Harnessing the power of small cap 'dividend dynamos'

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"While investors do not always associate small caps with attractive and growing dividends, for those prepared to look carefully, there are stocks that deliver on both counts."

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While UK PLC has been contending with Brexit uncertainty for more than three and a half years, at an individual company level there are still well-managed businesses trading successfully, growing their earnings and paying healthy and rising dividends.

Those dividends look particularly attractive in an era of ultra-low interest rates. Savers who look hard enough might be able to earn 1.9% annually on a two-year fixed-term deposit account with a bank. Meanwhile, at the time of writing, the dividend yield on the FTSE All-Share is around 4.05%.

There are pressures on UK dividends, of course. According to the Link Group UK Dividend Monitor, in the third quarter of 2019 underlying dividends, calculated on a constant currency basis, were almost 3% lower compared with the same period in the previous year. The monitor, which looks at companies listed on the London Stock Exchange's Main Market, warned that 2019 will "almost certainly" have proved a temporary high-water mark for UK dividends.

What is worth remembering though is that the headline figure for UK dividends depends to a large extent on the fortunes of a limited number of UK large cap stocks. The Link research shows that just 15 FTSE 100 companies paid out more than 60% of all UK dividends in the third quarter of 2019. This high degree of concentration brings stock-specific risk and the decision by a single company, Vodafone, to make a large cut to its dividend has been cited as a particular factor in the decline in 2019's third-quarter pay-outs.

AIM dividend growth

If we look further down the market cap spectrum though the dividend landscape looks more encouraging. On AIM, for example, underlying dividends rose by almost 16.5% in 2018 to a record of just under £1.1 billion, according to the Link AIM Dividend Monitor. And, in the first half of 2019, underlying dividends were up by almost 14%, compared to the first half of 2018.

This highlights the value of the UK's small cap 'dividend dynamos'. Many have track records of healthy dividends stretching back years and some have continued to announce double-digit dividend increases.

One example is the kettle component and water filtration business Strix. A global leader in its field, the AIM-listed company supplies international brands including Philips, Russell Hobbs and Tefal amongst others. While the worldwide market for kettles is growing at around 7% a year, Strix is also broadening its revenue mix. The company is launching a host of new products in areas including babycare (working with the well-regarded Tommee Tippee brand), water dispensers and coffee vending machines. Certified to the highest standards of safety, its products are also more energy efficient than some alternatives. Strix's new Water Station product, potentially launching this year, will offer the ability to produce a cup of chilled or boiled water within five seconds. It is designed specifically to reduce the excess water we heat up and then waste as a nation by overfilling our kettles, which is estimated to cost £300m annually. The product may have particular appeal for the growing number for whom the environment and sustainability are priorities. Strix raised its dividend 13% at the most recent interims and yields approximately 4%.

Another AIM company with a steady record of growing dividends is Mattioli Woods, the provider of wealth management and employee benefits services. The company's adjusted profits before tax grew 8.8% for the year to the end of May 2019. However, full-year dividends increased by even more at 17.6%. A yield of around 2.6% looks attractive given the rate of dividend growth.

24 years of dividend growth

FTSE SmallCap company Bloomsbury Publishing counts Harry Potter author J.K. Rowling among its writers. It also produces academic, professional and special interest titles that are sold around the world. Bloomsbury is growing the digital publishing side of the business profitably and global revenues have reduced the impact of Brexit uncertainty. The company has grown its dividends for 24 consecutive years and recently announced another increase, with the interim dividend up 6%. The share price has a had a strong run recently, but the stock is still yielding just over 2.8%.

Chesnara is a FTSE SmallCap business managing over £7bn of life insurance and pension policies in the UK and Europe. Following a sharp sector derating last year, the shares have begun their recovery, reinforced by positive interim results released in August 2019 that met consensus forecasts. We believe the business is misunderstood. It has been a consistent dividend payer over the past decade, with dividend growth supported by operational performance. This has been achieved in challenging market environments as well as more supportive ones. For example, the company wrote down only 1% of its net asset value (NAV) in 2008, compared with some larger peers experiencing 9% dents to their NAV. The latest interim dividend was increased by 3%, which although modest growth, is off a high yield level of around 6.6%.

While investors do not always associate small caps with attractive and growing dividends, for those prepared to look carefully, there are stocks that deliver on both counts. This area of the market has been unloved for some time and, in our view, offers interesting opportunities.

For investors seeking diversified portfolios, small cap 'dividend dynamos' can provide attractive additional options for income.

And, after an extended period when UK equities have been out of favour with investors, these smaller companies could be well positioned to reap the benefits of an improvement in sentiment.

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Risk Warnings

Capital is at risk. The following is a summary only of some key items in the Prospectus and more details can be found in the Prospectuses. Investors in Protected Cell Company (PCC) must have the financial expertise and willingness to accept the risks inherent in this investment.

Past performance is not a reliable indicator of current or future performance; it may not be repeated and should not be the sole factor considered when selecting funds.

It should be appreciated that the value of Shares is not guaranteed and may go down as well as up and that investors may not receive, on redemption of their Shares, the amount that they originally invested.

Investment in the Company should only be undertaken as part of a diversified investment portfolio.

Investment in the Shares should be viewed as a medium to long term investment.

Shares may not be redeemed other than on any Dealing Day.

There will not be any secondary market in the shares of the Company.

The individual cells of the fund act as feeder funds to various UK-authorised collective investment schemes, which may invest in smaller companies, and those listed on the alternative investment market (AIM), which carry a higher degree of risk than larger companies.

The shares of smaller companies may be less liquid and their performance more volatile over shorter time periods.

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