Investors' Chronicle | Alpha

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AlphaScreens: the quest for quality

29 April 2024

Getting behind the quality metrics

Our screen highlights a wide variety of market and geopolitical factors for investors to consider, from the benefits of scale in an inflationary environment to standing out for the wrong reasons in a time of conflict

Comment by Alpha deputy editor:

Fewer companies made the cut this time around on our UK large-cap screen, but one more made a clean sweep. Catering business **Compass Group (CPG)** joined Holiday Inn owner **InterContinental Hotels Group (IHG)** in passing all our tests.

Compass failed our EPS growth rate test in January, but the analyst consensus is now for the catering business to deliver more than 10 per cent EPS growth in the current and next financial years. The company kept full-year guidance unchanged in a February update after reporting organic revenue growth of 11.7 per cent in its first quarter. Compass and other big catering stocks like **Sodexo (FR:SW)** and **Aramark (US:ARMK)** are gaining share from regional players and self-operators as they are better-equipped to deal with wage and food inflation pressures.

Across the Atlantic, the Magnificent Seven stocks have been driving US market returns. There were some interesting movements amongst these top players on our US screen. **Meta Platforms (US:META),** whose valuation puts it on the cheap end of the big tech companies, appeared this time around after its shares fell last week on the back of announcing an increase in capex to drive AI growth. Revenue was up 27 per cent in the company's first quarter. On the other hand, **Nvidia (US:NVDA)** fell off the screen because it just failed our cash conversion test of having a metric of at least 95 per cent.

Elsewhere on our US screen, leading global oilfield services business **SLB (US:SLB)** stands out for its relatively low valuation. That doesn't automatically mean a good investment opportunity, though. Quite apart from financial metric considerations, unlike its rivals, the company still operates in Russia more than two years after the invasion of Ukraine.

Continued below

UK quality large-caps (passing at least 6 out of 7 tests)

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	Net debt (£mn)	3-mth share price momentum	Tests passed (out of 7)	Tests failed
InterContinental Hotels	IHG	8034	13102	22.9	1.5%	1775.2	7.4%	7	-
Compass	CPG	2229	37955	21.7	1.9%	3472.0	3.8%	7	-

Source: FactSet and Investors' Chronicle

UK main market quality mid-caps (passing at least 7 out of 8 tests tests)

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	Net debt (£mn)	3-mth share price momentum	Tests passed (out of 8)	Tests failed
A.G. BARR	BAG	566	634	14.5	2.7%	-48.7	2.7%	8	
Frasers	FRAS	796	3585	8.1	0.0%	1281.7	-1.2%	8	
Games Workshop	GAW	9600	3163	20.2	5.7%	-62.7	-3.4%	7	fc EPS Growth/
ME Group International	MEGP	163	613	11.1	4.5%	-20.6	29.4%	7	fc EPS Growth/
Moneysupermarket.com	MONY	216	1159	12.2	5.6%	41.4	-16.6%	7	fc EPS Growth/
Wilmington	WIL	368	330	15.8	2.8%	-18.0	12.2%	7	fc EPS Growth/
4imprint	FOUR	6280	1769	19.2	2.7%	-72.3	13.8%	7	fc EPS Growth/
Rotork	ROR	311	2674	19.5	2.3%	-134.4	-1.2%	7	fc EPS Growth/
Volution	FAN	423	837	15.2	2.0%	94.3	0.6%	7	fc EPS Growth/
Hill & Smith	HILS	1902	1529	16.7	2.3%	108.4	2.6%	7	fc EPS Growth/
Bodycote	BOY	672	1278	12.4	3.4%	51.7	1.8%	7	fc EPS Growth/
Mears	MER	355	342	11.1	3.7%	145.3	3.3%	7	fc EPS Growth/
Weir	WEIR	2010	5218	15.9	1.9%	690.1	10.6%	7	fc EPS Growth/
Vesuvius	VSVS	476	1271	9.3	4.8%	238.0	-2.3%	7	fc EPS Growth/
Cranswick	CWK	4290	2317	17.1	1.9%	141.8	6.1%	7	fc EPS Growth/

Source: FactSet, Investors' Chronicle

UK quality small-caps (passing at least 7 out of 8 tests tests)

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	Net debt (£mn)	3-mth share price momentum	Tests passed (out of 8)	Tests failed
Galliford Try	GFRD	247	254	10.4	4.7%	-166.5	-2.8%	8	
Gulf Marine Services	GMS	22	228	7.6	0.0%	212.3	31.8%	7	Interest Cover/
Zotefoams	ZTF	381	186	15.4	1.9%	31.6	-0.3%	7	Cash Conv/

Source: FactSet and Investors' Chronicle

Continued below

Aim quality shares (passing at least 7 out of 8 tests tests)

Name	Ticker	Share price (p)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	Net debt (£mn)	3-mth share price momentum	Tests passed (out of 8)	Tests failed
Gaming Realms	GMR	36	105	12.7	0.0%	-7.3	1.6%	8	
Tristel	TSTL	480	228	30.1	2.7%	-4.8	2.1%	8	
Johnson Service	JSG	128	530	13.3	2.2%	104.9	-9.9%	8	
Good Energy	GOOD	250	46	7.3	0.0%	-41.0	-28.6%	8	
NIOX	NIOX	67	282	23.0	0.0%	-18.8	10.6%	8	
Spectra Systems	SPSY	221	100	16.1	4.2%	-13.5	-3.9%	7	Interest Cover/
Yu Group	YU	1870	314	9.3	2.1%	-30.5	51.4%	7	fc EPS Growth/
GlobalData	DATA	208	1758	23.4	2.2%	269.6	2.7%	7	Interest Cover/
Nichols	NICL	994	363	16.3	2.8%	-65.2	-7.1%	7	fc EPS Growth/
Jet2	JET2	1415	3038	8.0	0.8%	-1820.9	5.9%	7	fc EPS Growth/
Nexteq	NXQ	151	100	10.2	2.2%	-20.6	23.4%	7	fc EPS Growth/
Elixirr International	ELIX	570	269	13.7	0.0%	-12.8	7.5%	7	fc EPS Growth/
Renew Holdings	RNWH	937	742	14.5	1.9%	-18.0	7.9%	7	fc EPS Growth/
Churchill China	CHH	1175	129	14.6	3.1%	-13.3	-13.0%	7	fc EPS Growth/
1Spatial	SPA	61	67	25.4	0.0%	0.3	17.5%	7	Interest Cover/

Source: FactSet and Investors' Chronicle

US S&P 500 quality shares (passing 7 out of 7 tests)

Name	Ticker	Share price ($)	Mkt cap ($mn)	Fwd 12-mth PE	Trailing 12-mth DY	Net debt ($mn)	3-mth share price momentum	Tests passed (out of 7)
Mastercard	MA	462	428073	30.5	0.5%	7276.0	5.4%	7
Meta Platforms	META	443	971311	21.0	0.1%	-20571.0	12.5%	7
Visa	V	275	432136	25.9	0.7%	312.0	2.5%	7
Booking	BKNG	3521	119787	19.1	0.0%	2292.0	0.0%	7
Cadence Design Systems	CDNS	282	76853	45.1	0.0%	-363.1	-2.9%	7
Verisk Analytics	VRSK	221	31709	32.7	0.6%	2787.6	-9.4%	7
Hess	HES	163	49921	17.1	1.1%	8205.0	12.7%	7
Synopsys	SNPS	544	82932	37.7	0.0%	-605.0	2.9%	7
Deckers Outdoor	DECK	833	21393	27.1	0.0%	-1376.8	8.6%	7
Rollins	ROL	45	21742	43.4	1.2%	732.5	3.9%	7
Starbucks	SBUX	88	99917	20.3	2.4%	21080.1	-4.9%	7
Cintas	CTAS	666	67598	40.8	0.8%	2536.9	11.4%	7
Netflix	NFLX	561	241870	28.7	0.0%	9464.2	-1.6%	7
Amphenol	APH	120	72483	34.0	0.7%	2345.9	19.6%	7
Waste Management	WM	210	84268	28.0	1.4%	15742.0	13.1%	7
TE Connectivity	TEL	140	42956	17.6	1.7%	3020.0	-3.0%	7
Trane Technologies	TT	305	68997	28.6	1.0%	4207.2	21.1%	7
SLB	SLB	49	70323	13.2	2.1%	8679.0	-7.0%	7
Eaton	ETN	324	129685	30.4	1.1%	7328.0	31.9%	7

Source: FactSet and Investors' Chronicle

Alpha Quality screening criteria

Our quality screen focusses on return on invested capital (ROIC) to better reflect how well management teams are doing at making returns at firm's with diverse capital structures.

Quality tests

- Return on Invested Capital (ROIC) above the median for the last two full financial years.
- ROIC is higher than two years ago.
- Earnings before interest and tax (EBIT) margins have been positive in the past two years. (Trailing 12-mth basis).

Growth tests

- Forecast earnings per share (EPS) growth rate for current and next financial years both above 10 per cent.

Liquidity tests

- Interest cover (EBIT divided by interest payments) of at least five times.
- Cash conversion (cash from operations divided by net profit) above 95 per cent.

Valuation tests

- NTM Fwd PE ratio not in top or bottom decile. **(Not US or UK large cap)**
- Price to earnings growth (PEG) ratio not in top fifth.

Screen rankings are on tests passed and then on composite of last full year's cash return on capital employed (CROCI) and EBIT margin.

The equities universe we screen from

Our UK equities universe methodology is inspired by the Numis family of UK indices (although we do not copy them exactly). The aim is to give investors a true overview of the genuine large-cap; mid-cap and small-cap companies that are exciting analysts and the markets.

We screen against the S&P 500 for large and mega-cap US companies.

Investors' Chronicle UK screening cut-offs:

Large cap: The top 80 per cent of the UK main market's market capitalisation.

Mid cap: The next 15 per cent of UK main market capitalisation (80th to 95th percentile)

Small cap: The bottom five per cent of the main market by capitalisation with a £35mn lower cut-off.

Aim: We cut off the Alternative market by excluding all companies below £35mn market cap.

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ISSN 0261-3115.