
CHAPTER 5

Growth at a reasonable
price

'It's far better to buy a wonderful company at a fair price, than a fair company at a wonderful price'.

Warren Buffett

We have seen how important it is to consider both the business model of the company and the competitive advantage of the sector, and how they fare in the economic cycle. The next step is now to analyse shares that have made it thus far in the sieving process. The objective for the investor is to have control over the share and choose those that offer growth at a reasonable price. This provides a margin of safety to minimise the risk that is inherent in investing. Overpriced shares can easily be de-rated and are a sitting duck if there is a profit warning. There are many books on this subject, such as Benjamin Graham's *The Intelligent Investor* and Jim Slater's *Beyond The Zulu Principle*. The statistics below are easy to evaluate using REFS, or Really Essential Financial Statistics, which was developed by Jim Slater. REFS also allows companies to be sieved using various criteria, such as growth rates and profit margins, and the whole market can be searched for the best opportunities.

1. Growth statistics

The following four growth statistics help to see the future, as they estimate a company's financial progress over the next 12 months.

Price earnings ratio

The price earnings ratio (PER) is usually regarded as the most important measure of a share, as it represents the number of years that the earnings per share (EPS) will repay your investment. Thus, a PER of 10 means that over 10 years the earnings will equal the cost of the share. The PER can be for the last set of results but it is more useful to look forward over the next 12 months, based on broker forecasts. Be wary of buying any share on a high PER, as all the good news is likely to be in the price and it can be very exposed if there is bad news flow or if there is a de-rating in the share or in the overall market. A PER of 10 or less is a good target and up to 15 is also acceptable, as long as the story is very good. The margin of safety is eroded if it is above 15 and it was difficult to find low PERs in the stock market mania that ended in 2000. Indeed, PERs of 70 and higher were common. That was a clear sell signal. Look at the PER over the last few years and see if the forecast PER is in the lower range, as it implies a reasonable