

UK Smaller Companies

William Tamworth gives his views on what will bring IPOs back to the UK, whether the wave of M&A activity can continue and how smaller companies can pick up where they left off in the first half of 2024.

2025 OUTLOOK



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What derailed the small-cap rally in the first half of 2024 and what can put it back on track?

UK small caps had a strong first half of 2024, but a rather lacklustre second half. The reasons behind that were the gap between the election and the Budget, the rhetoric around the Budget and then also the bigger-than-expected increase in tax on corporates in the Budget.

Now part of this is just a new government trying to get the bad news out of the way at the beginning of the Parliament, when they can blame everything on the previous government, and I would hope that we now start to see the **signs of stability**, which has been one of the key tenets of their promise and their manifesto.

I'd also make the point that now we've got past the Budget, the narrative from the government can start to change more positively to start talking up the progress they've made and that will enable some of the underlying strengths in the UK economy to come through. So we've got **low unemployment**, we've got **real incomes rising strongly**, **inflation's back at target and interest rates are starting to come down**.

So there are a number of positives about the UK. And the thing that's missing is sentiment: consumer sentiment, business sentiment and ultimately **investor sentiment**. And all of these things can change quickly.

What will bring IPOs back to the UK market?

There's been a shortage of IPOs in the UK market and that's not surprising. There are two barriers to IPOs. One is valuation and the second is certainty that you can actually execute an IPO. If you're

selling your business, why would you sell it into one of the most lowly valued markets? Now the thing that needs to change, in my view, would be money coming back into the UK, so **investor flows returning to the UK would drive up valuations** and also increase the confidence that you can actually execute an IPO.

I think that will happen. But it's just a question of timing. I'd also make the point that **you don't need IPOs for strong returns over the next three to five years**.

Will the wave of M&A activity in UK small caps continue?

There's been a lot of M&A activity in the UK over the last few years. If you take the fund as an example, we had five takeovers in 2024. That's not including the approach for TT Electronics.

We've had **32 takeovers since the start of 2019 at an average premium of nearly 50%**. Now, to me, that says that the acquirers are taking a more positive view on companies' outlooks – they are valuing the same traits that we're valuing, so strong market leaders, strong balance sheets, strong cashflows. And also that there is an enormous valuation discrepancy between what acquirers are willing to pay for an asset and how the UK markets are currently valuing those businesses. And that's the 50% premium.

If anything, I would expect **M&A activity to accelerate into 2025** because we are seeing **interest rates steadily coming down**. So unless we see valuations correct materially upwards, I think we'll see more M&A activity in 2025.

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