

## AlphaScreens: the market according to GARP

12 February 2021

### Games Workshop isn't too expensive yet

*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:

- Returns management and e-logistics specialist **Clipper Logistics (CLG)**, remains the only FTSE All Share company that passes all of our growth at reasonable price tests for large cap companies. But, at £582m market cap, it is also judged against our smaller company criteria used against the FTSE All Small Companies index. On these it comes up short, because it isn't one of the cheapest 25 per cent according to the price to earnings growth (PEG) that we use for small-caps.
- Companies higher up the market cap scale that score reasonably well on the large cap screen include **Games Workshop (GAW)**, which failed partly because its average compound EPS growth rate over five years is so good, our screen has flagged it as a sense check. Thus remains a high quality business, and the suggestion from the screen is that it's a holding definitely worth running.
- Paper-based packaging specialist **Smurfit Kappa Group (SKG)** also does well but a slight downgrade in the mean of analysts' earnings forecasts (from our FactSet data) is highlighted as one of the two tests that it fails.

## 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	582	572	22	0.9	1.8%	42.8%	17.2%	24.3%	189m	GBP	8	na
Safestore Holdings	SAFE	1,657	786	24	0.8	2.4%	7.5%	7.8%	-6.0%	512m	GBP	7	/mid PE/
Cranswick	CWK	1,847	3,510	18	1.5	1.8%	19.8%	2.6%	-4.7%	122m	GBP	7	/FCF/
City of London Inv.	CLIG	264	520	10	0.5	5.8%	60.8%	8.4%	26.8%	-13m	GBP	6	/5yr EPSgrth/HY EPSgrth/
SThree	STEM	434	327	17	1.4	1.5%	53.1%	26.4%	16.2%	-14m	GBP	6	/5yr EPSgrth/HY EPSgrth/
B&M Euro. Value Ret. SA	BME	5,594	559	17	0.5	1.7%	98.6%	-12.6%	11.5%	1,626m	GBP	6	/5yr EPSgrth/HY EPSgrth/
Smurfit Kappa	SKG	9,411	3,648	17	1.2	4.8%	2.2%	16.9%	10.7%	2,126m	EUR	6	/HY EPSgrth/Fwd EPS/
Sirius Real Estate	SRE	973	92	15	0.5	3.5%	32.4%	-1.2%	6.0%	349m	EUR	6	/mid PE/HY EPSgrth/
Games Workshop	GAW	3,441	10,500	28	0.8	1.3%	58.0%	10.1%	5.5%	-51m	GBP	6	/5yr EPSgrth/HY EPSgrth/
Target Healthcare REIT	THRL	533	117	18	1.5	5.7%	15.7%	7.4%	2.8%	114m	GBP	6	/5yr EPSgrth/Fwd EPS/
IG Group Holdings	IGG	2,874	776	12	0.8	5.6%	13.6%	-17.4%	-0.3%	-456m	GBP	6	/mid PE/Av FY2 Fwd EPSgrowth > 7.5%
Frasers	FRAS	2,358	454	17	2.0	0.0%	50.5%	12.6%	-3.2%	966m	GBP	6	/5yr EPSgrth/HY EPSgrth/

Source: FactSet, 12 February 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
SThree	STEM	434	327	17	0.42	1.5%	53.1%	26.4%	16.2%	-14m	GBP	7	na
City of London Inv.	CLIG	264	520	10	0.26	5.8%	60.8%	8.4%	26.8%	-13m	GBP	7	na
Capital Limited	CAPD	118	63	9	0.49	2.0%	17.2%	-16.3%	1.6%	-18m	USD	5	/Fwd EPSgrth/Mom or Upgrade/

Source: FactSet, 12 February 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
Robinson	RBN	27	163	11	0.17	3.4%	89.0%	4.3%	9.1%	6m	GBP	6	/Hi RoE or Marg/
Wentworth Resources	WEN	43	23	12	0.15	6.0%	91.9%	20.9%	37.3%	-11m	USD	6	/Fwd EPSgrth/
Sylvania Platinum	SLP	315	116	4	0.05	1.4%	160.9%	0.0%	65.0%	-45m	USD	6	/Fwd EPSgrth/
Jubilee Metals	JLP	293	13	6	0.09	0.0%	128.8%	-	78.8%	-1m	GBP	6	/Fwd EPSgrth/
Hummingbird Resources	HUM	85	24	5	0.02	0.0%	258.5%	17.8%	-26.5%	32m	USD	5	/Fwd EPSgrth/Mom or Upgrade/
Serabi Gold	SRB	52	88	5	0.07	0.0%	104.0%	70.4%	-0.6%	-7m	USD	5	/Fwd EPSgrth/Mom or Upgrade/
Trans-Siberian Gold	TSG	114	104	6	0.20	7.7%	126.4%	15.0%	2.5%	7m	USD	5	/Fwd EPSgrth/Mom or Upgrade/
Jarvis Securities	JIM	95	216	4	0.04	3.6%	463.9%	2.8%	4.1%	-3m	GBP	5	/Fwd EPSgrth/Cash Conv/
EKF Diagnostics	EKF	350	77	39	0.28	0.0%	201.2%	-43.6%	14.1%	-15m	GBP	5	/Fwd EPSgrth/Mom or Upgrade/
Gear4music	G4M	161	770	29	0.08	0.0%	258.1%	-46.0%	16.7%	16m	GBP	5	/Fwd EPSgrth/Cash Conv/
Character	CCT	94	438	4	0.03	1.1%	688.8%	-34.6%	25.0%	-17m	GBP	5	/Fwd EPSgrth/Hi RoE or Marg/
Draper Esprit	GROW	1,129	812	8	0.17	0.0%	157.5%	20.9%	28.9%	-61m	GBP	5	/Fwd EPSgrth/Cash Conv/
BOKU	BOKU	430	150	60	0.09	0.0%	1897.8%	46.1%	29.4%	-47m	USD	5	/Fwd EPSgrth/Hi RoE or Marg/
Alumasc	ALU	57	158	7	0.07	3.3%	150.9%	8.3%	49.8%	6m	GBP	5	/Fwd EPSgrth/Hi RoE or Marg/
OPG Power Ventures	OPG	74	19	9	0.11	0.0%	61.9%	-47.1%	54.2%	30m	GBP	5	/Fwd EPSgrth/Hi RoE or Marg/

Source: FactSet, 12 February 2021

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