Investors' Chronicle | Alpha

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AlphaScreens: the market according to GARP

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Sectors matter when picking 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.

Growth at a reasonable price, is a valuation and analysis framework which works best when applied to growth stocks: companies where the share price might be a chunky multiple of expected earnings per share, but where those earnings are still expected to grow at a decent annualised rate going forward. Shifting the emphasis to valuing the earnings growth rate, rather than merely static estimates of profits at various points in the future is the premise which underpins the price-to-earnings growth or 'PEG' ratio.

The trouble with PEG ratios is they can make stocks on a cyclical upswing look very cheap and attractive when they actually warrant the extra risk premium that's reflected in their modest pricing. In such cases, it could be the share price is too close to a cyclical peak and at risk of a reversal. For this reason, we also use a variation of the PEG method that blends historic and forward growth rates and the dividend yield, to give a smoothed out valuation ratio.

Yet this isn't foolproof. When interpreting screen results, the sector in which the companies operate must be front of mind. On our UK large-cap screen, the high ranking of insurers like **Aviva (AV)** and **Admiral (ADM)** can be partly attributed to the relatively high dividend yields of the sector and the current stage of the insurance and investing cycle. It's worth re-reading Alex Newman's excellent missive on understanding the sector before choosing to add these shares to your portfolio.

Aim is arguably the UK's growth market, although again a bit of qualitative sector analysis is important. Mining stocks like gold producers **Pan African Resources (PAF)** and **Serabi Gold (SRB)**, the bulk of Serabi's operations are in Brazil, are clearly going to be affected by movements in the price of the yellow metal. True, there may be good reasons to expect the gold bull run to continue, but cyclicality is a risk.

Arguably it's in the field of technology where GARP is a good starting point to assess long-run potential growth stocks. With that in mind, it is noteworthy to see electronic and communications equipment manufacturer **Filtronic (FTC)** ranking well on the Aim screen. It has contracts with Elon Musk's SpaceX and Simon Thompson has previously touted the shares' potential.

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October 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 Group	ADM	2714	8313	14.7	0.5	1.1	4.5%	48%	16%	5%	-	8	/5-yr EPS gwth/
Aviva	AV	479	12837	9.4	0.7	0.9	7.1%	14%	13%	-1%	-	7	/5-yr EPS gwth/Y-o-Y EPS gwth/
JD Sports Fashion	JD	136	7067	9.4	0.8	1.5	0.7%	7%	16%	15%	-1370.3	7	/Y-o-Y EPS gwth/EPS gwth next 2 yrs/
Standard Chartered	STAN	824	20376	6.3	0.4	0.2	2.9%	18%	14%	13%	-	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
Hunting	HTG	368	608	9.5	0.2	0.2	2.2%	87%	35%	-14%	-139.6	8	/5-yr sales gwth/
Spire Healthcare	SPI	224	905	16.2	0.4	0.3	0.9%	32%	42%	-6%	-291.7	8	/5-yr EPS gwth/
Bank of Georgia	BGEO	4045	1805	3.5	0.2	0.1	5.7%	23%	8%	-11%	-	7	/5-yr EPS gwth/Y-o-Y EPS gwth/
CMC Markets	CMCX	334	935	13.8	0.5	0.3	2.5%	36%	19%	5%	-	7	/5-yr EPS gwth/Y-o-Y EPS gwth/
Centamin	CEY	157	1826	8.6	0.1	0.5	2.1%	149%	13%	20%	13.9	7	/5-yr EPS gwth/Y-o-Y EPS gwth/
Fresnillo	FRES	669	4930	13.1	0.2	0.9	1.3%	8%	106%	7%	307.1	7	/5-yr EPS gwth/Y-o-Y EPS gwth/
Frasers	FRAS	819	3690	7.3	0.6	0.4	0.0%	10%	13%	-3%	-606.2	7	/5-yr EPS gwth/Y-o-Y EPS gwth/
Warehouse REIT	WHR	88	375	14.4	0.9	1.0	7.3%	21%	10%	3%	-	7	/5-yr EPS gwth/Y-o-Y EPS gwth/

Source: Investors' Chronicle and FactSet

UK small-cap 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 grwth FY+1	3-mth share price mom.	Net cash (£mn)	Tests passed	Tests failed
Secure Trust Bank	STB	820	156	3.2	0.1	0.1	3.4%	46.6%	36.1%	3.8%	-	8	/NI or Asset TO/

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 grwth FY	fc EPS grwth FY+1	3-mth share price mom.	Net cash (£mn)	Tests passed	Tests failed
hVIVO	HVO	29	201	17.9	0.9	0.6	0.7%	20.0%	18.5%	5.4%	1.8	9	n/a
Litigation Capital Mgmt	LIT	110	126	13.2	0.3	0.7	1.1%	26.2%	45.9%	0.2%	-	9	n/a
Pan African Resources	PAF	36	805	5.3	0.1	0.1	2.6%	75.6%	27.4%	27.9%	-46.3	9	n/a
Spectra Systems	SPSY	260	127	10.1	0.1	1.0	3.5%	25.3%	109.7%	0.0%	0.0	8	/EPS gwth/
Johnson Service	JSG	155	644	13.4	0.5	0.7	2.1%	28.1%	22.6%	-4.9%	-91.0	8	/NI or Asset TO/
Filtronic	FTC	73	161	24.1	0.5	0.4	0.0%	120.6%	-4.7%	-4.5%	-1.0	8	/EPS gwth/
Anpario	ANP	310	63	12.8	0.5	0.4	3.5%	43.0%	13.0%	1.6%	9.2	8	/NI or Asset TO/
Mpac Group	MPAC	475	102	11.0	0.3	0.5	0.0%	35.7%	28.3%	-5.4%	-48.4	8	/NI or Asset TO/
Helios Underwriting	HUW	184	134	5.4	0.2	0.3	3.3%	25.7%	39.7%	5.7%	-	8	/NI or Asset TO/
Serabi Gold	SRB	83	63	2.0	0.0	0.0	0.0%	296.7%	69.5%	25.8%	-2.3	8	/EPS gwth/
1Spatial	SPA	67	75	27.8	0.4	0.6	0.0%	71.9%	54.7%	-2.9%	-10.6	7	/EPS gwth/NI or Asset TO/
Calnex Solutions	CLX	53	46	53.9	0.1	0.5	1.8%	810.3%	312.4%	9.3%	6.8	7	/EPS gwth/NI or Asset TO/
Loungers	LGRS	268	278	18.1	0.7	1.0	0.0%	16.9%	31.4%	-5.0%	-81.3	7	/Net debt to Ebitda/NI or Asset TO/
System1 Group	SYS1	655	83	22.9	0.5	0.8	0.8%	46.7%	40.6%	-10.3%	1.2	7	/3-mth price or EPS mom/NI or Asset TO/
LBG Media	LBG	131	274	17.2	0.1	0.0	0.0%	776.9%	11.9%	23.6%	4.2	7	/EPS gwth/NI or Asset TO/
Kitwave	KITW	330	265	10.2	0.8	1.0	3.4%	11.4%	13.6%	-3.8%	-127.1	7	/Net debt to Ebitda/NI or Asset TO/
Yu Group	YU	1630	274	7.7	0.8	0.8	3.4%	8.2%	9.8%	-10.9%	-29.8	7	/EPS gwth/NI or Asset TO/

Source: Investors' Chronicle and FactSet

Continued below

US GARP screen (passing at least 8 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
Meta Platforms Class A	META	577	1260130	24.3	0.8	1.2	0.2%	44%	15%	18%	31176.0	9	/
Hartford Financial Services	HIG	120	35050	10.6	0.8	0.7	1.5%	13%	14%	16%	-	9	/
Eli Lilly and Co.	LLY	916	870989	43.2	0.5	2.2	0.5%	158%	39%	-3%	-23757.2	9	/
Lam Research	LRCX	74	96094	19.7	0.9	2.0	1.1%	16%	23%	-31%	1509.4	9	/
First Solar	FSLR	206	22011	10.5	0.1	0.4	0.0%	74%	59%	-7%	-24.0	8	/5-yr EPS gwth/
Progressive	PGR	255	149562	19.0	0.4	0.7	0.5%	115%	1%	22%	-	8	/EPS gwth next 2 yrs/
NVIDIA	NVDA	136	3329212	36.7	0.5	0.9	0.0%	118%	39%	7%	20831.0	8	/5-yr EPS gwth/
HCA Healthcare	HCA	409	105611	16.7	1.1	1.1	0.6%	18%	11%	28%	-13366.0	8	/2-yr fwd PEG/
Netflix	NFLX	702	301274	31.5	0.8	1.2	0.0%	59%	20%	7%	-3482.1	8	/5-yr EPS gwth/
Garmin	GRMN	167	32119	25.5	2.5	1.7	1.8%	8%	12%	-4%	601.8	8	/2-yr fwd PEG/
Alphabet Class A	GOOGL	165	1898915	19.5	0.9	1.2	0.1%	32%	13%	-10%	22812.0	8	/5-yr EPS gwth/
Alphabet Class C	GOOG	167	1898915	19.7	0.9	1.2	0.1%	32%	13%	-10%	22812.0	8	/5-yr EPS gwth/
Universal Health Services Class B	UHS	237	14086	13.6	0.4	0.8	0.3%	52%	11%	29%	-2020.4	8	/5-yr EPS gwth/
W. R. Berkley	WRB	59	22559	14.0	1.0	0.8	0.5%	23%	6%	9%	-	8	/EPS gwth next 2 yrs/
Molina Healthcare	MOH	331	19397	12.8	1.0	1.3	0.0%	13%	13%	8%	-	8	/Y-o-Y EPS gwth/
Corpay	CPAY	345	23949	16.0	1.1	1.7	0.0%	12%	16%	17%	-4295.3	8	/2-yr fwd PEG/
Mastercard Class A	MA	514	471253	31.8	1.9	2.0	0.5%	17%	16%	16%	-8202.0	8	/2-yr fwd PEG/
Globe Life	GL	111	9958	8.5	0.7	0.6	0.8%	12%	11%	25%	-	8	/5-yr sales gwth/
ResMed	RMD	238	34980	25.3	1.7	1.6	0.8%	18%	10%	15%	-672.3	8	/2-yr fwd PEG/
Amazon.com	AMZN	187	1961517	33.3	0.8	1.4	0.0%	63%	24%	-3%	-68589.0	8	/5-yr EPS gwth/
Westinghouse Air Brake Tech	WAB	190	33245	23.0	1.2	1.9	0.4%	26%	13%	13%	-3052.0	8	/2-yr fwd PEG/
Fiserv	FI	198	113821	20.1	1.2	1.8	0.0%	16%	16%	26%	-35006.0	8	/2-yr fwd PEG/
Cigna	CI	359	100241	11.5	0.9	2.0	1.5%	14%	12%	6%	-	8	/Y-o-Y EPS gwth/
Marsh & McLennan Companies	MMC	228	112076	24.3	2.7	1.7	1.3%	10%	8%	4%	-	8	/2-yr fwd PEG/
Automatic Data Processing	ADP	291	118555	28.3	3.0	2.2	1.9%	9%	9%	18%	-41782.6	8	/2-yr fwd PEG/
Global Payments	GPN	102	25886	8.1	0.7	1.9	1.0%	11%	11%	-1%	-7042.2	8	/5-yr EPS gwth/

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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