INTERNATIONAL

NEW FRONTIERS

Technology stocks are hot at the moment and deservedly so. Over the past year, the combined market valuations of the 20 listed global technology companies that we're watching increased by +60%, which for this list of companies represents an increase in value of +US$2.5 trillion.

The top seven gainers on our list made up 75% (US$1.9 trillion) of this extraordinary uplift in valuation: Amazon (up US$350bn); Tencent (up US$315bn); Apple (up US$300bn); Alibaba (up US$260bn); Microsoft (up US$245bn); Alphabet (up US$225bn); and Facebook (up US$180bn).

We remain buoyant on the outlook for the technology sector from an earnings perspective but feel more circumspect with respect to valuation.

While we still see merit in the investment case behind these technology leaders, we believe annualised uplifts in valuations are more likely to average in the order of +10% in future. This is why our strategy has transitioned in favour of targeting the up-and-coming emerging global technology leaders.

COMPELLING INVESTMENT CASE TO BACK INNOVATION AND TECHNOLOGY

Our research over the past few years has highlighted the technology advancements underway in China, so it came as little surprise that two Chinese companies (Tencent and Alibaba) made it into the top seven global stock performances listed above. In addition, Ping An - a leading Chinese financial services group with businesses in insurance, banking and healthcare - has transformed its business through financial technology (known as fintech), and its market value has increased by +US$110bn on the back of this shift in emphasis.

As China's urbanisation continues, companies will increasingly turn to technology to help overcome a growing shortage of skilled labour. There are two sectors in China that we believe will become increasingly dependent on technology innovation:

MANUFACTURING:

Incorporating robotics and artificial intelligence in smart manufacturing processes should help to lift productivity.

HEALTHCARE:

China does not have enough skilled doctors, surgeons and nurses to cope with the accelerating demand for improved healthcare services. Some of these services will increasingly be delivered by artificial intelligence applications.

Technology adoption is as important for the world's developed economies as for China. The game changer in favour of tech companies has been the development of telecommunications and semi-conductor technology, which has enabled the construction of a robust modern infrastructure of broadband networks and data centres.

This has in turn facilitated the growth of internet-based services such as ecommerce and advertising, and the development of new business models such as Software as a Service (SaaS) and on-demand entertainment. Companies in these areas are now experimenting with and implementing artificial intelligence software that should increase productivity and efficiency in data processing.

In our view we are at a point of inflection in the technology cycle where the growth rate of profitability from the global leaders may slow. We therefore believe the time is right to add breadth and depth to our technology investments through a portfolio of emerging technology leaders.

EMERGING TECHNOLOGY LEADERS ADD SCOPE FOR GROWTH :

Over the past six months we have reviewed over 60 global technology companies covering eight key technology segments: 1) E-commerce & Digital Payments; 2) Digital Media & Advertising; 3) Digital Content & Gaming; 4) Cloud Computing & Software as a Service (SaaS); 5) Artificial Intelligence; 6) Cyber Security; 7) Robotics; and 8) Semi-conductors.

Our goal in this search was to identify a group of global leaders, emerging leaders and "disrupters" that can provide investors with a well-diversified exposure across these eight themes, and where the investment case is supported by a fair or attractive valuation.

The combined current market value of our enlarged list of around 30 emerging technology leaders is around US$1 trillion. Over the past year the valuation of this group of 30 companies increased by around US$300 billion - a miserly 16% of the US$1.9 trillion uplift in value from the top 7 leaders listed above. We believe there is greater upside to earnings and share price of the emerging leaders over the next few years. From our review we identified a short list of emerging leaders, from which we highlight five below.

Company	Market Value (USDbn)	Key Technology Exposure	Share Price	Forecast PE ratio	3-years EPS growth (pa)	PE-for Growth ratio (PEG)
Salesforce	82.0	Digital Media/Advertising, SaaS and AI	US$114.63	85.9x	29% pa	2.9x
Electronic Arts	39.0	Digital Content & Gaming	US$126.64	29.5x	14% pa	2.2x
Weibo	30.0	Digital Media/Advertising	US$134.44	79.1x	47% pa	1.7x
Splunk	13.0	Cloud Data & AI	US$94.32	162.3x	46% pa	3.5x
Flex Technol-ogies	9.0	AI, Semi-conductors and Robotics	US$18.02	16.2x	23% pa	0.7x
		Average Valuation Metrics		**39.7x**	**32% pa**	**1.2x**

ELECTRONIC ARTS (EA US)

The company develops games across a plethora of themes such as sport, life simulation, arcade, adventure and first person shooting/war. The company's strategy is to capitalise on the gaming industry's shift from physical to digital distribution. By offering full-game digital downloads, subscriptions, multiplayer events, and extra content, EA has generated more consistent sales and higher user engagement. While EA's valuation is somewhat full we believe it is well positioned to deliver solid revenue growth and margin expansion over the medium-to-long-term.

SALESFORCE.COM (CRM US)

The largest pure-play vendor in the front-office Software as a Service (SaaS) space, its products are customer relationship management (CRM) applications used by sales reps, marketing agents, and service professionals. Several tailwinds are behind Salesforce's cloud-based platform including a growing number of connected devices and channels and the need for businesses to be agile and mobile with customer-facing activities. We see the company continuing to take share with its market leading product portfolio. The valuation looks fair.

WEIBO (WB US)

China's third-largest social platform (similar to Twitter), Weibo is differentiated by its open and interest-driven (e.g. news and celebrities) rather than relationship-oriented network. It monetises its user attention through advertisements, and has small and growing membership, data licensing and commission-based businesses. Expansion into lower-tier cities in China is driving continued user growth, while revenue per user is growing due to improved content targeting and ad bidding systems. Investor expectations that growth in both user numbers and Average Revenue Per User (ARPU) will slow significantly in the coming years look conservative.

SPLUNK (SPLK US)

A leading provider of data analysis software, Splunk is ideally placed to help enterprises make sense of the exploding volumes of data. SPLK offers a patented software platform that collects, indexes, and manages data regardless of format or source, enabling such data to be analysed for operational intelligence, application management, security and compliance, and web analytics. SPLK delivered an impressive 3Q18 result, with billings up +38% for the quarter driven by subscription-based products as the company makes the transition from a perpetual to subscription model. Taking a long-term view, SPLK's high valuation fairly reflects its rapid earnings growth rate.

FLEX (FLEX US)

Flex Technologies is a contract manufacturer of electronics and consumer goods that has started to differentiate itself by helping customers accelerate the process of getting new products from design to delivery. The valuation looks attractive if - as analysts expect - earnings-per-share (EPS) growth sustainably picks up from the modest/volatile rates of the past. Flex delivered a strong 2Q18 result, with all segments exceeding expectations, as the company continued to deliver on its Sketch-to-Scale strategy and transform its portfolio of offerings.

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