SECTOR GLOBAL TECHNOLOGY

How to separate winners and losers

Australian portfolios would get a significant boost from tech giants that actually make a profit

An investor who purchased the S&P500 Total Return index in April of 2012 would have generated a return of 147% from the index with an additional boost of 44% from the 30% decline in the Australian dollar.

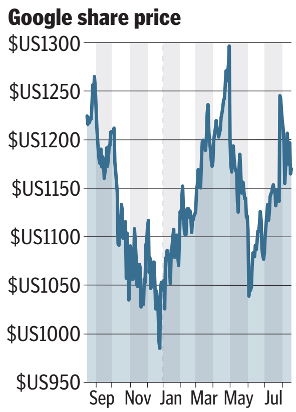
Few investors were that successful because they are often less confident with international companies than those in their own backyard. That is, of course, why an Australian-managed global fund can help find companies with large addressable markets and long growth runways. Think technology.

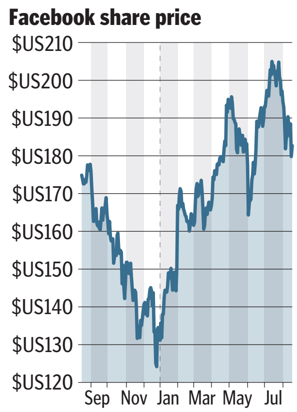
If you aren't willing to employ a fund manager, however, then you'll need to conduct some serious due diligence.

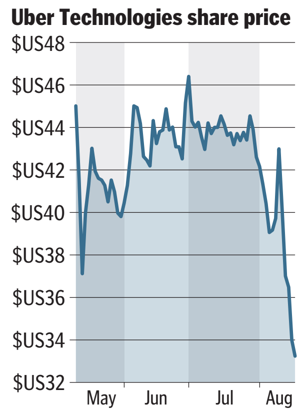
Start by separating companies that dominate markets, generate large profits and trade at reasonable prices from those that are profitless. It might surprise you that Apple trades on a one-year forward price earnings (PE) of just 15.7, Google's owner, Alphabet, is on a one-year forward PE of 21 while Facebook is on just 19.

Not all US tech titans are profitable, however, and many of the ones that aren't are frighteningly expensive too. Profitless prosperity can't last forever.

Roger Montgomery is the founder and CIO at the Montgomery Fund. For his book, Value.able, see rogermontgomery.com.







❶ Alphabet

Nasdaq GOOGL
Price $US1179
52wk ▲ $US1297
52wk ▼ $US978
Mkt cap $US817bn
Dividend -
Dividend yield -
PE ratio 24
BUY

Alphabet, Google's owner, recently surprised the market with a quick reversal from its prior quarter's "deceleration", with revenue up about 20% year on year, beating consensus forecasts. EBIT was up 13%. Importantly, Google Cloud is now a significant business with a $US8 billion ($12 billion) run rate that has doubled in 18 months. An increased focus on Google Cloud raises the potential for further separate disclosures. When Amazon did this with Amazon Web Services (AWS), the value of the business delighted the market.

❷ Facebook

Nasdaq: FB
Price $US184
52wk ▲ $US209
52wk ▼ $US123
Mkt cap $US524bn
Dividend -
Dividend yield -
PE ratio 19
BUY

In the second quarter, Facebook reported revenue growth of 28% year on year. Try finding a giant, profitable business in Australia with that kind of growth! Strong growth of 33% in the number of ad impressions served in the second quarter drove the impressive result. Management has pointed to incremental opportunities to grow Feed impressions, but it noted that most of the ad impression growth in the future will be driven by Stories ad formats. Having reached a $US5 billion settlement with the US Federal Trade Commission, a material overhang has been removed.

❸ Uber Technologies

NYSE: UBER
Price $US35
52wk ▲ $US47
52wk ▼ $US33
Mkt cap $US60bn
Dividend -
Dividend yield -
PE ratio -
SELL

Uber generated a $US5.9billion loss in the latest quarter, including $US3 billion of one-offs associated with its float. The underlying loss extends the 10-year run of losses. Uber has raised over $US24 billion from investors over a decade to achieve 2% penetration and I maintain the view that the company's service is only popular because it is underpriced. The losses are proof that prices are not high enough, but raising them will drive customers away. Moving to driverless cars is a long way off and would disenfranchise the drivers who are Uber's source of revenue.

Prices as at close of business, 15-August-19.