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News

Revival in M&A shows buyers feasting on UK stocks

2023 M&A deals look set for a record year as private equity funds and corporates take advantage of the UK's historically low valuations.


Mark Costar


Vishal Bhatia

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Higher cost of capital and fears of tightening credit conditions contributed to a lull in corporate activity in the UK in the opening months of this year. There was a sense that the strong deal flow of recent years was over for now. However, a cluster of deals and a rise in proposals in April suggests that, in the absence of a material revaluation of UK stocks, 2023 could be another record year for mergers and acquisitions.

Since the start of the year, the market has witnessed 11 active deals totalling a value of ~£13bn versus £9bn this time last year and a similar amount for the same period in 2021 *. Of note is that majority of this activity has come in the last month alone. In fact, a single week in April saw five bids for UK public companies including one raised offer and a counterbid, and all at very healthy premiums to the undisturbed price *. It is probably fair to assume that these deals were 'oven ready', having been prepared earlier but delayed as uncertainty prevailed following the regional bank collapses in the US.

These deals inject fresh capital into the UK market, helping to lift overall valuations, but what is at least as important is the quality of the investors. Taking on an entire company is a major commitment and not one that can be borne lightly. These are investors that, despite the uncertainty of their transaction ever consummating, undertake extensive and detailed due diligence, and make announcements that commit them to legal obligations, not to mention opening themselves up to intensive scrutiny from regulators, shareholders and the media during the process. It is very different to buying an allocation of shares that can be quietly sold off if things don't turn out as expected.

Why are the flows so large? The answer is simple. Companies listed on the UK market are meaningfully undervalued. The discount on the UK market relative to the US is near historical extremes. And most importantly there is no reason to comprise on quality when investing in the UK - for instance, majority of the JOHCM UK Growth portfolio is invested in companies that are clear market leaders in their area of expertise. It is little wonder that, in a survey by Numis, a stockbroker specialising in UK small and mid-cap, the majority of private equity funds listed the UK as their most attractive market.

Mark Costar, co-fund manager of the JOHCM UK Growth Fund has given examples of UK 'comedy valuations' in a recent video (Comedy Valuations Mar 2023 (johcm.com)). Another example is Rank (~3.5% of the fund) a market-leading operator in the leisure sector. The company has invested in revitalising its venues, has untapped potential in digital following a major platform upgrade, a strong balance sheet that supports accretive consolidation opportunities, and also has material regulatory upside optionality. It has recently upgraded numbers and trades on a double-digit free cash flow yield – simply put the shares could double and still be the wrong price*.

Private equity funds and trade buyers are not alone in appreciating the undervaluation of the UK stock market. Significant director / insider purchases are frequently reported – the JOHCM UK Growth fund, which is a concentrated 54 stock portfolio, saw over 100 such purchases in 2022, and is on track for a similar triple digit run-rate based on announcements through to April 2023. FTSE 100 companies are also not being left behind with £37 billion of share buybacks already announced for 2023 by the beginning of May, surpassing the previous high of £35 billion for full-year 2018**.

Retail investors and pension funds may still be allocating away from the UK, but other investors, among the most sophisticated and knowledgeable in the market, are increasingly filling the vacuum.

Sources:
*Bloomberg/JOHCM
**https://www.forbes.com/uk/advisor/investing/what-is-a-share-buyback/

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