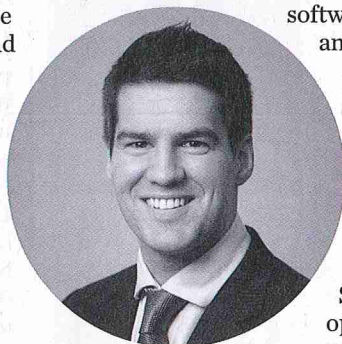


Spot successful tech stocks

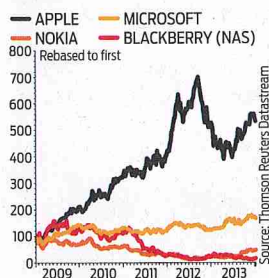
Provision of user interface and services is the way to go, hardware is not

SAM FORMAN

The buzz words of 2014 will continue to be big data, cybersecurity, cloud, mobile and wearable technologies – but how will the private investor be able to predict tech successes? The technology sector has long been an inviting investment area – with high profile winners amongst young start-ups and major corporations alike. Be it the early wins of companies like **Twitter (TWTR:NDQ)** or **WANDisco (WAND:AIM)**, or the sustained growth of **Amazon.com (AMZN:NDQ)** or **Google (GOOG:NDQ)**, tech stocks should form part of any private investor's portfolio.



Sam Forman
Restoration Partners



AMAZING JOURNEY

When analysing and predicting the performance of tech companies, the key is to identify their high level strategy and direction of travel – and learn from historic successes and failure in the industry.

Restoration Partners' IT Stack provides an insight onto the tech industry. It is a simple taxonomy that shows the different layers of product. Companies at the bottom of the Stack, building components and hardware, tend eventually to operate in a low margin environment and struggle to achieve any consumer loyalty or even awareness. Scale is achievable and success usually possible only as the lowest cost producer.

Towards the top of the Stack, software, applications and services are profitable. Companies in this segment understand the user interface and make the service they or their products offer central to their success. They typically have lower costs, are highly scalable and have sticky and loyal customers.

At Restoration Partners, we have long seen that the route to success for tech companies can be seen as a North-Easterly journey. Simply put, a successful strategy is one that aims to move the company from hardware and components towards user interface and service. It is not where the company is on the Stack but the direction in which it is heading that is the key.

LESSONS OF HISTORY

There are numerous examples in the public markets of companies who have made this journey, but more obvious ones of the power of the IT Stack are seen when we consider those who have failed to follow a North Easterly path. Compare the fortunes of **Apple (AAPL:NDQ)**, **Microsoft (MSFT:NDQ)**, **Nokia (NOK1V:HE)** and **BlackBerry (BBRY:NDQ)**.

Apple has pushed North-East, moving on from developing hardware products to offering

software and services that drive consumer adoption and loyalty, such as iTunes, Apps and iCloud.

Microsoft started heading in the right direction as a software business, but has made a number of strategic decisions to move towards vertical integration and is now moving back down the Stack. Microsoft's legacy as the provider of software for PCs made it slow to react to the fast-changing, post-mobile world. In buying Nokia, Microsoft has shifted further down the Stack into hardware production. Nokia had the opportunity to push on into the software and services sector but instead found itself being outcompeted in quality and cost in the handset market. Nokia, at its heart, was a hardware company. Its development process was dominated by hardware engineers; software experts were marginalised – resulting in a product suite that failed to attract consumers.

Microsoft's acquisition of Nokia, as well as the production of the Surface tablet, demonstrate Microsoft's desire to mimic Google and Apple's strategy of owning hardware, software and services. Where Microsoft has failed is in the crucial user interface and service aspect, with a mobile operating system that the market finds

unattractive, and with Nokia's smartphone sales continuing to struggle.

The dramatic failure of BlackBerry shows the impact of being unable to progress up the Stack. They were unprepared for the emergence of the 'app economy,' which drove massive adoption of the iPhone and Android-based devices. A lacklustre response, BlackBerry World, continues to fight for market share, but has failed to rescue the company. Since 2009, BlackBerry's stock price has collapsed by 90%. Its decline is a case study for what happens when a tech giant fails to innovate in a consumer-technology market – it did not travel North-East.

A movement up the IT Stack should see decreasing overheads

and increasing consumer loyalty, and is a strategy that has been ignored by many major tech players. While a number of other factors can cause businesses to collapse, failing to learn from historic precedence should not be one of them. Tech companies also need to acknowledge the crucial importance of a long-term strategy to move North-East on the tech Stack, which will have a huge impact on investor confidence. Identifying companies with a positive strategy presents attractive opportunity, while tech companies whose direction appears to be South-Westerly are the ones to avoid. **S**

RESTORATION PARTNERS' IT STACK

