

Brexit & Skin in the Game

Published on: 22 February, 2019 | Author: Investment Team

Stephen King, the bestselling author of horror and sci-fi stories wrote a book specifically about writing aptly called "On Writing". In it, he mentioned that the writer has a variety of tools in his/her toolbox. The fundamental tools include vocabulary, grammar and the elements of style. To be a good writer, one must have these tools easily within reach in their toolbox.

While the CEOs of public corporations are not in the business of writing prose, some essential tools are required to solve the main problem of every CEO which is the problem of capital allocation. CEOs essentially have five options when trying to allocate capital: investing in existing operations, acquiring new business, paying down debt, issuing dividends or repurchasing shares. Each of these levers can be accretive or destructive to returns and depends on a number of factors. One factor that is often not mentioned is that of timing.

Earlier this week, Lloyds bank announced it was returning £4bn to shareholders – £2.2bn through dividends and £1.8bn through share buybacks. To put this in perspective, the market cap of the bank is about £43bn. This share buyback therefore accounts for about 4% of the company's value, a non-paltry sum.

What is even more surprising is that this is the second time in the last 20 years where the company has repurchased its own shares. The first was between March and August of 2018 where the company purchased £1bn of its own shares. UK companies generally opt for dividend pay-outs over share repurchases when returning money to shareholders, which is in contrast to US companies that prefer to repurchase shares. Such large share repurchases by a UK bank at a time of economic uncertainty is surprising.

Based on the torrent of negative headlines about Brexit and the UK economy in general, one can conclude that the directors of Lloyds bank are either delusional or have found value where many fear to tread.

Looking at the current valuation of the bank, this share buyback appears to be accretive to returns. Buying back shares below its intrinsic worth creates additional value for current shareholders. With the shares currently trading on par with the bank's tangible book value, the company is a statistical bargain.

The large share buybacks by Lloyds shows that the company has decided to vote with its wallet at a time when many choose to vote only with their opinions. The rarity of share buybacks coupled with the magnitude of its recent and future buybacks is a vote of confidence in the company's future and by proxy, the longer-term resilience of the UK economy.

Important Information: Any views, insights, or commentary are for general information only, do not constitute personal investment advice or research, and are intended for UK residents. They may not be appropriate in all jurisdictions. While sourced from information we believe to be reliable, we make no guarantee as to accuracy or completeness. Past performance is not a guide to future results, and the value of investments can go down as well as up.

Regulatory Disclaimer: Tacit Investment Management is the trading name of TIML Limited (No. 9228395), part of Tacit Holdings Limited (No. 10611211). Both companies are incorporated in England and Wales, with the registered office at 14 Hanover Square, London W1S 1HN. TIML Limited is authorised and regulated by the Financial Conduct Authority (FCA ref. 670184) and approves and issues this communication under Section 21 of the Financial Services and Markets Act 2000. Please note, tax and estate planning services are not regulated by the FCA.