

Brexit's silver lining for Australian TMT stocks

It's not all bad news

While Brexit will have substantial ramifications for the UK in particular (if it all actually goes ahead), and while there will undoubtedly be a more cautious stance on the part of investors regarding smaller companies in general, we believe there may be a silver lining to Brexit for Australian Technology, Media and Telecom (TMT) stocks.

Risk-off stance increases competition for institutional money

The bad news first. As we saw last Friday, small caps typically get hurt much more by these macro events than large caps. While major, large cap, market indices across the globe fell by 3% to 8%, many Australian small caps TMT stocks declined by up to 20% towards the end of the Australian trading session as many small cap investors wanted to exit through the same door at the same time.

In the near to medium term, we expect the global risk-off stance will weigh on small caps as institutional investors will prefer the more liquid large caps during times of uncertainty. Small cap funding will likely be more difficult to secure and/or more expensive as the risk premia have increased since last Friday.

We expect small caps will see increasing competition for institutional money on the back of Brexit, as there will be less of it to go around, at least in the near term. This implies that small caps may have to crank up their investor relations a notch or two, especially in case of upcoming funding requirements.

IT talent on the move

On the positive side, we expect a certain number of UK-based TMT companies will be looking to relocate to other EU countries in the coming period to ensure unrestricted access to all of the EU's benefits, such as free movement of workers, i.e. IT talent, which is particularly important in the TMT space.

Additionally, some of London's start up hubs, such as Level 39, may want to diversify geographically to provide their members (startups) with more flexibility across the continent. As change provides opportunity, we believe such (partial) relocations may help Australian TMT companies (with operations in Europe) in their hunt for top IT talent.

M&A in the UK just got a whole lot cheaper

Friday's 7% decline of the British Pound versus the Australian Dollar was one of the strongest one-day declines ever seen in this currency pair, making acquisition targets in the UK substantially cheaper all of a sudden.

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Additionally, due to a deteriorated growth outlook in the UK, and to a lesser extent in Europe, valuations of UK companies in general should come down in the very near term. In other words, M&A in the UK just got a whole lot cheaper, almost overnight.

However, for TMT companies with a global focus, local economic developments in the UK are not all that relevant. What's relevant is the quality of IT staff, Intellectual Property (IP) etc, which forms the basis of TMT companies' global product. Therefore, we believe Australian TMT companies may need to revisit their shopping lists as the UK may have some TMT specials on offer in the next few quarters.

London's AIM will be less attractive for small caps

In terms of listing options for small caps, we would expect London's Alternative Investment Market (AIM) to lose some of its shine following Brexit. AIM is heavily skewed to technology, clean-tech and biotech companies and may not only see potential IPO candidates shy away following Brexit, but currently-listed companies as well. Exchanges in Europe, the US and indeed the Australian ASX would likely benefit from such a development, in our view.

What the CEO's think

A quick survey among a number of CEO's of ASX-listed TMT companies revealed that the general consensus is that Brexit will not have that much of an impact operationally, even for companies with UK operations. However, UK investment capital inflow will likely diminish and is expected to be diverted to other markets, including Asia and Australia.

Additionally, the view regarding free movement of workers is that genuine Tech talent will always be able to get visa's, no matter where they may come from.

One topic that stood out concerned privacy issues in UK. Current privacy legislation in the UK needs to conform to EU legislation, which appears to be less strict than what the UK might prefer stand alone. So following a potential Brexit, privacy protection in the UK might take a hit, potentially adversely impacting companies operating in the UK.

New general elections may avert Brexit

On a side note, we deliberately wrote "potential Brexit", because we are not convinced it is actually going to happen. The referendum was non-binding and maybe calling for new general elections with just one topic front-and-center (In or Out) might be a way out of this nightmare for all repentant Brexit voters and everyone that voted Remain in the first place.

Conclusion

Our view is that there is clearly a silver lining to a potential Brexit for Australian TMT stocks as well as for Australia's stock market listing environment as a whole. We believe Brexit is not a globally contagious event to the extent that Greece was a few years ago. Having said that, due to the current risk-off stance, small cap funding may be more difficult to secure in the near term.

However, investors' doors will always be open for solidly-run companies with a globally relevant proposition, be it in Tech, Telco or Media. Investors will just be looking to pick up these shares at more interesting valuations than before The Day Britain Shot Itself In The Foot.

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