Looks like a bubble, smells like a bubble…

January 2021

…we will not know if it sounds like a bubble until it pops. The AIM market has been absolutely stellar versus other UK indices in the last 12 months. As we know, last year was not a vintage one for UK equities, so why has AIM outperformed so much? We think there are a few reasons, but the primary ones can be summarised as follows:

- A very narrow leadership that was led by a few key COVID-19 winners (computer gaming, gold, ecommerce and ESG names)
- A lockdown led resurgence in retail interest
- Limited short availability, even in larger names that reduces market efficiency

Do not get us wrong, we love AIM as a great place to find new companies and fund their growth as they develop - I have had a significant portion of my portfolio in AIM ever since I started running small cap money over twenty years ago. We spent the last five years ringing the bell on the risks that IHT investors were driving many AIM names and some of these companies were on relative and absolute valuations that looked very vulnerable if this tax break was reformed. This policy change has oft been mooted, even before the need to raise more HMRC revenue became so much more acute in the last year. So, is this a case of us being stale bears proved wrong again and then missing a monster rally and just expressing some sour grapes? Well, no - we took part in that year-end rally with the best of them, but for us it was the 'dogs of war' not the 'gods of awe' that led the way. Solid UK small caps, unloved by all the many reasons there were not to be liked last year came back into the fold. At the same time people did not sell those COVID-19 winners that had kept the AIM index in positive territory to buy more value, they just bought more of the same on AIM.

Retail buyers getting excited about game changing small companies with slick stories is nothing new - we have been here many times before. Actions are perhaps turbo boosted by social media excitement and bizarrely there seem to be less warnings on share trading ads than gambling ones. A very few tiddlers come through to become fantastic larger companies, while others wither on the vine. Some of today's tech heroes were yesterday's tech flops. Digital marketing player *Tremor International* is a great example of this; containing the remnants of fallen angels such as *Autonomy's Blinkx* spin off and *Taptica*. One area that has been stratospheric is the battery, hydrogen and fuel cell plays. AIM has always had a few of these and 2020 is not the first time they have shone. Several floated in the aftermath of the tech boom, then spent nearly two decades proving the tech while getting rescue refinancing on the way. Sometimes they do not make it – I used to hold a Dundee based battery business called *Axeon Power* that had developed long range batteries for electric vans a decade ago. Their IP came from the batteries in handheld credit card readers in restaurants, that their predecessor *NCR* had developed in the 1900s. Had it survived maybe it would be a FTSE company now. Credit to those investors who kept backing many of these companies this summer when they, almost universally, became red hot. It is difficult to pin down quite why, but the excitement about EVs globally and read throughs from the *Tesla* valuation can go a long way. One can see a more mainstream carbon reduction agenda everywhere and probably most significantly bulging coffers of ESG funds trying to find a home.

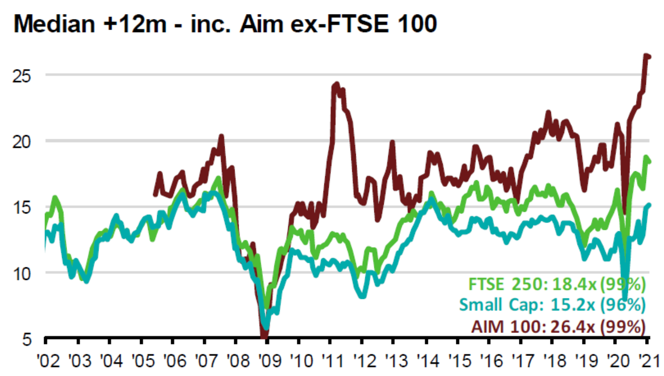
We have done very well in *Volex* as people have got excited about its vital role in the EV supply chain, it too was once a proper Norman no mates barely 18 months ago. It now trades on about 18X 2021 earnings, the share price is up c100% in the last year – the average 12m forward p/e of the top 15 AIM darlings is 32.2x. The median p/e for the AIM 100 is now 29.6x, my colleague Seb Jory has been tracking this data for a while and that is a new peak. Have the prospects for these companies really become that much better since their last bump in 2018 I ask myself?

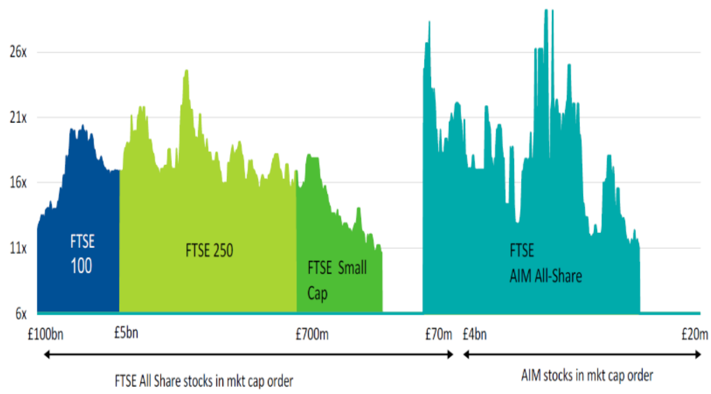
This was all brought home to us rather starkly this month in a good news story for one of our dearest dogs, *Ricardo*. The UK engineering consultancy has led the way in internal combustion engine development for many decades, selling its wares and services to every auto maker worth their salt. For most of the last 30 years this was a classic cap goods sector favourite, a premium name among metal bashers based in Shoreham-by-Sea, West Sussex not Smethwick, West Midlands. Management have worked hard to diversify in recent years into defence, railways, renewable energy and yes even EVs. With an £80m order book they cannot be doing it all wrong. But a big demand hole and a tight balance sheet killed the shares last year. This week they announced a strategic partnership with *AFC Energy*, an alkaline battery specialist. *Ricardo* shares popped up 11%, AFC 7%. So far, super. But have a look at this.

	Market Cap (£m)	EV (£m)	2021 sales	2021 eps	EV/Sales 2021	P/e 2020	1year SP perf
RCDO	237	347	350	27p	1.0x	14.0x	-53%
AFC	525	520	2	(1.2)p	260.0x	N/a	308.90%

Source: Bloomberg, as at January 2021

What conclusions can we draw? There is a heck of a lot of expectation in the *AFC* valuation and the market attributes nothing to *Ricardo* even if its expertise is the key to unlocking commercial value that *AFC* will need to justify their valuation. In reality it is not that simple, but this is a very prescient example that shows the divergence in valuation between the perceived old and the shiny new. It is great news that exciting new technologies can be successful after 20 years of painful development while listed, and AIM has done a sterling job for the UK economy here. We all love a multi bagging world changer, just do not lose sight of what you are actually getting for every penny of your market cap – is it hope and patents or a seemingly hopeless collection of orders, earnings, expertise, cashflow and patents?





Source: Bloomberg, Datastream, Tellworth Investments, 18th January 2021

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