

INDUSTRIAL TRENDS TOWARD POST-COVID 19 ERA BY MARKET CAPITALIZATION

Yuta Shikata

Industrial Research Dept. III, Industrial Studies Division
Mitsui & Co. Global Strategic Studies Institute

SUMMARY

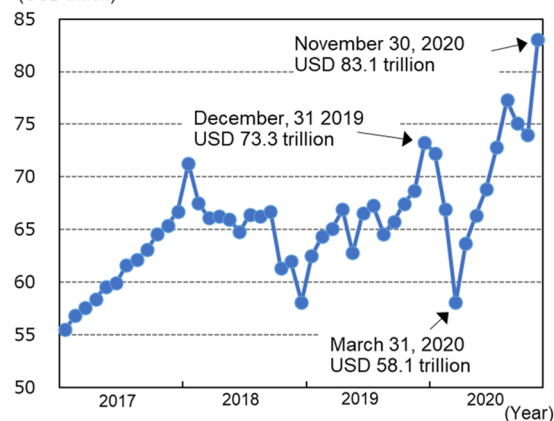
- In 2020, the combined market value of the world's top 3,000 companies by market capitalization temporarily plunged amid the COVID-19 pandemic, followed by a V-shaped recovery. At the end of November, it surpassed the 2019-end level, but the fluctuations vary by sector, industry, and region.
- An analysis of the changes in market capitalization of these 3,000 companies reveals the changes in our economic environment: (1) digitalization, (2) response to climate change, and (3) growth of the Chinese market. It also indicates their relationship with each industry and corresponding changes.
- The trends in market capitalization for the last 10 years also show a remarkable growth in the digital industry and the rise of Chinese companies. About 40% of the top 3,000 companies have been replaced. For a medium- to long-term outlook, it is necessary to expand the scope of observation and capture the rise and emergence of notable companies, including startups, in each industry.

The stock market in 2020 fluctuated wildly, with a sharp drop from February and a rapid recovery afterward. A company's stock price and resulting market capitalization are formed as a result of trading by numerous investors and market participants based on their analysis of wide-ranging information, including not only the relevant company or industry but also its economic conditions and financial environment. It can be said that such fluctuations provide hints for the future outlook of the industry, economy, and business environment. This report organizes and analyzes the market capitalization of the top 3,000 companies in 2020 to verify its relationship with the changes in the economic environment that are generally pointed out, while extracting events that may provide hints for the future outlook of each industry.

A BROAD PICTURE OF FLUCTUATIONS IN 2020

From the trend of the combined market value of the top 3,000 companies by market capitalization as of the end of each month, it is shown that the global market capitalization plummeted from February to mid-March in 2020. However, it made a V-shaped recovery from late March ahead of an economic recovery, thanks in part to monetary easing in various countries. From August onward, it returned to the level registered at the end of the previous year before the plummet. Although the companies' value fell again afterward, it grew significantly in November (Figure 1), partly because the US presidential election results, which had been a major uncertainty, were finalized.

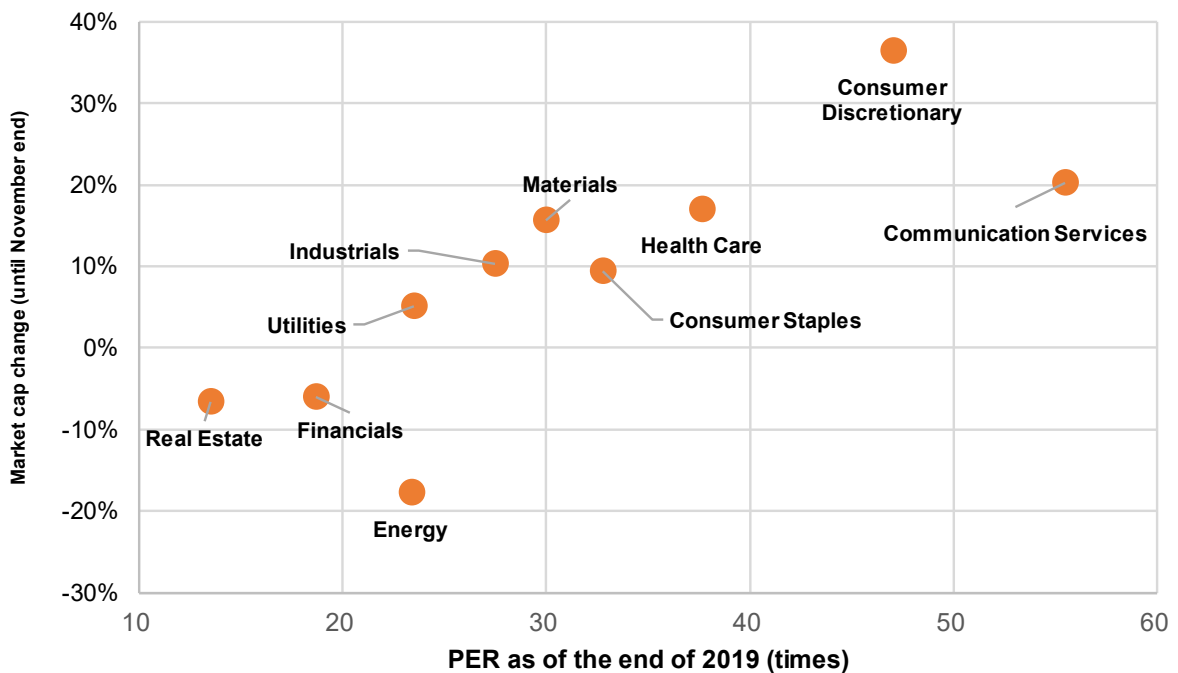
Figure 1. Trends in total market capitalization of top 3,000 companies in the world
(USD trillion)



Note: Trends in total market capitalization of top 3,000 companies at the end of each month
Source: Prepared by MGSSI based on Bloomberg

Moreover, Figure 2 is a scatter diagram of the top 3,000 companies¹ by market capitalization as of the end of December 2019, divided into 11 sectors according to the Global Industry Classification Standard (GICS)². They are plotted on the horizontal axis as the price-earnings ratio (PER), an indicator of corporate and industry growth expectations. The vertical axis indicates the percentage change in market capitalization from the start of 2020 to the end of November. This figure shows that the industrial sectors with a high PER at the end of 2019 increased in market capitalization even amid the COVID-19 pandemic in 2020. This suggests that the gap in growth expectations between industries is widening further amid the economic and social transformation.

Figure 2. Market cap change and PER by sector



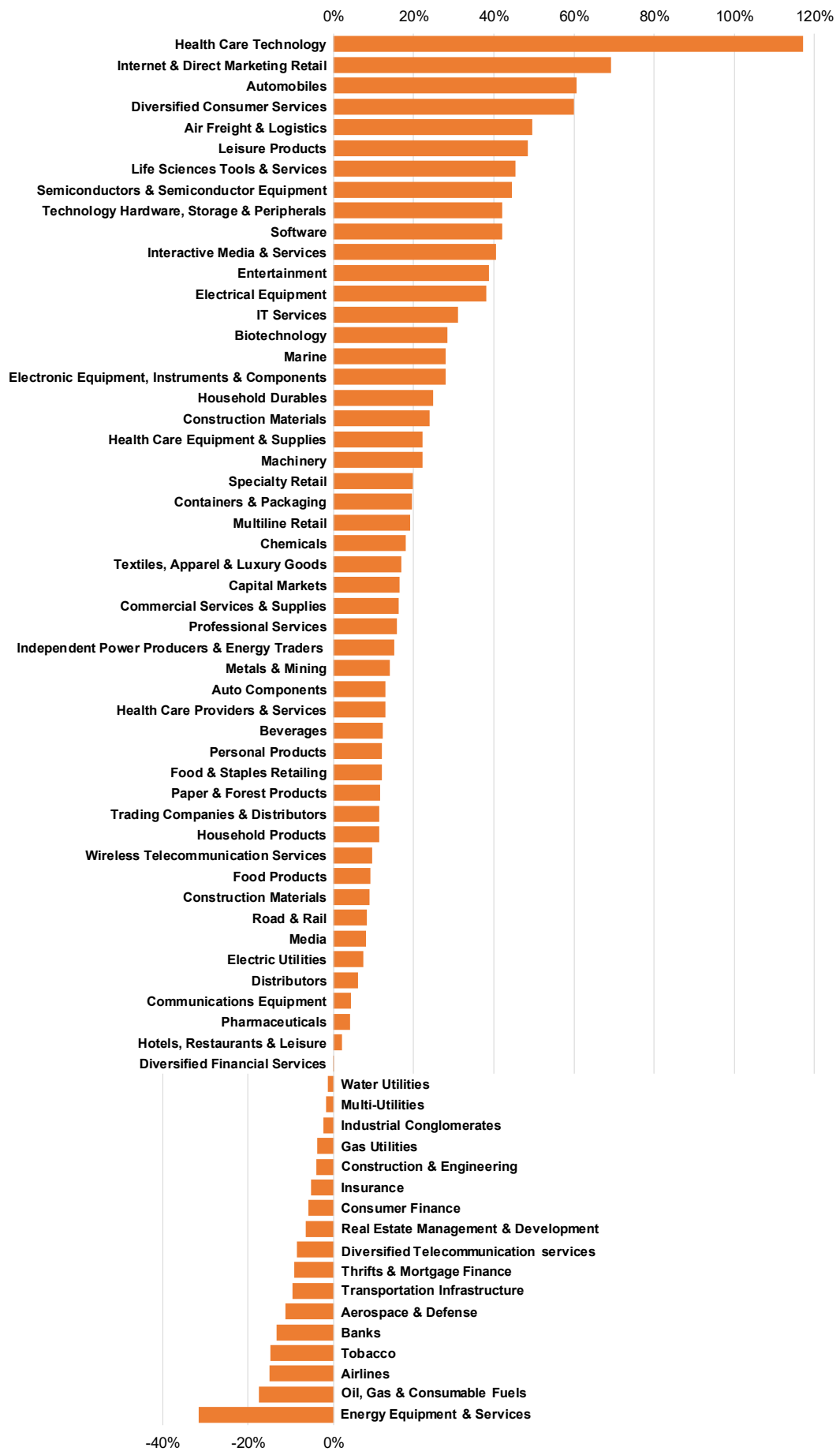
Note: Information Technology is excluded because of its outstanding PER of 137.1 and market capitalization growth rate of 37.5%.
 Source: Prepared by MGSSI based on Bloomberg

The differences between industries are presented in detail by aggregating the percentage changes in market capitalization for each of the 67 industries through November. The 3,000 companies at the end of December 2019 as a whole have recorded a 13.4% increase. The gap between industries is quite large, ranging from the highest growth of 117.2% for Health Care Technology, to the largest drop of 31.6% for Energy Equipment and Services (Figure 3). Health Care Technology was also at the top in growth rate among all 67 industries in 2019. Other medical and healthcare-related industries such as Life Sciences and Biotechnology stood in the middle of the 2019 ranking but are highly ranked in 2020, which characterizes the year of the COVID-19 pandemic.

¹ This report uses a data set of the top 3,000 companies among all the companies extracted in terms of the availability of data on market capitalization at the end of December 2019 and the end of November 2020.

² The GICS is an industrial classification developed jointly by S&P and MSCI in 1999. It divided all industries in the world into 11 sectors and further categorizes them into 24 industrial groups, 67 industries, and 158 industrial sub-groups.

Figure 3. Market cap change in 2020 by industry (until November end)



Source: Prepared by MGSSI based on Bloomberg

CHANGES IN BUSINESS ENVIRONMENT

The aggregate figures, which divide the top 3,000 companies into 158 industry subgroups (hereinafter “industries”), and the changes in market capitalization for each company show how changes in the environment affect each industry and company. Those changes include the advance of digitalization, the response to climate change, and the growth of the Chinese economy.

(1) Advance of digitalization

Digitalization is seen to have gained further momentum in 2020 due to the COVID-19 pandemic. The changes in market capitalization by industry show that Internet Retail, which consists of e-commerce (EC) companies such as Amazon (up 75% from the end of 2019, as of the end of November 2020), Alibaba (up 31.5%), soared by 69.3%. Other services that have seen an increase in market capitalization include gaming, social media, and other entertainment services that help people spend quality time indoors, such as Netflix (up 53.1%), Nintendo (up 40.3%), and Twitter (up 48.9%), and educational services, such as TAL education (up 53.9%). With the spread of teleworking, Application Software, including Zoom Video Communications (up 7.1 times), has recorded a 53.8% increase in market capitalization, while Software, such as ServiceNow (up 93.3%), have achieved 33.0% growth.

Of these, EC companies saw some remarkable changes that can be considered a characteristic feature of 2020. The first of them is the surge in the valuation of major local companies in emerging countries. As mentioned earlier, Amazon and Alibaba, the two largest EC companies, increased in market capitalization. However, much greater growth was recorded by Sea, a South-east Asian giant, and Mercado Libre, the biggest service in South America; they grew rapidly by 4.8 times to USD 90.2 billion and 2.7 times to USD 75.3 billion, respectively. This reflects the valuation attributed to the rapid expansion of users due to COVID-19. As of June, Sea’s quarterly sales had increased three times year on year, and Mercado Libre reported a 2.5-times year-on-year growth in September. As a result, Sea’s market capitalization was the highest in Southeast Asia, and Mercado Libre, too, had the highest value in Central and South America at one point in October (in November, it was overtaken by Vale at USD 77.1 billion). The second is the sharp rise in the market capitalization of companies that develop EC systems. Canada’s Shopify, which builds EC sites, increased by 2.7 times. The UK’s Ocado, which switched from being an online grocery store to a distribution systems vendor, grew by 1.8 times, more than the largest EC companies. Third, tremendous efforts were made by retailers with physical stores. Brick-and-mortar retailers had have been losing market share to EC companies. Nonetheless, Walmart and Target in the US, among others, developed their own EC businesses, which have grown rapidly due to the COVID-19 pandemic, leading to a higher valuation. For both companies, the EC division’s sales for the July 2020 period increased significantly by 97% and 195%, respectively, compared to the same period the previous year. As of the end of November, their market capitalization was also up 27.4% and 38.6%, respectively, from the end of the previous year.

Even though digital and information-related businesses, such as EC and various internet services, gain higher valuation as mentioned above, the market capitalization of telecommunication infrastructure companies remains sluggish. The industry group Telecommunication Services, mainly comprising telecommunication carriers, experienced a drop in market capitalization for 48 of the 81 companies, including major companies from each country, such as AT&T (down 27.5% from the previous year-end, as of the end of November) and BT (down 36.3%). While digitalization accelerated in 2020, telecom carriers have continued to be underestimated in terms of growth potential because they are viewed as an infrastructure industry whose business development is limited by regulation.

(2) Accelerated response to climate change

When the crisis posed by COVID-19 intensified and economic activity became greatly restricted, it was anticipated that fiscal expansion would be critical for protecting everyday life, which indicated a possibility of temporarily shelving measures to counter environmental issues, including climate change. However, as economic activities resumed with recovery measures in place, countermeasures for climate change rather

started to take a focal position in economic revitalization. Reflecting this, expectations for related companies are rising, as evidenced by the movement in market capitalization.

Among fossil fuel-related companies, Exxon Mobil, an oil giant with the highest market capitalization (down 42.4% from the previous year-end, as of the end of November), and Royal Dutch Shell, a company increasing investment in clean energy businesses, (down 41.0%) have experienced a massive decline in market capitalization. In contrast, Neste, an oil refinery in Finland (up 97.3%), drastically gained in market capitalization. The company is focused on recycled fuels in addition to oil refining. It manufactures diesel fuel and bioplastics by using used cooking oil and animal fats from discarded food products and sells such products. This eliminated 9.6 million tons of greenhouse gases in 2019, according to the company. Furthermore, NextEra Energy, one of the largest companies in the renewable energy business, (up 24.4%) surpassed oil giant Exxon Mobil in market capitalization in October, albeit temporarily (Exxon Mobil overtook it again by the end of November).

Although many startups have emerged in renewable energy-related businesses, the number of Renewable Electricity in the 3,000 companies by market capitalization is still small, at 13. However, the total market capitalization for these 13 companies had significantly increased to 36.7% by the end of November 2020, in stark contrast to the modest 7.5% in Electric Utilities, which consists of general power companies. As for individual companies, Portugal's EDP, a wind power generation company, saw an increase of 77.0% from the previous year-end, as of the end of November, in addition to four Chinese companies, such as China Longyuan Power Group, which deals in wind power (up 32.9%), and China Yangtze Power, which deals in hydroelectricity (up 19.7%), heightened their presence by increasing their market capitalization. Denmark's offshore wind power giant Orsted (up 74.7%), which is classified under Electric Utilities, announced that it plans to more than double its offshore wind power generation capacity over the next five years. In July, it signed the largest contract for the sale of renewable electricity with the largest semiconductor manufacturer TSMC, which has set a goal of switching 25% of its factory electricity consumption to renewable energy. This solidified Orsted's position in the wind power business, significantly increasing its market capitalization.

(3) Rising growth expectations of Chinese markets and companies

On top of COVID-19, the intensifying conflict between the US and China is positioned as a major factor in the year 2020's business environment change. However, market capitalization suggests high expectations for growth in Chinese companies. Chinese companies experienced a drastic fall in market capitalization due to the country's friction with the US in 2018. Recovering from that situation now, and the companies are increasing their presence. By the end of November, 196 of the top 3,000 companies more than doubled their market capitalization from the end of the previous year, and 90 of these were Chinese companies.

For Chinese companies, the impact of the US-China conflict is seen as positive for their business development, even though there is a risk of being cut off from other regional markets. In some industries, they can receive policy support for insourcing in response to decoupling and are protected from imports and competition from foreign companies as a result of market fragmentation. Semiconductor and Semiconductor Equipment is a typical example. While the market capitalization of 81 companies worldwide is up 44.5% from the end of 2019, the total market capitalization of 23 Chinese companies, including semiconductor manufacturing company SMIC (up 4.3 times from the previous year-end, as of the end of November), grew particularly strongly by 96.0%. PER for these 23 companies increased to 43.0 at the end of 2019, compared to 31.8 at the end of 2018. There are concerns about future escalation of the US-China conflict with possible import restrictions on semiconductor manufacturing equipment; however, it is apparent at this point that Chinese companies are rapidly gaining in valuation from the market.

There also are many companies, mainly in industries with domestic demand, that are highly regarded for the size and growth potential of the domestic market itself. One such example is companies related to food products. In Packaged Foods, the total market capitalization of the 59 companies, other than Chinese companies, rose by a slight 1.1%, whereas the 22 Chinese companies recorded an increase of 38.3%, showing a clear difference. Spices manufacturer Haitian Flavouring & Food marked particularly high growth at 88.1%. The gap is even

greater in Brewers. The 10 Chinese companies have a total growth rate of 70.9%, whereas the other 10 companies increased only by 1.6%. Kweichow Moutai, one of the largest companies in the industry (up 53.3%), has seen its market capitalization grow to USD 327.3 billion as of the end of November 2020. This factored in expectations that demand for its main product, *baijiu* (Chinese traditional distilled liquor), especially for gifts and banquets, would increase as the economy recovered. Additionally, it has also been pointed out that stocks were pushed up by a sudden rise in the price of *baijiu* due to speculative transactions. Still, it surpassed the Industrial and Commercial Bank of China and Ping An Insurance and became the third-largest Chinese company by market capitalization after Alibaba and Tencent.

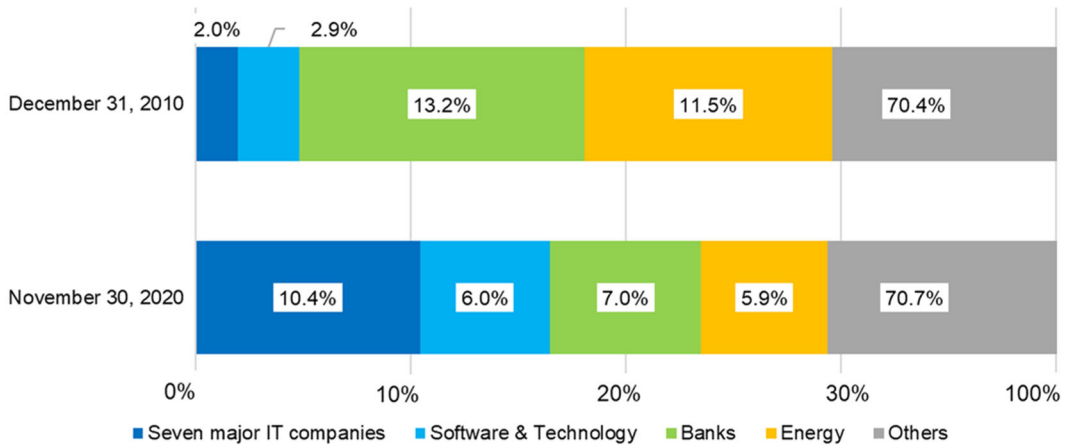
ANTICIPATING MEDIUM- TO LONG-TERM CHANGE

So far, this report has extracted the characteristics trends in each industry and the companies that showed remarkable changes in 2020. However, the broader picture reveals that market capitalization has increased for digital-related industries and Chinese companies, whereas energy-related industries, most of which are fossil fuel companies, have experienced a decline in valuation. This aligns with the direction of change seen over the past 10 years.

In this regard, a comparison between market capitalization at the end of November 2020 and that at the end of November 2010, 10 years ago, for the top 3,000 companies by industry and region makes the change extremely evident (Figures 4 and 5). As shown by the change in composition ratio by industry, the seven largest US and Chinese IT companies (Apple, Microsoft, Amazon, Alphabet, Alibaba, Facebook, and Tencent), which are currently among the world's top 10 companies by market capitalization, and other Software and Technology companies accounted for only 5% of the total in 2010. They are now approaching 20%. Conversely, Energy and Banks have seen their share of this category drop significantly, both by half compared to 2010. Regarding the changes in composition ratio by region, the US, with five of the IT giants, has seen the largest expansion in its share, but China has also increased its presence, from 11% to 16%.

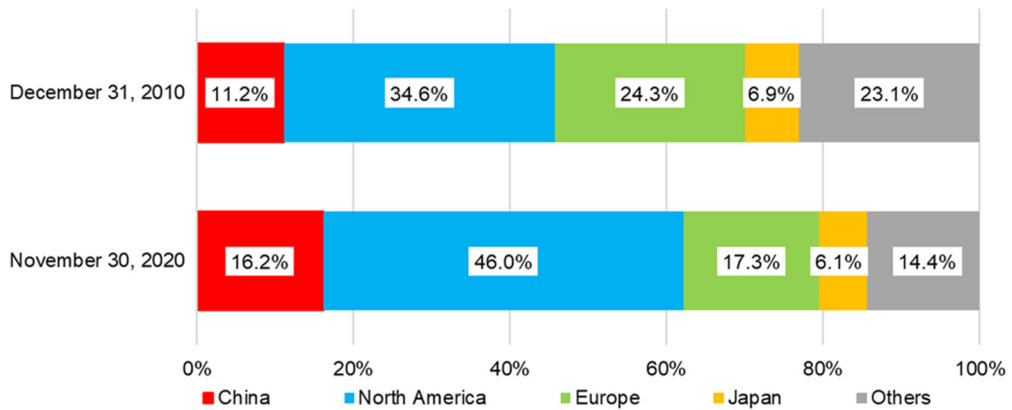
The companies that make up the top 3,000 companies are constantly changing. More specifically, 1,652 companies have remained in the top 3,000 companies for 10 years, and 1,348 companies, or about 40%, have been replaced. It is quite possible that there will be a constant turnover in the next decade as it has in the past. When looking at medium- to long-term trends, one should bear in mind the response to digitalization and climate change. Then, it is important to keep track of the trends of the top companies, while at the same time keeping an eye on the rise and emergence of companies, including startups, which are not currently in the top 3,000.

Figure 4. Top 3000 companies' market cap composition by industry



Note: Industry classification is based on the classification by ICB
 Source: Prepared by MGSSI based on Bloomberg

Figure 5. Top 3000 companies' market cap composition by region



Source: Prepared by MGSSI based on Bloomberg

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