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A timely reminder that a good company is not always a good investment

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Artificial intelligence and technology companies are all the rage at present. General perception is that the share price of any business that is involved in supplying or providing services in the artificial intelligence sector will have gone up over the last few years. This lazy view is actually not correct.

This week, investors were reminded of how good businesses do not necessarily make good investments in certain periods, as all businesses are susceptible to changing economic, political, and technological issues.

ASML, the Dutch company with a de-facto monopoly on manufacturing highly advanced extreme ultraviolet lithography machines (EUVs) that are used in making high-end silicon chips, saw its share price fall materially earlier this week after it cut its 2025 revenue forecasts. By Wednesday the company had lost 20 per cent of its market value, equivalent to one-quarter of the Netherlands' GDP.

Why did this company underdeliver?

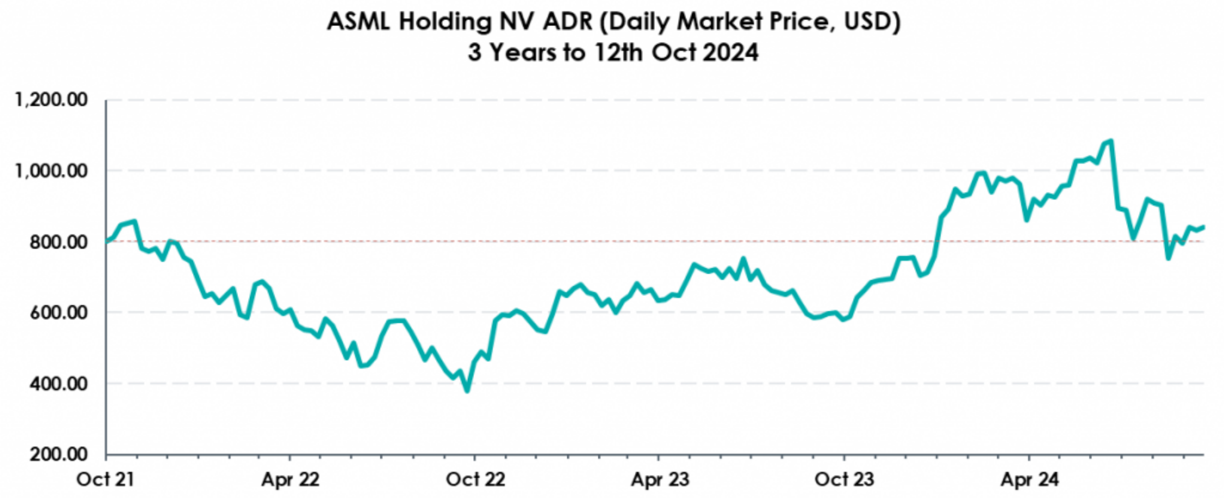
One problem is that some customers have fallen on hard times and pushed back orders. ASML's EUVs, at up to $380mn each, are not an impulse purchase: next year it expects to sell 50 such machines rather than the 80 it previously hoped. Another fact (contrary to popular perception) is that the chip-intensive artificial intelligence market is only estimated to account for 15 per cent of ASML's sales at present.

The other obstacle — and a harder one to quantify — is the effect of global chip wars between countries. ASML sells about half its equipment to China. Those sales could fall by one-third next year, it has warned. Some of this relates to cooling demand and some from the risk of export controls, as governments from The Hague to Washington curb sales of products to China. Since China buys machines with higher profit margins than ASML's average sale, that hurts future earnings.

Political risk has always been part of the chip sector. From the foundation of global chipmaking supremo, Taiwan Semiconductor Manufacturing Company, to the military budgets that fed Intel's precursors, national interests — and overt subsidies — have always shaped the industry.

None of this is new for a business such as ASML. It will continue to grow and is very well positioned in this specialised sector. The issue is that the hype around AI has crowded out other factors which investors need to consider such as why the semiconductor cycle is not behaving as it previously has, and what risk this poses to ASML's other revenue lines in the short term.

The share price chart below is an example of why being selective and not having all your eggs in one basket is as important today as it has always been.



Source: Tacit Investment Management, October 2024.

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