

QUARTERLY COMMENT – II 2017

‘Megatrends’ has been a buzzword in the investor community for many decades. The demographic trend of aging societies with its implications for healthcare comes to mind as a classic example. Due to this widespread familiarity, healthcare companies have had quite lofty valuations.

As an investor on the lookout for cash flow compounding companies, I find secular trends to be particularly interesting for coherent investment strategies. One of these megatrends has been so pervasive that we don’t really notice its continuing momentum because it has been so naturally integrated into many of our daily routines for quite some time now. I am talking about information technology and one of its advanced manifestations – the digital transformation of myriad (formerly manual) processes.

Digital transformation has changed and will continue to change even more business models. Because of this, some businesses will simply have no basis to exist in the future, some will be able to adapt and we will witness some completely new models arise. In any case, many of these businesses will seek outside help to facilitate digital change. External specialists not only have the human expertise but often also the software tools required to speed up the necessary transformation. There will be no way to replicate these change agents inhouse especially for midmarket and smaller companies. Instead the ‘outsourcing’ trend will prevail in which groups of external specialists will be brought in to improve process efficiencies and/or tackle competitive as well as market challenges.

IT service specialists have benefitted from this digital transformation trend for years. And my interaction with a number of them suggests they even see this trend accelerating. Well, that remains to be seen but I think we can all agree that this trend is likely to remain unbroken for many years to come. Therefore, I have started to build a sub-portfolio of national IT services speedboats. The track records of these businesses and their share price performances has been outstanding to date.

On top of this, I have investigated other offshoots of the information technology trend such as ecommerce and artificial intelligence. While ecommerce has clearly emerged as an unstoppable secular trend, its scope for profitability remains to be demonstrated. Some business models have provided proof of concept but are still in growth mode so that steady state margins are hard to envision. And business models and investment strategies for artificial intelligence are still in their infancy and pertain mostly to the venture capital arena.

After all, ‘megatrends’ are powerful contributors to the success of profit compounding companies. Yet, these megatrends still need to be disaggregated into smaller trend elements to find investable strategies, which can capture the inherent economic benefits.

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