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Football versus Soccer

by Matt Connor, Investment Analyst

The city has been abuzz with chatter recently after a very public, scathing attack on the unfriendliness of the UK stock market to new listings. Although the comments could be seen as an ego-massaging exercise to divert attention away from a floundering business, therein lies some truth that the UK stock market is evidently less attractive than our cousins across the pond.

The UK government is desperately trying to stem the bleed of British businesses favouring the US, with UK Prime Minister Rishi Sunak encouraging a relaxation of the London Stock Exchange's listing rules. Over-regulation of the markets has contributed to London's decline as a financial powerhouse, and despite Mr. Sunak's lobbying for de-regulation, little has been done to date.

The allure of looser regulation is not the only thing tempting businesses to make the transatlantic trip, it is the valuations they can achieve with a US listing versus the UK. The US has seen a decade of immense wealth creation, with the number of new Initial Public Offerings (IPO) reaching all-time highs in both 2020 and 2021[1] as a result of founders and private capital cashing in on lunatic valuations. Some businesses, such as DoorDash, achieved a whopping 11x sales multiple on its IPO that rocketed to 21x upon its stock market debut. Did I mention DoorDash hasn't turned a profit yet and lost $1.2 billion last year?

Although in the last 12 months, a reality has dawned on many investors which has tempered such irrational exuberance, it does not hide the fact that the US can still be a much more attractive place for companies to list that have significant operations in the country and want to achieve a richer valuation for their private backers. The darling of British innovation, ARM, is seeking a US listing, and is it any wonder why when the NASDAQ trades at a Price-to-Earnings ratio of 25x versus a measly 11x for the FTSE 100. But what can the UK do?

De-regulation can only go so far, and the ever-increasing depth of the US market commanding high valuations will only serve to further compound the problem of businesses choosing a new home stateside.

Although low valuations in the UK may dissuade new listings, it can also offer the opportunity to acquire high-quality businesses at a discount. The FTSE 250 trades on a Price-to-Book ratio of 1.4x versus its 10-year average of 2.0x, signalling that many UK companies (and in particular mid-caps) are an undervalued opportunity, one we are taking advantage of with a significant allocation within our multi-asset portfolios. Such opportunity has not gone unnoticed by private equity in their well-documented 'raid on corporate Britain'. Time will tell whether irrational exuberance will lead to unjustifiably high valuations of unprofitable, non-cash generative businesses again, but for now, some CEOs ought to focus on turning a profit rather than rueing what could have been.

Sources:
1 https://www.statista.com/statistics/270290/number-of-ipos-in-the-us-since-1999/#:~:text=2021%20was%20quite%20a%20year,of%20IPOs%20dropped%20to%20181.
Unless stated, all sources are Bloomberg Finance L.P.

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