UK: +44 (0)207 989 0813
NA: +1 646 896 3065
AU +61 2 9280 0700
action@proactiveinvestors.com.au

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Similar but different: Halma and Melrose fly flag for UK industrials

While Britain's once-dominant industrial sector has shrunk to a share of less than a fifth of the economy, a couple of updates on Tuesday showed that the country still has engineering and manufacturing companies of which it can be proud - and invest in.

On the back of its half-year results that included optimistic comments about continued growth, Halma PLC (LON:HLMA) shares leapt to a new all-time high, marking around almost a ninefold increase over the past decade for the maker of lift door sensors and smoke alarms.

Meanwhile, automotive and aerospace engineer GKN was showing continued signs of improvement under the turnaround specialists at Melrose Industries PLC (LON:MRO) to help wipe away most of the market's worries.

There are not many similarities in what they produce, but both companies long-term track records show they are very good at delivering shareholder returns.

And their similar-but-different successes shows the different ways of making a success of M&A.

Melrose by any other name would smell as sweet
When Melrose completed its £8bn hostile takeover of GKN a year and a half ago, concerns about the debt that was being taken on as well as wavering confidence over whether, in short, the turnaround was too big and complicated a project for the former AIM company.

But the third-quarter update continued the encouraging news from the company that the turnaround was pretty much going to plan, with improvements in GKN "delivered at pace" and resulting in improving profits.

Melrose is a "must own stock", say analysts at Peel Hunt, based on a belief in the board's confidence that it can "unlock significant shareholder value".

Melrose directors have set out a target of doubling the return on issued equity, which the analysts noted would translate to 137p of additional value.

But if they can deliver the sort of 2.7-times return as achieved on previous turnarounds, Peel Hunt, which has set a 12-month share price target of 240p, suggested this could add a further 90p on top.

The company is on many buy lists, with UBS also a fan, with a 250p share price target.

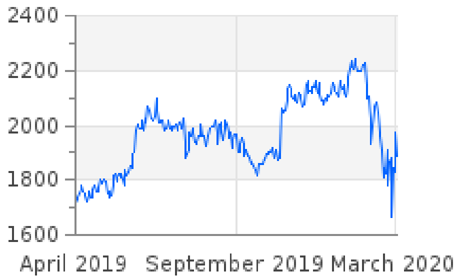
UBS analysts admit that the shares trade on high valuation multiples, with net debt remaining close to £3.2bn, but the EV/EBITA multiple drops to 10.2x for the 2020 financial year.

Different models

Price: 1891

Market Cap: £7.18 billion

1 Year Share Price Graph



Share Information

Code:		HLMA
Listing:		LSE
52 week	**High**	**Low**
	2261	**19.025**
Sector:		**Manufacturing & engineering**
Website:		**www.halma.com**

Company Synopsis:
Halma p. l. c. is a United Kingdom-based holding company. The business sectors of the Company are infrastructure sensors, health and analysis, and industrial safety. The infrastructure sensors sector is engaged in detecting hazards, and protecting people and property in buildings. The health and analysis sector is engaged in improving public and personal health, and protecting the environment.

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Melrose is known for its "buy, improve, sell" model, akin to a private equity strategy, that has catapulted the company from its roots on AIM in 2003 to the FTSE 100.

These acquisitions have scaled up over the years, from smaller McKenchnie and Dynacast in 2005, up to FKI in 2008 and then large Elster in 2012 and Nortek in 2016, which gave management the confidence to aggressively pursue GKN in 2018.

Asked to compared Melrose with Halma, Russ Mould, investment director at AJ Bell says: "Melrose will buy the businesses, improve performance and often them sell them on, returning chunks of cash to shareholders and using some of the proceeds to fund the next deal.

"It therefore uses deals to create momentum, whereas Halma uses them to supplement it."

At beautifully boring Halma, looking at the ice-hockey stick share price graph shows the incremental and pretty smooth progress the company has made with its version of the buy-and-build approach from below 15p in 1988, to 10 times that level in 2001, reaching 1,500p in February this year and topping £20 just a few months after.

"Halma uses selective, bolt-on acquisitions of relatively small scale to supplement the organic growth generated by the core business, which has a strong regulatory driver thanks to the importance of hazard detection and life protection mechanisms and systems," says Mould.

"The company also generates a consistent stream of follow-on business from servicing its installed base of equipment."

With its share price record, fans among retail investors and in the City are not in short supply.

In the view of broker Shore Capital, "Halma is a great quality business that operates in secular growth markets with long-term drivers (increasing: health and safety regulation, demand for healthcare services in developing economies and demand for life-critical resources) and strong margins but the valuations continue to look stretched with a significant premium against peers".

While Halma shares, at p/e ratio of more than 32 times forecast earnings, are among the highest in the sector, the ShoreCap analysts believe the valuation "reflects expected growth rates and the high-quality nature of the business" and as such it is keeping its 'hold' rating.

Different but similar
The success of Halma's and Melrose's quite distinct models can be seen in their respective dividend records.

As Mould notes, Melrose returned £2.4bn to investors in 2016 after asset disposals, with its previous returns being the £373mln in 2011 and £220mln in 2007.

On Tuesday Halma hiked its interim dividend 7% as it looks to extend what is the longest dividend growth streak among current FTSE 100 firms, having upped its annual shareholder payout every year since 1979, Mould points out.

"The model is different from that of Melrose, in that cash returns have been consistent and increased steadily, as a result of steady increases in earnings and cash flow, rather than in occasional lump sums once turnaround programmes are finished and major transactions completed, as at Melrose."

With some analysts pointing to global business sentiment bottoming out, both companies could extend their records for some time to come.

investors, private client brokers, fund managers and international investor communities.

Contact us +61 (0)2 9280 0700 action@proactiveinvestors.com.au

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