

AlphaScreens: the market according to GARP

2 November 2023

What's growth and what's fair value?

Growth at a reasonable price, or GARP, has proved a reliable strategy that has previously generated market-beating returns. Our GARP screen looks at both past rates of growth and analysts' forecasts, which can smooth out expectations, but the caution of actual buyers in the market is also worth considering.

Comment by Alpha editor:

Stock screens are rarely a crystal ball, but they give a good snap-shot of companies' financial performance and analysts' expectations at a point in time. Whether the shares that come through filtering subsequently perform strongly is influenced by macro factors such as confidence in the economy, monetary policy and a benign international situation. There is precious little certainty on any of these scores, although stock markets have shown a fair amount of resilience.

Judging which shares are well-placed to make good on analysts' positive forecasts and break highest when news improves is an even harder call to make than overall market direction. Our growth at a reasonable price (GARP) screen hopes to point us in the right direction by flagging companies that combine growing returns with decent value.

The chief metric of the screen is a variation on the PEG ratio, which in its simplest form is the share price to earnings per share (PE) ratio divided by the rate of earnings per share growth (EPS) over the period (trailing or forecast) being analysed. The idea is to place valuation multiples in the context of the continuous growth investors are paying up for and we apply the logic to US stocks included in the S&P 500 index, as well as large-cap, mid-cap and small-cap main market UK shares, and companies whose equity is valued above £35mn on Aim.

We use two variations of this metric. The first is a forward-looking PEG applied to each of the five universes we screen from. This is the two-year forward PE (today's share price divided by the forecast earnings per share (EPS) for the financial year after the current unreported one) divided by the implied growth rate between the last reported EPS and the EPS predicted for the year after the current unreported one.

The drawback of this figure is the over-reliance on analysts' forecasts and the ease with

which it can get sucked into buying on mania or on upgrade cycles that are due to some unsustainable factor with enough uncertainty that the market is right to price in a higher risk premium. Therefore, we view the forward-looking PEGs alongside blended versions that give a smoothed-out composite of past earnings growth and expected future growth.

For the huge US companies included in the S&P 500, as well as larger and mid-sized UK-listed shares, we take the historic PE ratio (for the most recently reported financial year) and divide it by a denominator designed to reflect realistic assumptions of the value that will be generated for shareholders. This denominator is calculated by splicing the trailing five-year compound annual growth rate of EPS with the forecast two-year rate. To this we add the dividend yield.

For smaller companies on the main market and Aim stocks, the past-future blend is achieved with a PEG made up of historic PE divided by forward two-year growth rate.

For all companies, viewing the forward-looking and relevant blended measures side-by-side is valuable. The blended PEG is the main determinant of being allowed to rank on our screen, but it isn't perfect: companies that have had wind in their sails from cyclical factors conducive to their business model need to be scrutinised as to whether they can continue their good run.

As a rule of thumb, a PEG of below one is considered cheap and anything beyond 1.5 is getting on for expensive. On our US screen, for example, the bright expectations for travel and hotels booking business **Booking Holdings (US:BKNG)**, see it valued on a forward PEG of 0.5 but the blended figure of 1.1 indicates fair value. The backward component of the blended PEG is over long enough to smooth out for the impact of the pandemic, but allowances for those lost years is part of the assessment would-be investors must undertake. With worries around economic headwinds and household incomes being squeezed, however, the forward-looking PEG may be baking in a reasonable risk premium.

Meta Platforms (US:META) was one of the tech superstars of the Covid-era but hit the skids in 2022 as valuation assumptions were realigned amid interest rate rise. Right now, having rebounded in 2023, the PEG of 1 suggests the stocks are bang on fair value. The forward PEG of 0.4, meanwhile, hints at investors being cautious about projected growth that could well come good if the company's open-source AI offering comes good. Although the uncertain timescales and the possible impact of an investment arms race in the new wave of technologies may mean caution is warranted.

That said, if US interest rate rises have peaked and cuts are in the offering next year – which is a crucial presidential race year after all – then there could be room for considerable upside for Meta even from here.

For mid-cap, small and Aim-listed UK companies, one of the tests we view alongside the PEG comparisons sets minimum levels for net profit margins and asset turnover (revenue divided by average total assets). These are two of the non-leverage components of return on equity and can be taken as a useful quality sense check. In other words companies failing these tests may be cheap for a reason.

November 2023 GARP results

UK large-cap stocks (passing at least 6 out of 8 tests)

Name	Ticker	Share price (p)	Mkt cap* (£mn)	NTM PE	2-yr PEG	PEG (Neff)	LTM DY	fc EPS grwth FY	fc EPS grwth FY +1	3-mth price mom.	Net cash (£mn)	Tests passed	Tests failed
Antofagasta	ANTO	1313	12944	20.0	1.0	0.5	3.8%	17.8%	19.6%	-20.5%	553	7	/2-yr fwd PEG/
Ashtead Group	AHT	4724	20683	12.1	0.8	1.3	1.7%	18.1%	13.1%	-17.3%	-1474	6	/Y-o-Y EPS/cash conv/
Coca-Cola HBC AG	CCH	2122	7816	11.8	0.3	0.8	3.2%	65.1%	8.5%	-7.2%	-1500	6	/5-yr EPS grwth/Y-o-Y EPS/
National Grid	NG	992	36594	14.0	5.9	0.4	5.6%	-2.6%	7.5%	-2.5%	-6362	6	/2-yr fwd PEG/fc EPS grwth/
BAE Systems plc	BA	1118	33969	16.7	1.6	1.0	2.5%	12.2%	8.8%	19.7%	-6839	6	/2-yr fwd PEG/5-yr sales grwth/

*Market caps here exclude non-traded shares so are lower than widely reported online
Source: Investors' Chronicle and FactSet

UK main market mid-cap stocks (passing at least 6 out of 9 tests)

Name	Ticker	Share price (p)	Mkt cap* (£mn)	NTM PE	2-yr PEG	PEG (Neff)	LTM DY	fc EPS grwth FY	fc EPS grwth FY +1	3-mth price mom.	Net cash (£mn)	Tests passed	Tests failed
TBC Bank	TBCG	2785	1543	4.1	0.4	0.2	6.1%	7.4%	12.7%	13.7%	-	7	/Y-o-Y EPS/fc EPS grwth/
Clarkson	CKN	2675	820	11.4	-	0.9	3.5%	-2.9%	-2.0%	-4.3%	13.4	7	/2-yr fwd PEG/fc EPS grwth/
Computacenter	CCC	2588	2954	14.5	6.1	1.0	2.6%	2.1%	2.8%	18.8%	-1443.9	6	/2-yr fwd PEG/fc EPS grwth/Nl or Asset TO/
XPS Pensions	XPS	212	440	14.5	1.4	0.9	4.0%	7.9%	11.8%	13.1%	-	6	/2-yr fwd PEG/5-yr EPS grwth/Nl or Asset TO/
Beazley	BEZ	524	3524	5.3	0.0	0.2	2.6%	313.6%	12.2%	0.7%	-	6	/5-yr EPS grwth/Y-o-Y EPS/Nl or Asset TO/
Fraser's	FRAS	808	3661	8.9	0.6	0.1	0.0%	19.2%	11.1%	-0.2%	-684.0	6	/5-yr EPS grwth/Y-o-Y EPS/Nl or Asset TO/
Bloomsbury Publishing	BMV	417	340	13.3	11.0	1.3	3.4%	3.7%	-1.3%	-1.9%	-73.3	6	/2-yr fwd PEG/fc EPS grwth/Nl or Asset TO/
Greggs	GRG	2394	2448	18.0	2.6	1.4	2.5%	3.1%	11.0%	-6.1%	-97.2	6	/2-yr fwd PEG/fc EPS grwth/Nl or Asset TO/
Hiscox	HSX	952	3306	7.0	0.0	0.1	3.1%	1116.4%	15.7%	-11.7%	-	6	/5-yr EPS grwth/5-yr sales grwth/Nl or Asset TO/
Rathbones	RAT	1514	1371	10.3	0.3	1.0	7.9%	47.0%	26.0%	-15.0%	-	6	/5-yr EPS grwth/Y-o-Y EPS/Nl or Asset TO/
Bank of Georgia	BGEO	3340	1531	3.7	-	0.2	8.0%	-7.5%	3.8%	2.0%	-	6	/2-yr fwd PEG/Y-o-Y EPS/fc EPS grwth/
Intermediate Capital	ICP	1309	3804	9.9	0.3	0.5	5.9%	40.8%	29.9%	-3.2%	-	6	/5-yr EPS grwth/Y-o-Y EPS/cash conv/
Plus500	PLUS	1421	1137	5.9	-	0.6	6.0%	-29.1%	11.9%	-4.3%	-	6	/2-yr fwd PEG/Y-o-Y EPS/fc EPS grwth/
IG Group	IGG	639	2489	6.2	0.4	0.4	7.1%	13.0%	14.4%	-7.9%	-	6	/5-yr EPS grwth/Y-o-Y EPS/cash conv/
PRS REIT	PRSR	73	401	17.9	0.9	0.3	5.5%	27.4%	10.1%	-11.1%	-	6	/5-yr EPS grwth/Y-o-Y EPS/cash conv/
Volution	FAN	367	726	14.0	3.4	1.3	2.2%	1.2%	7.0%	-8.7%	-46.2	6	/2-yr fwd PEG/5-yr EPS grwth/fc EPS grwth/
Games Workshop	GAW	10020	3298	22.4	4.3	1.4	4.7%	4.1%	6.5%	-13.6%	42.0	6	/2-yr fwd PEG/Y-o-Y EPS/fc EPS grwth/
Dunelm	DNLM	977	1974	12.8	3.6	1.1	4.3%	-1.3%	8.5%	-16.1%	-223.3	6	/2-yr fwd PEG/Y-o-Y EPS/fc EPS grwth/
OSB Group	OSB	288	1137	3.0	1.1	0.4	11.1%	-27.9%	45.4%	-21.4%	-	6	/2-yr fwd PEG/Y-o-Y EPS/fc EPS grwth/

*Market caps here exclude non-traded shares so are lower than widely reported online
Source: Investors' Chronicle and FactSet

UK main market small-cap stocks (passing at least 6 out of 8 tests)

Name	Ticker	Share price (p)	Mkt cap* (£mn)	NTM PE	2-yr PEG	PEG (Neff)	LTM DY	fc EPS grwth FY	fc EPS grwth FY +1	3-mth price mom.	Net cash (£mn)	Tests passed	Tests failed
Secure Trust Bank	STB	598	112	2.9	0.1	0.4	7.5%	12.2%	25.9%	4.9%	-	8	n/a
On The Beach	OTB	97	162	6.8	0.1	0.6	0.0%	69.8%	31.8%	11.7%	-197.2	7	/Nl or Asset TO/
Galliford Try	GFRD	232	239	10.8	0.5	1.0	4.5%	15.1%	22.0%	16.6%	-349.7	7	/Nl or Asset TO/
Marston's	MARS	30	199	4.1	0.2	0.2	0.0%	20.9%	36.8%	-2.3%	-264.5	6	/Net debt to Ebitda/cash conv/
Fuller, Smith & Turner Class A	FSTA	574	218	21.5	0.6	0.4	2.6%	51.8%	16.2%	-3.7%	-51.8	6	/Net debt to Ebitda/Nl or Asset TO/
Grit Real Estate Income	GR1T	20	99	2.7	0.1	0.9	16.7%	34.5%	21.6%	-38.5%	-	6	/Net debt to Ebitda/cash conv/

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Source: Investors' Chronicle and FactSet

Continued below

UK Aim stocks (passing at least 6 out of 8 tests)

Name	Ticker	Share price (p)	Mkt cap* (£mn)	NTM PE	2-yr PEG	PEG (Neff)	LTM DY	fcEPS grwth FY	fcEPSgrwth FY+1	3-mth price mom.	Net cash (£mn)	Tests passed	Tests failed
Eckoh	ECK	41	118	18.3	1.0	0.7	1.8%	29.0%	10.0%	-5.8%	-10.9	8	n/a
Gaming Realms	GMR	33	96	13.0	0.4	0.3	0.0%	48.8%	29.4%	-8.1%	1.6	8	n/a
Oxford Metrics	OMG	88	115	18.6	0.5	0.4	2.8%	45.0%	28.9%	-14.6%	2.6	8	n/a
Ashtead Technology	AT	469	375	15.6	0.7	0.4	0.2%	46.6%	5.5%	20.6%	-14.9	7	/EPSgrwth/
Warpaint London	W7L	315	243	19.7	0.9	1.0	2.4%	28.6%	13.2%	9.0%	-6.0	7	/NI or Asset TO/
Volex	VLX	282	512	9.7	0.5	0.9	1.4%	15.9%	18.7%	-3.4%	-129.6	7	/NI or Asset TO/
Supreme	SUP	104	121	6.7	0.4	0.3	2.9%	36.7%	2.7%	-8.4%	-26.8	7	/EPSgrwth/
Aquis Exchange	AQX	358	99	15.8	0.7	1.0	0.0%	21.1%	19.9%	-5.8%	-	7	/cash conv/
Water Intelligence	WATR	334	58	10.8	0.2	0.2	0.0%	91.2%	8.3%	-24.9%	1.6	7	/NI or Asset TO/
Metals Exploration	MTL	2	49	1.6	0.0	0.0	0.0%	638.9%	-42.9%	23.7%	-49.1	6	/EPSgrwth/NI or Asset TO/
H&T Group	HAT	490	216	7.5	0.2	0.2	3.4%	43.1%	26.4%	13.2%	-3.6	6	/cash conv/NI or Asset TO/
Pan African Resources	PAF	16	361	4.9	0.2	0.4	4.6%	4.7%	50.0%	12.0%	-33.5	6	/EPSgrwth/No cut to EPSfc/
Vertu Motors	VTU	76	258	7.2	0.6	0.7	3.0%	12.8%	10.2%	8.3%	-743.1	6	/Net debt to Ebitda/NI or Asset TO/
ECO Animal Health	EAH	106	72	33.8	0.6	0.9	0.0%	84.5%	26.8%	-4.1%	-0.5	6	/EPSgrwth/NI or Asset TO/
1Spatial	SPA	48	53	16.9	0.2	0.7	0.0%	155.1%	30.0%	-6.9%	-12.2	6	/EPSgrwth/NI or Asset TO/
Atalaya Mining	ATYM	303	424	6.6	0.1	0.7	2.3%	11.2%	120.8%	-8.5%	1.0	6	/EPSgrwth/NI or Asset TO/
Billington Holdings	BILN	312	40	6.1	0.5	0.1	5.0%	60.9%	-21.6%	-12.1%	-21.1	6	/EPSgrwth/NI or Asset TO/

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Source: Investors' Chronicle and FactSet

US S&P 500 GARP stocks (passing at least 7 out of 8 tests)

Name	Ticker	Share price (\$)	Mkt cap* (\$mn)	NTM PE	2-yr PEG	PEG (Neff)	LTM DY	fcEPS grwth FY	fcEPSgrwth FY+1	3-mth price mom.	Net cash (\$mn)	Tests passed	Tests failed
Booking Hldgs	BKNG	2766	98733	16.7	0.5	1.1	0.0%	45.9%	16.9%	-5.1%	2789	8	n/a
Meta Platforms Class A	META	312	692184	18.3	0.4	1.0	0.0%	67.7%	21.7%	-3.4%	30744	8	n/a
Chubb	CB	220	90489	10.5	0.6	0.8	1.5%	26.2%	9.9%	8.4%	-	8	n/a
Darden Restaurants	DRI	146	17525	15.9	1.5	1.4	3.4%	10.0%	10.0%	-12.5%	-1854	7	/2-yr fwd PEG/
United Rentals	URI	409	27755	9.7	0.6	0.8	1.1%	23.6%	6.9%	-13.6%	-3389	7	/fcEPSgrwth/
NVIDIA	NVDA	423	1045428	27.4	0.2	1.7	0.0%	223.1%	54.3%	-9.0%	5689	7	/Y-o-Y EPS/
FedEx	FDX	243	61153	12.3	0.5	1.3	1.9%	21.4%	23.9%	-9.3%	-6756	7	/5-yr EPSgrwth/
American Express	AXP	146	106725	12.1	1.0	0.7	1.6%	13.6%	10.6%	-13.7%	-	7	/5-yr sales grwth/
Lamb Weston Hldgs	LW	91	13183	15.0	0.9	0.7	1.2%	26.1%	7.2%	-11.8%	-1122	7	/fcEPSgrwth/
JPMorgan Chase & Co.	JPM	139	403771	8.9	0.7	0.5	2.9%	39.2%	-8.6%	-11.6%	-	7	/fcEPSgrwth/
Ameriprise Financial	AMP	318	32587	9.8	0.7	0.7	1.6%	17.3%	11.9%	-9.0%	-	7	/5-yr sales grwth/
Elevance Health	ELV	447	104947	12.3	0.9	1.3	1.3%	13.7%	12.1%	-4.6%	-	7	/Y-o-Y EPS/
Alphabet Class A	GOOGL	126	1478669	19.4	0.9	0.8	0.0%	25.9%	16.6%	-3.9%	33640	7	/5-yr EPSgrwth/
Alphabet Class C	GOOG	128	1478669	19.6	0.9	0.9	0.0%	25.9%	16.5%	-3.3%	33640	7	/5-yr EPSgrwth/
UnitedHealth Group	UNH	532	492424	19.4	1.6	1.5	1.3%	12.4%	11.8%	5.3%	-	7	/2-yr fwd PEG/
Hartford Financial Serv.	HIG	74	22215	7.8	0.6	0.2	2.3%	8.0%	19.4%	2.6%	-	7	/5-yr EPSgrwth/
T-Mobile US	TMUS	145	167747	15.0	0.1	0.4	0.4%	250.7%	41.1%	5.7%	-16587	7	/5-yr EPSgrwth/

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Source: Investors' Chronicle and FactSet

GARP criteria for US mega/large caps, UK large caps, UK mid-caps

Blended PEG ratio: historic price/earnings (PE) ratio divided by a combination of the blended past/expected earnings growth rate and dividend yield. The earnings growth rate is calculated based on the average of the five-year historic growth rate and the average forecast growth over the next two years.

Fwd PEG: The PE in the numerator is the ratio of current share price to expected earnings per share one year ahead of the current unreported year. The growth rate in the denominator is the compound annual growth rate between last reported earnings and the expected earnings at the end of the

period. A figure below one suggests that a company is cheaply valued relative to its expected earnings growth.

Screening criteria (US, UK large and mid-cap):

- **Compulsory test:** PEG ratio below the median average of the respective universe (see below).
- A two-year forward PEG below one.
- A five-year historic EPS compound annual growth rate above 7.5 per cent, but below 20 per cent (i.e. high, but sustainably so).
- A five-year historic revenue compound annual growth rate above 5 per cent (i.e. sales growth underpinning earnings growth).
- Year-on-year EPS growth in each of the past two half-year periods. (**Quarterly periods for the US stocks.**)
- Average forecast EPS growth of more than 7.5 per cent for the next two financial years.
- Cash conversion above 90 per cent..
- No downgrade to forecast EPS over the past three months.

All stocks must pass the historic PEG test to feature in the table. 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 PEG and three-month price momentum.

GARP criteria for UK small-cap and Aim-listed stocks

The small-cap screen uses a PEG based on the historic PE ratio and average forecast growth for the next two financial years. The screening criteria are:

- A PEG ratio in the bottom half of all stocks screened. **Compulsory test.**
- A two-year forward PEG below one.
- EPS growth forecast above at least 7.5 per cent for each of the next two financial years and an average growth rate over the period of more than 10 per cent and less than 50 per cent (i.e. high, but sustainably so).
- Either a net income margin above 10 per cent or a net income margin above 7.5 per cent and asset turnover of at least two. (i.e. we're looking for indicators of a quality business that may have a sustainable advantage).

- Either three-month share price momentum better than the median average or earnings upgrades of 10 per cent or more over the past three months (i.e. recent reasons to feel positive).
- Operating cash conversion of 90 per cent or more.
- Net debt of less than 1.5 times cash profits.
- No downgrade to forecast EPS over the past three months.

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 PEG and three-month price momentum.

Universe:

For the **US** we screen from the S&P 500 index

For the **UK main market** we start with all companies with a market cap of over £35mn and then split them as follows:

UK large-cap: The top 85 per cent of our list of main market companies by market cap.

UK mid-cap: Companies not in the top 85 per cent by size but above £250mn in market cap

UK small-cap: Companies between £35mn and £250mn market cap.

For **Aim-listed** shares we screen from companies bigger than £35mn market cap.

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ISSN 0261-3115.