Investors' Chronicle | Alpha

Alpha Editor: James Norrington
Alpha Production Editor: Sameera Hai Baig

AlphaScreens: the market according to GARP

7 June 2021

Making sure you don't pay too much for growth

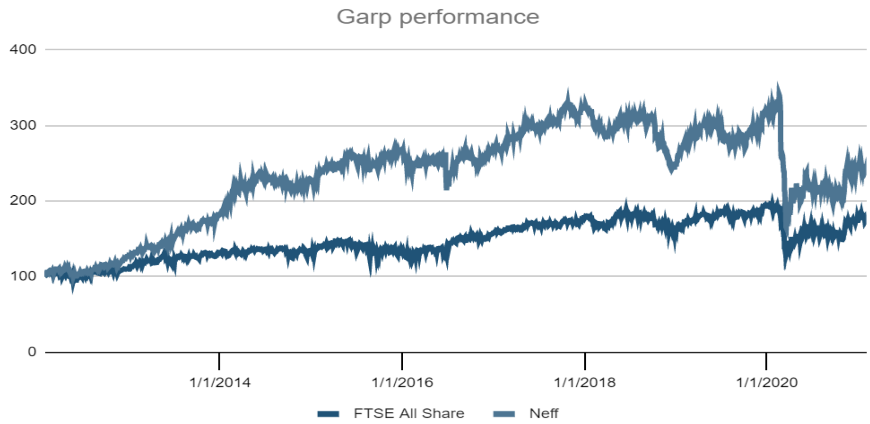
Growth at a reasonable price, or GARP, has proved a reliable strategy that has previously generated market-beating returns. We run our GARP screens across three indices: FTSE All-Share, All Small and Aim

Comment by Alpha editor:

- Plumbing and heating product distributor **Ferguson (FERG)** still scores well on our growth at a reasonable price screen. It has improved since last time we ran the data, now passing 7/8 of the large cap criteria. The improvement is that it now satisfies the average two year earnings growth forecast test.

- **Royal Mail (RMG)** has also enjoyed positive share price momentum in 2021 and it now passes 5/7 tests. It fails our five-year earnings per share growth rate test on account of being too good. This flag for earnings growth rate sustainability is reinforced by it failing our test to have posted year-on-year earnings growth for both of the past two half year periods. So although Royal Mail's redemption in the eyes of investors has been one of the stories of 2021, there are grounds to be a little cautious in assessing how much further the share price could rise.

- On Aim, **Smart Metering Systems (SMS)** came top of the pile, passing 7/7 of our small cap tests. This company also did well on our dividend yield screen recently. It seems a better fit to this screen than as an income pick (given its yield is only 2.8 per cent), but it is reassuring when companies do well on two sets of criteria. Further analysis is always needed for any stock highlighted by a screen (or even two screens) but these results do suggest that this company has reasonable prospects and that the shares aren't too expensive.



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 (£m)	Price (p)	Fwd NTM PE	PEG	Div yield	EPS grth FY+1	EPS grth FY+2	3-month momentum	Net cash/ debt(-)	Cur	Tests passed (out of 8)	Test failed
Safestore Holdings	SAFE	£2,026	961	25	0.7	1.9%	21.5%	5.6%	25.2%	512m	GBP	8	na
Luceco	LUCE	£560	348	19	0.5	2.3%	18.2%	9.3%	47.1%	14m	GBP	7	/5yr EPS grth/
Macfarlane	MACF	£191	121	13	0.8	2.1%	38.6%	5.6%	17.5%	29m	GBP	7	/HY EPS grth/
Ferguson	FERG	£21,946	9,824	21	1.0	2.1%	11.6%	6.6%	16.5%	1,656m	USD	7	/5yr EPS grth/
Smurfit Kappa	SKG	£9,677	3,736	16	1.1	4.7%	6.5%	15.8%	7.9%	2,126m	EUR	7	/HY EPS grth/
Hikma Pharmaceuticals	HIK	£5,576	2,409	18	1.4	1.5%	6.3%	16.0%	7.7%	425m	USD	7	/HY EPS grth/
Keller	KLR	£584	807	11	1.3	4.4%	-29.8%	27.0%	0.6%	193m	GBP	7	/Av FY2 Fwd EPS growth > 7.5%
Assura	AGR	£2,021	76	24	1.2	3.8%	11.5%	5.0%	-0.6%	908m	GBP	7	/HY EPS grth/
LSL Property Services	LSL	£496	472	12	0.6	0.0%	138.3%	7.3%	74.2%	36m	GBP	6	/5yr EPS grth/5yr Rev grth/
Tyman	TYMN	£969	494	16	0.8	0.8%	11.9%	6.0%	45.1%	153m	GBP	6	/5yr EPS grth/HY EPS grth/
Royal Mail	RMG	£5,910	591	10	0.5	1.7%	11.4%	3.8%	27.8%	478m	GBP	6	/5yr EPS grth/HY EPS grth/
Vistry Group	VTY	£2,890	1,300	10	0.9	1.5%	129.0%	15.5%	37.9%	4m	GBP	6	/5yr EPS grth/HY EPS grth/
SThree	STEM	£623	467	20	1.2	1.1%	69.5%	22.5%	39.4%	-14m	GBP	6	/5yr EPS grth/HY EPS grth/
S&U	SUS	£327	2,690	15	0.9	3.3%	33.2%	37.4%	22.8%	100m	GBP	6	/5yr EPS grth/HY EPS grth/
SEGRO	SGRO	£12,728	1,060	36	0.7	2.1%	10.0%	9.5%	17.4%	2,408m	GBP	6	/5yr EPS grth/HY EPS grth/
Vivo Energy	VVO	£1,333	105	13	0.8	4.5%	79.9%	15.8%	14.5%	227m	USD	6	/5yr EPS grth/HY EPS grth/
Pets At Home	PETS	£2,172	434	22	1.0	1.8%	39.2%	14.7%	14.3%	407m	GBP	6	/5yr EPS grth/HY EPS grth/
City of London Inv Grp	CLIG	£279	550	11	0.7	5.6%	58.6%	6.8%	10.0%	-16m	GBP	6	/5yr EPS grth/HY EPS grth/
Spirent Comms	SPT	£1,529	250	21	0.8	1.8%	10.1%	5.3%	9.4%	-156m	USD	6	/5yr EPS grth/HY EPS grth/
British Am Tobacco	BATS	£62,735	2,734	8	0.7	9.9%	-1.1%	8.1%	5.6%	40,088m	GBP	6	/5yr EPS grth/Av FY2 Fwd EPS growth > 7.5%
Alfa Financial Software	ALFA	£401	134	39	-2.8	0.7%	-50.4%	6.9%	4.0%	-20m	GBP	6	/5yr EPS grth/Av FY2 Fwd EPS growth > 7.5%
Fresnillo	FRES	£6,451	875	15	0.6	2.1%	75.3%	16.2%	-4.3%	120m	USD	6	/5yr EPS grth/FCF/

Source: FactSet, 7 June 2021

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

Name	TIDM	Mkt cap (£m)	Price (p)	Fwd NTM PE	PEG	Div yield	EPS grth FY+1	EPS grth FY+2	3-month momentum	Net cash/ debt(-)	Cur	Tests passed (out of 7)	Test failed
Hansard Global	HSD	£85	61	5	0.06	7.2%	237.3%	-12.5%	19.4%	-44m	GBP	6	/Fwd EPS grth/
PayPoint	PAY	£417	607	12	0.09	5.3%	137.6%	5.1%	2.9%	48m	GBP	5	/Fwd EPS grth/Mom or Upgrade/
Kenmare Resources	KMR	£484	441	6	0.07	1.7%	575.9%	-10.1%	10.8%	45m	USD	5	/Fwd EPS grth/Hi RoE or Marg/
Halfords Group	HFD	£755	379	15	0.17	0.0%	64.4%	-33.8%	15.4%	272m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
ScS Group	SCS	£99	260	17	0.01	0.0%	855.4%	-46.9%	23.5%	36m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
LSL Property Services	LSL	£496	472	12	0.14	0.0%	138.3%	7.3%	74.2%	36m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/

Source: FactSet, 7 June 2021

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

Name	TIDM	Mkt cap (£m)	Price (p)	Fwd NTM PE	PEG	Div yield	EPS grth FY+1	EPS grth FY+2	3-month momentum	Net cash/ debt(-)	Cur	Tests passed (out of 7)	Test failed
Smart Metering Systems	SMS	£1,020	900	67	0.15	2.8%	34.9%	12.3%	21.8%	-37m	GBP	7	na
Sureserve	SUR	£137	85	12	0.27	1.2%	65.8%	17.4%	26.9%	1m	GBP	7	na
Enwell Energy	ENW	£69	22	10	0.34	0.0%	85.0%	131.6%	-12.2%	-44m	USD	6	/Fwd EPS grth/
Griffin Mining	GFM	£214	123	9	0.13	0.0%	253.4%	14.7%	-11.2%	-12m	USD	6	/Fwd EPS grth/
Numis Corporation	NUM	£408	379	10	0.21	3.2%	38.6%	-	5.3%	-80m	GBP	6	/Fwd EPS grth/
Best of the Best	BOTB	£259	2,750	19	0.14	0.1%	234.4%	14.3%	5.8%	-11m	GBP	6	/Fwd EPS grth/
Caledonia Mining Corp	CMCL	£123	1,105	5	0.36	2.5%	27.8%	36.1%	8.3%	-9m	USD	6	/Cash Conv/
Central Asia Metals	CAML	£494	281	9	0.18	5.0%	81.8%	-5.9%	11.8%	24m	USD	6	/Fwd EPS grth/
Trans-Siberian Gold	TSG	£106	115	7	0.24	6.9%	120.8%	15.0%	31.0%	7m	USD	6	/Fwd EPS grth/
Kape Technologies	KAPE	£701	313	16	0.33	0.0%	72.1%	23.7%	62.2%	-6m	USD	6	/Cash Conv/
Morses Club	MCL	£90	68	11	0.17	4.4%	33.7%	87.2%	-8.4%	2m	GBP	5	/Fwd EPS grth/Mom or Upgrade/
Sigma Capital	SGM	£134	149	13	0.18	1.3%	289.6%	8.4%	-4.8%	17m	GBP	5	/Fwd EPS grth/Debt/
Robinson	RBN	£25	150	10	0.25	5.7%	69.0%	7.0%	-1.6%	7m	GBP	5	/Hi RoE or Marg/Debt/
Springfield Properties	SPR	£171	167	11	0.20	2.0%	69.9%	13.5%	9.8%	37m	GBP	5	/Hi RoE or Marg/Debt/
XLMedia	XLM	£125	47	18	0.06	0.0%	620.0%	168.2%	9.0%	-10m	USD	5	/Fwd EPS grth/Hi RoE or Marg/
Frenkel Topping	FEN	£57	51	17	0.27	2.6%	126.2%	19.3%	12.0%	-	GBP	5	/Fwd EPS grth/Debt/
Sylvania Platinum	SLP	£357	131	3	0.06	1.2%	137.9%	46.2%	9.6%	-49m	USD	5	/Fwd EPS grth/Cash Conv/
Gear4music	G4M	£183	875	37	0.07	0.0%	325.8%	-55.5%	16.7%	16m	GBP	5	/Fwd EPS grth/Cash Conv/
Pan African Resources	PAF	£404	21	5	0.08	3.3%	90.5%	18.8%	21.1%	62m	USD	5	/Fwd EPS grth/Cash Conv/
Journeo	JNEO	£10	112	10	0.17	0.0%	285.0%	66.7%	22.3%	0m	GBP	5	/Fwd EPS grth/Mkt Cap/
Jubilee Metals	JLP	£449	20	6	0.11	0.0%	110.1%	78.9%	25.8%	1m	GBP	5	/Fwd EPS grth/Cash Conv/
Titon Holdings	TON	£15	137	15	0.03	2.5%	1323.1%	31.1%	29.1%	-4m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Alumasc	ALU	£88	244	10	0.09	2.2%	167.3%	7.9%	41.4%	6m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Character Group	CCT	£143	670	15	0.12	1.3%	143.9%	4.2%	45.7%	-33m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/

Source: FactSet, 7 June 2021

Investors' Chronicle | Alpha

Alpha Editor: James Norrington
Alpha Production Editor: Sameera Hai Baig

ISSN 0261-3115.