

## AlphaScreens: the market according to GARP

10 October 2022

### Sometimes markets get ahead of management

*Growth at a reasonable price, or GARP, has proved a reliable strategy that has previously generated market-beating returns. We have tightened the focus of our UK screens targeting large, mid and small-cap shares. Plus we've added a new S&P 500 screen to try and find good value growing companies listed on the US market.*

#### Comment by Alpha editor:

- Packaging group **Smurfit Kappa (SKG)**, tops our growth at a reasonable price screen for UK-listed large-cap shares, but as Robin Hardy wrote in his [analysis of the company](#) last month, the lower share price may be a case of the market anticipating weaker profit guidance ahead, rather than the shares being a spectacular bargain. Recently, the company announced (subject to regulatory approval) the acquisition of the PaperBox packaging plant in Brazil, a deal that further expands its Latin American footprint. This is encouraging for long-run growth, but potential investors may still want to see the heightened optimism of previous profit guidance tempered by a realistic assessment of the issues caused by uncertain energy costs and a weakening outlook for developed economies. That said, **DS Smith (SMDS)** surprised the market positively recently, so perhaps there are wider industry factors that have been overplayed by pessimists.
- In the mid-cap range of UK companies, one of the leaders, energy producer **Drax (DRX)**, has been subject to some controversy with the BBC reporting it was [cutting down primary forest](#) for some of its biomass wood chips. At the very top of the mid-cap screen there is the mobile payments business **Network International (NETW)**. With a focus on the rapidly expanding markets in the Middle East and Africa, there appears genuine scope for investors to make a very good return here. Although the shares are up around 11 per cent since Robin Hardy [covered them for Alpha](#), by our screen the growth on offer is still fairly priced.

## GARP methodology: 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

We run our large-cap GARP criteria against the S&P 500 for US companies and for UK companies, we use the tests (listed below) against a universe of the top 80 per cent of the UK's market capitalisation.

We also run these tests against UK mid-cap stocks - which we are defining as from the 80th to the 95th percentile of size by market capitalisation.

The screen methodology 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.

As well as this PEG test, which includes some backward-measures, we have also an exclusively forward-looking PEG. The PE in the numerator is the ratio of current share price to expected earnings per share two years 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.

The large-cap screening criteria are:

- A PEG ratio below the median average.
- A three-year forward PEG below one.
- 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 past three months.

Not many stocks pass such a stringent list of criteria. 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.

## Small-cap GARP criteria

Our small-cap GARP screen is run against stocks in the bottom five per cent of the UK main market by size but with a lower cut-off of £35mn introduced to exclude the most illiquid shares.

We use the same small cap rules to screen the UK's Aim.

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 quarter of all stocks screened.
- A three-year forward PEG below one.

- 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. All stocks must pass the low blended 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.

## UK indices

For much of this year we have been using methodology inspired by the Numis index family to split into large cap, mid cap and small-cap plus Aim screens. We don't follow the exact Numis methodology - we screen for percentages of the market and have introduced an arbitrary lower cut-off for small cap, but we still owe a debt to the many years of research that has gone into the Numis large cap, Numis mid cap and NSCI indices.

Screen results for October 2022 are below

## UK large-cap GARP selection (passing at least 7 out of 9 tests)

Name	Ticker	Share price(p)	Mkt cap (£mn)	Fwd 12-mth PEG	3-yr PEG (Neff)	EV/ Ebitda	Trailing 12-mth DY	Fwd EPS grwth cur FY	Fwd EPS grwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 9)	Tests failed	Sector
Smurfit Kappa	SKG	2452	6380	7.9	0.7	0.3	5.4	4.4%	44.9%	-8.4%	-10%	-1643.9	9	na Containers/Packaging
Ashtead	AHT	4235	18628	12.5	0.7	0.9	8.7	1.6%	27.5%	9.0%	14%	-1162.4	8	HY +ve EPS/ Finance/Rental/Leasing
CRH	CRH	2911	21860	9.9	0.9	0.4	6.2	3.4%	18.3%	1.1%	2%	-1327.5	7	Mid PE/5yr Rev grth/ Construction Materials
Brit.American Tobacco	BATS	3313	74376	8.2	0.7	1.0	9.6	6.6%	12.5%	12.0%	-2%	-11879.0	7	5yr EPS grwth/HY +ve EPS/ Tobacco

Source: FactSet, Investors' Chronicle

Source: FactSet, Investors' Chronicle

## UK mid-cap GARP selection (passing at least 7 out of 9 tests)

Name	Ticker	Share price(p)	Mkt cap (£mn)	Fwd 12-mth PE	3-yr PEG (Neff)	EV/ Ebitda	Trailing 12-mth DY	Fwd EPS grwth cur FY	Fwd EPS grwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 9)	Tests failed	Sector	
NetworkInt'l	NETW	306	1709	17.3	0.3	0.7	16.0	0.0%	54.1%	39.8%	59%	-2022	8	5yr EPS grwth/	Regional Banks
Drax	DRX	560	2245	4.7	0.0	0.1	3.4	3.5%	260.6%	69.4%	-17%	-1915.5	8	5yr EPS grwth/	Electric Utilities
Watches of Switzerland	WOSG	720	1725	12.7	0.6	0.4	9.7	0.0%	29.0%	11.5%	-10%	-143.9	7	Mid PE/5yr EPS grwth/	Specialty Stores
OSB	OSB	430	1868	4.4	0.5	0.4	-	6.9%	7.8%	5.4%	-10%	-	7	Mid PE/HY +ve EPS/	Major Banks
Hikma Pharmaceuticals	HIK	1301	2865	7.2	0.7	0.7	7.1	3.3%	10.8%	14.9%	-24%	-417.9	7	5yr EPS grwth/HY +ve EPS/	Pharmaceuticals/Generic

Source: FactSet, Investors' Chronicle

Source: FactSet, Investors' Chronicle

## UK small-cap GARP selection (passing at least 6 out of 8 tests)

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	3-yr PEG (trail)	EV/ Ebitda	Trailing 12-mth DY	Fwd EPS grwth cur FY	Fwd EPS grwth next FY	Av EPS gr FY*2	3-mth share price mom	Net cash (£mn)	Tests passed (out of 8)	Tests failed	Sector	
EnQuest	ENQ	30	572	1.7	0.1	0.02	2.0	0.0%	73.2%	12.5%	42.8%	46%	-520.2	8	na	Integrated Oil
Kenmare Resources	KMR	399	378	2.4	0.3	0.04	2.4	6.4%	93.2%	-3.7%	44.7%	-7%	-34.2	7	/EPS Grwth/	Other Metals/Mins
Gulf Keystone Petroleum	GKP	230	496	2.1	0.3	0.02	1.6	19.0%	165.3%	-27.2%	69.1%	-6%	52.5	7	/EPS Grwth/	Integrated Oil
Alphawave IP	AWE	132	908	14.6	0.0	0.11	15.0	0.0%	354.4%	111.7%	233.1%	2%	344.5	7	/EPS Grwth/	Packaged Software
Seplat Energy	SEPL	115	677	2.3	0.1	0.03	2.5	6.9%	210.9%	-13.3%	98.8%	17%	-322.3	7	/EPS Grwth/	Integrated Oil
TCI Clarke	CTO	115	50	4.9	-	0.11	3.4	4.7%	52.4%	13.7%	33.0%	-26%	-95.5	6	/Cash Conv/	Engineering & Cons
Empiric Student Property	ESP	81	489	19.4	0.4	0.13	26.4	5.4%	96.3%	37.7%	67.0%	-7%	-	6	/EPS Grwth/Debt to Ebitda/	Real Estate Devpt
Galliford Try	GFRD	151	167	8.7	0.1	0.05	-0.6	5.3%	203.1%	14.9%	109.0%	-7%	-289.5	6	/EPS Grwth/RoE or margin/	Homebuilding
Ten Entertainment	TEG	214	147	7.2	0.1	0.01	6.3	1.4%	379.3%	6.8%	193.0%	-7%	-18.7	6	/EPS Grwth/Debt to Ebitda/	Movies/Entertain
Ecora Resources	ECOR	156	401	6.5	-	0.05	3.3	5.6%	121.0%	-56.2%	32.4%	7%	7.6	6	/EPS Grwth/	Other Metals/Mins
Hollywood Bowl	BOWL	206	352	11.9	0.1	0.01	6.4	1.5%	1716.0%	-8.8%	853.6%	7%	-2.0	6	/EPS Grwth/Debt to Ebitda/	Movies/Entertain
Ricardo	RCDO	441	274	12.6	0.2	0.14	8.1	1.8%	154.6%	15.1%	84.9%	18%	-59.3	6	/EPS Grwth/RoE or margin/	Misc. Comm Services
Baltic Classifieds	BCG	144	721	22.2	0.1	0.08	23.6	0.8%	1353.3%	17.8%	685.5%	15%	9.3	6	/EPS Grwth/Debt to Ebitda/	Internet Software/Serv
ASA International	ASAI	94	94	3.8	0.0	0.03	3.6	0.0%	220.9%	11.7%	116.3%	10%	-	6	/EPS Grwth/Debt to Ebitda/	Finance/Rental/Leasing
4imprint	FOUR	3540	994	16.4	0.2	0.11	16.5	1.6%	231.5%	8.4%	120.0%	47%	-23.2	6	/EPS Grwth/Cash Conv/	Adv/Marketing Serv

Source: FactSet, Investors' Chronicle

## UK Aim GARP selection (passing at least 6 out of 8 tests)

Name	Ticker	Share price(p)	Mkt cap (£mn)	Fwd 12-mth PE	3-yr PEG (trail)	EV/ Ebitda	Trailing 12-mth DY	Fwd EPS grwth cur FY	Fwd EPS grwth next FY	Av EPS gr FY*2	3-mth share price mom	Net cash (£mn)	Tests passed (out of 8)	Tests failed	Sector	
Sylvania Platinum	SLP	94	251	3.7	0.3	0.12	2.0	8.5%	49.4%	1.6%	25.5%	21%	90.7	8	na	Other Metals/Min
Griffin Mining	GFM	77	134	4.4	0.4	0.26	3.9	0.0%	40.9%	17.1%	29.0%	-12%	-2.0	7	/Mom or Upgrade/	Precious Metals
Learning Technologies	LITG	109	858	11.7	0.4	0.23	9.0	1.1%	69.3%	12.5%	40.9%	-8%	-135.8	7	/Cash Conv/	Packaged Software
Wentworth Resources	WEN	25	44	6.7	1.0	0.12	2.1	7.5%	58.3%	1.8%	30.1%	14%	15.0	7	/3yr PEG < 1/	Integrated Oil
ZOO Digital	ZOO	139	123	18.6	0.2	0.28	24.0	0.0%	154.6%	48.2%	101.4%	23%	-18.0	7	/EPS Grwth/	Movies/Entertain
LendInvest	LINV	98	135	7.2	0.2	0.26	22.6	4.5%	42.8%	33.8%	38.3%	-36%	-	6	/Cash Conv/Debt to Ebitda/	Finance/Rental/Leasing
XL Media	XLN	21	55	6.7	0.2	0.24	4.0	0.0%	50.0%	26.2%	38.1%	-32%	-12.9	6	/RoE or margin/Mom or Upgrade/	Adv/Marketing Serv
Totally	TLY	32	60	8.7	0.1	0.11	7.7	3.1%	439.8%	36.8%	238.3%	-29%	-28.4	6	/EPS Grwth/RoE or margin/	Medical/Nursing Serv
Frenkel Topping	FEN	60	76	13.2	0.4	0.25	15.3	2.3%	84.8%	20.5%	52.7%	-18%	-	6	/EPS Grwth/Cash Conv/	Fin Conglomerates
Kape Technologies	KAPE	258	1102	7.1	0.2	0.21	6.7	0.0%	88.4%	13.6%	51.0%	-15%	-319.9	6	/EPS Grwth/Mom or Upgrade/	Adv/Marketing Serv
Central Asia Metals	CAML	220	399	6.3	-	0.26	3.1	10.0%	20.2%	-22.3%	-1.1%	3%	6.3	6	/EPS Grwth/3yr PEG < 1/	Other Metals/Min
Gaming Realms	GMR	26	76	13.7	0.1	0.22	13.2	0.0%	183.8%	77.6%	130.7%	8%	-2.2	6	/EPS Grwth/RoE or margin/	Packaged Software
i3Energy	I3E	27	327	3.5	-	0.04	3.7	2.2%	165.4%	17.2%	91.3%	10%	-7.7	6	/EPS Grwth/3yr PEG < 1/	Oil & Gas Production
Hurricane Energy	HUR	7	147	3.0	-	0.01	0.6	0.0%	470.8%	-55.3%	207.7%	9%	-24.6	6	/EPS Grwth/3yr PEG < 1/	Integrated Oil
Yu Group	YU	213	35	6.7	0.1	0.03	2.0	0.0%	104.8%	4.4%	54.6%	12%	-42.7	6	/EPS Grwth/Cash Conv/	Gas Distributors
H&T Group	HAT	463	203	8.8	0.1	0.25	11.4	0.0%	74.5%	59.5%	67.0%	29%	-10.0	6	/EPS Grwth/Cash Conv/	Fin/Rental/Leasing
Serica Energy	SQZ	382	1042	3.3	0.2	0.01	1.3	4.5%	414.0%	-24.7%	194.7%	32%	-123.7	6	/EPS Grwth/Cash Conv/	Oil & Gas Production

Source: FactSet, Investors' Chronicle

US screen results on next page

## US S&P 500 GARP selection (passing at least 8 out of 9 tests)

Name	Share Ticker	price (\$)	Share price (\$)	Mkt cap (\$mn)	Fwd 12-mth PE	3-yr PEG	EV/ Ebitda	Trailing 12-mth DY	Fwd EPS grwth cur FY	Fwd EPS grwth next FY	3-mth share price mom	Net cash (\$mn)	Tests passed (out of 9)	Tests failed	Sector
Cigna	CI	288.38	87989	11.6	0.9	1.0	-	15%	12.3%	10.2%	5%	-	9	na	Managed Health Care
FLEETCOR Tech	FLT	179.59	13472	10.5	0.6	1.0	11.0	0.0%	20.9%	9.9%	-17%	-3039.7	9	na	Misc. Commercial Services
Charter Com. Class A	CHTR	312.53	50209	8.6	0.3	0.7	7.2	0.0%	35.4%	12.0%	-33%	-11857.0	9	na	Cable/Satellite TV
Molina Healthcare	MOH	348.76	20263	17.9	0.8	0.5	-	0.0%	30.8%	13.4%	25%	-	8	/5yr EPS grwth/	Managed Health Care
Deere & Co	DE	356.15	107493	13.7	0.9	0.6	14.3	1.2%	20.5%	14.1%	17%	-19127.0	8	/5yr EPS grwth/	Trucks/Construction/Farm Machinery
Globe Life	GL	105.98	10326	11.8	0.8	1.0	-	0.8%	17.1%	15.3%	7%	-	8	/Q +ve EPS/	Life/Health Insurance
Cummins	CMI	218.04	30742	11.3	1.0	0.7	11.0	2.7%	21.6%	10.6%	8%	-3897.0	8	/Q +ve EPS/	Trucks/Construction/Farm Machinery
Texas Instruments	TXN	159.28	145535	17.6	6.2	0.9	13.2	2.8%	14.2%	-5.4%	3%	7170.0	8	/Fwd PEG < 1/	Semiconductors
CDW	CDW	159.62	21588	15.4	0.9	0.9	15.4	1.2%	21.5%	9.3%	0%	-4837.9	8	/5yr EPS grwth/	Information Technology Services
VWV, Grainger	GWW	500.92	25482	17.0	0.8	0.0	13.6	1.3%	41.5%	6.2%	6%	-1287.0	8	/Mid PE/	Wholesale Distributors

Source: FactSet, S&P 500, Investors' Chronicle

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