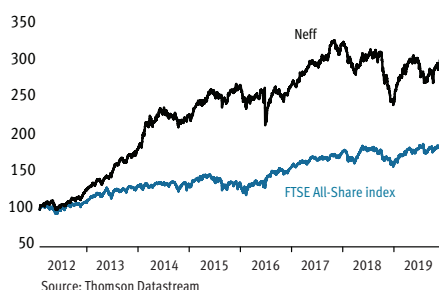




AlphaScreens: The market according to GARP

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

Neff versus All-Share



Algy Hall's view:

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.

■ In yet another sign Covid-19 has turned the world upside down, **British American Tobacco (BATS)** is ranked second on our growth at a reasonable price (Garp) screen of FTSE All-Share companies. Less surprisingly, it fails the EPS growth forecast test (although expectations are mildly positive over one and two years) but thanks to its commitment to its dividend so far and a positive EPS growth trend over the past five years, it does well enough on our mandatory price/earnings growth (PEG) measure and its defensive characteristics help it score on other tests.

■ The top ranked company, **Hikma Pharmaceuticals (HIK)**, carries more of the hallmarks of a growth stock, yet it still has a PEG of below one, indicating good value for a stock that offered investors cheer even in the depths of the market sell-off earlier this year.

■ Few smaller companies score well against the different tests we use for small-cap shares. The weak results against our EPS forecast tests could be a warning of value traps. In the coming months, however, this screen will be well worth watching for bargain growth when the economy turns the corner.

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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 (ie not suspiciously cheap) and below the top quarter (ie not dangerously expensive).
- A five-year historic EPS compound annual growth rate above 7.5 per cent but below 20 per cent (ie high, but sustainably so).
- A five-year historic revenue compound annual growth rate above 5 per cent (ie 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 (ie high, but sustainably so).
- Either a return on equity of over 12.5 per cent or an operating margin of over 15 per cent (ie 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 (ie 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 (ie 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 methodology formulated and explained by Algy Hall

Large-cap GARP selection (passing at least 6 of 8 tests)

Name	TIDM	Market cap	Price	Fwd NTM PE	PEG	DY	Fwd EPS grth FY+1	Fwd EPS grth FY+2	3-month momentum	Net cash/debt(-)	Cur	Tests passed (out of 7)	Test failed
Hikma Pharmaceuticals	HIK	£4,851	2,105	16	0.9	1.8%	7.6%	13.0%	-5.4%	165m	USD	8	na
British American Tobacco	BATS	£66,028	2,878	8	0.9	7.3%	2.5%	7.0%	-4.7%	42,243m	GBP	7	/Av FY2 Fwd EPS growth > 7.5%
National Express	NEX	£1,020	166	9	0.2	3.1%	-80.9%	318.5%	-35.8%	1,267m	GBP	7	/Fwd EPS/
RM	RM	£214	255	21	0.4	3.1%	-76.5%	162.1%	33.9%	15m	GBP	6	/5yr Rev grth/Fwd EPS/
Centamin	CEY	£2,172	188	15	0.6	2.3%	114.6%	-6.6%	36.6%	-215m	USD	6	/5yr EPS grth/HY EPS grth/
B&M European Value Retail SA	BME	£4,337	433	16	1.0	1.9%	41.3%	0.5%	44.4%	1,640m	GBP	6	/5yr EPS grth/HY EPS grth/
Stock Spirits	STCK	£456	228	13	0.7	3.4%	42.1%	6.1%	26.1%	38m	EUR	6	/5yr EPS grth/5yr Rev grth/
Medica	MGP	£139	125	17	0.5	0.0%	-29.9%	50.9%	19.9%	-4m	GBP	6	/5yr EPS grth/Fwd EPS/
SThree p	STEM	£353	266	15	0.9	5.8%	-55.3%	40.2%	13.5%	-11m	GBP	6	/Av FY2 Fwd EPS growth > 7.5%Fwd EPS/
Grafton	GFTU	£1,622	680	19	0.9	2.8%	-61.1%	87.3%	12.3%	534m	GBP	6	/HY EPS grth/Fwd EPS/
Beazley	BEZ	£2,565	422	22	0.1	2.9%	-91.3%	1061.8%	3.8%	232m	USD	6	/5yr EPS grth/Fwd EPS/
PageGroup	PAGE	£1,200	365	29	0.2	4.7%	-88.6%	464.6%	3.4%	31m	GBP	6	/HY EPS grth/Fwd EPS/
Henry Boot	BOOT	£318	239	20	0.8	2.1%	-72.6%	100.2%	-6.3%	-27m	GBP	6	/HY EPS grth/Fwd EPS/
Inchcape	INCH	£1,785	454	12	0.4	5.9%	-58.3%	93.3%	-9.1%	1,618m	GBP	6	/HY EPS grth/Fwd EPS/
Polypipe	PLP	£945	415	21	0.9	2.9%	-51.7%	80.1%	-12.5%	165m	GBP	6	/5yr EPS grth/Fwd EPS/
Empiric Student Property	ESP	£367	61	19	0.8	8.2%	-48.2%	68.8%	-15.5%	333m	GBP	6	/5yr EPS grth/Fwd EPS/
Forterra	FORT	£408	179	16	0.7	6.4%	-68.0%	98.0%	-21.3%	57m	GBP	6	/HY EPS grth/Fwd EPS/

Source: FactSet, as at 13 July 2020

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

Name	TIDM	Market cap	Price	Fwd NTM PE	PEG	DY	Fwd EPS grth FY+1	Fwd EPS grth FY+2	3-month momentum	Net cash/debt(-)	Cur	Tests passed (out of 7)	Test failed
Stock Spirits	STCK	£456	228	13	0.26	3.4%	42.1%	6.1%	26.1%	38m	EUR	7	na
De La Rue	DLAR	£246	126	8	0.20	0.0%	19.9%	30.9%	107.8%	116m	GBP	5	/Cash Conv/Debt/
Air Partner	AIR	£62	98	12	0.02	0.0%	1181.0%	7.8%	100.8%	-3m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/

Source: FactSet, as at 13 July 2020

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

Name	TIDM	Market cap	Price	Fwd NTM PE	PEG	DY	Fwd EPS grth FY+1	Fwd EPS grth FY+2	3-month momentum	Net cash/debt (-)	Cur	Tests passed (out of 7)	Test failed
SDI	SDI	£52	53	-	0.27	0.0%	75.6%	-	-13.0%	3m	GBP	6	/Fwd EPS grth/
Ergomed	ERGO	£230	475	20	0.33	0.0%	93.9%	13.2%	4.4%	-9m	GBP	6	/Fwd EPS grth/
Sureserve	SUR	£69	44	9	0.16	1.1%	76.9%	13.0%	16.9%	10m	GBP	6	/Hi RoE or Marg/
Anglo Asian Mining	AAZ	£160	140	7	0.26	4.6%	39.9%	-2.9%	25.0%	-9m	USD	6	/Fwd EPS grth/
Frenkel Topping	FEN	£30	40	13	0.22	3.4%	124.0%	14.3%	27.0%	-2m	GBP	6	/Fwd EPS grth/
Begbies Traynor	BEG	£119	93	14	0.17	2.9%	170.0%	7.3%	3.9%	10m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Bushveld Minerals	BMN	£161	14	6	0.00	0.0%	1037.2%	200.0%	4.9%	4m	USD	5	/Fwd EPS grth/Mom or Upgrade/
Wentworth Resources	WEN	-	18	12	0.27	0.0%	59.2%	40.8%	7.4%	-9m	USD	5	/Hi RoE or Marg/Mom or Upgrade/
Numis Corporation	NUM	£322	304	17	0.30	3.9%	116.0%	-	31.0%	-100m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Hummingbird Resources	HUM	£123	35	5	0.09	0.0%	467.2%	23.8%	33.1%	33m	USD	5	/Fwd EPS grth/Hi RoE or Marg/
Serabi Gold	SRB	£49	83	3	0.06	0.0%	258.3%	68.5%	34.1%	-5m	USD	5	/Fwd EPS grth/Hi RoE or Marg/
Draper Esprit	GROW	£564	474	5	0.09	0.0%	162.3%	28.4%	41.5%	12m	GBP	5	/Fwd EPS grth/Cash Conv/
Cello Health	CLL	£173	163	17	0.22	1.9%	104.9%	7.9%	47.7%	4m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Caledonia Mining Corp	CMCL	£159	1,318	5	0.12	0.0%	38.8%	67.5%	72.9%	-10m	USD	5	/Fwd EPS grth/Cash Conv/

Source: FactSet, as at 13 July 2020

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