

SMOKE AND MIRRORS

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Don't kill the messenger but the Internet sector is overvalued and you should sell. Many new clients of ours have transferred over many portfolios filled to the rim with Internet stocks. Many of these investors hold grandiose dreams of an enormous comeback. We disagree. This opinion has left us open to the cries of being a naysayer, an unbeliever. Investors have given us dozens of reasons why they should hold on, however, basing investment decisions on hope alone is not a recommended practice at Markowski Investments. The Internet explosion has created billions in new, largely paper wealth, for thousands of entrepreneurs and investors. However, the party is over, and it is time to sober up

The Internet phenomenon has no competitor as far as the speed and impact on society. According to the research firm IDC, so far in 1999 160 million people have used the Internet. Compare that figure to only 5 million in 1995. That figure is estimated to hit 500 million in 2003. As far as a business the Internet economy has grown at a rate of 170 percent from 1995 up to today. Revenue derived from e-business is now \$15.2 billion. Online advertisement spending has reached \$2 billion and predicted to reach \$8 billion by 2002.

This boom has boiled over to Wall Street. There have been 96 Internet IPO's since Netscape's public offering in August 1995. Morgan Stanley puts the total market capitalization at more than \$375 billion. This past year over 43 Internet companies have gone public. 63 are currently in registration. In fact 25% of the total \$21.9 billion raised in 1999 went to Internet companies. What is interesting is that 82% of these IPO's are trading above their offering price.

Benchmark Capital and Broadview International have done the current number crunching as far as the Internet sector and have studied the 133 public Internet companies. These 133 stocks have a combined value of \$410 billion dollars. This number is being supported by weak sales of \$15.2 billion with losses of \$3 billion. Only 16.5% of Internet companies show any profits at all. Bill Gurley an Internet industry guru from Benchmark Capital points out that for Internet companies to justify their current market valuations, they would have to grow their revenues by more than 80% a year for the next 5 years. Microsoft grew only 53% in the first 5 years; Dell Computers grew at 66% over the same period. Assuming that all 133 Internet companies could grow at the rate equivalent to Dell's the entire portfolio would still be overvalued by \$130 billion or 33%.

The theme behind these gross valuations is the individual. Investors driven by the get-rich-quick plan have become the backers of this new phenomenon. Institutional investors (also known as "smart money") own more than 50% of the stock of large-cap technology companies such as Microsoft, Dell and Intel. On the other hand, Internet stocks are overwhelmingly owned by individual investors (or "dumb money"). Venture Capitalist Jim Breyer of Accel Partners states about the Internet mania: "It's emotion, it's frenzy, it's the fad, and 90% of the companies should never have gone public and will either go out of business or hit very hard times."

There is a theory called industrial Darwinism. As was the case in other commercial revolutions, too many companies were started and a survival of the fittest game plays itself out. Take for instance the PC industry. Their growth continues at more than 25% for over two decades, however only one company, Apple Computer survives from the evolution. The two largest PC makers Dell and Compaq were born well after the PC explosion began.

Out of the 1,200 plus technology IPO's since the debut of the personal computer in 1980, a mere 5% has created 86% of the wealth. Bill Sahlman, a professor at Harvard Business School makes the case that IPO's are generally not good investments for non-insiders. "The long-term performance of most IPO's is bad." In conclusion we at Markowski Investments feel that investors must wise up and not be seduced by the latest fads in technology. This is especially

true of many web-based companies that lack any solid business model and profit potential. It is important to invest in companies that justify their stock prices on some multiple of earnings. The phrase, I hate using the most is "I told you so." Be smart don't get caught holding the bag.