GRANT'S
INTEREST RATE OBSERVER®
Vol. 38, No. 24b | 233 Broadway, New York, New York 10279 • www.grantspub.com | DECEMBER 11, 2020

Merrie olde value

In America, value investing is everything that Tesla isn't, including (we are now talking about the share price) profitable. It's that and worse in Britain, with unresolved Brexit, raging Covid and the sagging pound sterling thrown in for good measure. We write to anticipate redemption.

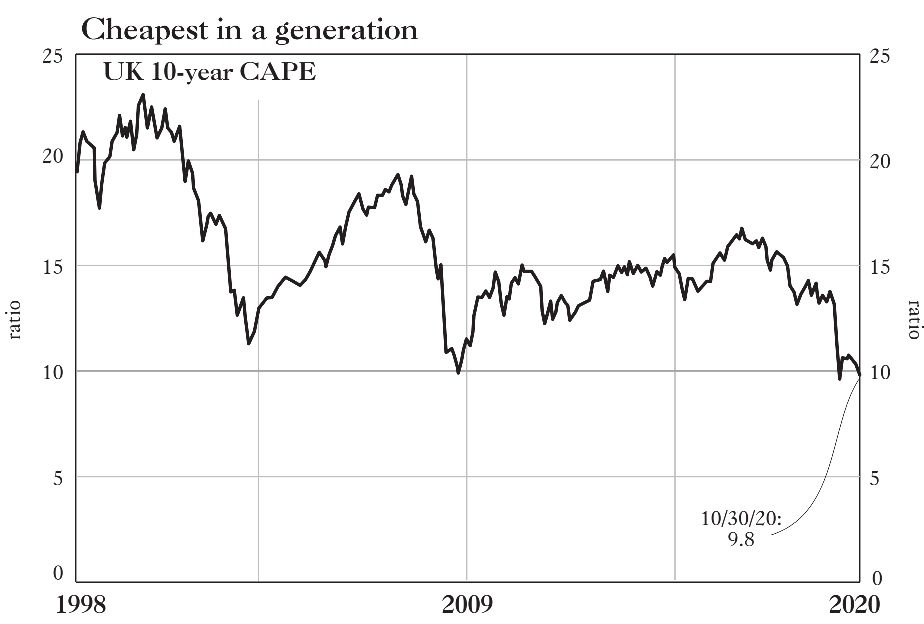
An article in the London *Daily Telegraph* sparked our interest. Gresham House Strategic plc, a closed-end fund pursuing private-equity strategies with orphaned public companies, was the subject.

The first thing to say about the Gresham House fund (a creation of a multi-strategy London asset manager of the same name) is that it's not for everyone. It couldn't be, because everyone couldn't fit into its current £46.12 million market cap. The second thing to say is that its value-laden portfolio (cheap on its own terms and discounted by 13% from its estimated net asset value) illustrates the set of equity opportunities on offer today and hints at a bigger and broader set tomorrow.

Richard Staveley, a Gresham House fund manager, kindly came to the transatlantic telephone. "In the UK," he tells *Grant's*, "there are a lot of similarities to the U.S. in terms of what everyone is in love with, and not. In the UK, value is outstandingly cheap on any sort of basis. When I look at Greek two-year bonds being negative-yielding, it's unbelievable. UK equities are very cheap relative to history and globally. Total market on a 2021 p/e basis is about 30% cheaper than the U.S. and 15% cheaper than the eurozone.

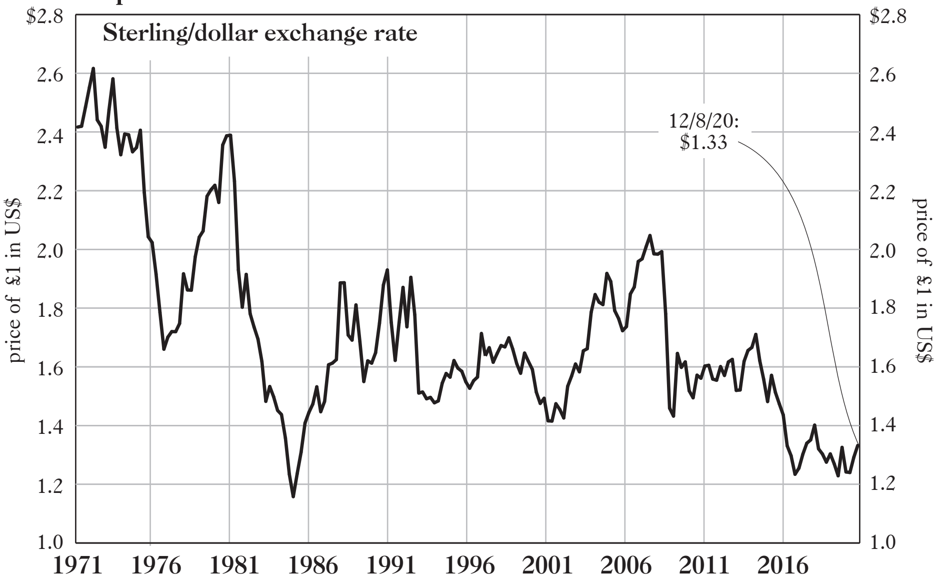
"Within that," Staveley goes on, "UK small cap is at a wider discount than usual. It is about a 30% discount to the market. The main FTSE all-shares for 2021 is now 14.7 times price-to-earnings ratio, and the small-cap index is roughly 10 times. The AIM [Alternative Investment Market, a small, lightly regulated division of the London Stock Exchange] is 24.7 times. For our portfolio, we don't actually run a p/e because we don't think it is very useful for a number of our companies. But our enterprise value to Ebitda next year is 6 times and our EV/sales is just over 1 times."

The objective of the Gresham House fund is to own and cultivate small British public companies as a private-equity steward might bring them along—employing all such familiar p.e. techniques except one. "Leverage," Staveley says—"we shun it. What we've been doing is buying companies where we are actually solving their balance-sheet problem and often changing the management and not allowing them to adopt a plan of releveraging. We've found that having control allows you to move things at pace and make changes, so we try and take much larger stakes and we also work collaboratively—unapologetically, in a more Anglophile version of activism. The p.e. approach that we've borrowed is fewer holdings, which allows us to do diligence that your significantly more diversi-



source: Panmure Gordon & Co., Gresham House Asset Mangement

A picture of Brexit



source: The Bloomberg

fied fund manager would not do with 70–80 holdings."

As of Sept. 30, the top-10 holdings represented 78% of the Gresham House portfolio. The biggest, a hazardous waste-disposal business aptly named Augean plc, comprised fully a quarter of those concentrated names. Its £224 million market cap marks the upside boundary of what Staveley regards as the sweet spot of UK small- and micro-cap investment. It's where inefficiencies and ignorance, therefore value, tend to abound.

"Typically under $200 million market cap," Staveley goes on, "you are doing really well if you have two people following you officially in the stock market. Regularly, there will be just the appointed stock broker writing research, and that is two to three times a year, so the ability to start doing your own work, and then quickly knowing more than everyone else, is there. That is driven by Mifid rules [those governing the sale and distribution of financial analysis in the European Union], which stopped research being economic in the UK."

Concerning the doughty British value tribe, Staveley reports that it's smaller: "In the last couple of years, within the broader UK market, value-oriented managers have been getting fired, basically. So we're down to a survivorship cohort now at a UK market level."

A pair of attempts to float new, value-themed funds fell flat in the autumn. In the wake of the unsuccessful offering of a Tellworth British Recovery and Growth Trust in September, *Shares* magazine quoted Laith Khalaf, analyst at AJ Bell, as observing that domestic sentiment toward the UK market was at a "low ebb." To which he added: "Smaller companies tend to beat their big blue chip rivals over the long term, but it's understandable that investors see them as being at the sharp end of any impending economic trauma."

Staveley's view, and ours, is that good things finally happen to cheap stocks: "I was joking with colleagues last week that even the people with no brains have stopped buying Tesla. The only people still buying Tesla are robots, because it is going into the S&P. I do feel the narrowness into a range of stocks, particularly when you are paying 40–50 years' worth of future profit up front, and when [those companies] cannot convert a sufficient number of years to free cash flow, then the house of cards will come tumbling down. The doubters can be broadly right, but that misses the point that the trade buyers—real buyers and normal p.e.—will arbitrage and take these companies off the market. They may be nicking them on the cheap, but they will be paying control premiums and hopefully there will be enough of us to fight them off and have them pay a proper price." Vaccine, patience and Brexit should do the trick.

•