

AlphaScreens: the market according to GARP

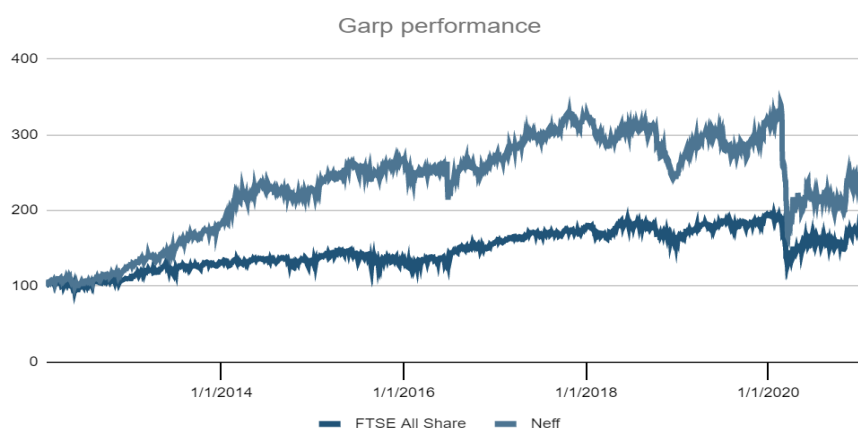
10 December 2021

Fairly priced for recovery?

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:

- The Competition and Markets Authority (CMA) ruling against JD Sports (JD) forcing it to sell Footasylum hasn't pulled the rug from under the business according to our growth at a reasonable price (GARP) screen. Analysts' forecasts for EPS growth are still positive according to FactSet data, but this is definitely a story worth investigating and not relying on screen numbers alone. We will have a longer analysis piece on the company for Alpha subscribers in the pipeline.
- Another company scoring well is plumbing and heating product distributor Ferguson (FERG), which published encouraging Q1 2022 results this week, although it cautioned that prior year comparatives for the rest of the year are tough, expectations among analysts remain positive. With a price to earnings growth (PEG) ratio below one, this ongoing success story isn't overpriced according to our screen.



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	EPSgrth FY+1	EPSgrth FY+2	3-mth momentum	Net cash/debt(-) in £	Tests passed (out of 8)	Test failed
Sirius Real Estate Ltd	SRE	£1,663	142	20	0.4	2.4%	43.8%	5.3%	11.8%	-	8	na
JD Sports Fashion	JD	£11,626	225	21	0.9	0.1%	58.8%	4.1%	9.2%	-591m	8	na
Macfarlane	MACF	£213	135	13	0.6	2.0%	63.6%	1.9%	-3.2%	-58m	8	na
Smurfit Kappa	SKG	£10,341	3,992	15	1.2	3.2%	8.7%	21.7%	-5.2%	-1,190m	8	na
Big Yellow	BYG	£3,070	1,669	31	0.3	2.3%	19.4%	7.4%	13.0%	-27m	7	/FCF/
Ferguson	FERG	£27,073	12,260	20	0.9	1.4%	18.4%	5.8%	16.2%	-2,523m	7	/5yr EPSgrth/
SEGRO	SGRO	£16,913	1,407	45	0.5	1.6%	10.8%	11.4%	10.7%	-	7	/5yr EPSgrth/
LondonMetric Property	LMP	£2,698	276	27	0.4	3.2%	2.6%	7.5%	8.8%	-	7	/Av FY2 Fwd EPS growth > 7.5%
Custodian REIT	CREI	£448	102	16	-1.0	5.4%	10.7%	6.5%	6.1%	-	7	/5yr EPSgrth/
Greencoat UK Wind	UKW	£2,873	135	10	0.3	5.3%	121.4%	-2.8%	0.7%	-	7	/5yr EPSgrth/
Pets At Home	PETS	£2,357	471	21	0.8	2.1%	55.0%	11.9%	-4.5%	-195m	7	/5yr EPSgrth/
Tyman	TYMN	£813	414	12	0.7	1.9%	15.0%	7.5%	-6.3%	-69m	7	/5yr EPSgrth/
Keller	KLR	£670	927	10	1.2	3.9%	-18.9%	20.0%	-5.5%	-446m	7	/Av FY2 Fwd EPS growth > 7.5%
IG Group	IGG	£3,394	787	10	0.8	5.5%	-28.8%	12.4%	-8.7%	-	7	/Av FY2 Fwd EPS growth > 7.5%
Severfield	SFR	£224	72	9	0.8	4.1%	14.8%	11.9%	-10.6%	-60m	7	/HY EPSgrth/
Hikma Pharmaceuticals	HIK	£5,248	2,267	14	1.0	1.7%	19.4%	16.1%	-10.2%	-495m	7	/HY EPSgrth/
Luceco	LUCE	£560	348	16	0.6	2.1%	31.5%	9.5%	-13.0%	-58m	7	/5yr EPSgrth/
TBC Bank Group	TBCG	£856	1,552	5	0.1	2.2%	161.6%	0.7%	9.3%	-	6	/5yr EPSgrth/HY EPSgrth/
Antofagasta	ANTO	£13,945	1,415	16	0.2	3.7%	173.2%	-16.4%	1.2%	1,498m	6	/5yr EPSgrth/Fwd EPS/
Vistry	VTY	£2,611	1,175	8	0.4	3.4%	137.6%	13.8%	1.3%	-625m	6	/5yr EPSgrth/HY EPSgrth/
Royal Mail	RMG	£4,864	487	8	0.3	3.4%	19.0%	1.0%	0.8%	-1,150m	6	/5yr EPSgrth/Fwd EPS/
Savills	SVS	£2,024	1,404	17	1.1	1.6%	43.7%	1.8%	2.8%	-373m	6	/5yr EPSgrth/HY EPSgrth/
Redde Northgate	REDD	£1,070	435	10	1.1	4.1%	32.4%	6.7%	1.6%	-264m	6	/5yr EPSgrth/FCF/
Target Healthcare REIT	THRL	£716	115	17	0.8	5.8%	15.6%	12.7%	-1.2%	-	6	/5yr EPSgrth/HY EPSgrth/
British American Tobacco	BATS	£61,589	2,684	8	0.9	8.0%	-1.5%	8.9%	-1.4%	-12,097m	6	/5yr EPSgrth/Av FY2 Fwd EPS growth > 7.5%
Kingfisher	KGF	£7,085	340	11	0.9	3.5%	25.8%	-15.6%	-2.3%	-2,041m	6	/Av FY2 Fwd EPS growth > 7.5% 5yr Revgrth/
S&U	SUS	£317	2,610	10	0.4	3.9%	115.7%	-1.2%	-3.7%	-	6	/5yr EPSgrth/HY EPSgrth/
Burberry	BRBY	£7,458	1,842	20	1.0	2.9%	25.8%	14.8%	-3.4%	559m	6	/5yr EPSgrth/5yr Revgrth/
City of London Inv. Group	CLIG	£255	503	10	1.0	6.6%	1.5%	3.4%	-3.7%	-	6	/Av FY2 Fwd EPS growth > 7.5% Fwd EPS/
Liontrust Asset Mgmt	LIO	£1,403	2,290	18	0.9	2.5%	42.7%	17.0%	-7.8%	-	6	/mid PE/5yr EPSgrth/
Assura	AGR	£2,062	70	22	1.0	4.1%	8.3%	6.1%	-9.0%	-	6	/Av FY2 Fwd EPS growth > 7.5% Fwd EPS/
LSL Property Services	LSL	£426	405	10	0.4	1.0%	138.2%	7.2%	-14.4%	-	6	/5yr EPSgrth/5yr Revgrth/

Source: FactSet, 9 December 2021

Small-cap GARP selection (passing at least 5 of 7 tests)

Name	TIDM	Mkt cap	Price	Fwd NTMPE	PEG	DY	EPSgrth FY+1	EPSgrth FY+2	3-mth momentum	Net cash/debt(-) in £	Tests Passed (out of 7)	Test Failed
LSL Property Services	LSL	£426	405	10	0.08	1.0%	138.2%	7.2%	-14.4%	-	6	/Fwd EPSgrth/
Kenmare Resources	KMR	£463	422	5	0.02	2.6%	687.4%	-3.0%	-0.7%	23m	6	/Fwd EPSgrth/
JKX Oil & Gas	JKX	£66	38	3	0.03	0.0%	163.7%	-	20.1%	-2m	6	/Fwd EPSgrth/
Forterra	FORT	£591	259	12	0.10	2.3%	159.8%	23.0%	-14.1%	-41m	5	/Fwd EPSgrth/Hi RoE or Marg/
Carclo	CAR	£28	38	7	0.05	0.0%	86.7%	27.3%	-9.5%	-12m	5	/Fwd EPSgrth/Debt/
Premier Miton Global Ren. Trust GBP	PMGR	£36	196	4	0.00	4.4%	654.7%	53.4%	10.7%	-	5	/Fwd EPSgrth/Cash Conv/
Robert Walters	RWA	£613	800	17	0.08	2.1%	406.5%	26.0%	17.0%	-38m	5	/Fwd EPSgrth/Hi RoE or Marg/
Foresight Group	FSG	£471	434	17	0.00	0.4%	1396.7%	31.1%	11.4%	-	5	/Fwd EPSgrth/Hi RoE or Marg/

Source: FactSet, 9 December 2021

Aim GARP selection (passing at least 5 of 7 tests)

Name	TIDM	Mkt cap	Price	Fwd NTMPE	PEG	DY	EPSgrth FY+1	EPSgrth FY+2	3-mth momentum	Net cash/debt(-) in £	Tests passed (out of 7)	Test failed
Steppe Cement	STCM	£94	43	8	0.20	8.1%	48.2%	4.5%	-21.8%	-3m	7	na
Michelmersh Brick	MBH	£125	132	15	0.26	2.8%	69.7%	3.6%	-8.7%	-2m	7	na
Somero Enterprises	SOM	£303	540	11	0.15	5.4%	86.2%	8.0%	-0.7%	17m	7	na
Sureserve Group	SUR	£151	94	12	0.29	1.1%	66.4%	20.6%	0.0%	-38m	7	na
Central Asia Metals	CAML	£432	246	7	0.11	6.5%	95.6%	3.1%	4.5%	-14m	7	na
Sanderson Design	SDG	£122	173	13	0.28	0.4%	53.1%	10.9%	-18.6%	-8m	6	/Hi RoE or Marg/
M.P.Evans	MPE	£457	836	14	0.08	3.2%	187.3%	-24.4%	12.4%	-32m	6	/Fwd EPSgrth/
Griffin Mining	GFM	£168	97	6	0.03	0.0%	293.0%	12.7%	11.6%	-19m	6	/Fwd EPSgrth/
Enwell Energy	ENW	£112	35	6	0.01	0.0%	860.4%	-16.3%	12.6%	39m	6	/Fwd EPSgrth/
Renold	RNO	£72	32	9	0.23	0.0%	78.9%	11.8%	26.7%	-20m	6	/Hi RoE or Marg/
Serica Energy	SQZ	£606	226	3	0.01	1.6%	2089.8%	6.0%	33.0%	-6m	6	/Fwd EPSgrth/
eEnergy	EAAS	£44	13	11	0.10	0.0%	9978.0%	42.5%	-30.4%	-5m	5	/Fwd EPSgrth/Hi RoE or Marg/
XLMedia	XLM	£112	43	9	0.08	0.0%	777.4%	152.0%	-28.2%	-7m	5	/Fwd EPSgrth/Hi RoE or Marg/
Time Finance	TIME	£20	22	6	0.17	0.0%	56.8%	65.5%	-18.9%	-	5	/Fwd EPSgrth/Hi RoE or Marg/
Wentworth Resources	WEN	£36	20	8	0.10	7.8%	90.0%	-11.1%	-18.8%	11m	5	/Fwd EPSgrth/Mom or Upgrade/
Character	CCT	£122	570	14	0.12	1.6%	123.6%	0.2%	-18.0%	-11m	5	/Fwd EPSgrth/Hi RoE or Marg/
Mission	TMG	£61	68	8	0.04	1.2%	500.0%	43.3%	-14.6%	-43m	5	/Fwd EPSgrth/Hi RoE or Marg/
Journeo	JNEO	£10	110	8	0.28	0.0%	134.5%	173.6%	-12.0%	-6m	5	/Fwd EPSgrth/Mkt Cap/
Totally	TLY	£59	32	15	0.06	2.3%	913.5%	40.6%	-11.6%	-12m	5	/Fwd EPSgrth/Hi RoE or Marg/
Filtronic	FTC	£23	11	40	0.15	0.0%	800.0%	-	-8.5%	-1m	5	/Fwd EPSgrth/Hi RoE or Marg/
Breedon	BREE	£1,627	96	16	0.31	0.5%	76.0%	25.2%	-6.0%	-283m	5	/Fwd EPSgrth/Hi RoE or Marg/
Litigation Capital Mgmt	LIT	£126	106	7	0.16	0.0%	143.9%	67.7%	5.8%	-	5	/Fwd EPSgrth/Cash Conv/
Frenkel Topping	FEN	£87	77	19	0.26	1.8%	146.0%	29.0%	7.0%	-	5	/Fwd EPSgrth/Cash Conv/
Wynnstay	WYN	£112	550	14	0.28	2.7%	56.3%	-7.2%	7.8%	-38m	5	/Fwd EPSgrth/Hi RoE or Marg/
Portmeirion	PMP	£95	680	12	0.11	0.0%	651.7%	53.8%	9.7%	-7m	5	/Fwd EPSgrth/Hi RoE or Marg/
Iofina	IOF	£27	14	6	0.06	0.0%	251.3%	39.1%	15.2%	-3m	5	/Fwd EPSgrth/Hi RoE or Marg/
Vertu Motors	VTU	£250	69	8	0.03	0.9%	190.1%	-57.7%	26.8%	-656m	5	/Fwd EPSgrth/Hi RoE or Marg/

Source: FactSet, 9 December 2021

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