Kopernik Global Investors. LLC

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Global Technology Perspectives

By Mark McKinney, CFA
Kopernik Tech Analyst & KGU Portfolio Manager

The land of technology investing is always a challenge, driven by fast changing life cycles and venture capital backed start-ups aiming at entrenched businesses. Unlike other industries, where it is a little easier to spot long term winners, tech is full of companies that used to be winners but are now in long term decline with no obvious way back.

At Kopernik, our stock picking goal in general is to find great, sustainable businesses selling at discounts to their risk adjusted intrinsic values. (I highlighted *sustainable* because it's not widely emphasized in tech investing.) The Tech Industry is full of "hot" component companies that prosper on one platform but miss out on the next. Apple's Asian supply chain is a great example. They have great technologies but the over-abundance of competitors vying for the same business greatly limits their consistency. We have no edge (or interest) in picking short term winners or losers. Again, our goal is to find long term winners valued inefficiently in the marketplace, which takes intensive research and analysis. I have found over the years that exploitable value is most often identified in great franchises with *wide moats*, which, as Warren Buffet likes to argue, protects their competitive advantage.

In tech these days (as in most environments) the goal of finding reasonably priced businesses is very difficult since the "new" technology companies (think cloud, software as a service, internet, big data, other buzzwords of the day) are generally priced at ridiculous multiples and are saddled with expectations that will be very difficult to meet. Meanwhile, the "old" guard of tech (think IBM, Dell, Cisco, Microsoft, etc.), are fundamentally struggling to grow revenue. (Are they "value traps"?) In fact, today's tech investment environment feels a bit like 1999/2000 when the "winners" were trading at P/E multiples well above 50 (if there were indeed earnings), and analysts used creative valuation metrics to justify market caps. (Back then it was enterprise value to customer or click; today it is enterprise value to sales.)

What we pay for businesses matters. While some new technologies may turn out to be long term winners, their current equity valuations leave us uninterested. As an example, Cisco had a market cap of $485 billion and sales of $18.9 billion (and $5.5 billion of net cash on the balance sheet) in 2000. Today, Cisco's market cap is $122 billion with sales of $48.6 billion (and $34 billion of net cash on the balance sheet). Revenues have increased 257% and the Firm has 28% of its market cap in cash, but Cisco shares are down 72% from their highs in 2000.

One of our great advantages is our *global industry research focus*. (We do not search for value in specific countries, but rather in industries wherever they may be.) This allows us to apply our detailed industry knowledge across the world. (The bottom-up analysis is then vetted and risk-adjusted for macro inputs.) This approach has allowed us to identify undervalued shares in good, sustainable industries in places like Europe, China and Russia within industries.

A good example is the data center business. In the US there are many competitors growing fairly quickly (i.e., Equinix, Rackspace, Amazon, etc.), but they are far too expensive for us to be interested. Applying our understanding of this industry globally, we were able to find overlooked foreign companies like Bit-Isle in Japan and 21Vianet in China that have similar growth potential and less domestic competition, and yet are valued much more reasonably. Both returned almost 100% in the time we owned them, and I am not sure most US focused investors have ever heard of either one.

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