Tech Stocks Even Warren Buffett Would Consider

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Warren Buffett has always preached to invest in companies you understand. Over the past fifty years, the Oracle of Omaha has built a portfolio of companies involved in everything from making underwear (Fruit of the Loom), to selling insurance (GEICO), to owning and operating railroads (Burlington Northern). Buffett consistently gravitates toward companies with businesses that are easy to understand, compete in industries with high barriers to entry, and are so simple to manage they can be run by "a ham sandwich."

In 2011, the investment world was surprised when Berkshire Hathaway took a stake in IBM. Historically, the company avoided technology stocks mainly because Buffett felt he could not understand them. In 1999, Buffett was chastised for not embracing the Internet boom and was labeled a dinosaur by some in the investment community (he avoided the tech bubble and then proceeded to outperform the S&P 500 annually over the next three years). However, Buffett's intrigue in IBM was not its technology, but that the company had transformed into a services business and at the time, was buying back a tremendous amount of its own stock; two concepts he definitely understands. With the Nasdaq Index finally surpassing its March 2000 tech bubble peak, many investors are scratching their heads if now is the time to buy tech stocks?

You don't need to live in Silicon Valley, or in Austin, Texas to benefit from the "Internet of Things" or the proliferation of technology in your investment portfolio. Invest in what you know. Global IT spending continues to grow at a mid-single digit rate. Whether it is through smart phones, data centers, social media, autos, or sensors, the trend for continued IT spend is a long tail. **How to play it?** ***To use the 1849 gold rush in California as an analogy, for our clients, one way we like to invest in technology stocks is to find those companies that sell the pickaxes, hard hats and shovels, rather than in the companies digging and exploring for gold. In technology, investors can apply the same concept by investing in companies that manage the supply chain or act as a distributor to those presumably on the cutting edge of innovation.***

One such company is **Flextronics (FLEX).** FLEX is a supply chain solutions provider. If Cisco needs a new router built, they design it and send the specification to FLEX who manufacturers it. As long as IT spending continues, products will need to be made and FLEX is one of the largest companies to do so. Valuation is very compelling at 10x 2016 price-to-earnings multiple; no debt is due for several years, and the company has bought back 10% of its stock each year for the past five years. The industry is very concentrated, the barriers to entry are high, valuation is cheap, the business is easy to understand, and management returns cash to shareholders; all qualities Buffett favors in a business.

Two other companies that fit Buffett's criteria are **Arrow (ARW)** and **Avnet (AVT).** They are the two leading technology distributors in the world. Consider them the Wal-Mart and Target of the IT universe. Outside of these two, the competition is scarce. Trying to replicate ARW and AVT's business model would be extremely difficult. They source millions of components, microchips, and other critical technology parts to companies that build hardware, and have over 75,000 vendor relationships worldwide. Both trade at around 9.5x price-to-earnings multiple, nearly a 40% discount to the S&P 500, yet have a business model that is easy to understand, but very difficult to replicate.

Mr. Buffett, if you are reading this, feel free to add these compelling, yet easy to understand tech companies to your portfolio!

Note: John J. Petrides, MBA, is a Managing Director and Portfolio Manager at Point View Wealth Management, Inc., a registered investment advisor at 382 Springfield Ave., Summit. Mr. Petrides and family do not own any individual shares of any of the companies mentioned. Certain clients of Point View Wealth Management does own shares of IBM, FLEX, ARW, and AVT.

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