Israel: A $400 Billion Stock Market

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Image by Ri Butov via Pixabay

At Israel Investment Advisors, LLC (IIA), we often talk about Israel's evolution from "Start-Up Nation" into "Scale-Up Nation." We are eager to see Israel's capital markets mature, as a platform that enables Israeli companies to scale well beyond the growth made possible in their early stages by venture capital alone. Signs that this maturation is taking place include a rise in the number of companies with high market capitalizations over the past decade and a current boom in initial public offerings (IPOs).

Israel Now Has 87 Public Companies Worth More Than $1 billion

The Israeli stock market was once small enough that a handful of companies with high market capitalizations comprised a significant percentage of the market, and fluctuations in their valuations created large swings in the market as a whole. Just six years ago, when Teva Pharmaceuticals was Israel's largest company by market capitalization, its value peaked at $60 billion, which made up almost 30% of Israel's then-$225 billion stock market value. Unfortunately, Teva was especially vulnerable to risk from competition.

In 1996 Teva received FDA approval for Copaxone, a blockbuster treatment for multiple sclerosis. In the year before Copaxone's market launch, Teva generated $668 million in revenues and $80 million in profits entirely from the sale of generic drugs. When the patent for a pharmaceutical product expires, generic drug companies are allowed to enter the market with copies. Over time, generic drug competition can reduce the price of a formerly patented drug by 80% or more. Copaxone was Teva's first, and only, significant patented product.

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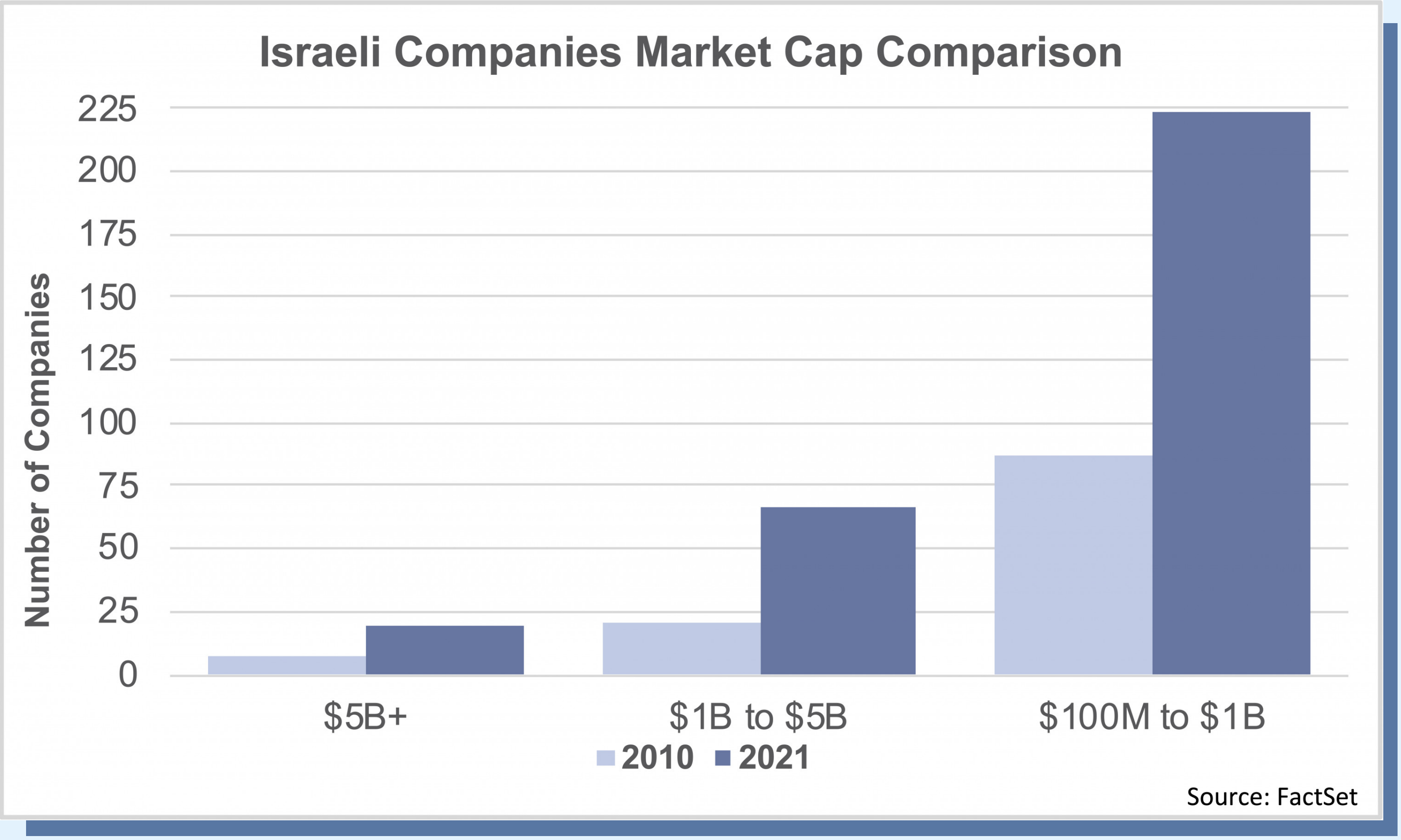
Teva retained its lead in the global generics market, but Copaxone propelled revenues and profits higher by an order of magnitude. When Copaxone lost patent protection in 2015, Teva's revenues exceeded $20 billion per year, and Copaxone accounted for more than 50% of Teva's $3 billion in net income. In a desperate attempt to forestall the inevitable, Teva doubled down on its core generics business, borrowing heavily to consolidate the generic drug industry through acquisitions. Although Teva became a dominant multinational generic pharmaceutical manufacturer, it could not replace Copaxone's profitability. In 2020, Teva lost $4 billion on $16.5 billion in revenue, and it has not turned a profit since 2017.

When we launched the Israel Investment Fund, L.P. on August 1, 2010, the Israeli stock market was worth $182 billion and Teva's market capitalization of $46 billion accounted for 25% of the total. Despite Teva's collapse, Israel's stock market capitalization is now $400 billion. Teva's $11.5 billion market value is only in fifth place behind Wix.com, Check Point Software Technologies, Solaredge Technologies, and NICE Ltd.

Since August 2010, Teva lost $34 billion in market value, yet the Israeli stock market has expanded by $218 billion. In August 2010, there were two Israeli public companies worth more than $10 billion – Teva Pharmaceuticals and ICL Group (Israel Chemicals). ICL mines potash from the Dead Sea and manufactures fertilizers. Like Teva, ICL's potash business was upended by intensified global competition pushing its market value down from $15.9 billion in 2010 to $8.9 billion today. Israel's two most valuable companies in 2010 fell on hard times, yet there are now eight Israeli companies whose market value exceeds $10 billion – in addition to the five mentioned above there are also Bank Leumi, Bank HaPoalim, and Playtika Holding Corp.

In 2010, there were five Israeli companies worth more than $5 billion but less than $10 billion, and 20 companies between $1 billion and $5 billion. Today there are 12 companies between $5 billion and $10 billion, and 67 companies with market values between $1 billion and $5 billion. In 2010, there were 114 Israeli companies with market values exceeding $100 million, while today there are 310.

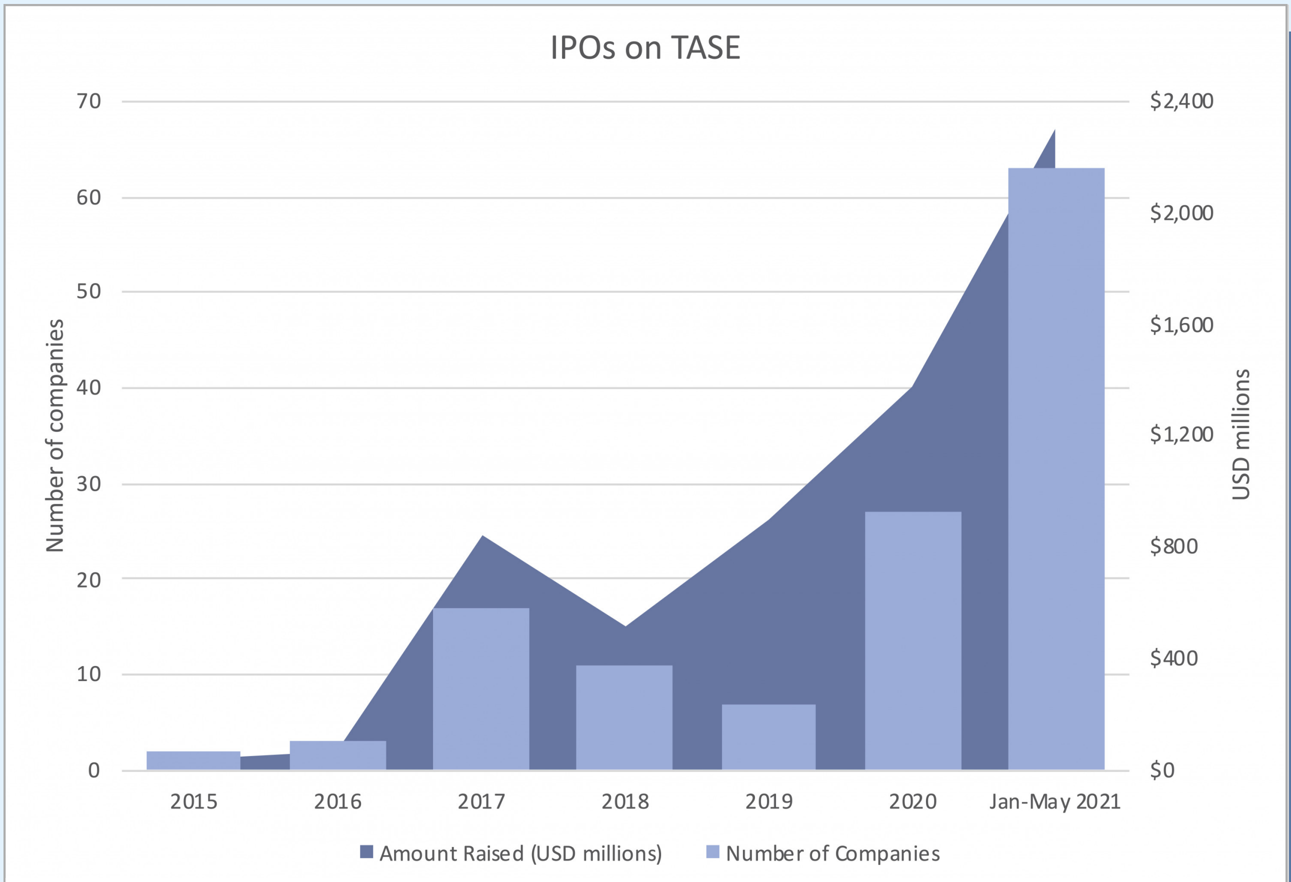


Israel's IPO Boom

Israel is in the midst of an IPO boom just like the United States, particularly for technology companies. The biggest offerings still prefer a U.S. listing, but the Tel-Aviv Stock Exchange (TASE) is becoming increasingly attractive as well. As we have noted in previous newsletters, domestic capital is piling up in Israel due to the country's high savings rate and robust pension system. As a result, the institutional asset management industry in Israel has expanded its scope and sophistication over the years, allocating more capital to the stock market.

According to a recent article in the Times of Israel, "As of June 17, 63 companies, including 44 tech firms, were newly listed on the TASE this year, raising a total of NIS 7.8 billion ($2.3 billion)… In all of 2020, only 27 companies held IPOs on the TASE, but it was still the highest figure in 13 years. Nineteen of the 27 firms were from the tech or biomed sectors, a spurt of activity after 2019 and 2018 saw no tech IPOs at all… There are now at least 511 firms listed on the TASE, up from 455 in 2020 and 442 the year before."

We have been actively investing in the Israeli markets for the past 11 years and are very pleased to see this heightened activity and attention.



Sources: TASE.co.il and https://www.timesofisrael.com/flurry-of-tech-ipos-buoys-renaissance-for-tel-aviv-stock-exchange

Even though most of the recent IPOs do not fit within our investment criteria at IIA, the IPO boom is good news for us as well as the Israeli capital markets. More capital increases overall liquidity within the market and inevitably brings new investors into other Israeli stocks as well. We have been actively investing in the Israeli markets for the past 11 years and are very pleased to see this heightened activity and attention.

Waiting for Earnings to Catch Up to Valuations

Many of the recent technology IPOs are exciting growth companies with speculative valuations and scant profits. For example, the biggest IPO so far in 2021 is Monday.com on the Nasdaq. Monday.com is an enterprise software company that allows teams to better coordinate their workflows and projects. At a time when remote work has become the norm, investors are understandably attracted to a company whose customers credit its project management software with increased productivity and improved collaboration, even at a distance.

Monday.com was founded as a startup in 2012. Revenues more than doubled in 2020 to $161 million. Monday.com is certainly a very high potential company and is incurring large losses to expand its staff, improve its product, and invest for future growth. In 2020 Monday.com lost $152 million (-$3.92 per share), significantly larger than its 2019 loss of $92 million. Revenues in the first quarter of 2021 grew by 85% over 2020:Q1 and 17.8% over 2020:Q4, so the growth story remains robust.

To raise the capital needed to pay for these growing pains of scaling up, Monday.com held an IPO in June 2021 that raised $574 million with a valuation of $6.8 billion. After the IPO, the stock popped higher, and, at this writing, boasts a market capitalization in excess of $10 billion. At this level, Monday.com's valuation exceeds 30 times revenues, while we often find companies that trade at 30 times earnings too rich for our blood. To meet our valuation benchmarks, Monday.com would need to generate well above $1 billion in revenues in the very near future. That is not an impossible threshold, but the probability is not high enough for our more moderate-risk investment strategy.

Despite Speculative Market Activity, We Remain Focused on Our Proven Moderate-Risk Approach

Even if Monday.com, like most recent Israeli IPOs, does not yet meet our investment criteria, the current IPO boom is exciting and good for the Israeli stock market. Our investors understand that our approach focused on profitable companies, reasonable valuations, and strong balance sheets has produced strong results over the years. While we will bide our time until these companies mature a bit or when their valuations come down to earth, their burgeoning market capitalizations are a sign that Israeli capital markets are entering a new phase of growth and liquidity.

Eleven years after we launched our fund, more global investors are starting to notice the Israeli stock market. We believe IIA will continue to lead an increasingly flourishing U.S. investment ecosystem focused on the Israeli financial markets.

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