

GROWTH AT A REASONABLE PRICE (GARP)

Growth investing has changed: the 10%+ annual growth rate stocks achieved before 2000 has changed to negative returns the last three years, and the technology sector is not only no longer the leading growth sector, it has seen the biggest losses. The fear of losing money (again) provides a formidable resistance to new investing. On the other hand, the miniscule money market rates and the low yields offered by fixed income products (bonds, treasuries, CDs) practically force us to find growth by investing in stocks.

I am convinced that technology will again - maybe in the next year - exhibit better than average growth and there are growth companies to invest in now. The key is to find companies that have good growth prospects, are not risky, and are not over-priced: *growth at a reasonable price (GARP)*.

5-YEAR GROWTH FORECAST

First, these are estimates. They are provided by equity research analysts who cover these stocks for brokerage firms. Theoretically these people are experts about the companies they follow, but there is no guarantee their forecasts will be accurate. I look for at least 10% 5-year growth.

P/E/G

This criterion is often the first I look at, because it reflects several ingredients: price compared to earnings, compared to the growth outlook. As a rule of thumb a stock is fairly valued when its P/E is the same as its long-term growth rate, which results in a P/E/G of 1. A P/E/G of less than one usually indicates an undervalued stock; greater than one, an overvalued stock. However, if a stock is a consistent grower, it is more valuable and deserves a higher P/E/G. I feel comfortable recommending a stock with a P/E/G over 1 (but less than 2) if the long-term growth rate is at least 14%, and other criteria are met.

There are reasons to avoid stocks with undervalued P/E/Gs: 1) the growth forecasts may be too high; 2) anticipated changes in the company, the industry, or the economy will negate the positive outlook currently held; 3) the price is so low because investors do not have confidence in the company or its leadership.

REVENUE GROWTH

Generally I look for companies that have increasing revenue for several years in a row. I have indicated the number of years to the present in which revenues sequentially increased. Many companies with excellent records in the past reported declining revenues in only one of the two most recent years, so I have indicated this situation by a minus one (for the one negative year) after the number of years revenues sequentially increased. If the minus one is followed by a plus one, that means this company has resumed increasing revenues in the most recently completed year.

DEBT/EQUITY

In the past year or two we have seen the demise of many companies, because they ran out of money before their business model became profitable, and they could not pay off their debt. While too much debt is typically a warning sign, some debt can be good if it is used to increase the return on equity. As a rule of thumb I look for a ratio less than one for all but financial companies, which naturally assume more debt. If the growth is strong enough, more debt is acceptable.

PRICE/SALES

The P/S can be used to identify stock prices that are too high relative to revenues, and is a better measurement than P/E, because EPS can be more easily manipulated by accounting. Generally a P/S ratio less than 1.5 indicates an under-priced growth stock. Again, with stronger growth, a higher P/S can be allowed.