

AlphaScreens: the market according to GARP

11 January 2021

Watching out for value traps

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:

- **Clipper Logistics (CLG)**, the e-logistics and returns management specialist for the retail sector, has benefited from the online mail order boom in lockdown. Although the shares have been on a tear for the past year, they are still reasonable value against analysts' forecasts of future earnings, according to our screen.
- No other company included in the FTSE All-Share index passes all our large-cap screening criteria. Some businesses, such as gift retailer **Card Factory (CARD)**, rank highly on the large-cap screen but fail the more appropriate price to earnings growth (PEG) test that we have for small companies, which is why it doesn't appear in our Small Cap rankings. With lockdown set to drag on for weeks, Card Factory is one to avoid.
- Another retailer that ranks well in the large-cap list is **JD Sports (JD)** (and valued at £8.28bn it is well-assessed against those criteria). The company has managed the challenges for retailers with physical outlets better than many in the sector and although not tremendously cheap, the shares are reasonably priced for the recovery expectations analysts have. Although, of course, much of those expectations are predicated on lockdowns ending by Spring.

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	Market cap (£m)	Price	Fwd NTM		DY	Fwd EPS grth FY+1	Fwd EPS grth FY+2	3-month momentum	Net cash/debt(-)	Cur	Tests passed (out of 8)	Test failed
Clipper Logistics	CLG	£642	631	25	0.9	1.6%	42.8%	17.2%	25.7%	189m	GBP	8	na
Card Factory	CARD	£142	42	4	0.1	0.0%	-88.9%	521.2%	15.8%	289m	GBP	6	/mid PE/HY EPS grth/
Sirius Real Estate	SRE	£972	93	14	0.5	3.5%	35.2%	-1.2%	14.7%	349m	EUR	6	/mid PE/HY EPS grth/
B&M European Value Retail	BME	£5,450	545	16	0.5	1.8%	98.3%	-13.5%	9.5%	1,626m	GBP	6	/5yr EPS grth/HY EPS grth/
IG Group	IGG	£3,246	877	15	1.4	4.9%	-2.0%	-10.1%	10.8%	-498m	GBP	6	/HY EPS grth/Av FY2 Fwd EPS growth > 7.5%
City of London Investment	CLIG	£230	453	10	0.5	6.6%	49.0%	11.0%	9.2%	-13m	GBP	6	/5yr EPS grth/HY EPS grth/
Target Healthcare REIT	THRL	£524	115	16	1.0	5.8%	32.7%	6.6%	10.0%	114m	GBP	6	/5yr EPS grth/Fwd EPS/
JD Sports Fashion	JD	£8,280	851	23	1.3	0.0%	-32.4%	63.1%	7.8%	1,026m	GBP	6	/5yr EPS grth/HY EPS grth/

Source: FactSet, as at 11 January 2021

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

Name	TIDM	Market cap (£m)	Price	Fwd NTM		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
City of London Investment	CLIG	£230	453	10	0.28	6.6%	49.0%	11.0%	9.2%	-13m	GBP	7	na
Luceco	LUCE	£461	287	19	0.32	1.1%	88.4%	5.3%	33.5%	22m	GBP	7	na
Capital	CAPD	£119	63	10	0.20	2.0%	42.2%	-34.5%	-7.4%	-18m	USD	5	/Fwd EPS grth/Mom or Upgrade/
LSL Property Services	LSL	£269	256	11	0.15	0.0%	84.8%	-3.6%	19.1%	48m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/

Source: FactSet, as at 11 January 2021

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

Name	TIDM	Market cap (£m)	Price	Fwd NTM		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
Trans-Siberian Gold	TSG	£117	106	6	0.21	7.5%	126.2%	18.0%	4.4%	7m	USD	6	/Fwd EPS grth/
EKF Diagnostics	EKF	£314	69	37	0.26	0.0%	194.4%	-46.7%	16.9%	-15m	GBP	6	/Fwd EPS grth/
Sureserve	SUR	£102	64	12	0.24	0.8%	78.5%	12.8%	20.8%	10m	GBP	6	/Hi RoE or Marg/
Wentworth Resources	WEN	£40	22	18	0.13	6.4%	104.2%	-28.9%	27.1%	-11m	USD	6	/Fwd EPS grth/
Sylvania Platinum	SLP	£245	90	5	0.11	1.8%	64.5%	-10.9%	42.9%	-45m	USD	6	/Fwd EPS grth/
Jubilee Metals	JLP	£283	13	7	0.09	0.0%	132.6%	-	157.7%	-1m	GBP	6	/Fwd EPS grth/
Hummingbird Resources	HUM	£116	33	3	0.02	0.0%	332.5%	107.1%	-14.7%	32m	USD	5	/Fwd EPS grth/Mom or Upgrade/
Serabi Gold	SRB	£58	98	5	0.06	0.0%	145.4%	59.5%	-3.0%	-7m	USD	5	/Fwd EPS grth/Mom or Upgrade/
Robinson	RBN	£23	141	-	0.17	3.9%	74.0%	-	4.1%	6m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Jarvis Securities	JIM	£96	220	4	0.04	3.6%	463.9%	2.8%	19.7%	-3m	GBP	5	/Fwd EPS grth/Cash Conv/
Character	CCT	£91	425	3	0.03	1.2%	688.8%	-34.6%	28.8%	-17m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Gear4music	G4M	£176	840	33	0.14	0.0%	164.6%	-28.4%	35.5%	16m	GBP	5	/Fwd EPS grth/Cash Conv/
Alumasc	ALLU	£41	114	7	0.20	4.3%	73.8%	14.5%	44.3%	10m	GBP	5	/Hi RoE or Marg/Debt/
BOKU	BOKU	£449	156	60	0.07	0.0%	2459.3%	22.1%	56.0%	-47m	USD	5	/Fwd EPS grth/Hi RoE or Marg/
OPG Power Ventures	OPG	£65	16	8	0.09	0.0%	61.9%	-47.1%	62.5%	30m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/

Source: FactSet, as at 11 January 2021

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ISSN 0261-3115.