288m	261p	9	4.8%	1.0%	14.9%	-6.5%	-225m	GBP	/DivCov/IntCov/	NO	6
Speedy Hire	LSE:SDY	£278m	54p	10	3.7%	13.1%	9.5%	-13.2%	-90m	GBP	/RoE/CashConv/	NO	6
MJ Gleeson	LSE:GLE	£429m	786p	12	4.4%	9.4%	9.6%	-1.1%	30m	GBP	/DivCov/CashConv/	NO	6
BAE Systems	LSE:BA	£17,421m	544p	11	4.1%	8.0%	5.5%	10.6%	-3,369m	GBP	/DivCov/CashConv/	NO	6
Clipper Logistics	LSE:CLG	£208m	205p	10	4.7%	45.1%	3.8%	-28.5%	-69m	GBP	/DivCov/Beta	NO	6
Ten Entertainment	LSE:TEG	£157m	241p	12	4.7%	21.8%	13.4%	3.8%	-10m	GBP	/DivCov/DivGrth/	NO	6
Tate & Lyle	LSE:TATE	£3,264m	701p	13	4.2%	1.9%	3.2%	-7.2%	-307m	GBP	/DivCov/DivGrth/	NO	6
Telecom Plus	LSE:TEP	£952m	1,218p	19	4.3%	9.7%	6.8%	-12.6%	-37m	GBP	/DivCov/CashConv/	NO	6

Source: S&P Capital IQ, 7 October 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)
STV	LSE:STVG	£146m	373p	8	5.4%	8.9%	12.9%	4.2%	-55m	GBP	/EPSGrth/	NO	7
BlackRock Latin Am IT	LSE:BRLA	£177m	451p	-	6.6%	-	-	-16.4%	-25m	USD	/FwdEPSGrth/EPSGrth/	YES	6
Reach	LSE:RCH	£290m	98p	3	6.3%	1.4%	-5.9%	25.4%	-13m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Record	LSE:REC	£67m	34p	14	8.8%	-25.8%	2.2%	7.9%	24m	GBP	/FwdEPSGrth/DivCov/	YES	6
S&U	LSE:SUS	£252m	2,090p	8	5.6%	5.9%	8.7%	-13.3%	-126m	GBP	/IntCov/FCF/	NO	6
Photo-Me Intl	LSE:PHTM	£356m	94p	10	9.0%	6.5%	3.6%	-2.3%	15m	GBP	/EPSGrth/DivCov/	NO	6
Headlam	LSE:HEAD	£376m	448p	12	5.6%	-10.1%	5.0%	-4.6%	-14m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Tyman	LSE:TYMN	£466m	239p	8	5.0%	3.0%	8.0%	-7.3%	-290m	GBP	/DivCov/IntCov/	NO	6

Source: S&P Capital IQ, 7 October 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	44p	8	4.6%	6.1%	6.5%	4.3%	15m	GBP	na	NO	8
Finsbury Food	AIM:FIF	£100m	79p	8	4.5%	8.5%	3.1%	21.9%	-35m	GBP	na	NO	8
The Property Franchise Grp	AIM:TPFG	£40m	153p	10	5.5%	9.8%	4.3%	-8.7%	3m	GBP	na	NO	8
Gateley	AIM:GTLY	£184m	165p	12	4.8%	6.3%	7.0%	-0.6%	-3m	GBP	na	NO	8
Northern Bear	AIM:NTBR	£13m	70p	-	5.8%	-	-	15.4%	2m	GBP	/FwdEPSGrth/	YES	7
The Character Group	AIM:CCT	£75m	350p	9	7.4%	-11.7%	21.4%	-40.2%	20m	GBP	/FwdEPSGrth/	NO	7
Somero Enterprises	AIM:SOM	£109m	194p	7	8.0%	-12.1%	1.5%	-32.6%	13m	USD	/FwdEPSGrth/	NO	7
M&C Saatchi	AIM:SAA	£151m	165p	8	6.7%	-14.5%	6.8%	-53.7%	-31m	GBP	/FwdEPSGrth/	NO	7
NWFAIM:NWF		£78m	161p	10	4.1%	-2.1%	1.5%	-5.3%	-10m	GBP/FwdEPSGrth/	NO	7	
Highland Gold Mining	AIM:HGM	£777m	214p	9	6.3%	75.0%	0.2%	6.1%	-217m	USD	/DivCov/	NO	7
Rotala	AIM:ROL	£27m	54p	7	5.0%	26.7%	9.1%	-10.8%	-35m	GBP	/IntCov/	NO	7
Frenkel Topping	AIM:FEN	£21m	31p	12	4.2%	73.3%	5.5%	-19.5%	1m	GBP	/DivCov/	NO	7
Trans-Siberian Gold	AIM:TSG	£87m	100p	-	6.8%	-	-	21.0%	-10m	USD	/FwdEPSGrth/DivGrth/	YES	6
Vertu Motors	AIM:VTU	£120m	33p	6	4.9%	0.0%	9.9%	-18.3%	0m	GBP	/FwdEPSGrth/EPSGrth/	NO	6
Elegant Hotels	AIM:EHG	£62m	70p	7	5.7%	9.2%	5.5%	-1.4%	-69m	USD	/DivGrth/IntCov/	NO	6
MS INTERNATIONAL	AIM:MSI	£28m	170p	-	4.9%	-	-	-18.7%	23m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Shoe Zone	AIM:SHOE	£58m	116p	7	10.0%	-7.5%	0.4%	-47.7%	3m	GBP	/FwdEPSGrth/IntCov/	NO	6
Polar Capital	AIM:POLR	£497m	534p	13	6.2%	-19.1%	14.5%	-7.0%	147m	GBP	/FwdEPSGrth/IntCov/	NO	6
ULS Technology	AIM:ULS	£29m	44p	7	5.4%	-8.7%	-1.9%	-41.0%	-3m	GBP	/FwdEPSGrth/DivGrth/	NO	6
Belvoir	AIM:BLV	£40m	107p	9	6.8%	6.4%	10.1%	-7.4%	-10m	GBP	/DivGrth/FCF/	NO	6
Redde	AIM:REDD	£311m	101p	8	11.5%	5.7%	2.1%	-12.1%	-35m	GBP	/FwdEPSGrth/DivCov/	NO	6
Inspired Energy	AIM:INSE	£109m	15p	8	4.3%	12.8%	12.2%	11.1%	-28m	GBP	/EPSGrth/DivCov/	NO	6

Source: S&P Capital IQ, 7 October 2019

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