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The Disparity Between Winners and Losers

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ALEX BERNSTEIN: Hello, I'm Alex Bernstein and you're listening to the Alger Podcast, Investing in Growth and Change. At Alger, many of our recent thought leadership pieces have focused on the wide disparity between the types of companies that are winning and losing in the current market environment, and the role that tech might play with those companies. To try to understand this disparity a bit more, I'm talking with Alger Tech Analyst Brandt Blimkie. Brandt, thanks so much for joining me this afternoon.

BRANDT BLIMKIE: Thanks, Alex.

ALEX: Brandt, can you tell me a little about this disparity between companies?

BRANDT: So, there are certainly beneficiaries and losers in this environment. There are companies that are helping transition the economy to work from home, the digitization of different aspects of our work. Think of online grocery delivery or e-commerce, videoconferencing so we can hold this conference online with different salespeople. So, there are companies that are benefiting in this environment as well as companies that are struggling, certainly the ones that are struggling are ones with more physical locations based on physical foot traffic where maybe people are more reluctant to travel. So, there's certainly been a discrepancy in those who are benefiting in this environment from those who are getting hurt.

ALEX: Where are you seeing some of the biggest discrepancies?

BRANDT: So, there's a discrepancy right now, we think, between high growth tech companies and value tech companies. We think the discrepancy is pretty wide in terms of valuation. And this is not just recent with COVID-19 – but over the last five to ten years we've seen just this big discrepancy between value tech and growth tech as the winners have become larger and the losers and laggards have continued to trail.

Now, a lot of legacy tech that is considered value tech, some of those companies are levered. Some of those companies have products that are in secular decline, and so the argument to invest in one of those companies is that the economy is going to recover smoothly, and then these products, these companies, won't have leverage issues, liquidity issues, and so the valuations are too cheap for where they're trading. That's contrasted with some of the higher growth software companies and other tech companies that are benefitting in this environment. Where the debate now is, are these priced too high for fundamentals that could eventually slow once the economy recovers? For example, will we use as much videoconferencing if everybody goes back to work? Have we purchased as much security products as we need to secure our employees? Will we need as many of those services if we return to a normal, or are we just going to be in a "new normal" where we're utilizing just more of those services going forward?

ALEX: And what do you think the answer to that is?

BRANDT: I think this is another time in our economy where we're seeing significant structural changes take place, and certainly a lot of companies we talk to, particularly in the tech space, are talking about more efficient ways of doing things, now that they found that it's actually not that bad having their employees work from home. Now, we'll have to see if once the economy reopens if that holds true, but right now companies are saving significantly on travel costs. That's made it more efficient for salespeople to talk to the customers and sell products if they don't have to get on a plane to talk to the customer. They can land a deal of similar value and you've significantly increased the value delivered to your company. It might be harder to land that deal over a videoconferencing tool. So, I think that part of the equation still remains to be seen.

BRANDT (continued): We've already seen a lot of tech companies offer their employees the opportunity to work from home through the end of the year and into next year. Some companies are extending increased benefits for their employees to work from home, so rather than building out an office, they're providing stipends for their employees to improve their home/work office. So, we are certainly seeing some structural changes. I think it'll be a mix.

ALEX: Brandt, have you seen many surprises in the tech sector?

BRANDT: Yes. There's been a tremendous number of surprises. I think what's been surprising is how well some of these companies have done in this environment as a result of the economic distress we've seen from COVID-19.

Satya Nadella, the CEO of Microsoft, summed it up probably best on Microsoft's recent earnings call where he said that we have seen two years of digital transformation in two months, and so what this has done is really just forced companies to pull forward technology roadmaps that they might have planned to execute on over the next couple of years in a matter of months out of sheer need, and that has significantly transformed certain companies and certain industries.

The communication space is probably the best example where all of a sudden since nobody is in the office, we've had to find new ways to communicate with our colleagues, with our customers, with others abroad, and so we've seen just a tremendous acceleration in the digitization of communication, whether that's just the phone services we use, contact centers that companies use to reach out and communicate with their customers, videoconferencing, electronic signature of documents, even just the transformation in the back office of companies, the way that companies handle their billing processes, tax filings, all that kind of stuff. It's just a really rapid pull-forward of this digital transformation that companies were already heading down but now had to accelerate.

ALEX: Brandt, can you tell me how you use volatility in your process?

BRANDT: Volatility ultimately creates opportunity. The fundamentals of a company don't generally change as quickly as the stock price does for a company. So if the price has increased significantly or decreased significantly, we're pretty confident in the fundamentals, particularly the longer-term fundamentals of the company. That volatility can create an interesting investment opportunity. If we have a perspective that's different longer term with the stock than what the stock price is reflecting, that's the interesting investment opportunity. So, there have been a lot of interesting opportunities that have arisen as a result of the COVID-19-induced volatility of the market.

ALEX: And Brandt, I just want to ask, how has your research process been going? I know it's difficult to do research when you are isolated and all the people you typically work with are also isolating. How has that experience been?

BRANDT: I think I'm actually working harder now than I did when I was in the office because I'm not spending hours traveling or don't have time to go to any other events, and it's forced a daily communication with portfolio managers which has been great because it's ensured that we're in constant dialogue and sharing ideas really on a real-time basis. I certainly do miss the opportunity to just catch up with people offline in the office. I think this environment forces you to have to just reach out to people and create those conversations that are not necessarily work-related with teammates.

ALEX: Brandt, thanks so much for talking with me this afternoon.

BRANDT: Thanks, Alex. Great talking with you.

ALEX: And thank you for listening. For more of our latest insights, please visit www.alger.com.

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