Renaissance Investment Management

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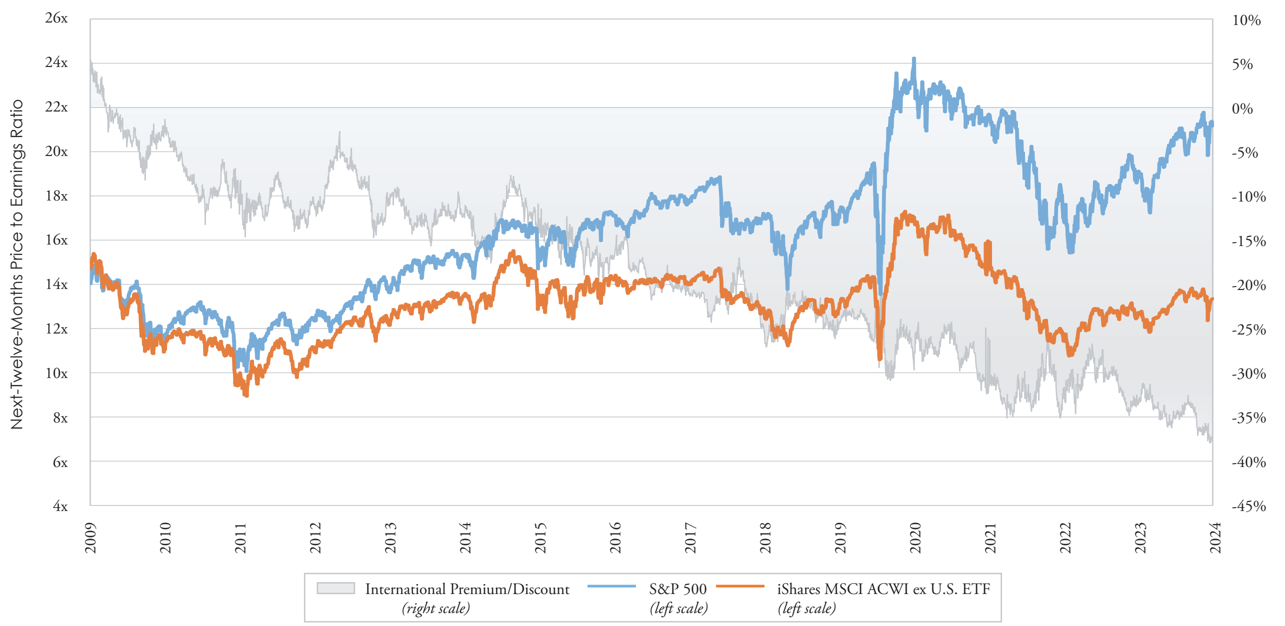
International Market Update

The International Valuation Disconnect

The valuation gap between U.S. and international stocks has steadily expanded over the past fifteen years, putting international equities "on sale" and offering historically attractive relative valuations. The increasing gap has been driven by a re-rating in U.S. stocks, which are trading at a 29% premium to their fifteen-year average. In contrast, international equities are trading at only a 2% premium to their respective average. Given the strength of the U.S. economy over the past decade and the significant growth of several U.S. mega-cap stocks, it is unsurprising that U.S stocks have outperformed. However, there are glaring examples of unwarranted valuation discounts that seem to be driven by the location of the primary listing and domicile of a company instead of business fundamentals.

International Equities Attractively Valued



Data from 8/31/2009–8/31/2024
Sources: FactSet, Renaissance Research

For example, Shell is a global oil and gas company based in the U.K., with operations across the energy spectrum, including exploration and production, refining, transport, and gas stations. Shell's integrated oil and gas business model is very similar to some of its U.S. based peers, including Exxon Mobil and Chevron. What is not similar, however, are the valuations of the three companies:

	P/E[(1)]	EV/EBITDA[(1)]	FCF Yield[(1)]
Shell	8.3x	4.3x	12.9%
Exxon Mobil	13.2x	6.7x	7.5%
Chevron	11.4x	5.6x	8.2%

Data as of 8/31/2024
[(1)] Based on analyst estimates over the next twelve months.
Sources: FactSet

As shown in the table, whether measured on a price-to-earnings basis, enterprise value-to-EBITDA basis, or free cash flow yield basis, <u>the valuation of Shell is 20–40% lower than comparable U.S. companies in the same economic sector.</u> Arguably, an investor seeking exposure to the global energy markets would consider buying Shell a very attractive way of investing in the sector.

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As investors and management teams have grown increasingly frustrated with their undervalued share prices, some international companies have switched their primary listing to the United States to appeal to more U.S.-based investors. For example, CRH, an Ireland-based building materials company, switched its primary listing to the United States nearly a year ago. The company's P/E ratio has expanded by nearly 30% since, significantly outpacing the valuation expansion of both U.S. and international equities during the same period. The company is also seeking inclusion in the S&P 500, which should help shares re-rate further. Other companies, such as TotalEnergies and Shell, are becoming more receptive to the idea of switching their primary listing. The CEO of Shell has acknowledged that Shell's share price is below what the company believes the fair market value should be. While the strategy, for now, is buying back shares to close the disconnect, the CEO has indicated that if buybacks do not close the valuation gap, all options would be on the table including switching the primary listing to the United States. If more companies see an uplift to their valuation from transitioning their primary listing to the United States, it could present a unique opportunity for other international companies to follow suit and help reduce the international discount.

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