

AlphaScreens: the market according to GARP

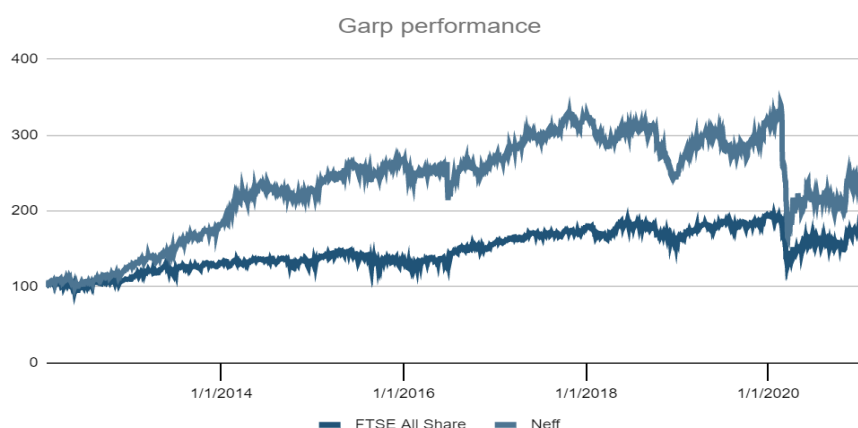
4 October 2021

Are GARP companies atop an earnings rollercoaster?

Growth at a reasonable price, or GARP, has proved a reliable strategy that has previously generated market-beating returns. We run our GARP screens across three indices: FTSE All-Share, All Small and Aim

Comment by Alpha editor:

- Investing is never just about painting by numbers. Although in theory and through back-testing many of the risk-return factors stock screens isolate show aggregate outperformance, stock-pickers must always look behind the numbers.
- Our growth at a reasonable price screen shows plenty of companies that have had a combination of a good earnings run and attractive forecast earnings. Also, they aren't expensive based on a multiple of that spliced past and expected profit growth.
- Where investors must kick the tires is in checking where companies are in the business cycle. Packaging specialist Macfarlane (MACF) which tops our screen has done very well recently and there is still optimism for e-commerce growth. There is a case, however, for investors to play devil's advocate and ask how demand for mail order would cope in a more traditional cyclical recession, rather than the enforced shutdown of the economy due to Covid-19.
- There is also the consideration that some earnings growth figures have been flattered by the bounce back from re-opening and in the case of JD Sports Fashion (JD.) acquisitions have helped. Again, what damage could a recession do?
- Finally, investors should always be wary of the property based businesses flagged as cheap relative to growth by the PEG ratios used in this screen. Rising build cost inflation and falling house price inflation, never mind the potential for land prices to be written down in a recession, means investors need to tread carefully at this stage in the cycle.



Source: Refinitiv, Investors Chronicle

Finding that magic combination of value and growth

Buying shares that offer growth at a reasonable price (GARP) can generate strong returns. Prominent exponents of this style of investing include the likes of Jim Slater, Peter Lynch and, arguably, also John Neff. A key metric to assess whether companies offer the magic combination of value and growth is the price-to-earnings-growth (PEG) ratio. In its most basic form the ratio simply compares a share's valuation against its earnings with its earnings growth rate (historic or forecast). This approach is not overly exacting, but over many years it has proved a very effective way of identifying great investment opportunities when combined with other factors that suggest there are solid foundations to the value and growth measures used by the ratio.

Large-cap GARP criteria

Our large-cap GARP screen is run on all FTSE All-Share stocks and uses a PEG ratio based on the historic price/earnings (PE) ratio divided by a combination of the 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. The screening criteria are:

- A PEG ratio below the median average.
- A PE ratio that is higher than that of the lowest quarter of stocks screened (i.e. not suspiciously cheap) and below the top quarter (i.e. not dangerously expensive).
- 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.
- Average forecast EPS growth of more than 7.5 per cent for the next two financial years.
- Positive free cash flow in each of the past three years.
- No downgrade to forecast EPS over the last three months.

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 at the top of page 4, followed by those failing one test, then those failing two tests and so on as detailed in the 'Tests passed' column. All stocks must pass the 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.

Small-cap GARP criteria

Our small-cap GARP screen is run on all stocks in the FTSE All-Small and Alternative Investment Market (Aim) indices, with the results from the individual indices listed in separate tables. The 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 quarter of all stocks screened.
- EPS growth forecast 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 return on equity (ROE) of over 12.5 per cent or an operating margin of over 15 per cent (i.e. an indicator 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.

- A market capitalisation of more than £10m (i.e. 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 tables on page 5, followed by those failing one test, then those failing two tests and so on as detailed in the 'Tests passed' column. All stocks must pass the low 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.

Stock screen and methodology by Algy Hall

Large-cap GARP selection (passing at least 6 of 8 tests)

Name	TIDM	Mkt cap	Price	Fwd NTM PE	PEG	DY	EPSgrth FY+1	EPSgrth FY+2	3-mth mom.	Net cash/debt(-)	Cur	Tests passed (out of 8)	Test failed
Macfarlane	MACF	£215	137	13	0.6	2.0%	58.9%	2.9%	17.7%	-58m	GBP	8	na
Safestore	SAFE	£2,254	1,069	25	0.4	1.9%	29.6%	7.8%	11.8%	-	GBP	8	na
JD Sports Fashion	JD	£10,677	1,035	20	0.9	0.1%	51.9%	6.2%	6.8%	-591m	GBP	8	na
City of London Investment	CLIG	£275	543	10	0.9	6.1%	6.8%	9.7%	1.7%	-	GBP	8	na
Sirius Real Estate	SRE	£1,383	130	19	0.3	2.6%	43.9%	-4.0%	16.1%	-	EUR	7	/HY EPSgrth/
Keller Group	KLR	£696	963	11	1.2	3.7%	-18.9%	20.2%	20.5%	-446m	GBP	7	/Av FY2 Fwd EPS growth > 7.5%
SEGRO	SGRO	£14,514	1,207	39	0.5	1.9%	11.1%	11.2%	10.3%	-	GBP	7	/5yr EPSgrth/
AEW UK REIT	AEWU	£163	103	13	0.2	7.8%	18.0%	12.4%	6.3%	-	GBP	7	/5yr EPSgrth/
LondonMetric Property	LMP	£2,219	244	24	0.5	3.5%	3.1%	5.2%	4.2%	-	GBP	7	/Av FY2 Fwd EPS growth > 7.5%
Greencoat UK Wind	UKW	£2,620	133	12	0.6	5.4%	58.8%	6.7%	3.9%	-	GBP	7	/5yr EPSgrth/
Pets At Home	PETS	£2,371	474	22	0.9	1.7%	49.5%	12.0%	2.2%	-195m	GBP	7	/5yr EPSgrth/
Assura	AGR	£1,949	73	23	1.1	3.9%	12.1%	5.6%	-1.7%	-	GBP	7	/HY EPSgrth/
IG Group	IGG	£3,491	809	11	0.9	5.3%	-28.7%	12.2%	-4.6%	-	GBP	7	/Av FY2 Fwd EPS growth > 7.5%
Severfield	SFR	£232	75	10	0.8	3.9%	14.7%	12.1%	-5.1%	-60m	GBP	7	/HY EPSgrth/
Tyman	TYMN	£826	421	13	0.7	1.9%	18.6%	5.7%	-7.7%	-69m	GBP	7	/5yr EPSgrth/
Hikma Pharmaceuticals	HIK	£5,479	2,367	15	1.1	1.6%	16.0%	14.0%	-6.8%	-495m	USD	7	/HY EPSgrth/
Luceco	LUCE	£503	313	15	0.6	2.3%	31.0%	8.6%	-23.1%	-58m	GBP	7	/5yr EPSgrth/
Alfa Financial Software	ALFA	£546	182	38	-6.0	0.5%	-30.8%	3.2%	38.9%	19m	GBP	6	/5yr EPSgrth/Av FY2 Fwd EPS growth > 7.5%
SThree	STEM	£760	569	18	0.6	1.4%	139.8%	10.4%	23.7%	-130m	GBP	6	/5yr EPSgrth/HY EPSgrth/
3i Group plc	III	£12,467	1,281	5	0.4	3.0%	38.7%	-23.4%	8.0%	-	GBP	6	/HY EPSgrth/FCF/
Spirent Communications	SPT	£1,703	278	23	0.8	1.6%	12.5%	7.2%	10.3%	63m	USD	6	/5yr EPSgrth/HY EPSgrth/
Legal & General	LGEN	£16,674	279	8	0.3	6.4%	60.3%	4.8%	5.7%	-	GBP	6	/5yr EPSgrth/FCF/
S&U	SUS	£345	2,840	11	0.4	3.6%	115.7%	-1.2%	6.4%	-	GBP	6	/5yr EPSgrth/HY EPSgrth/
Big Yellow	BYG	£2,576	1,400	28	0.5	2.4%	13.0%	7.7%	6.4%	-27m	GBP	6	/HY EPSgrth/FCF/
Vistry	VTY	£2,669	1,201	9	0.4	3.3%	137.1%	15.0%	0.4%	-625m	GBP	6	/5yr EPSgrth/HY EPSgrth/
B&M Euro. Value Retail SA	BME	£5,739	573	16	0.9	3.0%	-16.1%	2.4%	1.1%	-513m	GBP	6	/5yr EPSgrth/Av FY2 Fwd EPS growth > 7.5%
Ferguson	FERG	£22,739	10,230	19	1.0	1.7%	6.9%	7.1%	0.8%	-2,523m	USD	6	/5yr EPSgrth/Av FY2 Fwd EPS growth > 7.5%
LSL Property	LSL	£453	431	11	0.4	0.9%	139.1%	6.2%	-2.0%	-	GBP	6	/5yr EPSgrth/5yr Revgrth/
Fresnillo	FRES	£5,726	777	12	0.3	3.1%	80.4%	17.1%	-2.4%	534m	USD	6	/5yr EPSgrth/FCF/
Synthomer	SYNT	£2,062	485	9	0.8	3.6%	156.0%	-30.2%	-2.4%	-267m	GBP	6	/5yr EPSgrth/HY EPSgrth/
Antofagasta	ANTO	£13,344	1,354	14	0.2	3.8%	168.0%	-8.5%	-6.6%	1,498m	USD	6	/5yr EPSgrth/Fwd EPS/
Kingfisher	KGF	£7,023	333	10	0.9	2.8%	25.2%	-14.5%	-9.5%	-2,041m	GBP	6	/Av FY2 Fwd EPS growth > 7.5% 5yr Revgrth/
British American Tobacco	BATS	£58,273	2,540	7	0.9	8.5%	-1.5%	7.5%	-10.2%	-12,097m	GBP	6	/5yr EPSgrth/Av FY2 Fwd EPS growth > 7.5%
Royal Mail	RMG	£4,166	417	7	0.4	2.4%	16.1%	1.8%	-27.9%	-1,150m	GBP	6	/5yr EPSgrth/HY EPSgrth/

Source: FactSet, 4 October 2021

Small-cap GARP selection (passing at least 5 of 7 tests)

Name	TIDM	Mkt cap	Price	Fwd NTM PE	PEG	DY	EPSgrth FY+1	EPSgrth FY+2	3-mth mom.	Net cash/debt(-)	Cur	Tests passed (out of 7)	Test failed
LSL Property Services	LSL	£453	431	11	0.08	0.9%	139.1%	6.2%	-2.0%	-	GBP	6	/Fwd EPSgrth/
Kenmare Resources	KMR	£472	430	5	0.02	2.5%	654.9%	-6.9%	-1.8%	23m	USD	6	/Fwd EPSgrth/
ScS Group	SCS	£103	270	9	0.01	1.1%	1107.7%	-1.7%	-10.0%	-23m	GBP	5	/Fwd EPSgrth/Hi RoE or Marg/
Robert Walters	RWA	£557	728	17	0.08	2.3%	384.3%	24.3%	2.8%	-38m	GBP	5	/Fwd EPSgrth/Hi RoE or Marg/
Headlam	HEAD	£411	482	14	0.11	1.6%	121.4%	17.9%	3.4%	-132m	GBP	5	/Fwd EPSgrth/Hi RoE or Marg/
Forterra	FORT	£663	290	14	0.11	2.1%	159.9%	23.6%	5.5%	-41m	GBP	5	/Fwd EPSgrth/Hi RoE or Marg/
Foresight Group	FSG	£472	436	18	0.00	0.4%	13977.5%	31.0%	11.8%	-	GBP	5	/Fwd EPSgrth/Hi RoE or Marg/
Premier Miton Global Ren. Trust	PMGR	£34	187	4	0.00	4.7%	654.7%	53.4%	12.3%	-	GBP	5	/Fwd EPSgrth/Cash Conv/

Source: FactSet, 4 October 2021

Aim GARP selection (passing at least 5 of 7 tests)

Name	TIDM	Mkt cap	Price	Fwd NTMPE	PEG	DY	EPS grth FY+1	EPS grth FY+2	3-mth mom.	Net cash/debt(-)	Cur	Tests passed (out of 7)	Test failed
Michelmersh Brick	MBH	£120	127	15	0.29	2.9%	61.6%	8.7%	-10.9%	-2m	GBP	7	na
Property Franchise	TPFG	£88	275	11	0.36	3.8%	42.4%	8.9%	-8.0%	-	GBP	7	na
Caledonia Mining Corp.	CMCL	£110	900	4	0.37	3.4%	24.5%	34.2%	-1.1%	7m	USD	7	na
Sureserve	SUR	£127	79	10	0.24	1.3%	69.2%	18.2%	0.0%	-38m	GBP	7	na
Somero Enterprises	SOM	£286	510	12	0.17	5.7%	75.5%	8.6%	12.1%	17m	USD	7	na
United Oil & Gas	UOG	£17	3	2	0.01	0.0%	1170.4%	0.0%	-38.4%	-3m	USD	6	/Fwd EPS grth/
Pan African Resources	PAF	£299	16	5	0.30	4.6%	20.2%	7.5%	-16.2%	-51m	USD	6	/Mom or Upgrade/
Griffin Mining	GFM	£144	83	6	0.03	0.0%	283.7%	12.7%	-16.2%	-19m	USD	6	/Fwd EPS grth/
Breedon	BREE	£1,657	98	17	0.35	0.5%	70.1%	27.7%	-10.0%	-283m	GBP	6	/Hi RoE or Marg/
Steppe Cement	STCM	£97	45	8	0.22	7.9%	45.7%	4.2%	-7.3%	-3m	USD	6	/Mom or Upgrade/
Central Asia Metals	CAML	£391	222	7	0.11	7.2%	87.2%	-0.4%	-7.1%	-14m	USD	6	/Fwd EPS grth/
Wentworth Resources	WEN	£42	23	9	0.12	6.8%	85.4%	-11.1%	-6.3%	11m	USD	6	/Fwd EPS grth/
Numis Corporation	NUM	£401	351	12	0.11	3.4%	68.2%	-33.6%	-2.2%	-	GBP	6	/Fwd EPS grth/
Serabi Gold	SRB	£51	68	4	0.15	0.0%	53.7%	69.4%	3.1%	-7m	USD	6	/Fwd EPS grth/
STM Group	STM	£20	34	8	0.39	4.3%	29.6%	34.3%	6.3%	-	GBP	6	/Hi RoE or Marg/
Journeo	JNEO	£10	119	10	0.31	0.0%	134.5%	173.6%	13.3%	-6m	GBP	6	/Fwd EPS grth/
M.P.Evans	MPE	£443	810	14	0.08	3.3%	163.4%	-21.7%	13.3%	-32m	USD	6	/Fwd EPS grth/
Enwell Energy	ENW	£124	39	6	0.01	0.0%	837.5%	-16.3%	52.9%	39m	USD	6	/Fwd EPS grth/
Serica Energy	SQZ	£610	228	5	0.01	1.5%	1282.1%	10.1%	61.3%	-6m	GBP	6	/Fwd EPS grth/
Sylvania Platinum	SLP	£246	90	3	0.40	4.4%	8.5%	20.4%	-24.8%	67m	USD	5	/Mom or Upgrade/Cash Conv/
REACT	REAT	£11	2	-	0.31	0.0%	180.0%	-	-21.6%	1m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
XLMedia	XLM	£109	42	11	0.08	0.0%	756.4%	152.0%	-23.2%	-7m	USD	5	/Fwd EPS grth/Hi RoE or Marg/
Time Finance	TIME	£22	24	7	0.23	0.0%	56.8%	65.5%	-13.6%	-	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Morses Club	MCL	£103	77	11	0.32	3.9%	20.1%	92.6%	-11.6%	-	GBP	5	/Fwd EPS grth/Mom or Upgrade/
Filtronic	FTC	£23	11	39	0.15	0.0%	800.0%	-	-8.7%	-1m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Appreciate	APP	£53	29	8	0.19	3.5%	195.0%	35.3%	-8.3%	-11m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Portmeirion	PMP	£96	685	13	0.11	0.0%	651.4%	53.9%	-2.1%	-7m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Mission	TMG	£66	72	9	0.05	1.1%	500.0%	43.3%	4.3%	-43m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Iofina	IOF	£28	15	6	0.04	0.0%	332.5%	10.3%	14.6%	-3m	USD	5	/Fwd EPS grth/Hi RoE or Marg/
Frenkel Topping	FEN	£83	74	19	0.25	1.9%	146.0%	29.0%	34.9%	-	GBP	5	/Fwd EPS grth/Cash Conv/

Source: FactSet, 4 October 2021

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