

AlphaScreens: the market according to GARP

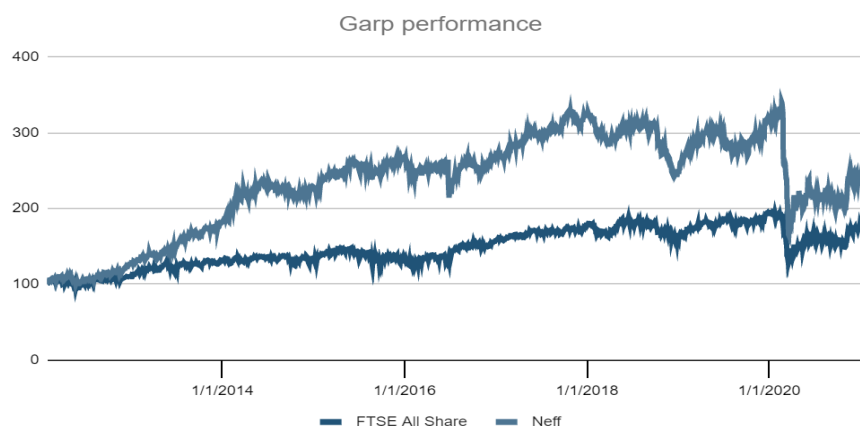
30 April 2021

Running gains and value on Aim

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)** is the largest company to rank well on our growth at a reasonable price screen. It scores 6/8 on the large cap criteria. With its North American focus it could benefit further from President Biden's stimulus package.
- For investors running their positions in hobby specialist **Games Workshop (GAW)**, it is reassuring to see that it still scores 6/8, too.
- On Aim, which is tested against seven small company rules, **Smart Metering Systems (SMS)** gets full marks. So does energy support services company **Sureserve Group (SUR)** and investment firm **Polar Capital Holdings (POLR)**.



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	£702	690	24	1.0	1.5%	47.2%	24.0%	29.9%	189m	GBP	8	na
Safestore Holdings	SAFE	£1,777	843	24	0.8	2.2%	10.8%	6.3%	4.3%	512m	GBP	8	na
Macfarlane Group	MACF	£186	118	13	0.8	2.2%	38.6%	5.6%	33.3%	29m	GBP	7	/HY EPS grth/
IG Group Holdings	IGG	£3,407	920	13	0.6	4.7%	46.2%	-30.1%	22.6%	-456m	GBP	7	/mid PE/
Keller Group	KLR	£607	840	11	1.3	4.3%	-29.9%	27.0%	11.3%	193m	GBP	7	/Av FY2 Fwd EPS growth > 7.5%
Vistry Group	VTY	£2,767	1,245	10	1.0	1.6%	120.0%	16.9%	45.4%	4m	GBP	6	/5yr EPS grth/HY EPS grth/
Vivo Energy	VVO	£1,272	100	12	0.8	4.7%	81.0%	17.3%	28.7%	227m	USD	6	/5yr EPS grth/HY EPS grth/
SThree	STEM	£527	395	19	1.3	1.3%	57.5%	26.7%	23.2%	-14m	GBP	6	/5yr EPS grth/HY EPS grth/
Luceco	LUCE	£511	318	19	0.6	2.5%	6.7%	8.1%	17.8%	14m	GBP	6	/5yr EPS grth/Av FY2 Fwd EPS growth > 7.5%
S&U	SUS	£306	2,520	14	0.9	3.6%	33.2%	37.4%	15.1%	100m	GBP	6	/5yr EPS grth/HY EPS grth/
Alfa Financial Software	ALFA	£414	138	40	-2.8	0.7%	-50.4%	6.9%	7.3%	-20m	GBP	6	/5yr EPS grth/Av FY2 Fwd EPS growth > 7.5%
Ferguson	FERG	£20,490	9,148	21	1.1	2.3%	1.9%	8.4%	6.9%	1,656m	USD	6	/5yr EPS grth/Av FY2 Fwd EPS growth > 7.5%
Games Workshop	GAW	£3,510	10,710	28	0.8	1.7%	61.4%	9.6%	2.0%	-51m	GBP	6	/5yr EPS grth/HY EPS grth/
Smurfit Kappa	SKG	£9,009	3,478	16	1.2	5.0%	0.0%	17.7%	-1.0%	2,126m	EUR	6	/HY EPS grth/Fwd EPS/
Hikma Pharmaceuticals	HIK	£5,365	2,325	17	1.3	1.6%	8.0%	15.7%	-5.1%	425m	USD	6	/HY EPS grth/Fwd EPS/

Source: FactSet, 30 April 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
Air Partner	AIR	£47	75	14	0.00	1.1%	2100.0%	-65.2%	9.7%	-29m	GBP	5	/Fwd EPS grth/Mom or Upgrade/
Kenmare Resources	KMR	£481	438	6	0.06	1.7%	580.3%	-6.8%	14.4%	45m	USD	5	/Fwd EPS grth/Hi RoE or Marg/
ScS Group	SCS	£104	273	17	0.01	0.0%	855.4%	-46.9%	30.0%	36m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Halfords Group	HFD	£757	380	15	0.17	0.0%	64.4%	-33.8%	39.4%	272m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
LSL Property Services	LSL	£421	400	12	0.14	0.0%	115.3%	7.7%	70.2%	41m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/

Source: FactSet, 30 April 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
Polar Capital Holdings	POLR	£749	759	12	0.38	4.5%	45.5%	8.9%	17.9%	-132m	GBP	7	na
Smart Metering Systems	SMS	£933	826	62	0.14	3.0%	34.8%	12.4%	20.9%	-37m	GBP	7	na
Sureserve Group	SUR	£129	80	13	0.39	1.3%	52.4%	11.1%	29.0%	-3m	GBP	7	na
Caledonia Mining Corp.	CMCL	£124	1,080	5	0.21	1.9%	37.9%	28.2%	-2.3%	-13m	USD	6	/Mom or Upgrade/
Numis Corporation	NUM	£411	381	10	0.37	3.1%	37.5%	-	15.5%	-139m	GBP	6	/Fwd EPS grth/
Central Asia Metals	CAML	£488	278	9	0.18	5.0%	81.5%	-6.0%	26.1%	24m	USD	6	/Fwd EPS grth/
Best of the Best	BOTB	£301	3,200	22	0.16	0.1%	234.4%	14.3%	41.6%	-11m	GBP	6	/Fwd EPS grth/
SDI Group	SDI	£177	180	26	0.47	0.0%	114.8%	28.2%	57.2%	3m	GBP	6	/Fwd EPS grth/
Kape Technologies	KAPE	£667	298	16	0.38	0.0%	59.7%	22.7%	56.6%	-6m	USD	6	/Cash Conv/
Journeo	JNEO	£10	115	11	0.18	0.0%	285.0%	66.7%	61.3%	0m	GBP	6	/Fwd EPS grth/
Hummingbird Resources	HUM	£74	21	10	0.01	0.0%	255.3%	-69.5%	-33.5%	32m	USD	5	/Fwd EPS grth/Mom or Upgrade/
Enwell Energy	ENW	£62	19	10	0.29	0.0%	88.0%	131.6%	-14.0%	-44m	USD	5	/Fwd EPS grth/Mom or Upgrade/
Robinson	RBN	£25	150	10	0.25	5.7%	69.0%	7.0%	-3.2%	7m	GBP	5	/Hi RoE or Marg/Debt/
Anexo Group	ANX	£153	132	8	0.40	1.1%	31.0%	17.9%	0.4%	40m	GBP	5	/Cash Conv/Debt/
Trans-Siberian Gold	TSG	£101	116	7	0.23	6.9%	124.4%	15.0%	3.3%	7m	USD	5	/Fwd EPS grth/Mom or Upgrade/
OPG Power Ventures	OPG	£74	19	10	0.11	0.0%	61.9%	-47.1%	15.6%	30m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Springfield Properties	SPR	£159	158	10	0.26	2.1%	50.4%	28.5%	18.0%	37m	GBP	5	/Hi RoE or Marg/Debt/
Sylvania Platinum Ltd.	SLP	£327	120	3	0.05	1.3%	158.5%	25.0%	17.6%	-49m	USD	5	/Fwd EPS grth/Cash Conv/
Gear4music (Holdings)	G4M	£194	925	39	0.08	0.0%	325.8%	-55.5%	18.6%	16m	GBP	5	/Fwd EPS grth/Cash Conv/
Atalaya Mining	ATYM	£459	332	7	0.14	0.0%	126.7%	21.5%	22.1%	-29m	EUR	5	/Fwd EPS grth/Hi RoE or Marg/
Draper Esprit	GROW	£1,168	840	7	0.07	0.0%	382.1%	-27.7%	22.1%	-61m	GBP	5	/Fwd EPS grth/Cash Conv/
Character Group	CCT	£122	573	8	0.27	0.9%	113.9%	141.0%	33.1%	-17m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
Jubilee Metals Group	JLP	£376	17	5	0.09	0.0%	113.5%	78.9%	39.7%	1m	GBP	5	/Fwd EPS grth/Cash Conv/
Alumasc Group	ALU	£79	220	10	0.09	2.4%	150.9%	8.3%	67.6%	6m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/
REACT Group	REAT	£16	3	22	0.46	0.0%	180.0%	-	106.7%	-2m	GBP	5	/Fwd EPS grth/Hi RoE or Marg/

Source: FactSet, 30 April 2021

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