Tech wreck 2.0?

Technology stocks are flavour of the month as start-ups and angel investors flirt outrageously in the hope of joining the headlines. News that Xero is among New Zealand's largest companies, despite mediocre revenue and consistent losses, has stoked the fires of angel fervour, but left some scratching their heads and asking if we are heading for another tech wreck. **Beverley Head** *investigates...*

When the owners of Freelancer.com, a skills crowdsourcer based in Sydney, knocked back a $A430 million takeover bid for the company in favour of a listing on the Australian Stock Exchange in November last year, it signalled a new level of investor confidence in the technology sector.

The shares, priced in the prospectus at 50 cents, enjoyed a volatile few days; soaring above $A1.80, plunging back to around $A1, before settling to around $A1.35 a month after the float.

Very little of the company was actually available to investors – less than seven percent of the shares. But what they could get, they liked. Based on the prospectus which forecasts a net after-profit-tax for the current financial year of $A500,000 on revenues of around $A18.3 million, investors were punting on a very strong future for the business. Even at $A1.35 the stock was still priced at 1300 times earnings – a clearly speculative punt.

New Zealand's Xero has buoyed similar investor enthusiasm. Listed on the New Zealand and Australian stock exchanges, at time of writing the New Zealand listing values the business at more than $NZ3.6 billion. Not bad for a company which has never made a profit.

Anyone with their nose to the wind could be forgiven for scenting more than a whiff of dot-com mania.

Sandy Plunkett remembers that period keenly; she spent over a decade working in California, first in venture capital, then a start-up, and then back into venture capital. Now returned to Australia she remains an advisor to BullPen Capital, is on the investment committee of lean capital firm TankStream Ventures, and is also an industry fellow in the University of Technology, Sydney's entrepreneurship programme.

She harbours some concerns that another technology bubble is brewing – but maintains this one is different.

"We are definitely in a boom period that started around 2009. It's not yet like 1999. But, another tech bubble is brewing," she says.

Plunkett says that bubbles, as opposed to booms, are spurred by external factors such as government policy – particularly the US Federal Reserve's programme of quantitative easing – and what she describes as "irrational investment exuberance".

Australian and New Zealand technology stocks are riding the coat-tails of the global demand for technology stocks which is still led by the US markets. It's why Australian software company Atlassian is expected to list not on the Australian Stock Exchange but the Nasdaq, which was awash with tech IPOs in 2013.

Peter James, long-term technology investor, besides co-founder and chairman of cloud business ninefold, believes many Australian and New Zealand companies will follow Atlassian's trajectory, upping sticks to list in the US where there is access to deeper pockets and a larger market, although he laments the resultant migration of A/NZ IP.


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Advice from a tech dragon

Derek Handley has over a decade's experience of start-ups and the tech sector. Co-founder of The Hyperfactory, director of Booktrack, BigLittleBang and chairman of Snakk Media, Handley is also founding CEO of the corporate social responsibility pioneer The B Team chaired by Sir Richard Branson and Jochen Zeitz.

iStart asked Handley what he thinks is going on in the Australian and New Zealand technology sector.

How easy is it to get funds to start and grow businesses, and is the current appetite for tech IPOs in Australia and New Zealand sustainable?

Derek Handley: To start a venture with a good team and a good idea, there are definitely far more avenues to get funded than there were five or ten years ago. Things have never been better for the start-up entrepreneur in New Zealand looking for that first $NZ250,000 or $NZ1-2m. There are still challenges at the $NZ3 million-plus level which is where you'd typically get what's known as an 'A Round' of venture capital.

Personally, I think the NZX can help fill that gap and Snakk has proven that in 2013 raising $NZ6.5 million off the back of raising $NZ1 million privately in 2012. As long as there are amazing business opportunities based on technology – which there will be for many years to come – then the appetite should only build over time.

There appears to be great interest and appetite for tech IPOs in general – even when the traditional fundamentals (revenues, profits, dividends) are in short supply. Are we headed for another tech wreck?

DH: I think these periods are not comparable. This time around we do have huge revenues and extraordinary margins – Facebook is a perfect example, it is a multi-billion dollar company that everybody thought was too expensive when Microsoft first invested at the $US10 billion valuation. A company like Pinterest is a huge success even though it has zero revenue, because it is so easy even for the layperson to imagine how they would 'turn' revenue on.

We are not heading for a tech wreck, we are heading for a tech boom in terms of how technology changes the way people live and work and how business models are created. With the mobile revolution, underpinned by cloud technology and the internet of things around the corner we truly are on the cusp of greater incremental and transformative innovation due to the internet, than we ever have been.

So as much as thousands of amazing companies will be born in the coming years and that won't change, what may change is the appetite to take higher valuations at early stage companies that have greater risks. Sometimes demand and hype play more of a role here than the company itself. Xero for example is an amazing company with an incredible opportunity still ahead of it. It is of course, arguably overvalued with almost every single possible positive outcome being already incorporated into its valuation today. It has to win on every single one of them to justify where it's at.

What should investors look for in their technology investments?

DH: Things they understand i.e., how does this work and why would anybody use it or buy it, and something that is backed by a team that looks like they know what they are doing or have built companies before.

Alternatively, they should invest in people and models that specialise in helping them get exposure to technology investments. Things like funds or partnerships.

What should investors avoid?

DH: Things they don't understand or things that they are investing in simply not to miss out. The fear of missing out is the greatest reason not to invest in a tech company.

"It's not that there isn't a growing number of incubators and funds here. But if you want to prove your business model you've got to go offshore," he says.

Certainly the US market for tech listings is red hot. According to Plunkett; "The only better year than 2013 for tech IPOs was 1999 and the Twitter IPO seems to have created a new thrust for the tech sector. Its stock price 'pop' first day of IPO went up 72 percent.

Although investors should probably remain alert to the potential for a bubble to burst, it's a little early for outright alarm. Plunkett says that the raw numbers suggest today's tech market is a little more sober than that of 1999.

For example there were 368 US IPOs in 1999, compared to 32 in 2013. The average first day return in 1999 was 87 percent compared with a much more sedate 26 percent in 2013, while the average age of a company at IPO is today 13 years compared to just four in 1999.

Plunkett however says that there are warning signs, as 73 percent of companies floated in the US in 2013 have yet to make a profit, compared to 27 percent in 1999 – although generally revenue streams are now much stronger at listing.

For conservative investors the fact that Twitter

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could be valued at $US11 billion, Pinterest $US3.8 billion, Snapchat $US7.3 billion without a skerrick of profit between them should prompt a few furrowed brows.

“My main concern re all the Twitterpation in the local tech sector now is timing. We have a history of getting into the action too late in the boom cycle, and with a relative lack of investor savvy in the space. So, we have a boom and we buy in, but only after that boom is deep into its cycle. Then there is a bubble and then it crashes,” says Plunkett, concerned this may impact the availability of venture capital in the future.

Peter James agrees, saying that the A/NZ market is probably a quarter of a cycle behind the US.

But he doesn’t believe that the bubble will burst this time, saying that while the dot com era involved a lot of “wishing and hoping” he feels that although there is still something of a land-grab going on, with the current crop of new listings, “this time it’s real business,” coming from companies with revenues, if not yet profits.

Blair Galpin, senior equity analyst at New Zealand-based Forsyth Barr, says that the global technology sector is driven to a large extent by the US market. While there is something of a “halo effect” in New Zealand, cast by Xero and Diligent, there are still very few technology stocks listed on the New Zealand Exchange or the New Zealand Alternative Market (NZAX) he says, a situation he does not expect to change quickly.

While Australia’s National Stock Exchange struggles to attract many tech floats, there are 130 technology-related companies listed on the ASX, including recent successful listing OzForex along with more seasoned tech companies such as Seek, CarSales.com and Technology One. But that list pales compared to the 2700-plus companies listed on the Nasdaq – most of which are tech stocks.

Galpin says that Xero’s performance will prove the bellweather for the New Zealand listed tech sector, and its movement – up or down – will affect the entire market. He notes however that as a tightly held stock, the impact of movement will affect mainly institutional investors rather than mum and dad investors dabbling in the share market.

Adrian di Marco, chairman of Technology One, which listed on the ASX back in 1999 believes that there are in fact two technology markets operating – one mature, based around service providers, and the IP-related start-up market which can attract “sky-high” valuations he acknowledges. He urges investor caution noting that stocks that run too high can drag back the entire market when they correct.

“Sky-high valuations where there are no earnings are dangerous for investors and the companies.” It’s something he experienced when Technology One’s share price was caught up in the dot com bubble and share prices soared to become what di Marco frankly admits were overvalued. The share market valuation he said became a “gorilla on your back,” although the company managed to stay profitable even when the market tanked.

While markets continue to fluctuate, there is no shortage of tech-related investment opportunity in Australia and New Zealand (see breakout box overleaf).

And today, unlike the dot com era, there is a slew of incubator companies, venture capital firms, and even big businesses like ANZ and Telstra setting up funds to inject seed capital into » start-ups on both sides of the Tasman, receiving access to both smarts and early stage stakes, although there are some who believe this is less about supporting start ups and more a reaction of FOMA (fear of missing out) on tech booms.

Whether it's FOMA or fundamentals there is keen appetite for tech.

In December, investment bank UBS along with private equity investors provided $A3.4 million in funds to ingogo a Sydney startup which has developed a mobile phone taxi booking app, planning to list on the ASX in 2014. The funds injection values ingogo at $A25 million, despite the company having plenty of established competition in the market.

Stephen Moss is a co-founder of Sydney-based venture capital company Black Citrus, and prides himself on being very selective about which companies to invest in. Moss says the firm, which raised A8 million for investment in 2013, considered about 400 opportunities during the year and invested in just three.

One of the companies on its books is COZero which he describes as supplying "disruptive technology for the energy retail market". The plan is to list the company on the ASX in early 2014.

Other companies are keeping their options open. Alec Lynch is the founder of crowdsourcing business DesignCrowd.com, which has raised $A6.3 million in three funding rounds. His major push for 2014 will be to open offices in San Francisco in order to grow the market for the company internationally. As to his exit options Lynch says they are wide open – either an ASX listing, a US IPO, even a trade sale.

He believes that there is a tech boom taking hold, driven by a fresh crop of entrepreneurial graduates and that a rash of strong local listings such as Freelancer.com's are positive for the market overall. "I think that the multiples some businesses have received reflects the future and their future potential. I think investors are looking for the next Seek or CarSales.com," he says.

While Stephen Moss remains optimistic for the year ahead he tempers that, saying; "Where I'm concerned is on the broader economy in 2015/16," which could lead to a decrease in disposable incomes which then impacts the availability of investment funds.

Asked about the valuations on companies such as Freelancer.com and Xero Moss warns that investors are; "Speculating on potential, which is dangerous because it's speculative." Moss does not think there is much danger of a technology bubble popping, but does acknowledge that there needs to be a more rigorous model to allow proper valuation of tech stocks.

"No-one's buying Twitter because they understand the intricacies of the market – it's because it's speculative."

It would seem that the motto to be carved on tech investors' wallets remains *caveat emptor.*

Australia and New Zealand score well at top of tech tree

The entrepreneurial spirit is alive and well in Australia and New Zealand according to Deloitte.

More than 100 of the fastest growing technology companies in the Asia Pacific region hail from either Australia or New Zealand according to the Deloitte Tech Fast 500 report.

Sixty six of the companies on the Deloitte Tech Fast 500 in Asia Pacific for 2013 are based in Australia with a further 40 based in New Zealand. The fastest top 20 list meanwhile features four Australian companies – Plan B Logistics, Blue Chilli Technology (both in the top ten), Vinomofo, b2Cloud and one New Zealand business, BookMe.

In 2012 only one ANZ business made the top ten cut – New Zealand based software company ERoad. This year the company dropped back to 68th slot in the Fast 500 even with a still remarkable 463 percent growth rate over the last three years.

While software, hardware and telecommunications are eligible to be considered for the Fast Tech 500, to be included companies must have achieved a base-year revenue of $US50,000.

Plan B was identified as the fastest growing technology company in Australia – and the fifth fastest growing technology business in the region. A travel management and corporate booking system, the company was established in 2008 and has grown by 3832 percent over the last three years.

Deloitte's top 500 companies averaged a revenue growth of 356 percent during 2013, which was slower than the 467 percent achieved last year. China took out line honours with 128 of the fastest growing 500 companies in the region.

Joshua Tanchel, leader of Deloitte's Technology Fast 50 Program said that the performance of local companies was an indication of a thriving entrepreneurial environment and embrace of digital business models.

"In the traditional business world Australian company growth may have been constrained by the size of the domestic market. However, in the high growth digital economy that is no longer an issue. By utilising the internet and mobile technology, Australian tech companies are building businesses that compete and win globally.

"We are certainly punching well above our weight and taking on the well-established Asia Pacific technology powerhouses such as Taiwan, Japan and South Korea."