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Investment Insights
from **Silicon Valley**

www.rcmtechnologytrust.co.uk

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With over 40 years of experience of investing in technology companies, Walter Price has witnessed the technology sector improve user productivity through the revolution in semiconductor design, the birth of the personal computer and the arrival of the internet. Based in San Francisco, giving him close proximity to many of the world's most innovative companies, he heads up the Global Technology Team which manages US$4 billion* in assets.

Technology: a bubble?

The fears of a second bubble in technology had been mounting: there were once again hints of exuberance on the part of investors after the NASDAQ hit highs not seen since the giddy days of 2000, and the IPO market for technology companies attracted headline-grabbing debuts from, among others, Twitter and the interactive entertainment for mobile company, King Digital.

The market appeared ripe for a reality check and this is what we've seen since the beginning of March. Some high profile stocks were sold off, and in some cases this sell-off was dramatic. Investors have been quick to extrapolate this sell-off to a long-term change in sentiment towards the high-growth companies in the technology sector, but having lived through the last technology bubble, we believe there are some important differences. For example, companies are showing good progress against tangible metrics. There are some where valuations look high, but they may still be growing sales at 50% to 100% per year. Where there are very high valuations - 10x sales or higher - it is generally matched by an exceptionally high growth rate.

That said, there are a number of IPOs in which the Trust has not participated because it believes valuations allow little room for strong returns to investors. There are those IPOs where companies have demonstrated high growth in the past, but need to make some kind of transition in their business model to shore up future profitability - Twitter or King fall into this category. Then there are those that are good, high growth companies, but where the valuations are simply too high, in our view.

*Source: Allianz Global Investors Europe GmbH as at December 2013. This is no recommendation or solicitation to buy or sell any particular security.

We have reassessed some of the holdings in our portfolios in line with a more risk-averse environment. In response, we have moved out of some positions in higher multiple companies where valuations looked over-extended; these have performed well in a climate of buoyant sentiment towards technology names but are likely to face challenges in the current environment of greater caution.

However, it should be said that there are parts of the technology that have been largely untouched by the recent weakness, notably the large technology companies, which remain on low valuations. We have increased our portfolio exposure to this area, but still maintain our conviction in the core, secular growth areas of technology.

When growth isn't enough: Alibaba

Alibaba - the Chinese equivalent of eBay and Amazon - has been in the headlines ahead of its imminent listing in New York, expected to be one of the largest in history. We previously had exposure through Yahoo, which owns 24% of Alibaba, but have backed away more recently on the basis that the company faces some structural problems before its share price is likely fully to reflect its growth potential.

The valuation placed on Alibaba could be as high as $150bn - around 30x 2015 pre-tax earnings – and the IPO offering could reach $20bn. Facebook's IPO was initially priced at $16bn - a popular, well-known, US brand - and didn't meet expectations. We would ask whether a Chinese Internet business could really create sufficient demand?

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Nevertheless, China remains exciting. A recent visit demonstrated that while there are undoubtedly pockets of poor capital allocation and over-leverage, the consumer economy remains vibrant and growing. Wage increases are high and that is creating a committed and engaged consumer. We are finding other ways to play this trend…

Soufun

Soufun is the leading real estate site in China and commands a 60-70% share of the internet retail market. The company has now launched a product called Membership, where investors pay $1,000 a year and receive a discount of 5% on any property they buy. The developers like it because they get committed buyers, and the buyers like it because they receive early access to developments and discounts.

Soufun is also building a market in second hand property. This had previously been a largely disintermediated market, undertaken buyer-to-buyer. The final area of development for the group is in financing. Securing loans in China is not easy and banks are not 'open' for many potential borrowers. SouFun is putting borrowers and lenders together.

It is clear that there is a rich seam of technology innovation in China; everyone is in a hurry and the entrepreneurial spirit is well-established among 20 and 30-year olds. In this way it resembles the same spirit that presides in Silicon Valley, and we would expect to see more exciting opportunities emerging from China just as they continue to do from California.

Big data

The management of 'big data' has hit the headlines after Silicon Valley start up Cloudera raised $900m in a private share sale, the biggest fundraising from a US technology company since the Twitter IPO.

The concept is relatively simple - companies are drowning in a sea of data, some of which is potentially valuable, but much of which is in unstructured formats and may also be misleading if used inappropriately. Companies need to find a way to harness and manage this data, allowing them to use it to best effect. 'Big data' companies that enable this process to happen are potentially in a powerful position.

The management of big data has widespread use anywhere where the identification of patterns is important. For example, it can analyse whether shopping data correlates with a TV advertising campaign. It can look at whether certain weather patterns affect certain behaviour, or the type of activity that correlates with web traffic. This has obvious uses for advertisers, but also in areas such as medicine, where environmental patterns can be analysed in line with a spike in certain diseases, for example. It also has some obvious uses for government statistics.

It is a crowded space and investors are increasingly trying to isolate the likely winners from the trend. With this in mind, we hold a company called Tableau Software, listed on the NASDAQ and with around 26,000 users and analysts. Some larger companies are also participating in the 'big data' trend. We hold Salesforce.com and Oracle which are both participating in creation of applications and development platforms for 'big data'.

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