Global Matters Weekly

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It's lights out and away we go

by Matt Connor

The first race of the 2022 Formula One season didn't disappoint, as Sir Lewis Hamilton sought a strong start to his record-breaking 8th World Championship in Bahrain. Many were quick to write off the Mercedes man, due to a lack of pace in free practice and qualifying compared to rivals Ferrari and Red Bull. Despite the negative outlook, Hamilton still managed to achieve a podium. As value investors we often view negative sentiment around a company as a potential opportunity to capitalise on irrational valuations.

A prime example of such irrationality is Purplebricks, an online estate agent in the UK. After underperforming peers in a buoyant housing market, coupled with an issue in its lettings business, it's shares plummeted, reaching a low of 12.5p*. This gave a business with close to £60m of cash on the balance sheet, and no debt, a market capitalisation of just over £38m i.e. a negative enterprise value for what is the UK's largest estate agent brand.

The dislocation between Purplebricks' valuation and logicality did not go unnoticed by us or company directors who have been actively buying the stock over the last few weeks. With a new management team at the helm, market sentiment has now turned more positive, with the share price more than rallying from its lows, however the UK's largest estate agency still only has an enterprise value of less than £30m; a lot less than what it was twelve months ago, despite the company gaining market share in recent months.

Another recent opportunity presented to us was dotdigital Group, a SaaS omnichannel marketing company. Its shares tumbled after revenue growth slowed. We have followed dotdigital closely for some time and despite the recent headwinds to the business, we believe it to be of high quality and able to continue delivering healthy returns on invested capital. This was not reflected in the 2x enterprise value-to-sales multiple, a 66% discount to dotdigital's 5-year average. The shares have subsequently rallied 50% but still only trade on a 3.4x multiple.

Irrational moves in valuations aren't always preceded by bad news or a downgrade, as demonstrated by our most recent investment, Games Workshop, the world's largest hobby miniatures company behind Warhammer. Games Workshop has seen its market capitalisation almost halve in the six months from September 2021 to March 2022, caught up in the market sell-off that started with the onset of Omicron.

Games Workshop is an extremely high-quality business with a shrewd management team and solid business model. The company has demonstrated that it can grow invested capital rapidly, whilst increasing economic profits meaningfully. The unwarranted sell-off in the company's shares has provided an attractive entry point.

Unlike Formula One where it is difficult to draw long term conclusions this early on in the season, our long-term, value focussed approach allows us to invest in companies that can provide shareholder value over the long haul, and in the short-term we can take advantage of opportunities that may arise, just like Hamilton in Bahrain.

*Source: Bloomberg Finance L.P

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