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Why change winning formula?

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Melrose Industries

Today, Melrose Industries is expected to give details of its latest return of capital to its shareholders. In the second half of last year, the company sold five businesses worth about £950 million that were acquired as part of its 2008 purchase of the engineer FKI.

This is what Melrose does. It buys underperforming engineers, turns them around and then sells them at a thumping profit. Then it hands money back to shareholders.

The biggest sale last year was of Crosby, which makes lifting equipment, and Acco, a materials handling business, to KKR, the buy-out specialist. These went for the equivalent of £627 million; both were part of the FKI stable.

FKI cost about £1 billion. Crosby went out of the door for about three times what Melrose paid for it. This is about standard. Companies tend to be retained for three to five years. Any investor who bought into Melrose in 2005 will have multiplied the initial investment by five times. Over that period, it has created about £3 billion of shareholder value.

Melrose is sometimes referred to as an engineering conglomerate. This is not quite right; the old conglomerate model required combining disparate businesses under the same roof, on the assumption that earnings would be smoothed over the business cycle, as one company did well and another less so. That model has largely fallen out of favour.

Melrose more resembles a private equity firm, but a quoted one in which all can invest. I have sung its praises before, over the past three years or so, and that share price graph tells its own tale.

The latest cash hand-back is expected to come in at about 47p a share. It will be tax-efficient; investors can either take it as capital, incurring a normal tax charge, or under a B share scheme which means they pay capital gains tax. The next return looks to be some way off. In August 2012, Melrose bought Elster, a maker of gas, water and electricity meters. This has performed better than expected, raising margins to the targeted 16 per cent ahead of time, but a sale is still years away.

The next big corporate move will be another large purchase, for anything up to £3 billion, and probably in the United States, but nothing seems imminent. The Melrose business model requires a supply of underperforming companies, but there is little likelihood of these drying up. The shares, up 3½p at 311¾p, sell on about 18 times this year's earnings. They should remain on any investor's buy list.

Engineering deals

Melrose Industries share price