Nov 23 2016 at 12:15 AM | Updated Nov 23 2016 at 12:15 AM

Making money out of mega trends

Electric cars are on investors' minds, but rather than backing a brand some are looking at manufacturers of components. **Robert Shakespeare**

by **James Frost**

In a world where Netflix, Facebook and Apple products are part of everyday life, it can be tempting to think that identifying and backing the next big theme is child's play.

But the reality is that long before streaming video, social media and iPhones became commonplace, these companies were speculative business propositions built on blue sky.

And that's hardly the recipe for a solid investment opportunity.

Alessandro Barbi is the portfolio manager of Platinum's International Technology Fund. He says that while it's important to be on top emerging themes, you need to dig much deeper in order to correctly identify the long-term success stories.

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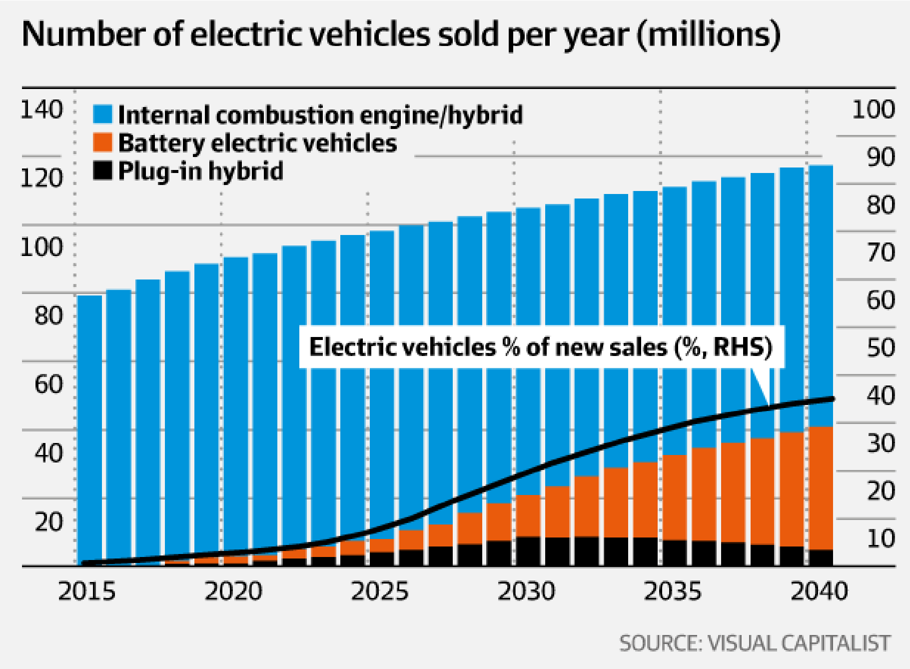


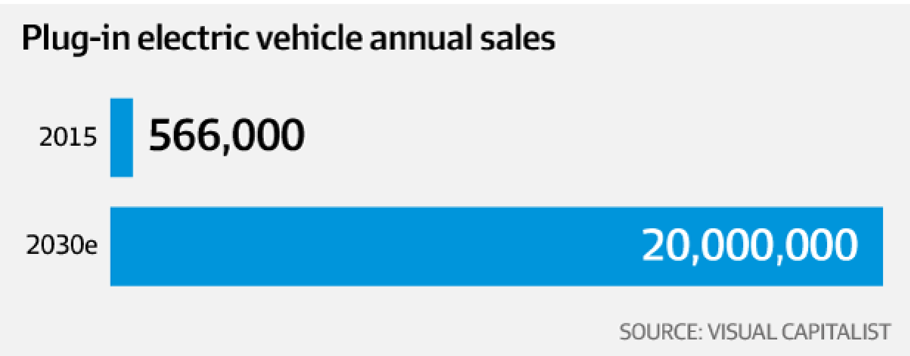
"Things change very rapidly in technology, so you need to be on top of trends and themes. But even if you have a company that is an early leader, you need to be certain that they are going to be one of the ultimate winners," Barbi says.

Robert Bruce is the head of research and a portfolio manage at Acorn Capital, one of the few Australian-based fund managers that specialises in backing small companies in the listed and unlisted sectors, sometimes while they are still running at a loss.

"You can have the greatest product in the world, but if it's too hard to roll out or too expensive to bring to market then it will struggle," Bruce says.

Ideas are not enough

Bruce says that although most of his firm's investments are in companies where there is some profit or at least revenue to assess, occasionally they will single out a company before they get a product to market. But only rarely.



"Providing the vision is there, the business model is scalable and it's clear what the lifetime value of the customer and the cost of acquiring those customers is, we are prepared to back management over a reasonable period of time," he says.

One example of the type of technology company Acorn Capital is attracted to is the ASX-listed Amaysim. Bruce says the budget mobile services reseller wasn't profitable at the time of the investment but is growing. The management team has a clear vision but are flexible, have a large customer base and a low cost of acquiring new customers.

While Bruce and Acorn Capital are prepared to go out on a limb and back emerging companies on the basis of measures other than profits, the vast majority of professionals believe that ideas alone are not enough. They argue that no matter how inevitable a theme might be, such as the shift to electric cars (see graphic), a trend alone won't drive a successful long-term investment.

Andrew Macken is global portfolio manager with Montgomery Investment, where he oversees a sum of about $250 million.

He has invested in a number of technology-focused companies including Alibaba, the world's largest e-commerce platform. Macken describes the company as a shareholder in all the businesses that use the platform. It's size delivers scale advantage and it collects and owns all the data created by merchants and customers.

Other companies he has taken a shine to include computer game company Take 2, the maker of the *Grand Theft Auto* series, and PlayTech, which provides online gambling websites with infrastructure. But as he says, these companies are much more than stocks with a good story behind them.

"It's insufficient to pick a theme, invest in a basket of companies on that basis and say, 'That's fine'. You are always coming back to a business' competitive position. What can this business do that is difficult to replicate?" Macken says.

The Tesla example

Macken uses the example of the electric car and Tesla, an electric car manufacturing company founded by billionaire Elon Musk, which has developed a cult-like following among both its consumers and shareholders.

"That does not mean that Tesla will do well as a business. Tesla needs to either make cars or provide a transportation service in a way, and at a cost, that no one else can," Macken says.

"There is no inherent barrier to entry that says Tesla is the only one who can do this. There is every chance that others will enter the market, compete and push the return on investment down to a level where it is not attractive," he adds.

Platinum's Alessandro Barbi has also spent a great deal of time thinking about electric cars without investing in Tesla. Rather than backing a brand of car, his fund is invested in the manufacturers of components that go into electric cars.

To that end he has invested in the NASDAQ-listed NXP Semiconductors and battery maker Samsung SDI, which he says are well placed to benefit from the shift to electric cars requiring more and higher-grade electronic components than regular vehicles.

A characteristic that allowed Tesla to develop such a strong group of supporters is that it was one of the first to market with an electric car. However, having first-mover advantage is no guarantee of a company's long-term success.

Continual improvement

David Kirk is a partner in and co-founder of Bailador, a listed investment company that invests in businesses seeking growth-stage investment or capital to expand into new markets. He says the first-mover advantage is important but not critical.

"You can build a great market position and be first to market, but if you don't continue to develop the tech and make sure it's working on other platforms then you are at risk. It's about continually improving your offering," Kirk says.

Barbi agrees with the view that success in a trailblazing sector can be fleeting. His example shows that not even billionaire media magnate Rupert Murdoch is able to guarantee the success of an investment.

"Take social media. One of the first companies to emerge was MySpace. It was very popular and was acquired by News Corp for $US500 million, and for a variety of reasons they couldn't get it to the next step," Barbi says.

"A young developer called Mark Zuckerberg came along with a product called Facebook and the rest is history. Technology is tough. You can't confuse the strength of an idea with a company's ability to achieve profitable growth."