Macro investment themes

27th August 2019

Foreign buyers gorging on UK stocks

Like whales feasting on Krill, overseas firms are today stuffing themselves silly with choice fillets of corporate Britain. Why? Well look no further than geopolitical tensions and Brexit, which have disproportionately impacted UK equities and the £. Indeed the **FTSE100 has lagged the S&P500 by a hefty 19% over the past 2 years**, with **Sterling dropping to 34 year lows** vs US$ (see below).

That said to us, based purely on fundamentals, **this period of underperformance appears over-cooked**, leaving many quality British companies vulnerable to predatory interest.

Sterling vs the US Dollar

Source: Macrotrends.net

M&A feeding frenzy shows no sign of abating

We're not the only ones who think so either. Of late there's been a deluge in M&A, as deep-pocketed international groups dine on UK plc at mouth-watering prices. Namely Takeda's (Japan) £46bn purchase of Shire, along with many other foreign takeovers, including RPC (£5.2bn), Merlin Entertainment (£5.9m), Green King (£4.6bn), Cobham (£4bn), Just East (£5bn), Safecharge (£699m), BTG (£3.3bn), Dairy Crest (£975m) and Inmarsat (£5bn). Moreover last Friday, came news that Peppa-Pig owner Entertainment One was also being snapped up for £3.3bn by US toy maker Hasbro.

So who might be the next corporate krill?

Clearly trying to 2nd guess, who will be the next domino to fall is impossible. However given today's ultra-low interest rates and the abundance of cheap credit to fund such deals, **even some of the FTSE's megacaps may not escape the 'M&A banquet'**. For instance in February 2017, Unilever - the maker of Hellman's, Dove soap and Magnum ice-cream - received an audacious £115bn bid from Kraft Heinz.

Equity Development is **an industry thought-leader -** providing freely available global insights, opinions, company forecasts, valuations, sector comparisons, macro developments and detailed research across the entire investment universe.

Moreover the firm offers retail / professional investors, family offices, institutions and asset managers of all types, **access to key directors via presentational forums, webinars and 1-2-1 meetings**.

Here investors can ask questions, 'kick-the-tyres' and reach their own conclusions with regards to the quality of a company's investment thesis and management team.

A crucial factor that is becoming ever more important, as individuals take responsibility for their own savings, finances and retirement funds.

Indeed there has been a step change in the regulatory environment since 2012, which has further encouraged DIY investing. Namely the removal of stamp duty on AIM stocks, pension reforms, RDR, and the ongoing attractiveness of tax-free wrappers like ISAs/SIPPs.

ED clients mentioned in this report: **Gattaca** (AIM: GATC), **Rosslyn Data Tech** (AIM: RDT), **Kromek** (AIM: KMK), **ClearStar** (AIM: CLSU), **Elecosof**t (AIM: ELCO), **Northbridge Industrial** (AIM: NBI) and **Blancco Technology** (AIM: BLTG).

Paul Hill (Analyst)
0207 065 2690
paul.hill@equitydevelopment.co.uk

Any strategic asset trading at bargain basement levels

Elsewhere we suspect the likes of plant fire firm **Aggreko**, insurer **Aviva**, energy supplier **Centrica**, **ITV**, **William Hill** and many others (see our best 15 ideas below) – might be in the cross-hairs too. The **attractions here being compelling valuations** (ie in $s, Yen or €s), **respected brands**, **industry consolidation, leading technology** and **economies of scale**. Particularly at a time when organic growth is proving hard to achieve in the face of decelerating global GDP, macro-headwinds and trade tariffs.

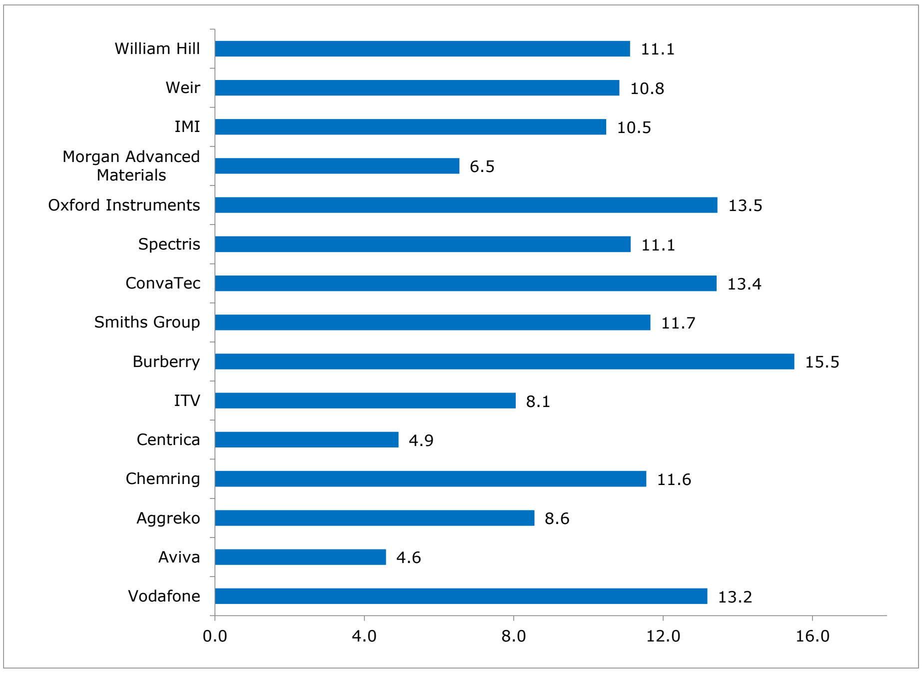
Nonetheless, by forcing oneself to peer through the Brexit 'looking glass' and take a 2-3 year view - we reckon patient investors could be richly rewarded by considering these **possible targets**, regardless of short-term volatility.

15 potential takeover ideas of large/midcap FTSE stocks

Company	Share price	Mrkcap (£ms)	CY+1 PER	CY div yield	Average analyst target price	Strategic rationale
Vodafone	150p	39,900	13.0	5.5%	183p	Possesses a global brand, alongside a collection of coveted wireless spectrum & network assets. Possible break-up to unlock shareholder value
Aviva	361p	14,079	5.6	9.0%	492p	Industry consolidation with the likes of Allianz being mooted as possible buyer
Aggreko	772p	1,969	11.4	3.7%	817p	Cheap & cash generative temporary power supplier which generates the vast majority of revenues overseas. 2020 earnings underpinned by Olympic Games contract in Japan
Chemring	190p	536	14.1	1.9%	180p	Consolidation in tier 1 aerospace components supply chain - eg £4bn purchase of Cobham by private equity house Advent International. Indeed a small bid premium may already be reflected in the shareprice
Centrica	66p	3,828	5.5	9.1%	83p	Poor recent performance, but still possibly attractive to integrated E&P giants (eg Shell) who are seeking to expand upstream into power distribution. Est SOTP breakup higher than existing mrkcap. CEO leaving soon
ITV	115p	4,600	8.9	7.0%	135p	Media 'trophy asset' sporting huge back catelogue. Potentially of interest to mobile/broadband networks, Silicon Valley titans (eg Apple, Amazon, Netflix) and content owners (eg Disney, Sony)
Burberry	2,135p	8,647	21.8	2.1%	2,051p	Iconic British clothing brand. Substantial synergies by combining with another luxury name such as LVMH
Smiths Group	1,584p	6,352	14.8	2.9%	1,627p	Company plans to demerge & separately list its medical division in H1'20 - which along with its detection arm, would then make both businesses much simpler takeover targets
ConvaTec	176p	3,450	17.9	1.9%	174p	Financial & trade buyers alike might be interested in acquiring this medical device maker, after a period of underperformance
Spectris	2,289p	2,774	12.5	2.8%	2,718p	Possibly attractive to private equity and trade buyers in light of its cutting edge technology (precision instruments), scalable business model and sector consolidation (eg GKN by Melrose)
Oxford Instruments	1,348p	720	19.8	1.1%	1,293p	Like SXS, OXIG owns world class hi-tech products & systems for industry & research. Stock already appears to be pricing in a small bid premium
Morgan Advanced Materials	248p	712	8.9	4.4%	310p	Maker of thermal & ceramic products used for industrial applications
IMI	963p	2,610	12.5	4.3%	1,081p	Manufacturer of specialist fluid-flow, hydraulic products and systems
Weir	1,351p	3,513	11.8	3.8%	1,730p	Consolidation in oil and gas services industry. Strong pump IPR and well respected brand
William Hill	164p	1,427	11.2	4.9%	228p	Possible bidders include online gambling firms along with US casino operators, who might wish to leverage William Hill's 'in-game' technology & name, as industry is regulated in America

Source: Equity Development. CY+1 relates to 2020 (ie post Brexit). CY = 2019. Average analyst target prices from Market Screener

CY+1 EV/EBIT multiples



Source: Equity Development. CY = Current year (ie 2019)

Many smallcaps are tech-rich and scalable…

Likewise, **the same is true on the lower rungs of the equity ladder**. As evidenced by a slew of recent approaches for Telford Homes, Premier Technical Services, Accesso, Proactis, easyHotel, Sanderson, EU Supply, WYG, Tarsus, Manx Telecom, Laura Ashley & Tax Systems.

Additionally, many **smallcaps offer far greater upside in terms of scalability** (eg healthcare, software & Technology) **and growth trajectory** - where their cutting edge science/solutions can be leveraged across a wider geographical footprint and/or customer base.

generating plenty of overseas & recurring revenues too

In fact, several in our coverage universe are expanding rapidly, possess robust positions within their chosen niches, derive the majority of their turnover from outside the UK, and enjoy high retention rates & predictable income streams.

Consequently, we've highlighted a further **15 smallcap ideas** in the table below. Better still, **we believe each of the mentioned names are undervalued**. Meaning that this 'margin of safety' should (in theory at least) both afford downside resilience and deliver capital appreciation over the medium-long term. Even if ultimately, no takeover materialises.

Typical takeover premiums of 30%

Finally according to Factset Mergerstat/BVR, the average bid premium paid for such transactions between 2004-14 was 30%, with this figure trending upwards since the global financial crisis.

Please note, that I rarely (if ever) invest in stocks solely in the hope they might be acquired. Equally though, augmented by strong fundamentals, this inherent 'optionality' can provide welcome upside. Plus all these views are my own - independently researched and without prior input from the associated companies listed.

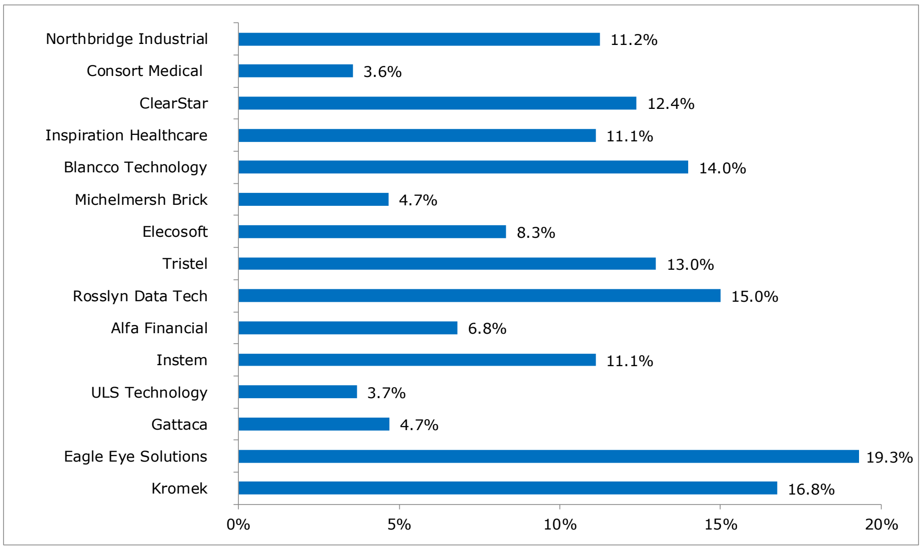
15 potential takeover ideas of smallcap/AIM stocks

Company	Share price	Mrkcap (£ms)	CY EV/sales	CY EV / EBITDA	Average analyst target price	Strategic rationale
Kromek	25p	86.2	3.9	26.5	45p	Proprietary image scanning technology (CZT) that serves three $100m+ addressable markets in medical, nuclear and homeland security. Scalable business that might be attractive to a range of suitors, including perhaps ultimately one of the main healthcare imaging OEMs
Eagle Eye Solutions	163p	41.6	2.1	19.4	265p	Leading SaaS firm that creates digital connections enabling personalised, real-time marketing through coupons, loyalty, apps, subscriptions and gift services
Gattaca	119p	39.2	0.9	4.6	200p	STEM & technology focused recruitment agency, with growing international footprint. Two possible trade buyers (Morson and HRNet Singapore) are already shareholders. Undervalued stock currently being turned around
ULS Technology	65p	42.3	1.5	7.9	105p	Provider of online software/technology platforms for the UK conveyancing & financial intermediary verticals. Opportunity for any buyer to replicate ULS' UK success abroad
Instem	370p	60.3	2.2	9.8	400p	SaaS provider for the drug discovery, medical Big Data and healthcare regulatory sectors. Strong #1 position in fragmeted niche, with majority of sales derived internationally and recurring in nature
Alfa Financial	80p	240.0	2.4	7.1	166p	Developer of mission critical software for the asset finance industry. Ongoing Fintech sector consolidation
Rosslyn Data Tech	7p	13.5	1.7		12p	Big data software specialist helping corporates optimise their supply chains, streamline operations and eliminate unnecessary expenditure. Continued market M&A, with majority of turnover being recurring
Tristel	272p	118.9	3.8	13.7	325p	High margin developer & manufacturer of infection prevention, contamination control and hygiene products. Expanding overseas on the back on #1 position in UK. Possible target for someone like EcoLab
Elecosoft	74p	60.8	2.3	10.8	104p	*Build* tech software developer, serving a prestigious list of bluechip clients generating high recurring revenues (57% group) and overseas income (63%). Significant industry consolidation. Scalable business with major growth opportunities in the UK, continental Europe, North America and the RoW
Michelmersh Brick	86p	79.1	1.8	7.3	103p	4th largest UK brick maker, that focuses on high quality bricks for the new build and RMI sectors. Industry consolation
Blancco Technology	125p	93.1	2.7	13.8	174p	World's #1 developer of 'data erasure' software and mobile diagnostics. Long runway ahead given tightening regulatory environment (eg GDPR) & data profliferation (eg IoT). Scalable model and ramping up R&D investment
Inspiration Healthcare	62p	19.7	1.0	9.0	NA	Global distributor of medical products for use in critical care & operating theatres. Growing base of own IP vs 3rd party technology
ClearStar	64p	23.3	1.0	23.7	113p	Rapidly expanding provider of Human Capital Integrity tech-enabled services specialising in background and medical screening (eg Gig economy). Almost all revenues are repeat/recurring and US$ denominated. Plus recently there has been a step change in LFL top line growth (now circa 25%-30% organic), with positive PBT expected in 2020. Ongoing sector consolidation
Consort Medical	758p	374.5	1.5	8.0	1,069p	Leading global, single source drug and delivery device company. Healthcare consolidation
Northbridge Industrial	133p	37.5	1.5	6.8	203p	Loadbank (Crestchic) and oil/gas well equipment hire (Tasman) businesses - benefitting from secular trends in renewables, distributable power, data centres and Australian domestic oil/gas production

Source: Equity Development. Paul Hill owns shares in Elecosoft, ClearStar, Michelmersh, Northbridge Industrial and Blancco. CY+1 relates to 2020 (ie post Brexit), whilst CY = 2019. Blancco EV/sales multiple has been adjusted for minorities. Average analyst target prices have been sourced from Market Screener.

.

CY+1 sales growth rates



Source: Equity Development. CY = Current year (ie 2019)

Investor Access

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk