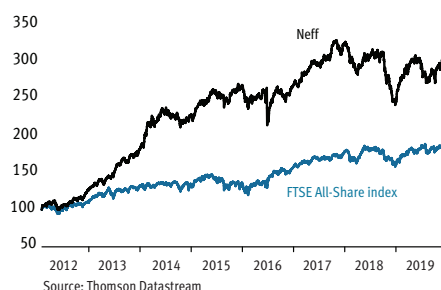




AlphaScreens: The market according to GARP

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.

- Packaging firm **Macfarlane (MACF)** tops our FTSE All-Share screen, only failing the requirement for forecast EPS growth above 7.5 per cent for the next two years. The rules for the All-Share screen are designed for larger companies, however, and Macfarlane fails the momentum or earnings upgrade and the net debt tests on our Small Cap screen.
- **Moneysupermarket.com (MONY)** is the largest company by market capitalisation that ranks reasonably well on the All-Share screen. Phil Oakley looked at the company as part of his latest weekly Alpha round-up and although the recent trading update was grim, it's a business he likes for the longer term.
- More intrepid investors may want to further examine the two Aim-listed companies that pass all our small-cap tests. Self-styled internet of things enabler **Telit Communications (TCM)** scores perfectly but prospective investors will need to assess supply chain issues thanks to coronavirus and the prospects for the UK's 5G roll-out.
- Competition firm **Best of the Best (BOTB)** has seen its share price rise after an encouraging set of full-year results and announcing it had completed its transition to a digital only strategy.

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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
Macfarlane	LSE:MACF	£119m	76p	9	0.7	3.2%	35.6%	0.4%	-18.8%	-39m GBP	7	/Fwd EPS/
Moneysupermarket.com	LSE:MONY	£1,710m	319p	20	1.6	3.7%	-12.1%	18.9%	14.6%	-10m GBP	6	/Av FY2 Fwd EPS growth > 7.5%/Fwd EPS/
Target Healthcare REIT	LSE:THRL	£494m	108p	17	0.6	6.2%	26.7%	8.3%	3.3%	-102m GBP	6	/HY EPS grth/FCF/
S&U	LSE:SUS	£206m	1,700p	7	0.3	7.1%	5.7%	12.3%	-11.7%	-119m GBP	6	/FCF/Fwd EPS/

Source: S&P Capital IQ, as at 15 June 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
Triple Point Social Housing REIT	LSE:SOHO	£333m	95p	21	0.48	5.5%	34.2%	17.9%	16.1%	-102m GBP	7	na
Capital Drilling	LSE:CAPD	£87m	64p	9	0.60	1.8%	10.8%	23.6%	47.7%	16m USD	7	na
Hansard Global	LSE:HSD	£46m	34p	10	0.67	13.1%	3.8%	25.9%	-1.7%	1,141m GBP	6	/Mom or Upgrade/
Impact Healthcare REIT	LSE:IHR	£321m	101p	16	0.58	6.3%	21.6%	9.8%	3.1%	24m GBP	6	/Cash Conv/
Residential Secure Income	LSE:RESI	£157m	92p	26	0.37	5.4%	20.7%	36.9%	8.2%	-131m GBP	6	/Cash Conv/
Kenmare Resources	LSE:KMR	£237m	216p	10	0.16	4.1%	-28.9%	167.7%	27.8%	16m USD	6	/Fwd EPS grth/
Macfarlane	LSE:MACF	£119m	76p	9	0.68	3.2%	35.6%	0.4%	-18.8%	-39m GBP	5	/Mom or Upgrade/Debt/
Georgia Healthcare	LSE:GHG	£117m	90p	8	0.32	-	41.4%	21.7%	4.7%	-424m GEL	5	/Hi RoE or Marg/Debt/

Source: S&P Capital IQ, as at 15 June 2020

Continued on next page

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

Name	TIDM	Market cap	Price	Fwd NTM			Fwd EPS grth FY+1	Fwd EPS grth FY+2	3-month momentum	Net cash/debt (-)	Cur	Tests passed (out of 7)	Test failed
				PE	PEG	DY							
Telit Communications	AIM:TCM	£167m	126p	12	0.21	-	8.1%	34.1%	28.2%	37m	USD	7	na
Best of the Best	AIM:BOTB	£76m	810p	31	0.82	0.2%	47.6%	3.4%	100.0%	5m	GBP	7	na
Duke Royalty	AIM:DUKE	£62m	26p	9	0.57	11.4%	53.0%	20.5%	-26.7%	1m	GBP	6	/Mom or Upgrade/
Quixant	AIM:QXT	£65m	98p	7	0.63	-	26.9%	5.0%	-12.9%	15m	USD	6	/Mom or Upgrade/
K3 Capital	AIM:K3C	£69m	163p	11	0.67	4.7%	50.6%	0.5%	-9.2%	6m	GBP	6	/Mom or Upgrade/
Cake Box	AIM:CBOX	£65m	163p	15	0.86	-	31.6%	12.9%	3.2%	2m	GBP	6	/Cash Conv/
Atalaya Mining	AIM:ATYM	£192m	140p	9	0.17	-	-71.9%	517.2%	10.2%	12m	EUR	6	/Fwd EPS grth/
Caledonia Mining Corp.	AIM:CMCL	£257m	1,350p	-	0.00	-	33.1%	39.5%	84.9%	12m	USD	6	/Cash Conv/
Springfield Properties	AIM:SPR	£93m	97p	6	0.69	-	10.0%	10.2%	-20.2%	-56m	GBP	5	/Cash Conv/Debt/
Nexus Infrastructure	AIM:NEXS	£72m	160p	11	0.54	-	36.2%	14.5%	-17.9%	5m	GBP	5	/Mom or Upgrade/Cash Conv/
RBG	AIM:RBGP	£59m	69p	8	0.72	8.7%	17.9%	6.6%	-10.4%	-5m	GBP	5	/Mom or Upgrade/Cash Conv/
Spectra Systems	AIM:SPSY	£68m	121p	-	0.00	-	-11.5%	6.4%	2.6%	13m	USD	5	/Fwd EPS grth/Mom or Upgrade/
Urban Logistics REIT	AIM:SHED	£259m	138p	19	0.25	2.7%	77.2%	18.5%	7.8%	54m	GBP	5	/Fwd EPS grth/Mom or Upgrade/
Hummingbird Res.	AIM:HUM	£90m	26p	7	0.22	-	225.8%	-7.5%	12.8%	-63m	USD	5	/Fwd EPS grth/Hi RoE or Marg/
Volex	AIM:VLX	£213m	143p	11	0.46	2.8%	147.3%	-10.7%	28.8%	1m	USD	5	/Fwd EPS grth/Hi RoE or Marg/
Touchstone Exploration	AIM:TXP	£158m	46p	-	0.00	-	-	-	42.9%	-1m	USD	5	/Hi RoE or Marg/Cash Conv/
Pan African Resources	AIM:PAF	£313m	16p	5	0.11	0.6%	147.8%	18.2%	59.3%	-111m	USD	5	/Fwd EPS grth/Cash Conv/
Venture Life	AIM:VLG	£61m	73p	14	0.73	-	220.3%	-7.0%	139.3%	4m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/

Source: S&P Capital IQ, as at 15 June 2020

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