

AlphaScreens: the market according to GARP

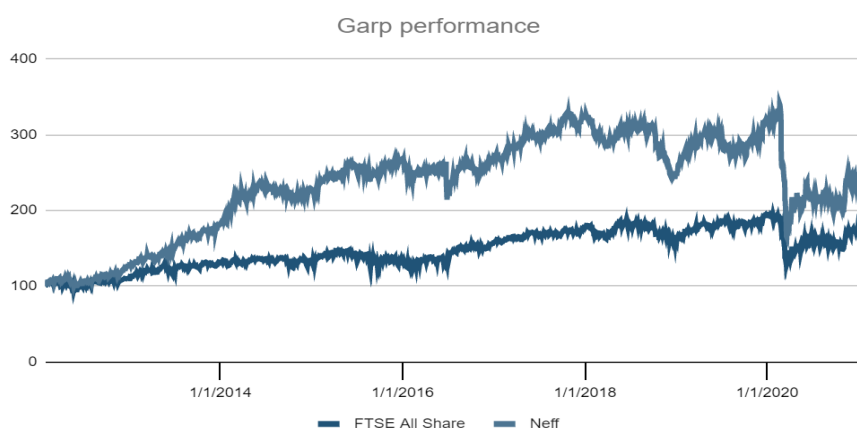
6 January 2022

Are new buying opportunities emerging?

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:

- Once again retailer JD Sports Fashion (JD.) is riding high on our growth at a reasonable price (GARP) screen. In his recent analysis piece for Alpha, Robin Hardy argued that EV/EBITDA was a better measure for valuing the business. On latest FactSet figures the ratio of EV to estimated full current year EBITDA is still only around 7.2 times. Although it is possible that the demographic representing a large slice of its target market may suffer disproportionately from rising inflation, once the omicron surge is subsided there may be good times ahead for JD.
- A handful of Aim stocks pass all seven of our tests designed for smaller companies. Steppe Cement (STCM) and Michelmersh Brick Holdings (MBH) top the screen. Perhaps reflecting a build back narrative with the pandemic (hopefully) in its last phase.



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 NTMPE	PEG	DY	EPS grth FY+1	EPS grth FY+2	3-mth momentum	Net cash/debt(-) in £	Tests passed (out of 8)	Test failed
Sirius Real Estate	SRE	£1,670	143	20	0.4	2.4%	42.6%	6.6%	10.4%	-	8	na
JD Sports Fashion	JD	£11,296	219	20	0.8	0.1%	61.9%	4.3%	2.4%	-591m	8	na
Royal Mail	RMG	£5,250	527	8	0.3	3.2%	20.2%	0.6%	27.1%	-1,150m	7	/5yr EPS grth/
Big Yellow	BYG	£3,172	1,724	32	0.3	2.2%	20.4%	7.3%	25.7%	-27m	7	/FCF/
Ferguson	FERG	£29,306	13,290	22	0.9	1.3%	16.7%	5.8%	27.4%	-2,523m	7	/5yr EPS grth/
Custodian REIT	CREI	£460	104	16	-1.0	5.3%	10.7%	6.5%	12.3%	-	7	/5yr EPS grth/
Norcros	NXR	£263	325	9	1.5	3.5%	13.1%	4.1%	12.1%	-76m	7	/5yr EPS grth/
IG Group	IGG	£3,582	830	11	0.8	5.2%	-28.0%	12.5%	4.1%	-	7	/Av FY2 Fwd EPS growth > 7.5%
Pets At Home	PETS	£2,320	464	20	0.8	2.1%	55.0%	11.9%	-3.4%	-195m	7	/5yr EPS grth/
Severfield	SFR	£217	70	9	0.7	4.3%	14.8%	11.9%	-5.4%	-60m	7	/HY EPS grth/
LondonMetric Property	LMP	£2,749	281	27	0.4	3.1%	2.6%	8.0%	16.4%	-	6	/mid PE/Av FY2 Fwd EPS growth > 7.5%
Bloomsbury Publishing	BMV	£295	361	18	1.4	5.2%	-10%	9.4%	10.4%	-23m	6	/5yr EPS grth/Av FY2 Fwd EPS growth > 7.5%
Redde Northgate	REDD	£1,073	436	10	1.0	4.1%	39.2%	5.4%	7.8%	-264m	6	/5yr EPS grth/FCF/
Up Global Sourcing	UPGS	£170	190	13	1.4	2.6%	31.6%	6.8%	6.4%	-39m	6	/5yr EPS grth/HY EPS grth/
Liontrust Asset Mgmt	LIO	£1,308	2,135	16	0.9	2.7%	42.9%	17.3%	5.7%	-	6	/mid PE/5yr EPS grth/
Target Healthcare REIT	THRL	£738	119	18	0.8	5.6%	15.6%	12.7%	4.2%	-	6	/5yr EPS grth/HY EPS grth/
Bellway	BWY	£4,066	3,295	8	1.4	3.6%	10.0%	6.4%	2.8%	-612m	6	/5yr EPS grth/FCF/
Burberry	BRBY	£7,482	1,861	20	1.0	2.9%	26.0%	14.3%	-1.4%	559m	6	/5yr EPS grth/5yr Rev grth/
Assura	AGR	£2,035	69	22	1.0	4.2%	8.3%	6.1%	-4.3%	-	6	/Av FY2 Fwd EPS growth > 7.5%/Fwd EPS/
Chemring	CHG	£820	290	16	1.0	1.7%	9.9%	5.1%	-5.1%	-97m	6	/5yr EPS grth/5yr Rev grth/
City of London Inv.	CLIG	£255	503	10	1.0	6.6%	1.5%	3.4%	-7.4%	-	6	/Av FY2 Fwd EPS growth > 7.5%/Fwd EPS//

Source: FactSet, 6 January 2022

Small-cap 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 momentum	Net cash/debt(-) in £	Tests passed (out of 7)	Test failed
JKX Oil & Gas	JKX	£71	42	-	0.04	0.0%	156.9%	-	-20.2%	-2m	6	/Fwd EPS grth/
LSL Property Services	LSL	£436	415	10	0.08	1.0%	138.2%	7.2%	-2.6%	-	6	/Fwd EPS grth/
Kenmare Resources	KMR	£463	488	5	0.02	2.2%	669.1%	9.5%	14.0%	23m	6	/Fwd EPS grth/
Headlam	HEAD	£360	422	11	0.10	1.8%	120.9%	17.8%	-13.0%	-132m	5	/Fwd EPS grth/Hi RoE or Marg/
Forterra	FORT	£624	273	13	0.10	2.2%	159.8%	23.0%	-9.3%	-41m	5	/Fwd EPS grth/Hi RoE or Marg/
Premier Miton Global Ren. Trust GBP	PMGR	£36	196	3	0.00	4.4%	654.7%	53.4%	5.4%	-	5	/Fwd EPS grth/Cash Conv/
Robert Walters	RWA	£599	782	16	0.08	2.1%	434.3%	23.2%	7.1%	-38m	5	/Fwd EPS grth/Hi RoE or Marg/
Carclo	CAR	£28	38	7	0.05	0.0%	86.7%	27.3%	26.7%	-12m	5	/Fwd EPS grth/Debt/

Source: FactSet, 6 January 2022

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 momentum	Net cash/debt(-) in £	Tests passed (out of 7)	Test failed
Steppe Cement Ltd	STCM	£93	43	8	0.21	8.2%	44.4%	4.5%	-1.2%	-3m	7	na
Michelmersh Brick	MBH	£124	130	15	0.26	2.8%	69.7%	3.6%	4.8%	-2m	7	na
Central Asia Metals	CAML	£442	251	7	0.12	6.4%	91.3%	4.2%	10.8%	-14m	7	na
Somero Enterprises, Inc.	SOM	£332	592	13	0.18	4.9%	81.4%	8.0%	16.1%	17m	7	na
Sureserve	SUR	£161	98	12	0.31	1.0%	66.4%	20.6%	36.1%	-38m	7	na
Sanderson Design	SDG	£121	170	13	0.28	0.4%	53.1%	10.9%	-14.4%	-8m	6	/Hi RoE or Marg/
M.P. Evans	MPE	£449	820	14	0.08	3.3%	179.9%	-24.4%	-3.1%	-32m	6	/Fwd EPS grth/
Wentworth Resources	WEN	£38	22	10	0.12	7.1%	79.7%	-17.9%	-2.3%	11m	6	/Fwd EPS grth/
Serica Energy	SQZ	£671	249	4	0.01	1.4%	2042.5%	6.0%	7.3%	-6m	6	/Fwd EPS grth/
Griffin Mining Ltd	GFM	£155	89	8	0.04	0.0%	250.3%	-12.1%	10.1%	-19m	6	/Fwd EPS grth/
Renold	RNO	£68	30	8	0.22	0.0%	78.9%	11.8%	15.0%	-20m	6	/Hi RoE or Marg/
Atalaya Mining	ATYM	£601	435	6	0.02	6.7%	304.6%	-14.2%	35.9%	-77m	6	/Fwd EPS grth/
Erwell Energy plc	ENW	£109	34	6	0.01	0.0%	835.6%	-16.3%	-21.2%	39m	5	/Fwd EPS grth/Mom or Upgrade/
Agronomics Limited	ANIC	£206	22	20	0.23	0.0%	746.2%	-	-18.5%	-	5	/Fwd EPS grth/Cash Conv/
Mission Group	TMG	£58	64	7	0.04	1.3%	500.0%	43.3%	-11.8%	-43m	5	/Fwd EPS grth/Hi RoE or Marg/
Portmeirion	PMP	£87	620	11	0.10	0.0%	651.7%	53.8%	-9.5%	-7m	5	/Fwd EPS grth/Hi RoE or Marg/
eEnergy	EAAS	£51	15	12	0.11	0.0%	9978.0%	42.5%	-8.4%	-5m	5	/Fwd EPS grth/Hi RoE or Marg/
Anexo	ANX	£159	137	8	0.39	1.1%	29.0%	19.0%	-2.5%	-41m	5	/Cash Conv/Debt/
Litigation Capital Mgmt	LIT	£122	102	7	0.16	0.0%	140.5%	68.2%	-1.4%	-	5	/Fwd EPS grth/Cash Conv/
Breedon	BREE	£1,622	96	16	0.31	0.5%	76.6%	25.0%	-0.1%	-283m	5	/Fwd EPS grth/Hi RoE or Marg/
Totally	TLY	£63	35	15	0.06	2.2%	910.5%	41.3%	-0.7%	-12m	5	/Fwd EPS grth/Hi RoE or Marg/
Finsbury Food	FIF	£130	100	9	0.35	2.4%	32.6%	-4.4%	5.3%	-57m	5	/Fwd EPS grth/Hi RoE or Marg/
Wynnstay	WYN	£117	578	14	0.29	2.6%	56.3%	-7.2%	6.1%	-38m	5	/Fwd EPS grth/Hi RoE or Marg/
Time Finance	TIME	£22	24	6	0.27	0.0%	40.5%	73.1%	6.7%	-	5	/Fwd EPS grth/Hi RoE or Marg/
Filtronic	FTC	£25	12	43	0.16	0.0%	800.0%	-	7.0%	-1m	5	/Fwd EPS grth/Hi RoE or Marg/
Iofina	IOF	£36	19	8	0.08	0.0%	242.3%	39.1%	20.6%	-3m	5	/Fwd EPS grth/Hi RoE or Marg/
Vertu Motors	VTU	£261	72	9	0.03	0.9%	190.2%	-57.4%	46.9%	-656m	5	/Fwd EPS grth/Hi RoE or Marg/

Source: FactSet, 6 January 2022

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