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Investment Insights

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Investment Insights from Silicon Valley



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With over 40 years of experience of investing in technology companies, Walter Price has witnessed the evolution of the technology sector from the birth of the personal computer to the arrival of the internet and now the shift to cloud computing. 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.

*Source: Allianz Global Investors GmbH.

Vision of change

Technology leaders are, to some extent, paid to be visionary. In an age of speedy obsolescence, they need to stay ahead of consumer and market trends. This has become particularly important at a time when technology is increasingly under pressure to redefine its place in society. Policymakers are taking a more forensic interest in the sector.

More recently, technology leaders have been at pains to seize control of the narrative. Mark Zuckerberg used **Facebook's** recent annual conference, not to unveil a new product - as has been the norm - but to set out his vision of a 'privacy-focused' future. This included an overhaul of the website, new encryption and a new app to encourage users to communicate in groups rather than individual public posts. It is taking some of the strengths of WhatsApp and Instagram and bringing them across to Facebook.

China's social media and entertainment giant **TenCent** has been talking about its 'tech for good' vision, discussing the group's position in society and how it plans to handle artificial intelligence. It said Artificial Intelligence should have socially beneficial uses such as medicine and agriculture, but should be used in a way to preserve the social contract between companies and users over data.

This new drive is as much necessity as altruism. Facebook faces a \$1.6bn fine, after the Irish Data Protection Commissioner opened a formal investigation into its latest data breach. It is estimated that fines may be costing major technology companies as much as 2-3% of their advertising revenues a year. It is also a reaction to all the negative publicity. They recognise they need to be more explicit about what is in the public and private realm.

Legacy businesses

Just a few years ago, the former technology giants of Microsoft, Oracle, IBM and other 'legacy' businesses appeared to face an uncertain future - could they make that all important transition to cloud computing? And if not, what was left for them? Today, there are notable winners and losers.

Microsoft, which we hold in the portfolio, has made the transition successfully. It has developed its cloud product - Office 365 - and grown it to be the dominant player. Along with Amazon and Apple, it continues to be a contender for the \$billion crown within cloud computing. Cloud is a volume business, so we would expect the dominance of these incumbent businesses to increase.

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Not all legacy businesses have done such a good job. The large hardware companies have found it more difficult to make the transition. They have faced competition on one side from Amazon and Microsoft, but there have also been a lot of smaller businesses that have been more successful. Few have managed to build a comprehensive suite of products. For these companies, the future remains uncertain.

Uber's IPO

Uber finally made its stock market debut on 10th May. It is early days, but it has been greeted with a shoulder shrug by the market (although admittedly at a time of higher volatility). Generally, investor enthusiasm for recent IPOs has depended on how committed the companies are to improving profitability. Companies such as Lyft and Uber have done a lot for transportation, but can they make money? And how much should investors pay for that growth?

There is some evidence from Russian firms such as **Yandex** that there are ways to make money in this business. That business is now becoming profitable on a cash flow basis.

Uber sold to them having tried to launch its own service in Russia.

As the market sees it, the problem for these ride-hailing services is that to be profitable they may need to raise their prices. But if they raise their prices, will they lose their end market? Local competition has sprung up, with rival firms using their own apps. At the same time, competition can come from unexpected sources - **Tesla**, for

example, is planning to launch its first robotaxi as part of broader vision for an autonomous ride-sharing network in 2020.

This has been part of the problem with readily available venture capital funding. Public markets apply more scrutiny and these questions need to be answered when a company comes to market. In general, private equity is interested in revenues, while public shareholders look at elements such as free cash flow, cash that could be distributed as dividends or reinvested back into the business. Investors have the tolerance for companies to lose money for a while, but little tolerance for companies that could be destined to lose money for a long time.

Silicon Valley's crown

Silicon Valley has long been the global hub for technology innovative. It is a well-established nexus of innovation and financing. It is not just easy to have ideas there, but also to get those ideas off the ground. However, does it face any challenges for its crown?

Certainly, China could make some claim to the title. Social media is far more developed and nuanced than its US equivalents. It is possible to get social media targeted at performers, for example. The gaming industry is well-developed and shows real innovation, as do areas such as dating sites.

However, the regime change in China does create problems for businesses there. The more the government interferes, the more Silicon Valley is likely to remain dominant. For example, TenCent recently had to pull

the hugely popular *PlayerUnknown's Battlegrounds* mobile game whilst encouraging players to look towards the more politically palatable *Elite Force for Peace*.

The country is very idea-rich, but the government can come along and say 'I don't like what you are posting' in a dating site, and take the service off air. This can be inhibiting and it makes it harder for entrepreneurs to thrive.



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Please note that we can only offer information and are unable to provide investment advice. You should contact your financial adviser before making any investment decision.

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