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EI Group Bought by Stonegate

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One of the UK's top leisure activities is still, "going down the pub." The eating and drinking market according to the MCA UK Pub Market Report (2018) is worth £89 billion per year. Despite the well documented decline in public house numbers, it's estimated that 15 pubs a week are closing, there are still some 43,000 operating establishments taking a £22.5 billion slice of the "out-of-home eating and drinking market."

A number of our key funds hold EI Group Plc, formerly Enterprise Inns Plc, which is a key player in this marketplace comprising a blend of managed and tenanted pubs. This week the Stonegate Pub Company agreed to buy 100% of the share capital of EI Group at 285p, representing a 38% premium to last Friday's price, in a deal worth £2.96 billion including net debt of £2bn.

EI investors can certainly feel justified in opening a bottle of the nearest frizzante in celebration. But what does deal tell us about the wider market place?

The remorseless drumbeat of Brexit has damaged business confidence and consumer spending. However, the EI / Stonegate deal shows that even in a difficult environment, enterprising investors, armed with plentiful and cheap capital, will find opportunities to extract value from inefficient, sub-scale or underperforming operations.

It is no surprise that Stonegate is owned by a private equity group, TDR capital. By combining the 772 pubs, including the 333 acquired from Mitchell and Butler in 2010, with the 4000 owned by EI, Stonegate will acquire immediate scale with debt funding secured by the rentals of an extensive property portfolio.

From a private equity perspective, the deal is attractive because it can monetise a large and defensive but low-growth industry and it can do it away from the short-term scrutiny that a public listing entails.

The deal illustrates a number of market drivers:

1. Although Brexit is a barrier to growth, at least, in the short-term compelling financial deals will still attract investors
2. Brexit has led to foreign investors shedding UK stocks. Therefore, the UK is likely trading with a "Brexit" discount. At this point, long-term investors simply seek clarity which, if and when, clarity is achieved, may lead to a substantial re-rating of domestically focussed UK stocks which have largely fallen off the radar for international investors
3. Whilst capital remains cheap and remember the broader macro-economic picture suggests that interest rates have already peaked in this cycle, the trend to de-equitise or for companies to go private will continue. A diminishing supply of public equity will tend, ceteris paribus, to support equity prices to the benefit of investors.

In the meantime, the board of EI Group has heartily endorsed the transaction doubtlessly in the manner befitting a purveyor of fine ales, wines and champagnes.

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