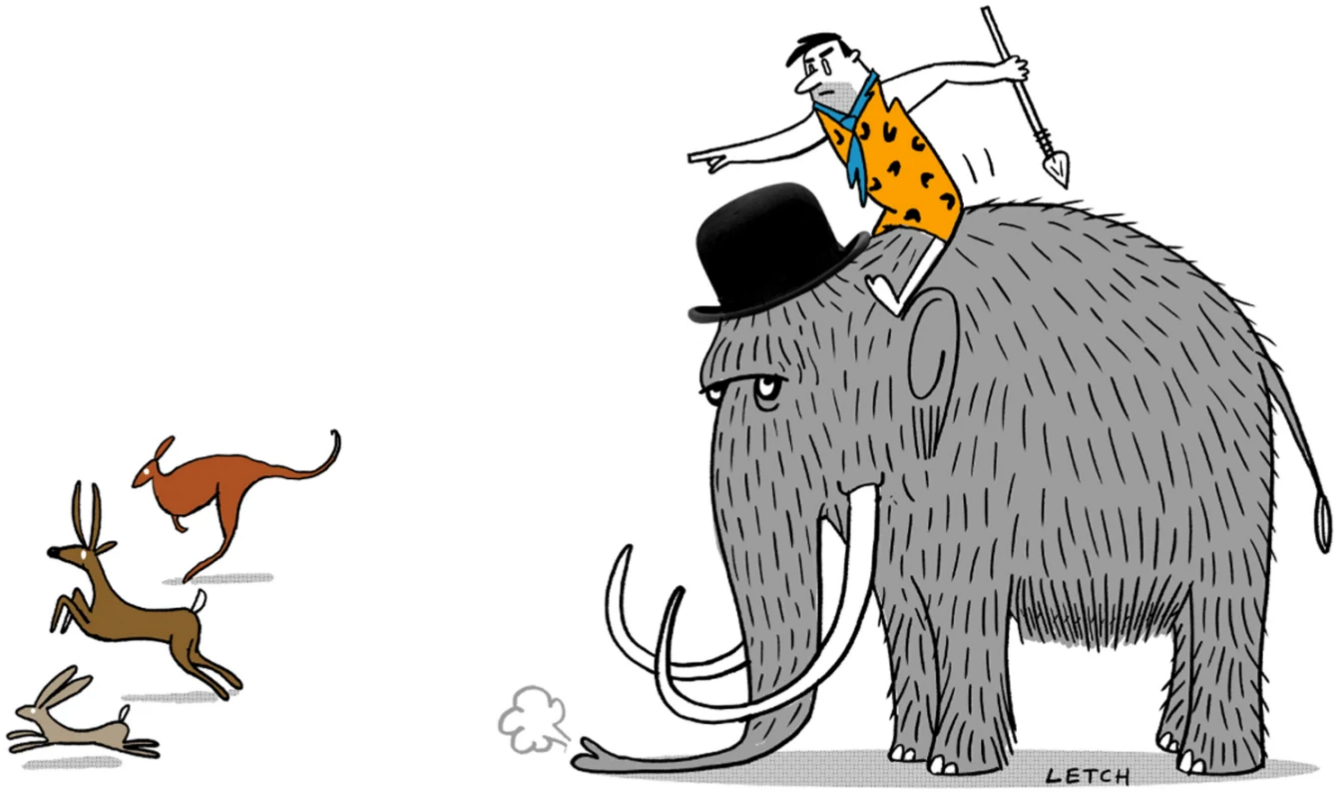
FINANCIAL REVIEW

Wealth Personal Finance Dividends

Where to chase dividends outside large caps

Investors looking to make the most of a shrinking payout pool are beginning to search outside the top 100. These are the small- and mid-cap stocks the fundies like.



Prospects for capital growth in the small- and mid-cap part of the market are much better than those for mature companies at the large end of town, say fund managers. **Simon Letch**

William McInnes *Reporter*

Oct 3, 2020 – 12.00am

Large-cap stocks – the big banks, miners, Telstra, Wesfarmers and Woolworths among others – have been heavily sought after for their dividends for years. But professional investors are warning the dividend pool could be coming to an end.

While Australia had long held the mantle of paying the highest dividends in the world, it has lost that title to Singapore with payouts, particularly in

4 per cent in financial 2021 while those outside the top 100 will boost their dividends by 4 per cent.

Dividend-seeking investors are starting to move away from the large caps and looking to mid- to small-cap names where a number of companies still pay a generous dividend, sometimes with the added benefit of strong capital growth.

"With a number of key large caps having their dividends cut and many struggling to grow earnings, we are definitely seeing a pick up in investors turning to the small- and mid-cap part of the market to look for yield," says Ophir Asset Management senior portfolio manager Andrew Mitchell.

"The best part of the dividends from the small- and mid-cap part of the market is that you can generally find companies that are growing the dollar value of the dividends much faster than some of the large caps."

Small-mid cap stocks paying dividends

Company	Price ($)	FY20 dividend ($)	Dividend yield (%)
Nick Scali	8.45	0.48	5.6
Vita Group	1.03	0.02	2.3
Jumbo Interactive	11.78	0.36	2.9
Metcash	2.71	0.13	4.5
Kelly Partners	1.25	0.05	3.9
IPH	7.05	0.29	4.0
GR Engineering	1.12	0.06	5.9
Pro-Pac Packaging	0.17	0.004	2.3
City Chic*	2.83	0.07	2.2
Dicker Data	7.80	0.15	1.9

As at Oct 2. * City Chic = FY19. SOURCE: BLOOMBERG

Discretionary

forgiveness, JobKeeper payments and early superannuation withdrawals.

Nick Scali was a standout in the retail sector and paid out a generous dividend in 2020, after receiving $3.9 million in JobKeeper payments.

"Following the establishment of its online store in April this year, Nick Scali has traded extremely well through the COVID period and remains well positioned to achieve further growth through both network expansion and market share gains in what is still a relatively fragmented industry," says First Sentier Investors senior portfolio manager Tim Canham.

"The company also has a well-established dividend policy, currently yielding high single digits."

Dilution is unlikely, with the company not raising capital since listing.

Telstra store licensee and health and wellness clinic operator **Vita Group** is a top dividend pick for Dean Fergie, portfolio manager at Cyan Investment Management. In the 2020 financial year, it paid a total dividend of 7.7¢, representing a dividend yield of about 7.5 per cent.

First Sentier Investors' Tim Canham. **Ryan Stuart**

"While the retail telco business is mature, its health and wellness clinics (Artisan) are beginning their roll-out and are expected to provide good growth," says Fergie. Vita also boasts a very strong balance sheet, with net cash of $24 million.

the year.

"Jumbo is a rare beast in that it pays out about 35¢ annually in dividends and is a growing online tech business with around $50 million on the balance sheet," says Fergie.

Consumer discretionary stocks with a global reach offer particular appeal and shareholders in City Chic have been reaping the rewards of both dividends and a near 20 per cent share price rise in the last 12 months.

"Investors searching for capital growth, complemented with dividends, can take comfort in City Chic's enviable $112 million cash war chest, no debt and a $40 million undrawn debt facility providing flexibility to pursue both organic and acquisition opportunities in a $50 billion plus-size market," says Ausbil portfolio manager Arden Jennings.

"Despite COVID severely affecting many retailers, City Chic's strong digital offering resulted in sustained profitability at a time when many retailers closed their doors."

Staples

Metcash's resilient revenues have helped produce sustainable dividends at a healthy 4.5 per cent yield, fully franked. "With more people spending time at home, they have been shopping more locally, which has benefited the food retailers in the Metcash network," says Investors Mutual senior portfolio manager Simon Conn.

Cyan Investment Management's Dean Fergie. **Stefan Postles**

"We also like Metcash's recent move into the tool supplies market through the acquisition of Total Tools, which gives Metcash an opportunity to grow both organically and through further acquisition."

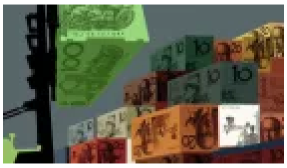
Business services

paying generous dividends.

Kelly+Partners, a chartered accounting firm, is not the first name on many people's lips when it comes to dividends but with a quarterly dividend of 1.33¢, it has a dividend yield of more than 4 per cent and the share price has risen 24.2 per cent since the start of the year.

"Growth has been a little stagnant of late but if they can ramp up their accounting practice acquisition strategy and extract some synergies, there should be some bottom-line growth in what is a very stable industry," says Cyan's Fergie.

IPH is a favourite for Investor Mutual's Conn who says the intellectual property and trademark company had predictable and stable cash flows, with a dividend yield of 4 per cent. Importantly, it hasn't needed to raise capital this year.



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"IPH looks like a growth company, but pays a dividend," says Conn. "It does both as its earnings grow, but also its shares on issue don't grow as well. Maths is important, because the number of shares on issue is the denominator and that is the powerful part of the fraction."

Industrials

GR Engineering might be smaller than other mining services companies but pays out one of the healthiest dividend yields in the market.

Investors Mutual's Simon Conn. **Edwina Pickles**

"It's a small company but has a great balance sheet, excellent management and its strongest-ever order book and outlook," says Canham.

"It produces cash flow, is delivering growth and has not raised any equity. Dividends come from cash flow, not EBITDA. For example, if it pays out 85

Packaging and logistics companies have proved incredibly resilient through the pandemic with stocks like **Pro-Pac Packaging** up close to 50 per cent this year.

"Pro-Pac has a significant cost-reduction opportunity which the management team is diligently pursuing which will help deliver earnings growth. Given the fragmented industry structure, there are opportunities for bolt-on acquisitions in time," says Conn.

"We believe it's only a matter of time until the market appreciates the turnaround that has occurred at Pro-Pac. It's attractively priced and also has a good fully-franked 4 per cent dividend."

Tech

While many investors are attracted to the strong capital growth in tech stocks, the lack of profit can be an obstacle. Dicker Data offers the best of both, with dividends growing at a rate of 20 per cent annually and its share price up 15 per cent year-to-date.

"Investors have benefited from strong capital gains in Dicker Data shares in recent years, a consistent stream of fully-franked dividends and a healthy yield," says Ausbil portfolio manager Mason Willoughby-Thomas.

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"The growth outlook for the company looks healthy (underpinned by a number of structural tailwinds), operating margins have been steadily improving as the business scales and capital investment demands are set to wind down over the next 12 months as the company completes a major upgrade to its warehousing infrastructure."

As dividends dry up in the large-cap sector, investors may need to start learning lessons from the US, where dividends have consistently been below 2 per cent. "If you're getting enough capital growth from your shares, you can easily sell some to meet your lifestyle needs if dividends aren't enough," says Mitchell.

"In Australia we think the prospects for capital growth in the small- and mid-cap part of the market remain much better than those for the older and more mature companies at the large end of town."

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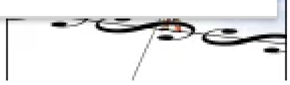

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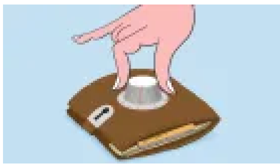

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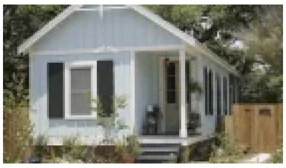

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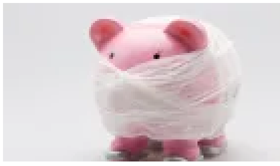

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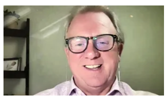

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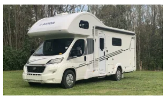

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