

MARKET INSIGHT

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September generally marks the return of activity for financial markets with the holiday season concluded, kids back at school, and offices that bit busier. Throw in shortening daylight hours, the prospect of another wet winter, not that this summer was pure sunshine, and nostalgia over recent holidays, and things can seem somewhat gloomy. While this is a somewhat cyclical emotion, a more permanent gloom continues with respect to UK financial markets.

It's no secret that there are continued outflows of UK equity funds, declining UK allocations for both retail and institutional investors, and a significant valuation discount of UK equities to their US peers. Despite this, our domestic market has delivered some reasonable returns for the year thus far, with the FTSE All Share Index up 11.3% at the end of August. Our topic for this edition of Market Insight focuses on the UK market, and some reasons to be optimistic.

Seen as an income-focused market, the UK can indeed be a rich hunting ground for dividend investors. The FTSE All Share Index alone offers a yield of 3.9% at the time of writing, a small premium to the 3.7% UK 10-year gilt yield. Within the index, 227 constituents, including investment companies, offer a yield above that of the index, with a number tipping into the double figures. Some of these names have significant track records of growing their dividend distributions, with the likes of Halma plc achieving 45-years of consecutive dividend growth greater than 5%. In the UK's listed investment companies sector, 21 trusts hold the coveted Association of Investment Companies Dividend Hero status, awarded for achieving more than 20-years of consecutive dividend growth. Some hold significantly longer track records, with City of London Investment Trust achieving 58-years of consecutive dividend growth.

However, the UK isn't just an income market, several companies are market leaders with dominant positions within their sectors, such as the online property search platform, Rightmove. Others, such as Bloomsbury Publishing, which takes the spotlight in our Stock Focus article, holds the rights to key intangible assets such as the Harry Potter book franchise, which are impossible to replicate. In the investment companies space, firms own significant amounts of healthcare properties, a vital infrastructure for our nation's changing demographics, and wind farms, critical to the clean energy transition.

As UK equities trade cheaply to global peers, particularly the US, and to its own historical levels, seemingly the most active buyers are companies themselves. Merger and acquisition activity has been notable recently, especially in the real estate sector, and companies continue to allocate cash to buying back their own shares on perceived discounts to their intrinsic value. With such activity seemingly so widespread, the question remains as to whether those who continue to shun the UK market will be left wishing they hadn't.

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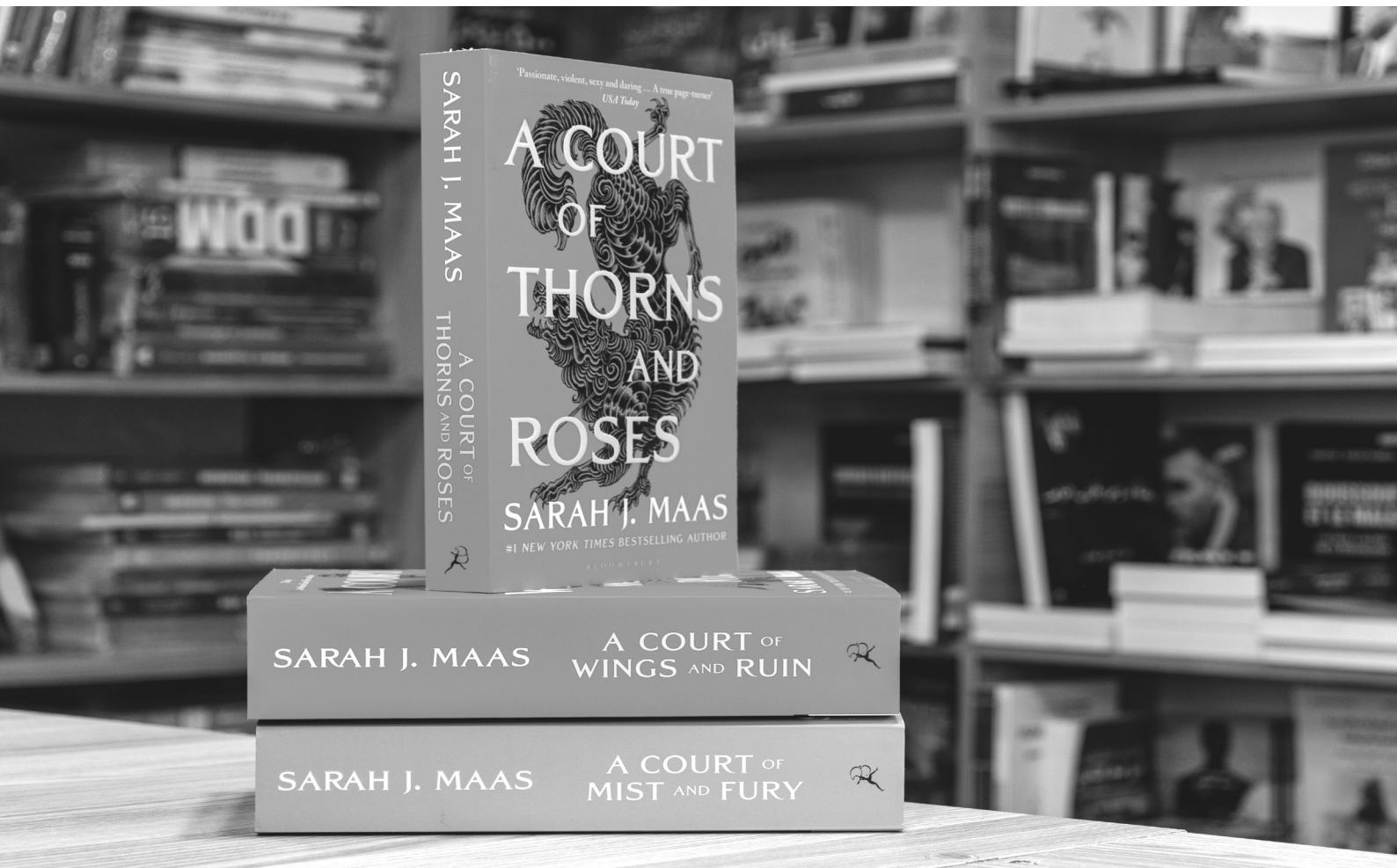
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STOCK FOCUS



BLOOMSBURY PUBLISHING

RUTH HARRIS | INVESTMENT RESEARCH ANALYST



Bloomsbury Publishing is a quintessential British name, perhaps most well-known for publishing the world-famous Harry Potter series. For investors, Bloomsbury at times may have appeared to be a Harry Potter annuity of sorts, as readers of all ages return to the series. Book sales continue even 26 years after their first publication and, in 2023, Harry Potter and the Philosopher's Stone was the number one bestselling children's book for the first time since 2002.

However, it has become apparent that Bloomsbury's investment case extends beyond the Harry Potter story. The most recent annual report, covering the 12 months to February 2024, showed stellar results. Sales hit £343m and profit before tax was £42m, which was 60% higher than the previous year. Return on capital employed hit 33.1%, compared to 20.4% in the year prior. On the surface, this appears even more remarkable as 72% of company revenues come from the old-fashioned print business.

Indeed, new digital trends are a key driver of the exceptional book sales performance of the last year. The online BookTok community has gained popularity on social media platform TikTok in recent years, with people using the platform to share favourite books, reviews, and celebrate reading culture. Prevalent genres include young adult fiction, romance, and fantasy. ‘Romantasy’ has been exceptionally popular, a portmanteau coined by Bloomsbury which was quickly adopted by the BookTok community. With book recommendation videos often garnering millions of views, TikTok has become a powerful word-of-mouth marketing channel for authors and publishers alike.

“The value of Bloomsbury shares has surged 63% over the past year on the back of increased investor attention, and in August it joined the FTSE 250 index with a market cap of £533m at the time of writing.”

In particular, bestselling author Sarah J. Maas has been a major contributor to Bloomsbury’s recent success. While her first book was published in 2012, she became a global phenomenon in 2023 due to a vocal and rapidly growing fanbase on social media. Her sales have grown 161% year-over-year and she has now sold over 38 million copies worldwide. While there is no book planned for 2025, she has a further six instalments contracted with Bloomsbury in the coming years.

The surge in fantasy fiction demand has drawn investor attention to the company. While TikTok trends are fickle and the Sarah J. Maas hype may not last, Bloomsbury has a remarkably robust and high-quality business model. It has developed a diversified portfolio of authors and income streams across various formats, territories, and subject areas.

Bloomsbury operates in both the consumer and academic markets, which offer different revenue dynamics and end consumers. Over recent years, the company has invested heavily in its Academic & Professional division, which tends to

be less exposed to consumer trends and offers more resilient recurring revenues. The biggest academic market in the world is the US and, in May this year, Bloomsbury announced its acquisition of Rowman & Littlefield’s academic business, one of the largest independent publishers in the US Academic market. The deal is an exciting one for Bloomsbury and will double the size of its US Academic & Professional business.

Strategic investment in digital is another priority for the company as publishing is ‘platform agnostic’, meaning it must offer products across print, digital, and audio depending on consumer demand. Within the US Academic & Professional segment, Bloomsbury Digital Resources is expanding content offerings across its online subject hubs, benefiting from trends towards hybrid teaching methods in higher and further education, which combines online and in-person learning.

Within the consumer space, Bloomsbury balances names across established best sellers and promising new authors. The majority of sales come from backlist (previous) titles, alongside frontlist (new) titles. The recent success of Sarah J. Mass shows the striking upside potential of identifying a promising author, alongside deep understanding of consumer demand and marketing channels. Combined with steady backlist sales and recurring revenues from the growing US Academic & Professional business, Bloomsbury offers a compelling and diversified mix of defensive and cyclical revenue streams.

Earnings have been backed up by a high-quality balance sheet, with a £65.7m net cash position as of February 2024. Strong free cashflow generation supports both strategic reinvestment and shareholder returns. While the dividend yield is nothing too exciting - 2.3% at the time of writing – the company has a strong track record of dividend growth, increasing at a compound annual growth rate of 9.7% over the last 10 years. Moreover, it has a policy of ensuring the dividend is at least twice covered by earnings, ensuring payouts are sustainable.

The value of Bloomsbury shares has surged 63% over the past year on the back of increased investor attention, and in August it joined the FTSE 250 index with a market cap of £533m at the time of writing. Despite the share price performance, the valuation may not be outsized at a price-earnings ratio of 16.7x relative to a five-year median of 17.9x. It is worth noting that this is based on very good earnings which may not be sustainable as consumer trends shift. Given lofty results last year, management are expecting to report a moderate fall in revenues for 2025. However, given the increasing quality of earnings, strategic investment, and healthy balance sheet, there may be some magic left for Bloomsbury. ■

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INSIGHT

THE CASE FOR UK EQUITIES

GREG LODGE | PERFORMANCE & RISK ANALYST



The origins of the London Stock Exchange can be traced back to Jonathan's Coffee House in the heart of the City in 1698. John Castaing began publishing a list of stock and commodity prices for the benefit of the traders gathering there after their expulsion from the Royal Exchange for rowdy behavior. Over the following centuries, rules and systems were formalised, traders found some decorum and the scope of the exchange grew ever wider. Today, the London Stock Exchange is headquartered close to St Paul's Cathedral, only a short distance from the site of its founding. The main market contains over 1,000 issuers and has a market capitalisation of £4.4tn. The UK equity

market is of global importance and almost everyone in the UK will have a stake somehow, whether directly or through a workplace pension.

Recent years have seen a pessimistic narrative emerge for UK equities, however, and their importance on the world stage has diminished. UK equities now represent only 3% of global market capitalisation, down from 5% in 2019. Pension funds have slashed their UK equity allocation and UK-focused equity funds have seen net outflows for some time. The small and mid-cap space in particular has suffered, with a falling number of companies decreasing the overall market cap and

liquidity. This in turn means limited funds for initial public offerings (IPOs) and capital raises which will inhibit the growth of smaller UK companies. Growing concerns have led to calls for a 'UK ISA' with a separate allowance for investment in UK companies in a bid to revive a lacklustre market. Similar schemes have been proposed by politicians, think tanks and columnists.

Despite this seemingly gloomy outlook there is still a strong investment case to be made for the UK equity market. Fundamentally, the UK can be a good place to invest, benefitting from the rule of law, a well-established financial services sector and London as a global financial centre with access to capital from around the world. The UK market contains many quality, market-leading companies. Valuations are cheap, acquisitions are frequent and income-seeking investors can find reliably growing dividends. Specialist sectors where the UK excels, such as bioscience and TV and film production, may also present potential opportunities. Let's examine some of the companies defying the prevailing narrative and powering UK growth.

Rolls Royce plc has become a household byword for luxury, but its eponymous cars are only a small part of this FTSE 100 constituent's business. The company manufactures engines for aircraft, ships, submarines and other specialist engineering projects. 2020 saw something of a low point for the company. Heavy annual losses caused the dividend to be suspended and the company was compelled to launch an emergency rights issue in order to raise £2bn, with the UK Government acting as guarantor. Four years later, however, the company has performed an impressive turnaround. 2023 saw record cashflow and a 60% increase in underlying profits. The share price has reacted accordingly, growing by over 100% in the last 12 months alone. When the company announced in August 2024 that dividends would be resumed, the price reached an all-time high of 501p. In the same month, the company also announced a deal with Cathay Pacific airlines to manufacture 60 Trent 7000 engines for its fleet, along with a maintenance package. Looking to the future, as a market leader in small modular reactors (SMRs), this currently unproven technology could present a growth opportunity if the UK Government does decide to commission any.

There may also be value to be found in UK real estate. Many will be familiar with the buy-to-let model popular with individual landlords, but there are other avenues to income through property. For example, Primary Health Properties is a real estate investment trust (REIT) and a FTSE 250 constituent which invests in long-lease healthcare properties in the UK and Ireland, such as GP surgeries where the rental income comes from the Government or Government-backed bodies. The portfolio contains 514 healthcare properties, valued at a total of £2.8bn. The long investment horizon, a high occupancy rate and secured income have led to 27 consecutive years of dividend growth, with a yield currently standing at around 5.8%. There are, though, concerns that many current GP surgeries require significant modernisation, as referenced in a June 2024 report by the Institute for Government.

While financial news is often dominated by stories of American tech giants and artificial intelligence (AI) speculation, UK investors should not overlook those profitable home-grown companies with a proven track record. For example, Halma plc has been a publicly listed company for 50 years and currently holds a place on the FTSE 100. It consists of a group of companies specialising in safety equipment and infrastructure, healthcare and environmental analysis. Collectively, these companies have operations in more than 20 countries worldwide. In its full year results for 2024, Halma announced 10% growth on revenue and profit and its dividend increased by 7% to 21.61p. Dividend growth has historically been strong, with 45 consecutive years of dividend growth of 5% or higher. The company aims to continue growth via acquisitions of quality businesses and deliver value for shareholders by doubling earnings every five years. However, in its 2024 annual report, the firm noted that its residual risk level relating to economic and geopolitical uncertainty had increased, despite having limited direct exposure to geographies with high geopolitical risk.

There are also some positive tailwinds for the UK market. Inflation has returned to a more manageable level. From a peak of 11% in the autumn of 2022, inflation has fallen back to 2.2%, tolerably close to the Bank of England's 2% target. After 13 consecutive base rate increases, the Bank's Monetary Policy Committee announced the first cut of 0.25% in August 2024. If inflation continues on a downward trajectory, further rate cuts may be expected. A new landscape of falling rates and the yields available on cash and fixed interest stocks could see a resurgence of enthusiasm for the UK equity market. After slowing down towards the end of last year, the UK's growth trajectory looks more promising. This summer, the International Monetary Fund (IMF) upgraded its UK growth forecast from 0.5% to 0.7%. Overseas investors have been taking an interest in UK companies, with 2024 seeing the highest value of bids for UK companies since 2018. This is significant, as it suggests these overseas bidders see a buying opportunity in this overlooked sector. However, it can't be forgotten that the UK saw two successive months of zero growth between June and July 2024, with the new Government naming the growth of the economy as one of its priorities.

While it's certainly the case that the UK doesn't have an equivalent to the fast-growing NASDAQ titans of Apple or Nvidia, the FTSE 100 is not necessarily the old-world index it has been typecast as. Banks, miners and oil and gas companies remain, but the index has a much more diverse and global scope than might be assumed - around 77% of the index's aggregated earnings come from overseas. Profitable and well-run companies are in the business of everything from precision engineering to leasing GP surgeries. If investors do their research, they may find a wealth of opportunities. ■

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