

AlphaScreens: the market according to GARP

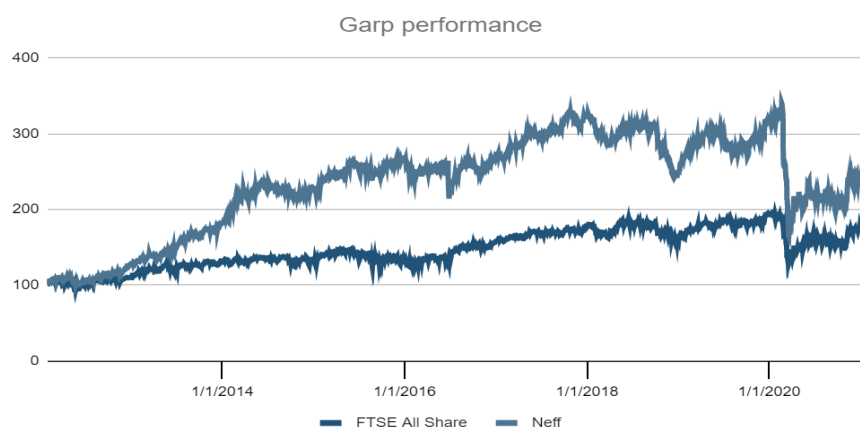
22 March 2021

Large-cap growth doesn't come cheap

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:

- Bigger companies that offer good growth prospects just don't come cheap nowadays and that's reflected in the results of our FTSE All-Share screen. The largest company passing even 6/8 tests is insurance and investment business **Legal & General (LGEN)**.
- Against our different set of tests just for smaller companies, packaging specialist **Macfarlane (MACF)** gets 7/7.
- On Aim, which is also tested against the small company rules, **Cohort (CHRT)**, a holding company for defence-related businesses gets full marks. So does **Smart Metering Systems (SMS)**, which is involved in rolling out the eponymous technology. Completing them at the top of the Aim class is asset and energy support services company **Sureserve Group (SUR)**.



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
Clipper Logistics	CLG	£572	562	20	0.8	1.8%	47.2%	24.0%	-2.9%	189m	GBP	8	na
Macfarlane	MACF	£167	106	12	0.8	2.4%	38.6%	5.6%	19.1%	29m	GBP	7	/HY EPS grth/
Safestore	SAFE	£1,651	783	23	0.8	2.4%	8.5%	7.6%	3.2%	512m	GBP	7	/mid PE/
IG Group	IGG	£3,233	873	12	0.6	4.9%	46.2%	-30.1%	1.6%	-456m	GBP	7	/mid PE/
Cranswick	CWK	£1,835	3,488	18	1.5	1.8%	20.4%	2.6%	-1.5%	122m	GBP	7	/FCF/
Smurfit Kappa	SKG	£8,771	3,386	16	1.2	5.1%	2.1%	15.4%	-3.4%	2,126m	EUR	7	/HY EPS grth/
SThree	STEM	£568	381	18	1.3	1.3%	57.8%	26.9%	24.5%	-14m	GBP	6	/5yr EPS grth/HY EPS grth/
Vistry Group	VTY	£2,380	1,071	9	1.0	1.9%	117.3%	17.6%	19.5%	4m	GBP	6	/5yr EPS grth/HY EPS grth/
City of London Inv Grp	CLIG	£259	512	10	0.7	6.1%	60.5%	5.4%	17.2%	-16m	GBP	6	/5yr EPS grth/HY EPS grth/
Vivo Energy	VVO	£1,195	94	12	0.8	5.0%	81.8%	17.4%	14.2%	227m	USD	6	/5yr EPS grth/HY EPS grth/
Keller	KLR	£566	784	11	1.3	4.6%	-29.8%	26.9%	17.0%	193m	GBP	6	/HY EPS grth/Av FY2 Fwd EPS growth > 7.5%
Legal & General	LGEN	£16,583	278	9	0.4	6.3%	52.9%	7.6%	8.6%	-12,407m	GBP	6	/HY EPS grth/FCF/
B&M Euro Value Retail SA	BME	£5,426	542	16	0.5	1.8%	111.1%	-15.3%	6.4%	1,626m	GBP	6	/5yr EPS grth/HY EPS grth/
Sirius Real Estate	SRE	£1,011	96	16	0.5	3.4%	29.4%	-1.2%	5.8%	349m	EUR	6	/HY EPS grth/Fwd EPS/
Target Healthcare REIT	THRL	£575	112	18	1.4	5.9%	12.0%	11.0%	-1.2%	114m	GBP	6	/5yr EPS grth/Fwd EPS/
Games Workshop	GAW	£3,130	9,550	25	0.8	1.9%	62.8%	9.1%	-12.5%	-51m	GBP	6	/5yr EPS grth/HY EPS grth/
Hikma Pharmaceuticals	HIK	£5,099	2,212	16	1.4	1.7%	8.2%	14.6%	-14.3%	425m	USD	6	/HY EPS grth/Fwd EPS/

Source: FactSet, 22 March 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
City of London Inv Grp	CLIG	£259	512	10	0.29	6.1%	60.5%	5.4%	17.2%	-16m	GBP	7	na
Macfarlane	MACF	£167	106	12	0.43	2.4%	38.6%	5.6%	19.1%	29m	GBP	7	na
Air Partner	AIR	£45	70	14	0.00	1.1%	2100.0%	-65.2%	-3.0%	-29m	GBP	5	/Fwd EPS grth/Mom or Upgrade/
McBride	MCB	£152	87	7	0.39	1.3%	18.3%	8.4%	6.9%	118m	GBP	5	/Hi RoE or Marg/Debt/
LSL Property Services	LSL	£310	295	10	0.10	0.0%	137.9%	-2.5%	12.2%	48m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
ScS Group	SCS	£89	235	14	0.01	0.0%	801.5%	-45.0%	13.0%	36m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Halfords	HFD	£652	328	13	0.18	0.0%	54.2%	-32.4%	25.0%	272m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/

Source: FactSet, 22 March 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
Cohort	CHRT	£258	630	9	0.32	1.7%	78.7%	6.4%	4.0%	13m	GBP	7	na
Smart Metering Systems	SMS	£870	770	62	0.17	3.2%	26.3%	17.1%	9.4%	-37m	GBP	7	na
Sureserve	SUR	£109	69	11	0.34	1.5%	52.4%	11.1%	26.9%	-3m	GBP	7	na
EKF Diagnostics	EKF	£296	65	33	0.24	0.0%	201.5%	-45.3%	0.8%	-15m	GBP	6	/Fwd EPS grth/
Robinson	RBN	£26	157	11	0.16	3.5%	89.0%	4.3%	1.3%	6m	GBP	6	/Hi RoE or Marg/
Wentworth Resources	WEN	£43	23	13	0.16	6.0%	86.5%	15.9%	27.8%	-11m	USD	6	/Fwd EPS grth/
Kape Technologies	KAPE	£595	280	16	0.35	0.0%	60.6%	22.7%	63.7%	-6m	USD	6	/Cash Conv/
Best of the Best	BOTB	£286	3,050	24	0.15	0.1%	234.4%	-	127.6%	-11m	GBP	6	/Fwd EPS grth/
Hummingbird Resources	HUM	£74	21	4	0.01	0.0%	257.2%	17.8%	-27.4%	32m	USD	5	/Fwd EPS grth/Mom or Upgrade/
Trans-Siberian Gold	TSG	£99	114	6	0.23	7.0%	125.6%	15.0%	-0.4%	7m	USD	5	/Fwd EPS grth/Mom or Upgrade/
Portmeirion	PMP	£81	583	14	0.30	0.0%	646.4%	54.6%	21.4%	7m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Springfield Properties	SPR	£147	146	10	0.24	2.3%	50.4%	28.5%	21.7%	37m	GBP	5	/Hi RoE or Marg/Debt/
Draper Esprit	GROW	£1,190	856	7	0.13	0.0%	216.9%	11.5%	33.3%	-61m	GBP	5	/Fwd EPS grth/Cash Conv/
OPG Power Ventures	OPG	£72	18	10	0.10	0.0%	61.9%	-47.1%	41.2%	30m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Sylvania Platinum	SLP	£333	122	4	0.06	1.3%	134.3%	13.1%	51.0%	-49m	USD	5	/Fwd EPS grth/Cash Conv/
Alumasc	ALU	£63	174	8	0.07	3.0%	150.9%	8.3%	54.7%	6m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/

Source: FactSet, 22 March 2021

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ISSN 0261-3115.