

AlphaScreens: the market according to GARP

13 December 2024

US is the best place to find GARP winners

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. We're also checking revenue growth expectations as the system is likely to work better when companies are expanding sales.

Tempering optimism is important when analysing shares based on analysts' forecasts of earnings growth. It's also worthwhile to consider the effects of cyclical or periods of disappointment when judging how that growth should be valued. For this reason, we look at two versions of the share price-to-earnings growth rate (PEG) ratio in our growth at a reasonable price (GARP) screen.

The most straightforward is the forward PEG which, in our screen, we apply based on the Year 2 PE (i.e., based on forecast earnings for the year after the current unreported year) divided by the growth rate in earnings to that time. Based on this, stocks on our US screen like Facebook owner and web tech development company **Meta Platforms (US:META)** look cheap.

However, it's worth paying attention to our other PEG ratio - the one we hold greater store by on the screen - which combines forward and historic growth rates and dividends, to give a smoothed out sense of how a stock delivers returns on its investors' capital. In the past, this wouldn't have been a great way to assess a US tech stock. After all, they were capital-light businesses, experiencing almost exponential growth. But the game has changed somewhat.

A couple of years ago, investors balked at the vast investment in research and development Meta was making in its metaverse project. The way these costs can drag on earnings needs to be reflected in any long-term analysis of the stock, especially as there may be bets that don't pay off as rapidly as management and investors may hope for. Tech is in an arms race with Artificial Intelligence (AI) and when you also consider digital (crypto) currencies and the metaverse, there are plenty of projects for ambitious CEOs to burn cash on.

In the UK, there is a preponderance of sectors where following GARP can lead to cyclical miss-steps. On the Aim market, there are some businesses that might fit the bill as growth plays, but they are often vulnerable to bumps in the road, so the cheap valuation relative to expected growth rates ought to be seen as a risk premium for both uncertainty and the lower levels of liquidity (ease of buying and selling) that you see with these stocks.

December 2024 GARP results

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

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	2-yr Fwd PEG	PEG Neff	LTM DY	fc EPS gwth FY	fc EPS gwth FY+1	3-mth share price mom.	Net cash (£mn)	Tests passed	Tests failed
Admiral	ADM	2659	8145	13.9	0.5	1.1	4.6%	49%	15%	-7%	-	8	/5-yr EPS gwth/
Severn Trent	SVT	2549	7652	18.2	0.3	1.8	4.7%	28%	67%	-5%	238.1	8	/5-yr EPS gwth/
3i Group	III	3631	35344	6.8	0.4	0.3	1.8%	26%	11%	17%	-	7	/5-yr EPS gwth/Y-o-Y EPS gwth/
Standard Chartered	STAN	989	24049	7.0	0.3	0.2	2.4%	24%	16%	31%	-	7	/5-yr EPS gwth/Y-o-Y EPS gwth/

Source: Investors' Chronicle and FactSet

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

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	2-yr Fwd PEG	PEG Neff	LTM DY	fc EPS gwth FY	fc EPS gwth FY+1	3-mth share price mom.	Net cash (£mn)	Tests passed	Tests failed
Spire Healthcare	SPI	223	899	15.5	0.4	0.3	0.9%	28%	46%	-11%	-291.7	8	/5-yr EPS gwth/
Harbour Energy	HBR	256	3687	6.0	0.0	0.3	8.0%	846%	25%	0%	-1113.0	7	/5-yr EPS gwth/Y-o-Y EPS gwth/
Bank of Georgia	BGEO	4560	2027	3.8	0.2	0.1	5.1%	24%	17%	12%	-	7	/5-yr EPS gwth/Y-o-Y EPS gwth/
Fresnillo	FRES	699	5151	11.0	0.2	0.7	1.2%	25%	106%	35%	307.1	7	/5-yr EPS gwth/Y-o-Y EPS gwth/
Hunting	HTG	302	497	8.3	0.2	0.2	2.7%	64%	36%	-26%	-139.6	7	/5-yr sales gwth/No fc EPS downgrade/
Warehouse Reit	WHR	80	339	13.3	0.9	1.0	8.0%	17%	12%	-9%	-	7	/5-yr EPS gwth/Y-o-Y EPS gwth/

Source: Investors' Chronicle and FactSet

UK Aim GARP screen (passing at least 7 out of 9 tests tests)

Name	Ticker	Share price (last close)	Mkt cap (£mn)	NTM PE	2-yr PEG	PEG (Neff)	LTM DY	fc EPS gwth FY	fc EPS gwth FY+1	3-mth share price mom.	Net cash (£mn)	Tests passed	Tests failed
Gaming Realms	GMR	37	110	11.5	0.5	0.5	0.0%	17.3%	30.4%	3.9%	6.1	9	n/a
Spectra Systems	SPSY	239	117	8.5	0.1	0.9	3.8%	25.3%	109.7%	1.7%	0.0	8	/EPS gwth/
hVIVO	HVO	22	150	13.1	0.6	0.5	0.9%	20.0%	18.5%	-25.4%	1.8	8	/3-mth price or EPS mom/
Tatton Asset Mgment	TAM	674	408	22.9	1.5	1.6	2.6%	18.3%	12.8%	-2.3%	-	8	/2-yr fwd PEG/
Anpario	ANP	373	76	15.1	0.6	0.5	2.9%	43.0%	13.0%	19.2%	9.2	8	/NI or Asset TO/
Water Intelligence	WATR	398	69	12.2	0.4	0.4	0.0%	45.7%	15.7%	1.9%	-4.8	8	/NI or Asset TO/
Mpac Group	MPAC	487	146	10.9	0.3	0.5	0.0%	35.7%	28.3%	9.4%	-48.4	8	/NI or Asset TO/
Pan African Resources	PAF	38	779	5.2	0.1	0.1	2.5%	98.8%	35.7%	33.1%	-46.3	8	/EPS gwth/
Serabi Gold	SRB	112	85	2.2	0.0	0.0	0.0%	357.2%	63.4%	46.4%	2.3	8	/EPS gwth/
Mortgage Advice Bureau	MAB1	658	381	15.9	0.8	1.6	4.3%	20.9%	16.3%	5.4%	-	7	/No cut to EPS fc/NI or Asset TO/
Johnson Service	JSG	148	612	12.4	0.5	0.7	2.2%	28.1%	22.6%	-4.9%	-91.0	7	/3-mth price or EPS mom/NI or Asset TO/
Yu Group	YU	1810	304	8.4	1.0	0.9	3.1%	8.2%	9.8%	14.6%	-29.8	7	/EPS gwth/NI or Asset TO/
1Spatial	SPA	70	77	27.0	0.4	0.6	0.0%	71.9%	54.7%	7.8%	-10.6	7	/EPS gwth/NI or Asset TO/
Loungers	LGRS	307	319	19.2	0.6	0.8	0.0%	28.6%	33.3%	12.5%	-89.7	7	/Net debt to Ebitda/NI or Asset TO/
System1	SYS1	635	81	22.2	0.5	0.5	0.8%	46.6%	31.2%	-13.0%	2.2	7	/3-mth price or EPS mom/NI or Asset TO/

Source: Investors' Chronicle and FactSet

Continued below with US GARP results

US GARP screen (passing at least 8 out of 9 tests)

Name	Ticker	Share price(\$)	Mkt cap (\$mn)	Fwd 12-mth PE	2-yr Fwd PEG	PEG Neff	LTM DY	fc EPS gwth FY	fc EPS gwth FY+1	3-mth share price mom.	Net cash (\$mn)	Tests passed	Tests failed
Meta Platforms Class A	META	633	1379243	25.1	0.8	1.2	0.2%	53%	12%	24%	37660.0	9	/
Eli Lilly and Company	LLY	796	755684	36.0	0.4	1.9	0.6%	109%	72%	-14%	-21155.7	9	/
Hartford Financial Services	HIG	113	32766	9.8	0.7	0.8	1.7%	14%	14%	-1%	-	9	/
W. R. Berkley	WRB	61	23196	14.0	0.9	0.8	0.5%	22%	9%	7%	-	9	/
HCA Healthcare	HCA	315	79824	12.9	0.9	1.3	0.8%	15%	12%	-19%	-11917.0	9	/
Progressive	PGR	244	142780	17.5	0.3	0.6	0.5%	115%	7%	-2%	-	8	/EPS gwth next 2 yrs/
Nvidia	NVDA	139	3411702	33.0	0.4	0.9	0.0%	127%	47%	19%	22008.0	8	/5-yr EPS gwth/
First Solar	FSLR	201	21519	10.0	0.2	0.4	0.0%	71%	56%	-16%	-504.1	8	/5-yr EPS gwth/
Goldman Sachs	GS	593	186010	13.9	0.4	0.8	1.9%	60%	15%	26%	-	8	/5-yr EPS gwth/
Morgan Stanley	MS	128	205552	16.0	0.7	1.0	2.7%	42%	9%	31%	-	8	/5-yr EPS gwth/
Alphabet Class C	GOOG	197	2230315	22.0	0.9	1.0	0.2%	38%	12%	29%	12427.0	8	/5-yr EPS gwth/
Alphabet Class A	GOOGL	195	2230315	21.9	0.9	1.0	0.2%	38%	12%	29%	12427.0	8	/5-yr EPS gwth/
Garmin	GRMN	221	42393	28.9	1.8	1.4	1.3%	24%	9%	21%	845.4	8	/2-yr fwd PEG/
Norwegian Cruise Line	NCLH	28	12092	13.3	0.2	1.2	0.0%	136%	25%	47%	-5706.0	8	/5-yr EPS gwth/
Netflix	NFLX	937	400340	39.8	1.0	1.1	0.0%	65%	20%	37%	-1481.3	8	/5-yr EPS gwth/
Marsh & McLennan	MMC	214	105272	22.7	2.6	1.8	1.4%	9%	8%	-6%	-	8	/2-yr fwd PEG/
Amazon.com	AMZN	230	2421186	37.4	0.8	1.1	0.0%	77%	20%	25%	-69840.0	8	/5-yr EPS gwth/
Universal Health Serv. Class B	UHS	191	11197	10.6	0.3	0.8	0.4%	51%	14%	-17%	-1905.1	8	/5-yr EPS gwth/
Royal Caribbean	RCL	246	66014	17.2	0.4	0.9	0.2%	72%	24%	51%	-9213.0	8	/5-yr EPS gwth/
Molina Healthcare	MOH	300	17178	11.7	1.0	1.5	0.0%	13%	11%	-13%	-	8	/Y-o-Y EPS gwth/
ResMed	RMD	246	36079	25.0	1.6	1.8	0.8%	21%	9%	-3%	-477.7	8	/2-yr fwd PEG/
Corpay	CPAY	365	25445	16.6	1.1	2.0	0.0%	12%	17%	19%	-4194.7	8	/2-yr fwd PEG/
Microsoft	MSFT	449	3338187	32.1	2.4	2.2	0.7%	10%	15%	6%	-36772.0	8	/2-yr fwd PEG/
Globe Life	GL	105	8820	7.8	0.6	0.7	0.9%	16%	10%	4%	-	8	/5-yr sales gwth/
Mastercard Class A	MA	534	486760	33.0	2.2	2.3	0.5%	18%	12%	9%	-5857.0	8	/2-yr fwd PEG/
Visa Class A	V	314	542668	27.3	2.0	2.1	0.7%	12%	13%	11%	-7078.0	8	/2-yr fwd PEG/
Lam Research	LRCX	78	100657	20.4	1.1	1.5	1.1%	17%	17%	2%	724.8	8	/2-yr fwd PEG/
Westinghouse Air Brake Tech.	WAB	204	35040	23.8	1.1	2.0	0.4%	29%	13%	24%	-3271.0	8	/2-yr fwd PEG/

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).
- **Compulsory test:** past five-year compound annual growth rate (CAGR) for sales averaged with two-year forecast sales CAGR to be above five per cent and the forward sales CAGR to be above five per cent on its own.
- 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.
- No downgrade to forecast sales growth over the past three months.
- 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.**
- **Compulsory test:** past five year compound annual growth rate (CAGR) for sales averaged with two-year forecast sales CAGR to be above 7.5 per cent and the forward sales CAGR to be above 7.6 per cent on its own.
- **Compulsory test:** No downgrade to forecast sales growth over the past three months.
- 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).
- 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 sales growth forecasts.

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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