

## AlphaScreens: the market according to GARP

15 March 2022

### Widening the net for reasonably priced growth

*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:

Our growth at a reasonable price methodology has performed well when applied to the FTSE All-Share index, but as that includes companies that vary greatly in size, it is possible the returns could be down to the selection and weighting of smaller companies. Our new universes, based on the Numis index family, give a better demarcation between large, mid and small-cap shares, with plenty of ideas in each size category. We also have a new US screen that looks at S&P 500 companies.

#### Highlights this month:

First off the big red flag that needs waving is over the result of **Polymetal International (POLY)** in the large-cap screen. The precious metal miner has business relating to Russia, so definitely comes into the category of cheap for a reason given ongoing uncertainties.

Other UK-listed large caps that rate well include equipment hire business **Ashtead (ASH)**; and US-focused plumbing and heating products distributor **Ferguson (FERG)**. Ireland-based **DCC (DCC)** is interesting, as the sales, marketing and support services business has an important Liquefied Petroleum Gas and Retail & Oil divisions.

Our new US screen applies the large-cap methodology to the S&P 500 index, ahead of a crucial Federal Reserve Open Markets Committee announcement it is hard to gauge the immediate future for growth stocks. On the one hand there is the worry a new Cold War and energy crisis will choke off economic growth, and on the other hand the 40-year-high US inflation needs addressing. If interest rate increases are more aggressive than expected, it will be bad for expensive growth stocks.

Overall, there are five US companies that pass all nine of our tests including **FleetCor Technologies (US:FLT)**, which provides fuel cards and workforce payment products and services; and **Charter Communications (US:CHTR)**, which has a heritage position in US

cable TV connectivity, but is now eyeing opportunities from saving customers money with converged wireline and mobile broadband. Two financial services firms, **Signature Bank (US: SBNY)** and broker **Charles Scwab (US: SCHW)**, pass 9/9 tests with the latter looking particularly cheap on our PEG ratios. That said, with banks it is always worth assessing whether assumptions on long-run return on equity (RoE), suggest a good return will be made over the likely cost of equity for the business.

**Fortune Brands Home & Security (US: FBHS)** is the fifth company to get full marks. This business makes home fittings and security solutions. Consensus outlook remains positive, but the potential impact of inflation and any slowing in the US housing market as interest rates rise are serious risks to consider.

## 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 large-cap companies based on the Numis large-cap index and a universe of mid-cap companies based on the Numis mid-cap index.

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 introduced 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 on all stocks in a universe based on the NSCI index plus Aim, excluding investment trusts.

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.

## New UK indices

**Numis Large Cap** index (excluding investment companies/trusts): This includes the top 80 per cent of companies by market capitalisation that are listed on the UK main market. The lower size cut-off for 2022 is **£4.12bn** market cap.

**Numis Mid Cap** index (excluding investment companies/trusts): This includes the 15 per cent of UK main market listed companies below the top 80 per cent but above the bottom five per cent by market capitalisation. The upper size cut-off is **£4.12bn** and the lower cut-off is **£880mn** market cap.

**NSCI plus Aim**, version excluding investment trusts: This adds all Aim companies below the **£1.64bn** market cap cut-off to the NSCI index for UK smaller companies.

**AlphaScreen GARP tables below**

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

Company	TIDM	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	3-yr PEG	EV/ Ebitda	Trailing 12-mth DY	Fwd EPS gwth cur FY	Fwd EPS gwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 9)	Tests failed	
Ashtead	AHT	5072	22549	18.7	0.6	1.0	11.0	0.9%	41.1%	18.3%	-1.6%	-737.7	8	HY +ve EPS/
DCC	DCC	5752	5674	12.2	1.4	1.7	8.7	2.8%	10.6%	11.1%	4%	-1209.5	7	Fwd PEG < 1/
Ferguson	FERG	11670	25441	17.8	1.3	0.6	14.0	1.5%	25.6%	5.7%	-6%	-2523.1	7	5yr EPS gwth/Fwd PEG < 1/
Burberry	BRBY	1594	6323	15.7	0.8	0.6	7.2	3.4%	36.5%	11.4%	-9%	558.5	7	5yr EPS gwth/5yr Rev grth/
Smurfit Kappa	SKG	3312	8618	11.7	1.1	1.0	7.9	3.2%	22.4%	4.4%	-15%	-1643.9	7	HY +ve EPS/Fwd PEG < 1/
Electrocomponents	ECM	993	4677	18.5	0.7	0.5	15.6	2.2%	56.3%	10.8%	-13%	-433.1	7	5yr EPS gwth/HY +ve EPS/
Polymetal Int'l	POLY	168	797	0.9	0.1	0.2	1.9	42.9%	9.8%	-4.4%	-87%	-368.4	7	Mid PE/HY +ve EPS/

Source: FactSet, Numis Large Cap, Investors' Chronicle

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

Company	TIDM	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	3-yr PEG	EV/ Ebitda	Trailing 12-mth DY	Fwd EPS gwth cur FY	Fwd EPS gwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 9)	Tests failed	
Assura	AGR	68	2005	21.1	2.7	0.9	28.8	4.3%	8.6%	6.1%	0%	-	8	Fwd PEG < 1/
Renishaw	RSW	3994	2907	20.9	1.1	0.9	13.6	1.7%	42.2%	2.6%	-12%	121.6	8	Fwd PEG < 1/
Pets At Home	PETS	386	1930	16.0	0.6	0.5	9.2	2.5%	62.0%	9.3%	-16%	-195.2	8	5yr EPS gwth/
PageGroup	PAGE	493	1619	10.7	0.8	0.7	6.9	8.5%	22.0%	8.7%	-21%	-135.5	8	HY +ve EPS/
Mediclinic Int'l	MDC	346	2551	12.9	0.4	0.9	10.1	0.0%	59.6%	24.2%	16%	-388.0	7	5yr EPS gwth/HY +ve EPS/
Drax	DRX	690	2753	10.4	0.1	0.4	6.2	2.7%	182.7%	47.2%	19%	-1915.5	7	5yr EPS gwth/HY +ve EPS/
Beazley	BEZ	434	2644	8.7	0.3	0.7	-	3.0%	28.6%	23.5%	4%	-	7	5yr EPS gwth/HY +ve EPS/
Sirius Real Estate Ltd	SRE	126	1477	17.3	1.1	0.3	27.8	2.7%	43.6%	6.6%	-7%	-	7	Mid PE/Fwd PEG < 1/
Hays	HAS	126	2100	12.9	0.2	0.3	8.8	8.8%	141.5%	23.1%	-8%	-412.4	7	5yr EPS gwth/HY +ve EPS/
Dunelm	DNLN	1128	2282	13.8	1.5	0.6	9.4	12.3%	29.7%	0.3%	-15%	-107.3	7	5yr EPS gwth/Fwd PEG < 1/
Liontrust Asset Mgmt	LIO	1204	737	9.6	0.4	0.7	8.5	4.8%	42.5%	9.8%	-42%	-	7	5yr EPS gwth/Fwd EPS/

Source: FactSet, Numis Mid Cap, Investors' Chronicle

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

Company	TIDM	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	3-yr PEG	EV/ Ebitda	Trailing 12-mth DY	Fwd EPS gwth cur FY	Fwd EPS gwth next FY	Av EPS gr FY '2	3-mth share price mom	Net cash (£mn)	Tests passed (out of 8)	Tests failed	Sector
Sanderson Design	SDG	148	105	10.3	0.4	0.18	6.7	0.5%	69.4%	6.8%	38.1%	-15%	-8.0	7	/RoE or margin/ Home Furnishings
LSL Property Serv.	LSL	365	384	9.0	0.2	0.07	6.0	1.1%	139.1%	6.2%	72.6%	-14%	-	7	/EPS Gwth/ Real Estate Devp
Central Asia Metals	CAML	212	373	5.6	0.2	0.09	4.4	7.5%	104.2%	7.1%	55.7%	-12%	-13.6	7	/EPS Gwth/ Other Metals/Minerals
Atalaya Mining	ATYM	366	512	4.9	0.1	0.02	3.2	8.0%	311.9%	-2.7%	154.6%	-12%	-76.5	7	/EPS Gwth/ Precious Metals
Wentworth Res.	WEN	22	38	8.8	0.6	0.12	3.0	7.1%	77.8%	-3.0%	37.4%	6%	11.3	7	/EPS Gwth/ Oil & Gas Prod
Base Resources	BSE	17	212	5.7	0.5	0.02	2.2	22.9%	454.3%	-29.2%	212.5%	5%	-1.8	7	/EPS Gwth/ Other Metals/Minerals
Kenmare Res.	KMR	451	428	3.7	0.1	0.02	6.2	2.4%	737.4%	41.7%	389.6%	5%	23.4	7	/EPS Gwth/ Other Metals/Minerals
M.P.Evans	MPE	924	505	13.8	0.3	0.07	9.2	2.9%	230.3%	-26.3%	102.0%	10%	-32.3	7	/EPS Gwth/ Agricultural Com/Milling
Serica Energy	SQZ	325	876	2.4	0.0	0.01	8.6	1.1%	2912.8%	53.3%	1483.0%	32%	-6.1	7	/EPS Gwth/ Oil Refining/Marketing
Erwell Energy	ENW	20	63	3.2	-	0.00	0.7	0.0%	1647.9%	-51.4%	798.2%	-44%	38.8	6	/EPS Gwth/ Oil & Gas Prod
Eurocell	ECEL	205	230	9.3	0.2	0.05	5.1	1.6%	204.9%	10.7%	107.8%	-19%	-50.6	6	/EPS Gwth/RoE or margin/ Building Products
Integrated Diag.	IDHC	84	1084	10.1	0.4	0.07	4.9	8.9%	146.5%	-30.1%	58.2%	-16%	-8.4	6	/EPS Gwth/Mom or Upgrade/ Hospital/Nursing Mgmt
Marshalls	MSLH	635	1270	19.7	0.3	0.11	14.3	1.4%	235.4%	11.5%	123.4%	-8%	-53.5	6	/EPS Gwth/RoE or margin/ Construction Materials
Ocean Wilsons	OCN	910	322	10.5	2.3	0.16	5.1	0.0%	56.2%	-30.1%	13.0%	-3%	209.5	6	/EPS Gwth/ Marine Shipping

Source: FactSet, NSCI plus Aim, Investors' Chronicle

## US large-cap GARP selection (passing at least 8 of 9 tests)

Company	TIDM	Share price (\$)	Mkt cap (\$mn)	Fwd 12-mth PE	3-yr PEG	EV/ Ebitda	Trailing 12-mth DY	Fwd EPS gwth cur FY	Fwd EPS gwth next FY	3-mth share price mom	Net cash (\$mn)	Tests passed (out of 9)	Tests failed	Sector
Charles Schwab	SCHW	832.6	151085	20.4	0.8	1.6	9.5	0.9%	19.6%	24.9%	3%	-	9	na Invest.Banks/Brokers
FLEETCOR Tech	FLT	226.47	17639	14.3	0.7	1.4	14.1	0.0%	16.4%	13.9%	5%	-3039.7	9	na Misc Commercial Serv
Charter Comm. Class A	CHTR	566.14	97796	17.7	0.5	1.6	10.1	0.0%	24.9%	22.1%	-9%	-11857.0	9	na Cable/Satellite TV
Signature Bank	SBNY	289.78	16699	13.9	0.3	0.9	-	0.8%	31.6%	28.2%	-3%	-	9	na Regional Banks
Fortune Brands Home & Security	FBHS	82.53	11073	12.5	0.9	1.2	10.3	1.3%	12.5%	11.6%	-20%	-1498.3	9	na Building Products
Mastercard Incorporated Class A	MA	328.59	318643	30.2	0.9	1.9	30.0	0.6%	23.6%	23.8%	-4%	-4682.0	8	/Mid PE/ Finance/Rental/Leasing
J.B.Hunt Transport Services	JBHT	195.35	20482	21.9	2.4	1.5	13.1	0.6%	22.4%	9.6%	-1%	-1374.1	8	/Fwd PEG < 1/ Trucking
Visa Class A	V	200.33	332232	25.8	1.1	1.8	24.8	0.7%	21.3%	18.1%	-5%	3825.0	8	/Fwd PEG < 1/ Finance/Rental/Leasing
Ball Corp	BLL	88.44	28433	21.0	1.0	1.6	18.9	0.8%	17.0%	16.1%	-4%	-5374.0	8	/5yr EPS gwth/ Containers/Packaging
News Corp Class B	NWS	21.48	12515	22.3	0.9	1.1	8.3	0.9%	33.4%	10.9%	2%	-998.0	8	/5yr Rev grth/ Publishing: Newspapers
News Corp Class A	NWSA	21.11	12515	21.9	0.9	1.1	8.3	0.9%	33.4%	10.9%	0%	-998.0	8	/5yr Rev grth/ Publishing: Newspapers
VWV Grainger	GWW	483.4	24706	19.2	1.1	1.2	15.9	1.3%	23.9%	12.1%	-5%	-1287.0	8	/Fwd PEG < 1/ Wholesale Distributors
United Rentals	URI	320.26	23120	11.4	0.5	0.7	7.7	0.0%	23.8%	13.4%	-5%	-2459.0	8	/5yr EPS gwth/ Finance/Rental/Leasing
Texas Instruments Inc	TXN	166.72	153974	18.2	5.6	1.3	15.5	2.5%	10.4%	2.6%	-12%	7170.0	8	/Fwd PEG < 1/ Semiconductors
A.O. Smith Corp	AOS	65.88	8658	18.3	1.7	1.7	14.8	1.6%	19.9%	7.3%	-20%	-487.4	8	/Fwd PEG < 1/ Building Products
Skyworks Solutions	SWKS	120.56	19773	9.9	0.8	1.5	10.2	1.8%	10.3%	11.5%	-24%	361.6	8	/Q +ve EPS/ Semiconductors
Darden Restaurants	DRI	124.19	15862	15.0	0.4	0.4	12.8	2.8%	75.2%	12.2%	-17%	-633.6	8	/5yr Rev grth/ Restaurants
KLA Corp	KLAC	320	48229	13.9	0.7	0.7	14.0	1.2%	40.9%	17.9%	-20%	391.3	8	/5yr EPS gwth/ Semiconductors
Qualcomm Inc	QCOM	141.29	159234	11.7	0.7	0.7	13.0	1.9%	37.6%	6.9%	-22%	463.0	8	/Q +ve EPS/ Telecomms Equipment
Lam Research Corp	LRCX	469	65426	12.6	0.9	0.7	12.0	1.2%	21.4%	17.3%	-31%	2201.3	8	/5yr EPS gwth/ Electronic Prod.Equip

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

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