Important lessons for investors from soaring tech startups

Published 28 August 2024

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Key Takeaways

- Alphabet’s bold move with Wiz tells us something very important about cybersecurity.
- Groq’s valuation shows that companies can differentiate themselves in the semiconductor industry.
- As rates are cut, smaller companies and thematic exposures stand to benefit.

Plenty of deals are happening in the world of tech startups, but two stories stand out, offering three important lessons for investors.

The first story is about Google's parent Alphabet, which was considering a $23 billion acquisition of the cybersecurity startup Wiz. Had this deal gone through, it would have been the largest in Alphabet’s history, far exceeding its previous $12.5 billion acquisition of Motorola Mobility over a decade ago. A notable detail from this story is that Wiz’s most recent valuation before Alphabet’s bid was $12 billion[1]. This means Alphabet was willing to pay nearly double for a startup that secures cloud-based programs. Ultimately, Wiz did not accept the bid, stating it intended to go public.

The second story relates to semiconductor startup Groq, which was recently valued at $2.8 billion, more than double its last valuation of $1.1 billion in 2021[2]. Groq’s chips are designed for fast artificial intelligence (AI) inference, which is particularly useful for enabling AI-powered chatbots to deliver quick responses.

In both instances, two tech startups with specialised expertise have seen their valuations soar. So, what lessons can investors draw from these stories?

Big tech knows the importance of key technologies

With AI swiftly becoming mainstream across all industries, few themes are as hot as cybersecurity. Given that generative AI – currently all the rage – is built on data, securing that data is paramount to maintaining public trust in technology companies.

Google (or its parent company, Alphabet) understands this very well. The reputational risk of a cyber breach is too great, even for tech giants. It’s better to pay top dollar now to avoid a catastrophic scenario later. This idea was further reinforced by the recent CrowdStrike Windows Software update, which crashed 8.5

million computers worldwide[3]. Though this wasn't a cyberattack, it was a stark reminder of the importance of technology working smoothly and securely.

For investors, this represents an exciting opportunity to consider a theme that benefits from the AI revolution while offering a differentiated mix of companies.

Small players with a specialism are highly valuable

We've all seen the rapid rise of OpenAI. If a small player has a unique idea and executes it effectively, they can quickly become a behemoth. The goal of these startups is not to follow the crowd and compete directly with big tech companies but to identify a niche where they can create something compelling that could appeal to the masses.

Groq's example shows that this principle applies even in the world of semiconductors, a product that is often seen as homogeneous. However, semiconductors from different companies serve different functions and cater to different customers. Not all devices in the Internet of Things require Nvidia chips, even though Nvidia has garnered much of the recent hype. A simple analogy is cars – not everyone needs or wants to buy from a single brand.

For investors, broad exposure across a wide range of companies doing interesting things in the digital economy appears to be the best way to diversify and capture the potential upside of emerging companies.

Timing matters

In one of our recent blog posts, we highlight how smaller companies stand to benefit from a rate-cutting cycle by the US Federal Reserve (Fed). Smaller companies with more uncertain future cash flows naturally have a higher sensitivity to interest rates. It's no surprise that big tech companies are looking to make deals before the Fed's rate-cutting cycle gets underway.

While the two examples discussed in this blog are of private companies, the lessons also apply to small, publicly listed companies. Publicly listed companies offer investors the added cushion of being on slightly firmer ground than privately owned companies while still in the early stages of growth.

Investors seeking pure exposure to themes like AI and cybersecurity will likely have a healthy mix of small and medium-sized companies in their portfolios. This should set them up nicely for the next phase of the economic cycle.

[1] Bloomberg, 23 July 2024.
[2] Financial Times, 05 August 2024.
[3] Financial Times, 25 July 2024.

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