Investment insights from Silicon Valley

Digitalisation, cyber security and the integration of ecommerce: An overview of tech trends and challenges in 2022

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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$11 billion* in assets.

*Source:
Allianz Global Investors GmbH.

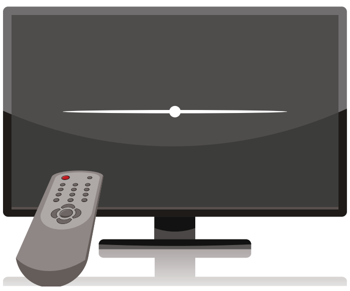
Netflix sheds subscribers

Streaming service Netflix alarmed markets in April as it said it had lost 200,000 subscribers in the first quarter of the year and expected to lose another 2 million in the second quarter[1]. It is a moment of reckoning for the streaming industry, which has been struggling with increasing competition, a maturing market and cost of living pressure on consumers.

We have long seen the potential for a shake-out in streaming services. While streaming has undoubtedly revolutionised the way we consume TV, it has been clear that too many companies are trying to gather subscriptions at a time when consumer wallets are increasingly squeezed. There has been a proliferation of streaming services launched in recent years – from Disney Plus to Hulu and Starz. In the midst of this competitive landscape, Netflix decided to raise subscription prices and found that consumers were more price sensitive than expected.

Netflix plans to launch a cheaper, ad-based service and tackle the password sharing problem that allows many people to watch for free. It also launched its own TikTok style service, Fast Laughs[2] in November 2021 in a bid to capture a younger audience.

However, streaming services have a hill to climb with eight to ten major companies competing for the same users. In many countries round the world, there are also domestic players that take market share. These issues aren't going away in the short term and it remains a challenging operational environment.



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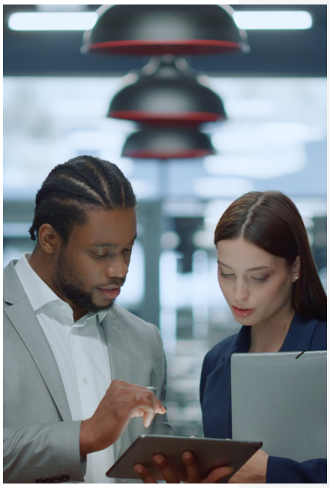
The pandemic problem

Netflix's woes also highlight a nagging problem facing many technology companies: it is clear that Covid has pulled certain trends forward that the market has often extrapolated into persistent, longer term growth - a 'new normal'. However, it is becoming clear that some of the growth trends are not enduring and the expected higher demand may not materialise.



For certain companies – Zoom, Docusign for example – the pandemic brought a one-time benefit, but this can't be used as a baseline for future growth. Consumers and companies are moving back to their old habits and these companies are now seeing flagging demand. With high expectations built into share prices, some companies, including Netflix, have seen their stock slide significantly on bad news.

This comes on top of a wider repricing of high growth technology companies in response to the Federal Reserve's rise in interest rates. Plus, there is pressure on companies and consumers as inflation rises. As technology investors, we aim to ensure that the growth we've seen over 2020 and 2021 is the 'real deal', that there really is a new normal for the companies in which we invest.

This is unquestionably happening in certain sectors. The pandemic certainly accelerated the move to the Cloud, for example, and this is still in its early stages. While it may slow down once the majority of companies have moved across, many companies are still in the early stages or are still to act at all.

Ecommerce

The other area where the pandemic's influence is in evidence is in the ecommerce sector. The prevailing view had been that the pandemic forced consumers to adopt online shopping and once they had moved across, they wouldn't go back to stores. This optimism has proved premature. Ecommerce continues to grow, but not at the pace that many expected in the wake of the pandemic.

Even market leaders such as Amazon are not immune to these difficulties

A second problem is that companies have been spending significant sums to remain competitive. There has been spending on infrastructure, including expensive warehousing to facilitate 'just in time' delivery. This is money well spent if companies can get the volumes they need to support it, but may prove a poor investment if demand doesn't materialise.

Even market leaders such as Amazon are not immune to these difficulties. It has spent significant sums growing its distribution network across the world, yet its sales growth dropped below 10% in the fourth quarter of 2021[3]. It is not clear that the company will get the growth to support its recent investment. Since the late 1990s, Amazon has only had one year of "below 20%" revenue growth - 2014's 19%[4].

The danger is that ecommerce groups will need to raise prices to allow their economic model to work effectively. Walmart has a pick-up in store model because it realises that it can't afford to support a delivery model without raising prices. Ecommerce may quickly lose its lustre if consumers need to pay a premium for buying online.

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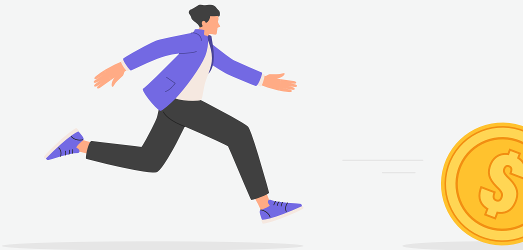
The IPO market

2021 was still a fruitful year for technology IPOs, with plenty of demand from investors matched with a good stream of opportunities. However, it has been a difficult time in stock markets – and particularly for the technology sector. Has the malaise in public markets had an impact on private markets?

Certainly, we see that valuations in private markets haven't always adjusted to the new reality in public markets. Deal activity has slowed, with EY reporting Q1 2022 global IPO volumes down 37% year on year[5], with particular weakness in the US. There was a considerable fall in cross-border, unicorn (companies that reach a valuation of $1 billion without being listed on the stock market) and SPAC (Special Purpose Acquisition Company) IPOs. There may be some residual adjustment needed to valuations in the private market.

However, it is worth noting another trend that has emerged as public market valuations have weakened. Private companies have been looking at the valuations in public markets and spotting some bargains. Bravo buying SailPoint, for example. There is a lot of money in private equity and it's getting to a point where the mid-sized companies look very attractive. This may help provide some support to public market valuations in the coming months.



[1] https://www.bbc.co.uk/news/business-61153252
[2] https://www.theverge.com/2021/3/3/22311418/netflix-tiktok-clips-funny-movies-tv-shows-streaming-big-mouth-seinfeld
[3] https://fortune.com/2022/02/03/amazon-q4-2021-earnings-ad-business-shares-skyrocketing/
[4] https://www.investing.com/analysis/big-week-for-tech-part-ii-200622786
[5] https://www.ey.com/en_gl/news/2022/03/global-ipo-market-experiences-significant-slowdown-in-q1-2022

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