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GLOBAL IDEAS

Feedback from the UBS Global Technology Conference

We recently attended the UBS Global Technology Conference in San Francisco and below we highlight a few key takeaways from the event.

The San Francisco Bay Area has to be the innovation capital of the world. Apple, Google, Facebook, Twitter and a host of other technology companies are concentrated in this beautiful part of the world. Across the Pacific, China's Alibaba, Tencent and Baidu may be putting up a fight but collectively these companies are no match for the Bay Area - at least not yet.

The tech industry is going through another major shakeup - this time it is because of cloud computing and the shift to mobile devices. Internet security is also hugely topical but this is more of a sideshow that is generating regular headlines as companies suffer breaches to their IT systems from hackers, both state sponsored and the traditional types.

Below we list the various company presentations we attended and next to each company we give our rough verdict on the future of the business (ignoring share price etc). In some cases we just didn't have a feel for the company and dismiss it accordingly. YES means their business sounds promising; NO means the opposite or that we don't have a feel for the business; and MAYBE is somewhere in between. This approach is rough and ready but sometimes global investing requires an analyst to narrow the sample as quickly as possible. While we won't be providing a list of buys and sells – at least not yet – we at least try to provide some potential investment options. We will be working in greater detail on some of these in the near future.

Adobe Systems YES

The company has embraced the cloud quicker than most (creative cloud products) and the market has given it credit for this. The outlook looks exciting, in our view, and competition may be more limited for this Group than in the case of other large software companies, particularly the enterprise software businesses such as Oracle and SAP. We have not analysed this company before.

LinkedIn MAYBE

This platform business is focusing on increasing user engagement through content creation. This includes things like Slideshare and the Influencer programme where prominent individuals around the world write articles for LinkedIn. We are not convinced about this company although the idea of a platform for professionals sounds good. We believe LinkedIn needs to offer users more. Facebook is also expected to launch Facebook at Work next year – potentially a competitor.

Micron Technologies NO

The Dram and NAND memory industry has improved dramatically in the past few years because of industry consolidation (now dominated by Micron, Samsung and Hynix). Profits have risen accordingly. We think the horse has bolted here already so we won't be spending more time on Micron.

Nvidia YES

We like the emphasis on a platform approach for this graphic chip business. It has a niche that was built on gaming but is also extending this now into auto, mobile etc. It could be interesting, in our view.

Zynga NO

This gaming business is just not for us.

Cognizant Technology NO

This is a people-heavy business and also not for us.

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Global Ideas is a newsletter published three times a week (Monday, Wednesday and Friday) and available only to clients of Investor Campus and Anchor Capital. The key objective of this newsletter is to provide ideas for investment in the global investment universe.

We scan the globe looking for good opportunities. We provide our model portfolios, as well as news and views on our watchlist, which is continually reviewed and updated.

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IBM MAYBE

For a company that has successfully managed through many technology shifts in the past, the current ructions over cloud computing and mobile are hurting. Results in 3Q missed expectations and we could see a few more bad quarters ahead. However, we think the company will get through this and will be keeping an eye on IBM. The Group remains well respected by other tech companies and it has a reputation for buying well i.e. buying other businesses at good times in the cycle.

Citrix NO

Not interested.

Tableau Software MAYBE

The growth rate makes this interesting but we are not even sure what they do yet!

VMware NO

We could be more interested if we knew more about this company.

Microsoft YES

Microsoft is back in favour with Steve Ballmer out of the business and its cloud initiatives taking hold. It was early to the cloud with Office 365 and Azure and it currently leads in the cloud business services (Google leads in cloud consumer services and clearly Amazon leads in cloud commerce services). Overall, revenues are growing faster than the other large software companies such as Oracle and SAP - i.e. high single-digits to low double-digits. In our view this growth is unusual for large tech nowadays. Its mobile strategy still has a lot of progress to make - market share is low single-digits but there are some encouraging signs. The company does need to be better here. The new CEO is doing well.

The stock market's view of Microsoft has changed considerably since we last wrote about the company in October 2012 (when we recommended a BUY but we sold our shares in early 2013 as the PC market continued to plunge). Steve Ballmer has moved on to play ball (he now owns a basketball team); the PC market has stabilised since the dropping of support for Windows XP; Nokia's device business has been acquired and, most importantly, Microsoft's business software, and its cloud initiatives, are growing nicely.

The share price has risen accordingly from $28 to $49 over this period, while historic diluted EPS has grown from $2 in FY12 to $2.63 in FY14 (year to June). This implies a rerating of the company, with the P/E expanding from a 14x historic, then, to 18.5x, now. *What do we do now?*

For starters, Microsoft is growing faster than many other large tech companies like IBM, Oracle and SAP. This should be very comforting for those who still own the share. The other mature tech companies mentioned above are struggling to grow revenues in the face of the shift to the cloud - a major disruption. Microsoft was early to the cloud and if anything is benefiting from the cloud in the short term. *If we don't own the shares, should we start a new holding in Microsoft?*

With a DCF value of $63, there is modest upside from the current price of $49 (+29%). The bulk of Microsoft's profit still comes from the Windows PC operating system, Windows Office and the Server business. The Windows PC operating system is not growing (19% of revenues), while the business software i.e. Windows Office and the Server business (Office and Server are 48% of revenues and >2/3rds of profits) are collectively growing in the 7%-11% range. The Server business appears to be growing strongly and has scope to grow market share, in our view. This leaves Windows Office - the largest business of them all. *Is the cloud a major risk to Windows Office?*

Office 365 is the Microsoft Office cloud offering that runs on Windows Azure – Microsoft's cloud platform. The main competitor for Office 365 is Google Apps which is a lot cheaper than Office 365 and is quite popular in small businesses. In large businesses, however Google Apps doesn't appear to be gaining traction. For now, Window Office looks secure in the cloud but it may be too early to make any long-term predictions.

The case for Microsoft is therefore mildly positive in an expensive stock market. With EPS growth over the next three years of c. 10% p.a., Microsoft has scope to grow earnings faster than the broader US market. Much of the large discount to the DCF value has already been unlocked so the handsome returns from Microsoft since 2012 are probably behind us. The threat from the cloud appears to be less than it is at IBM, Oracle and SAP. *For existing shareholders – be happy! For those contemplating a new investment, unfortunately we don't see enough of an incentive and potential investors would probably need price weakness to change that.*

FireEye YES

The security area is the fad now with all the recent network security breaches. This means that incumbent providers could be in some trouble if their solutions are weak. The problem is it is difficult to really know how good these security firms are. They sell based on fear (note a $30bn market) and with the shift to the cloud and the proliferation of devices, it seems that existing solutions are actually not good enough to protect corporate networks. There also appears to be a need for more endpoint security solutions (e.g. chip-based) - according to Bromium and Fortinet. Enterprises are currently very vulnerable with their legacy networks and there is also a lack of maturity in their approach to security. Fire Eye is drawing attention and talks a good game. However the question arises: Are its solutions good?

Seagate YES

The horse has probably bolted here already. Seagate is also in the memory business.

EMC NO

Storage is not the place to be, in our view, and storage demand has suffered as people sweat their assets a lot more than before.

Cisco NO

This is a no growth tech company and we cannot see anything interesting here. John Chambers has been in charge for a long time. ***/cont...***

Check Point Systems NO or maybe YES

We may be interested purely because of the growth outlook. This is a high-margin incumbent security company but aside from this it doesn't stand out for us.

3D Systems MAYBE

This was the hot area (i.e. 3D printing) for 2013 but in 2014 it has failed to meet all the high expectations. The CEO is a true innovator but he may be trying to do too much with a wide range of 3D printers. Clearly its products are revolutionary with particular expertise in healthcare and aerospace products. Nevertheless, its probably too risky for us.

Demandware YES

This is an enterprise SaaS company in the e-commerce sector. It has a good track record with attractive growth rates and competes with SAP's Hybris solution. Subscriptions are 90% of revenue. Demandware is worth looking at although we are not convinced of the quality of the business.

Hubspot NO

This is not for us as we currently don't understand what exactly it does.

Tesla Motors YES

Like 3D Systems, Tesla is a true innovator. Although it is also not meeting very high expectations and the market is probably becoming wary of all the hype, Tesla probably has a far better chance of succeeding than 3D Systems. It is breaking all the rules re car making. Other than battery manufacturing (done by Panasonic, but designed by Tesla) it makes 70-80% of the products that go into the car, making it the most vertically integrated car company, and, it claims, possibly the most vertically integrated of any major business. Tesla cars are also the only truly connected cars in the world which means it would never have to have recalls for software upgrades. The key target is to lower the cost of the battery pack. Tesla believes that the petrol car will become obsolete when it can reduce the cost of a battery to $100-$150/kWH. The only problem here is the valuation of the company. We would have recommend waiting for a better time to invest. We are however, looking forward to the launch of their revolutionary Model X SUV in 2015 which is the same size as an Audi Q7 but has 40% more interior space, and very interesting doors, and the mainstream Model 3 in 2017.

Fortinet YES

This is another security business that sounds quite plausible. The CEO is hugely knowledgeable even though the broader team is not that impressive. We believe it has scope to grow market share in this hot market.

Blackberry NO or MAYBE

The business is a turnaround and sees itself as being almost halfway through the process. It has returned to its roots as an enterprise phone company - with a focus on 'power' professionals. The need for better security in enterprise networks actually helps Blackberry because this has always been its strength. Turnarounds in tech companies are rare but it has a chance - although we wouldn't bet on it.

Conclusion:

Adobe and Microsoft appear to be on the right track partly because of their success in the cloud – However in our view Microsoft needs to do better in mobile. IBM is likely to suffer a while longer but has been through tough times like this before. The security category is experiencing a growth spurt but the quality of these businesses is questionable. An unlisted company Bromium, based in Cupertino, with a South African co-founder and CTO is a leading thinker in endpoint security (chip based). We think it may have a great future. Cisco looks unexciting. Enterprise software is under threat from a plethora of cloud software companies and this means that Oracle and SAP will feel some pressure for their highly priced products. Some of these competitors look interesting but it is important to judge their quality. 3D Systems and Tesla are true innovators but stock market pricing reflects this - particularly in Tesla. We are not interested in the memory companies because profitability has already improved dramatically as a result of strong demand from mobile products and industry consolidation. Nvidia is an interesting niche chip-platform company. In terms of LinkedIn we are not sure if it has enough to offer to drive user engagement.

Feedback from the venture capital market is as follows: the players acknowledge that the market is in a bubble. The bubble is partly caused by: the large mature tech companies really paying up for new companies to stimulate their own growth (e.g. SAP buying Concur); hedge funds now entering the unlisted market; unlisted companies waiting longer before they list on the market; and the leading companies in a field (like Uber) attracting massive premiums which generally don't make sense.

Company comparatives (sorted by market cap):

	Price, $	Market Cap, $mn	Current P/E	12M fwd P/E
Microsoft	48.46	399 448.6	18.0	16.4
IBM	162.67	160 988.1	9.7	9.7
Cisco	27.82	142 260.0	16.7	12.8
EMC	30.21	61 474.6	22.3	14.3
Micron Technologies	35.61	38 220.4	12.8	9.4
Adobe Systems	73.47	36 642.3	150.7	35.3
VMWare	84.61	36 423.3	36.4	20.9
Cognizant Technology	54.49	33 179.9	23.3	18.8
Tesla Motors	231.43	29 017.1	na	81.2
LinkedIn	215.02	26 700.5	na	79.3
Seagate	67.54	22 101.7	14.7	12.3
Nvidia	20.61	11 202.3	19.5	15.1
Citrix	66.19	10 654.7	37.0	18.1
Tableau Software	82.80	5 741.0		353.8
Blackberry	10.63	5 616.7	na	na
FireEye	31.64	4 759.3	na	na
Fortinet	27.47	4 528.6	145.6	47.3
3D Systems	34.13	3 795.8	130.0	33.9
Zynga	2.48	2 239.1	na	121.1
Demandware	55.03	1 998.1	na	348.4
Hubspot	33.59	1 054.4	na	na
Check Point Systems	13.18	550.9	42.7	16.2

Source: Bloomberg, Anchor Capital

David Gibb

The business of money: Global asset management and stockbroking

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