AXA IM

The Search for Growth Stocks

We have previously examined the power of compounding growth and how the concept can be observed in dynamic growth companies within equity markets. In this article we outline some of the key characteristics that help us identify companies that are likely to deliver positive earnings growth over the long term.

It is important to remember that successful investments in growth stocks require an appropriate time horizon. We suggest an investment horizon of at least three to five years as this improves the chances of the company fundamentals being reflected in its valuation.

Therefore, when searching for high quality growth companies, what do we look for? We can summarise the key attributes as follows:

- high quality management team
- strategic positioning in a growing industry
- healthy cash-backed earnings growth, facilitating dividend growth and corporate investment
- strong balance sheet
- sustainable profit margins and business model

Case Study:

A good example is RPC Group, a plastics products specialist with a broad customer base, including many household names, such as Garnier Mineral and Champneys.

RPC has consistently delivered[1] on the key criteria mentioned above. The company is positioned in an industry that is currently benefiting from structural growth. Advances in technology mean rigid plastics are replacing more traditional (expensive and heavier) packaging such as glass and metal. Furthermore, the firm is maximising its potential within this growth sector through service and innovation. For example, they know from their clients in the cosmetics and personal care space that a large proportion of a product's success is actually attributed to the look, feel and quality of the packaging, rather than purely its contents. Consequently, strong relationships and collaborative efforts have enabled them to develop innovative design solutions, providing additional avenues of growth. Overseeing these activities is what we believe is a strong – and shareholder friendly – management team. By exercising financial discipline the company has delivered consistent dividend growth of 16.3% (YoY)[2], supported by strong growth in earnings (19.5% EPS growth (YoY)[2]) and a successful campaign of acquisitions in the highly fragmented packaging market. The ability of management to strike the appropriate balance between rewarding equity holders and re-investing in the business and new opportunities has contributed to an impressive share price total return of 333%[3] over five years.

We believe RPC has expertly applied the criteria required to be a successful growth company and investors have been reaping the rewards. Fortunately, there is a rich pool of dynamic companies in the UK that are harnessing the benefits of profit growth. In many cases, they have sound business models as well as the managerial and financial strength to maximise future opportunities. Focusing on these key areas should help ensure that they continue to demonstrate sustainable turnover growth which, together with the potential of expanding margins, should translate into strong returns for equity investors over the longer term.

For more insights from Chris St John, visit our website.

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Chris has been a portfolio manager at Framlington Equities since 2005 responsible for managing UK multi-cap and mid/small cap strategies. Prior to AXA IM, he was Lead Portfolio Manager on institutional and retail FTSE Small Cap portfolios at ISIS (now F&C Asset Management). Chris started his career at PricewaterhouseCoopers in 1995, latterly specialising in valuing unlisted businesses, before moving to Friends, Ivory & Sime as trainee fund manager. Chris holds a degree in Philosophy/Psychology from Durham University; he is also a Chartered Accountant .

[1] Since we began investing in the company at the launch of the AXA Framlington UK Mid Cap Fund on 4 March 2011.
[2] Dividend growth and EPS growth figure based on eight years to 31 December 2015.
[3] Performance from 31 December 2010 to 31 December 2015. Past performance is not a guide to future performance.