Global Matters Weekly

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For what it's worth

by Richard Parfect

What is it worth then? This is a question investors should be asking themselves all the time. However, the true answer is not always obvious. There are many ways to approach it and there is of course an easy "short cut" to establishing an answer; the stock market price. However, relying on such a public pricing mechanism implies a high level of faith on efficient markets and to believe there is no such thing as "the madness of crowds".

While it may be possible to assume markets are efficient for certain stocks much of the time; we believe, as active investors, that there are pockets of inefficiency throughout the market all of the time. Herd mentality and a reluctance to stand out from the crowd can lead to instances of a build up of excessive sentiment in either direction on stocks.

Benjamin Graham discussed how in the short term the stock market is a voting machine (sentiment) but in the long term it is a weighing machine (value). We certainly saw the stock market's short term failings in 2020 as COVID-19 brought company valuations down to levels that implied their futures were permanently impaired. The subsequent strong recovery reflects how the voting sentiment has swung the other way as investors play the "reopening trade". Share prices in the longer term (the weighing element of the market) will almost certainly be closer to (and above) the recovered prices than the distressed levels of 2020.

So, the short termism of markets presents a problem to investors as they see their holdings marked down in crises, however if they apply a more long term mindset, that presents a (buying) opportunity. Indeed, we are now starting to see parties enter the UK equity market with a clear view on the longer term return potential of listed companies; as a number are now facing bids from either trade buyers (competitors) or private equity.

In order to have confidence to act on those short term opportunities, then investors need to apply some fundamental analysis to the investment proposition; an inexhaustive list would include assessments on: intrinsic asset value and their future income/dividend generating potential supported by profit expansion (which in turn relies on revenues and margins).

These are fundamental and important quantitative and qualitative questions to answer by digging into the company, its management and their philosophy.

However, restricting one's framework to companies that are already established on a revenue or even profit generating path, can result in some missed opportunities. It can be argued that investing in pre-revenue generating companies is the preserve of "growth investors"; however if there is clear visibility in a company to profitable revenue generation and sensible assumptions can be put in place for that, then it should be possible to appraise whether the quoted market price is a fair value for those future returns. Nevertheless, it is important to distinguish here the difference between companies that have a credible product or technology platform that needs commercialisation at scale, from those that are more "blue sky" and uncertain.

Valuing such companies can be more subjective and requires a more qualitative and in depth understanding of the company than a pure spreadsheet analysis will reveal. This is perhaps most apparent in the disruptive breed of owner-managed businesses raising "cross-over" private capital before they list on public markets. Similarly, sectors like healthcare can see companies valued, both by private and public markets, at material discounts to what they are intrinsically worth.

The clearest indication of what a company is worth is ultimately what someone is prepared to pay to own it out-right. A recent example would be Kymab, which was a private company held within Schroder UK Public Private Trust (SUPP). It develops monoclonal antibody therapeutics for use in oncology and immune disorders amongst other indications; technology that is transformative for medicine. It was recently purchased outright by the global pharmaceutical company, Sanofi, for up to $1.5bn; which is a price per share 4x the level of where it had been formally valued within SUPP.

In summary, it is important to understand that listed markets will immediately tell you the price of everything, but in that snapshot of time it will inform you the value of nothing.

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