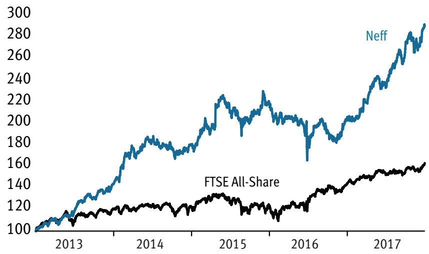
investors CHRONICLE alpha

27 August 2019

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 5-year cumulative total return



Source: Thomson Datastream

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.

■ No FTSE All-Share company passes all our large-cap-focused tests for growth at a reasonable price (GARP). Several companies only miss one test, but many of these are in some way connected to property (either housebuilders or Reits), which are better valued on price to net asset value (P/NAV) than the price-to-earnings growth (PEG) ratio used in our screen.

■ Non-property companies that only fail one test include **NMC Health (NMC)**, recruiter **Page Group (PAGE)** – which will be vulnerable if the economy tips into recession – and entertainment group **Cineworld (CINE)**.

■ Scanning further down the All-Share screen (large-cap rules), the tests failed by companies such as **Imperial Brands (IMB)**, **British American Tobacco (BATS)**, **Games Workshop (GAW)**, **JD Sports (JD.)**, **Rio Tinto (RIO)** and **Legal & General (LGEN)** offer clues to questions investors should be asking about their prospects. *JN*

Analyst: Algy Hall
algy.hall@ft.com

Alpha Production Editor: Sameera Hai Baig

www.investorschronicle.co.uk
telephone: +44 (0)20 7873 3000 email: icalpha.editorial@ft.com

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 socks 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 socks 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	Mkt 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 8)	Test failed
The Unite Group	LSE:UTG	£3,046m	1,049p	25	0.7	2.8%	13.5%	11.9%	9.9%	-592m	GBP	7	/HY EPS grth/
Sirius Real Estate	LSE:SRE	£722m	70p	16	0.4	4.5%	5.1%	12.9%	6.2%	-296m	EUR	7	/mid PE/
Bovis Homes	LSE:BVS	£1,408m	1,047p	10	0.6	5.4%	5.6%	10.9%	6.0%	127m	GBP	7	/Fwd EPS/
MJ Gleeson	LSE:GLE	£453m	830p	14	0.7	3.9%	8.8%	9.8%	-4.1%	28m	GBP	7	/5yr EPS grth/
NMC Health	LSE:NMC	£4,503m	2,157p	15	0.9	0.8%	29.4%	17.9%	-9.8%	-2,228m	USD	7	/5yr EPS grth/
SThree	LSE:STHR	£328m	260p	8	0.4	5.6%	10.1%	7.0%	-13.4%	-8m	GBP	7	/5yr EPS grth/
Macfarlane	LSE:MACF	£148m	94p	12	0.9	2.4%	38.1%	2.0%	-12.3%	-45m	GBP	7	/Fwd EPS/
Robert Walters	LSE:RWA	£365m	510p	10	0.4	2.9%	12.3%	5.5%	-20.7%	-28m	GBP	7	/5yr EPS grth/
PageGroup	LSE:PAGE	£1,354m	426p	12	0.6	6.1%	10.0%	9.5%	-17.7%	-57m	GBP	7	/Fwd EPS/
Cineworld	LSE:CINE	£3,143m	229p	9	0.8	5.3%	20.8%	8.7%	-25.9%	-7,011m	USD	7	/HY EPS grth/
Barratt Developments	LSE:BDEV	£6,468m	636p	9	0.3	7.0%	6.7%	-0.5%	13.8%	379m	GBP	6	/5yr EPS grth/Av FY2 Fwd EPS growth > 7.5%
Segro	LSE:SGRO	£8,446m	773p	30	0.6	2.4%	10.6%	8.7%	9.6%	-1,897m	GBP	6	/mid PE/HY EPS grth/
Ashtead	LSE:AHT	£9,878m	2,147p	10	0.6	1.9%	18.0%	8.5%	7.8%	-3,745m	GBP	6	/5yr EPS grth/HY EPS grth/
Norcros	LSE:NXR	£175m	217p	6	0.8	3.9%	8.3%	3.4%	7.1%	-35m	GBP	6	/Av FY2 Fwd EPS growth > 7.5%FCF/
Imperial Brands	LSE:IMB	£19,425m	2,055p	7	0.7	9.1%	3.9%	2.0%	-2.6%	-12,807m	GBP	6	/Av FY2 Fwd EPS growth > 7.5%5yr Rev grth/
British American Tob	LSE:BATS	£67,696m	2,961p	9	0.8	6.9%	9.4%	7.8%	-3.5%	-46,817m	GBP	6	/5yr EPS grth/HY EPS grth/
Games Workshop	LSE:GAW	£1,399m	4,304p	21	0.7	2.9%	3.7%	4.6%	-4.1%	29m	GBP	6	/5yr EPS grth/Av FY2 Fwd EPS growth > 7.5%
JD Sports Fashion	LSE:JD.	£5,847m	601p	18	0.9	0.3%	14.9%	9.7%	-4.5%	125m	GBP	6	/5yr EPS grth/FCF/
Arrow Global	LSE:ARW	£340m	194p	5	0.6	6.5%	-3.5%	21.5%	-5.5%	-1,002m	GBP	6	/HY EPS grth/FCF/
RHI Magnesita N.V.	LSE:RHIM	£2,188m	4,432p	8	0.4	2.0%	13.7%	6.4%	-8.0%	-669m	EUR	6	/5yr EPS grth/HY EPS grth/
Mondi	LSE:MNDI	£7,642m	1,577p	10	0.9	4.7%	-6.7%	1.6%	-5.9%	-2,341m	EUR	6	/Av FY2 Fwd EPS growth > 7.5%5yr Rev grth/
Aviva	LSE:AV.	£14,155m	361p	6	0.7	8.4%	-2.3%	5.0%	-11.0%	6,062m	GBP	6	/Av FY2 Fwd EPS growth > 7.5%5yr Rev grth/
Rio Tinto	LSE:RIO	£63,719m	3,925p	8	0.3	5.9%	31.5%	-10.8%	-15.5%	-4,544m	USD	6	/mid PE/5yr Rev grth/
Legal & General	LSE:LGEN	£13,162m	222p	7	0.4	7.4%	8.9%	11.4%	-16.5%	9,659m	GBP	6	/mid PE/FCF/
Grafton	LSE:GFTU	£1,705m	717p	11	0.9	2.5%	-5.8%	7.9%	-18.4%	-53m	GBP	6	/Av FY2 Fwd EPS growth > 7.5%Fwd EPS/
FDM	LSE:FDM	£813m	745p	19	1.0	4.3%	5.8%	6.4%	-21.9%	4m	GBP	6	/5yr EPS grth/Av FY2 Fwd EPS growth > 7.5%
Synthomer	LSE:SYNT	£1,273m	300p	9	1.0	4.4%	-6.1%	9.0%	-21.4%	-270m	GBP	6	/HY EPS grth/Av FY2 Fwd EPS growth > 7.5%

Source: S&P CapitalIQ, as at 27 Aug 2019 investors CHRONICLE alpha

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

Name	TIDM	Mkt 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
GCP Student Living	LSE:DIGS	£675m	163p	31	0.41	3.8%	29.7%	15.4%	0.8%	-212m	GBP	7	na
Capital Drilling	LSE:CAPD	£78m	57p	10	0.64	3.0%	21.9%	14.7%	14.0%	16m	USD	7	na
TClarke	LSE:CTO	£47m	113p	6	0.67	3.6%	16.9%	5.2%	-20.9%	-1m	GBP	6	/Cash Conv/
Residential Secure Income	LSE:RESI	£161m	94p	26	0.12	5.3%	233.3%	-2.5%	-2.6%	-67m	GBP	6	/Fwd EPS grth/
DWF	LSE:DWF	£357m	119p	11	0.60	0.8%	57.4%	19.3%	-1.4%	-35m	GBP	6	/Cash Conv/
Target Healthcare REIT	LSE:THRL	£451m	117p	20	0.87	5.6%	2.6%	24.3%	0.6%	-41m	GBP	6	/Cash Conv/
Civitas Social Housing	LSE:CSH	£522m	84p	16	0.73	6.0%	44.6%	6.6%	0.7%	-151m	GBP	6	/Cash Conv/
Empiric Student Property	LSE:ESP	£572m	95p	20	0.60	5.3%	35.9%	8.5%	4.0%	-322m	GBP	6	/Debt/
Kenmare Resources	LSE:KMR	£278m	254p	6	0.89	1.7%	4.5%	10.9%	27.5%	-1m	USD	6	/Fwd EPS grth/
Speedy Hire	LSE:SDY	£249m	48p	9	0.95	4.2%	12.9%	9.7%	-23.2%	-90m	GBP	5	/Hi RoE or Marg/Mom or Upgrade/
Macfarlane	LSE:MACF	£148m	94p	12	0.83	2.4%	38.1%	2.0%	-12.3%	-45m	GBP	5	/Mom or Upgrade/Debt/
Huntsworth	LSE:HNT	£349m	95p	10	0.93	2.4%	22.4%	9.1%	-6.5%	-132m	GBP	5	/Hi RoE or Marg/Debt/
Georgia Healthcare	LSE:GHG	£293m	227p	18	0.77	0.6%	30.4%	36.0%	-6.5%	-428m	GEL	5	/Hi RoE or Marg/Debt/
UP Global Sourcing	LSE:UPGS	£57m	73p	9	0.59	3.7%	46.3%	0.6%	-7.5%	-14m	GBP	5	/Cash Conv/Debt/
ASA International	LSE:ASAI	£385m	385p	14	0.90	1.5%	15.4%	25.9%	-2.5%	-205m	USD	5	/Hi RoE or Marg/Cash Conv/
Regional REIT	LSE:RGL	£449m	104p	13	0.75	7.7%	8.0%	6.9%	-2.6%	-270m	GBP	5	/Fwd EPS grth/Cash Conv/
Sirius Real Estate	LSE:SRE	£722m	70p	16	0.68	4.5%	5.1%	12.9%	6.2%	-296m	EUR	5	/Fwd EPS grth/Debt/

Source: S&P CapitalIQ, as at 27 Aug 2019

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

Name	TIDM	Mkt 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
EKF Diagnostics	AIM:EKF	£144m	32p	23	0.61	-	38.8%	6.3%	-4.4%	9m	GBP	7	na
Atalaya Mining	AIM:ATYM	£269m	196p	5	0.19	-	26.4%	52.2%	-3.4%	9m	EUR	7	na
Elektron Technology	AIM:EKT	£99m	55p	19	0.78	-	43.2%	18.9%	28.2%	10m	GBP	7	na
Hydrogen	AIM:HYDG	£15m	47p	6	0.42	4.3%	25.0%	7.6%	-37.8%	5m	GBP	6	/Hi RoE or Marg/
Rosenblatt	AIM:RBGP	£65m	82p	11	0.57	5.2%	45.4%	3.1%	-27.7%	13m	GBP	6	/Cash Conv/
Augean	AIM:AUG	£97m	94p	8	0.53	-	42.8%	-0.1%	-13.1%	23m	GBP	6	/Fwd EPS grth/
Concurrent Technologies	AIM:CNC	£48m	66p	10	0.64	3.5%	56.9%	-4.1%	-11.4%	8m	GBP	6	/Fwd EPS grth/
Eland Oil & Gas	AIM:ELA	£260m	121p	4	0.22	-	54.0%	0.1%	-6.9%	-4m	USD	6	/Cash Conv/
Universe	AIM:UNG	£13m	5p	13	0.69	-	21.2%	20.6%	-1.4%	2m	GBP	6	/Hi RoE or Marg/
M.T.I Wireless Edge	AIM:MWE	£20m	23p	8	0.44	5.3%	30.1%	15.2%	-2.1%	5m	USD	6	/Hi RoE or Marg/
Urban Logistics REIT	AIM:SHED	£113m	129p	16	0.40	5.4%	17.6%	9.8%	0.4%	-62m	GBP	6	/Debt/
Anexo	AIM:ANX	£199m	181p	11	0.69	0.8%	45.8%	4.1%	9.7%	-17m	GBP	6	/Cash Conv/
Caledonia Mining Corp	AIM:CMCL	£92m	475p	-	0.00	-	-42.7%	19.1%	10.0%	7m	USD	6	/Fwd EPS grth/
Warpaint London	AIM:W7L	£44m	58p	6	0.81	7.7%	11.0%	17.7%	-45.2%	1m	GBP	5	/Hi RoE or Marg/Mom or Upgrade/
Ashley House	AIM:ASH	£3m	5p	-	0.40	-	-	-	-50.8%	-2m	GBP	5	/Fwd EPS grth/Mkt Cap/
Bushveld Minerals	AIM:BMN	£232m	21p	5	0.77	-	51.1%	-18.2%	-18.5%	44m	USD	5	/Fwd EPS grth/Cash Conv/
PCF	AIM:PCF	£62m	25p	8	0.41	1.2%	34.6%	20.3%	-20.6%	-22m	GBP	5	/Hi RoE or Marg/Cash Conv/
Pelatro	AIM:PTRO	£23m	72p	6	0.39	-	60.0%	-0.8%	-17.0%	2m	USD	5	/Fwd EPS grth/Cash Conv/
Tekmar	AIM:TGP	£62m	123p	13	0.73	-	60.7%	7.5%	-8.4%	3m	GBP	5	/Mom or Upgrade/Cash Conv/
Springfield Properties	AIM:SPR	£98m	102p	7	0.54	3.8%	22.7%	12.2%	-5.6%	-25m	GBP	5	/Cash Conv/Debt/
Cerillion	AIM:CER	£43m	147p	13	0.64	3.1%	71.9%	-0.2%	-0.4%	3m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Good Energy	AIM:GOOD	£26m	160p	18	0.38	2.2%	36.4%	34.5%	1.3%	-45m	GBP	5	/Hi RoE or Marg/Debt/
Synectics	AIM:SNX	£33m	194p	9	0.57	2.4%	42.1%	23.5%	4.5%	5m	GBP	5	/Hi RoE or Marg/Cash Conv/
Rotala	AIM:ROL	£29m	58p	8	0.51	4.7%	26.7%	9.1%	4.5%	-35m	GBP	5	/Hi RoE or Marg/Debt/
H&T	AIM:HAT	£142m	358p	10	0.78	3.1%	17.9%	11.3%	14.0%	-32m	GBP	5	/Hi RoE or Marg/Debt/
Amerisur Resources plc	AIM:AMER	£213m	18p	11	0.55	-	1466.0%	-53.7%	40.8%	35m	USD	5	/Fwd EPS grth/Hi RoE or Marg/

Source: S&P CapitalIQ, as at 27 Aug 2019

www.investorschronicle.co.uk
telephone: +44 (0)20 7873 3000 email: icalpha.editorial@ft.com

ISSN 0261-3115.