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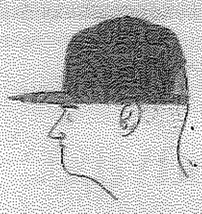
Reality bites for techs while telcos struggle



Technology

YOLANDA REDRUP | Tech and telecommunication stocks with strong recurring revenue and growth prospects is where the money will be in 2017. Analysts say the changing climate in investment markets is likely to put pressure on tech stocks and result in lower valuations.

They predict the continuation of a trend that started in 2016, where investors became more critical of high valuations and price to earnings ratios thanks to global uncertainty surrounding Brexit and the election of Donald Trump, plus rising interest rates in the later part of the year.

Victor Gomes, UBS co-portfolio manager for the Australian small companies team, says tech stock performances in 2016 has been a "mixed bag", with some starting to show signs of "wear and tear".

Gomes' top technology stock picks for 2017 are **TechnologyOne**, **WiseTech Global** and **NextDC**.

"In the tech space we look for companies with recurring earnings and growth, so you put TechnologyOne into that space," he says. "WiseTech is an earlier stage business for us as it hasn't been listed long, but it has a strong inorganic growth profile and a low risk acquisition strategy, and the management and founders are aligned with us.

"NEXTDC is another one I like. It's capital intensive to build data centres, but if you believe in software-as-a-service and cloud-based solutions, it's going to exceed everyone's expectations."

Other tech stocks tipped to perform well are **Superloop**, **Integrated Research** and **4DS Memory**. Analysts also tip **Catapult Sports** and **Aconex** as two stocks with the potential to bounce back from falls in 2016.

RBC Capital Markets equity research vice-president Paul Mason says Aconex has suffered in the past few months because its full-year results fell within guidance for the first time, rather than exceeding predictions, and co-founders Leigh Jasper and Robert Phillpot reduced their stakes in the firm.

"At the same time, the market was asking some questions about Aconex's accounting and how its cash flow and revenue is reconciled, and shorters have asked if they've used rebates to increase the size of their revenue numbers," says Mason. "I don't think those issues are real for the firm. But for Aconex to see a rally in the stock, it would need to announce another marquee deal."

For the first nine months of 2016, NEXTDC performed strongly, rising from about $2.30 to $4.46 at its peak. But in the past few months the stock has slipped to under $3.

And unlike Gomes, TMT analytics managing director Marc Kennis believes the company will face overcapacity headwinds in the data centre industry. "I'm not a fan of NEXTDC. While the market is not in oversupply today, I think it will be," he adds.

Kennis believes the telco sector will struggle in 2017. "Looking at the last part of 2016, we've seen a rotation in tech stocks and we've seen telco companies hit hard as some NBN news has filtered in. In my view, it's becoming obvious that telcos in general need to speed up new avenues of revenue because it will become tough to maintain their legacy businesses."