Vol. 7, Issue 36
November 8, 2013

# Something to Think About

OAKWORTH CAPITAL BANK

COMMON CENTS

One of the more important business lessons I have learned happened in a casino. I am not a huge gambling fan, but I was in Atlantic City for a friend's bachelor party, many moons ago, and 'when in Rome do as the Romans do.' Since I had some rudimentary knowledge of blackjack, I tried to find a table, but even 'back in the day' all of the tables were $20/hand or higher. Even at this price, all of the tables were full with waits.

I watched people fork over fistfuls of Andrew Jacksons only to get a few brightly colored plastic chips in return. That's when it dawned on me: the poker chip is the world's most perfect and nefarious invention. When you exchange your money for a poker chip, the chip quits being cash, and becomes something else.

After all, how crowded would the gaming tables really be if you had to put currency down in order to get cards? Watching a dealer sweep plastic chips is a lot easier on the stomach than watching them sweep Andrew Jacksons, Alexander Hamiltons, Grants, or Franklins. Isn't it?

So, I went over to a craps table, and was bemused and befuddled by the game. Some fellow was near me was yelling in the ear of another, trying to explain the rules of the game. His advice must not have been so good, as the dealer seemed to make a habit out of sweeping the other sucker's plastic chips. My first thought was the guy doing the shouting was an employee of the place, whose sole purpose was to keep rubes throwing their money down the rat hole as long as possible.

Perhaps casino gambling wasn't for me, you know? The odds aren't in my favor; if they were, there wouldn't be casinos in the first place. No matter how good I am, if I stay at the tables long enough, the odds are I will lose all of my money, which, not coincidentally, I have willingly exchanged for little plastic chips. The games; the free drinks; the buffets and all of it are part of a not so complex money transfer mechanism. As P.T. Barnum was credited for saying: "there is a sucker born every minute."

Still the promise of a big pay day lures people of all walks of life to casinos. It doesn't matter they don't completely understand the rules of the games or the odds against them. As far as the casino owners and dealers are concerned, the clientele's ignorance is blissful. It is latter's hope coupled with ignorance which keeps them coming back for more.

Now, investing in stocks and bonds is really nothing more than gambling. However, the odds are normally on the side of the investor over time. Inflation and the economy's propensity to grow helps corporate profitability, which ultimately helps stock prices. Further, we tend to create new Americans at a faster rate than we die, meaning there are constantly more potential investors and/or gamblers. It is a beautiful money making machine that doesn't require much more than patience and prudence to come out ahead over the long haul. A ha. Patience and prudence; these are the true differences between gambling and investing.

***Inside this issue:***



*"It is generally agreed that casinos should, in the public interest, be inaccessible and expensive. And perhaps the same is true of stock exchanges."* *- John Maynard Keynes*

## *Something to Think About Cont.*

As probably all of you know, Twitter went public this week, and the response to the IPO was, shall we say, pretty impressive. You know, I will give you one better and call it baffling. Was this gambling OR was it investing? Hmm. I think you can guess where I fall on the subject.

Please consider what I wrote on the subject for this Sunday's Montgomery Advertiser:

> **The world is all atwitter over Twitter. The company went public this week, and the stock price zoomed out of the gate. Wall Street seems to love it, but all this social media leaves me scratching my head. What gives?**

I have to start by saying I don't own Twitter either personally or professionally. We make small use of the service at Oakworth Capital Bank, and I occasionally read a random tweet here or there. To put it bluntly, if everyone used Twitter the way I use Twitter, no one would be talking about the company's IPO. Heck, it might not even exist.

Like you, I am a little overwhelmed by all the social media outlets there are. There are: Facebook, Twitter, LinkedIn, Pinterest, MySpace, Google Plus+, Instagram, DeviantArt, LiveJournal, Tagged, and a whole host of avocation or vocation specific sites and user groups.

Virtually all of them rely on advertising dollars to some extent, often a large extent. Therefore, all these fancy social networking sites have to compete with magazines, radio, television, newspapers, and just about any other media outlet you can imagine for the same pool of dollars.

Consider the Montgomery Advertiser. Its parent company is Gannett, which is a massive global company with over $5 billion sales. In 2012, its newspaper division had revenue of $3.728 billion, with $2.356 billion in ad sales. Overall, the big company reported net income of $424.28 million in 2012. Currently, the market values Gannett at $6.230 billion. The New York Times, by comparison, has a market capitalization of around $2 billion.

Still, for better or worse, the investing world this past Thursday morning valued Twitter around $25 billion, on significantly less revenue, let alone profit, than either Gannett or the New York Times. How now brown cow?

People love a good story, particularly if it straddles the line between fantasy and reality. Such was the case with the Internet back in the 1990s, and the dot.com/tech bubble. That the Internet was revolutionary, and would change our lives and how we conduct business, was beyond question. However, how to make money on the Internet wasn't. That didn't stop us from trying though, did it?

In the dust of the ensuing tech stock, um, correction, companies like America Online, Lycos, Pets.com, inktomi, GeoCities, InfoSpace, and others were either gone or a shell of their former selves. Others are still around, but nowhere near the market capitalization of 1999. In other words, people who bought into them during the height of the tech boom still don't have their money back.

Are social media stocks the same thing? While only time will tell, investors have put pretty huge growth assumptions on some of these companies. Since there don't seem to be significant barriers to entry in this sector, and since these companies have a lot of competition for advertising dollars, I am not sure how all of them will be able to live up to investor expectations over the long haul.

If they do, well, I hope you enjoy your social media sites because newspapers, magazines, television, and radio will be out of business for the want of revenue. I can only hope all the friends and celebrities you follow have something meaningful and erudite to say, because reading "hanging out with my

## *Something to Think About Cont.*

> buds at EastChase" isn't all that intellectually stimulating.
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> Trust me, this isn't as ridiculous as it sounds,

I won't mince words: the likelihood any of these social media sites will live up to investor expectations is pretty low, in my estimation. Facebook, whose IPO was a disaster, is the 800-lb gorilla in this arena, with some 800 million users worldwide. Still, the stock price is up an amazing 138% over the last 12 months. Even those folks that got in at the beginning are making money, good money. Still, when you step back and look at the situation soberly, here are the facts on FB: trailing Price/Earnings 113.62; estimated forward Price/Earnings 58.27; Price/Book 8.98; Price/Sales 16.7; Price/Earnings / Growth Rate 1.98; Free Cash Flow to Basic Share $0.19; Operating Profit Margin 10.6%, and Return on Equity 7.6%.

By just about every traditional valuation measure, this particular company is fully priced but for expectations it will grow even faster in the future. But how can this be IF there aren't significant barriers to entry? How can this be when the competition for advertising dollars is so immense, and the US economy so, well, mediocre. Do companies spend their advertising dollars on social media websites, which people seem to primarily use to brag about themselves or spy on others? Further, what happens when social media websites like the ones I listed earlier become saddled with so many pop ups, banners, and other ads that folks opt out? Or go to yet another social media site which isn't as cluttered?

With this in mind, I want to give you some snippets from an article on Bloomberg.com this morning by Leslie Picker, Lee Spears & Sarah Frier:

> "Twitter's management and its bankers are happy with the IPO's outcome, according to a person with direct knowledge of their thinking. While they're not surprised the stock gained so much, because of the overhang in demand, they expect it to drop toward $30 a share during the next three weeks, this person said.
>
> Pricing Game
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> Leaving money on the table was worth it for Twitter, according to Moshe Cohen, professor of finance and economics at Columbia Business School.
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> "Pricing an IPO is a game," Cohen said. "After Facebook, Twitter needed to price conservatively. Otherwise, the risk of what would happen had the IPO not performed well was too big."
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> Twitter's 73 percent jump is more than double the average pop that U.S. technology and Internet companies had in their debuts this year, according to data compiled by Bloomberg. Worldwide, it's the biggest day-one surge for an IPO that raised more than $1 billion since Alibaba.com Ltd. in 2007,

## *Disclosure*

> the data show.
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> At yesterday's closing price, Twitter is valued at about $25 billion, or 22 times estimated 2014 sales of $1.14 billion, according to analysts' projections compiled by Bloomberg. That compares with 11.2 times for Facebook and a price-to-sales ratio of 11.7 for LinkedIn Corp."

Using that metric, it would appear Twitter is valued twice as much as Facebook and LinkedIn. Why? Well, the answer is simple: it shouldn't be, and even the investment bankers AND company management expect the stock to fall back to $30, according to the article.

However, for their part, Facebook and LinkedIn also seem a little, um, frothy based on the Price/Sales ratios in excess of 11. After all, Gannett, who they have to battle for advertising dollars, has a Price/Sales ratio of 1.2. The New York Times' P/S is 1.0. CBS comes home at 2.4. Yahoo's is 7.6, and Google, the real competition in this space, has a Price/Sales ratio of 5.9. I almost HAVE to use Google, but I don't HAVE to use any one particular social media website.

So, why is Twitter at 22 times sales again? Why are social media companies so popular? It is the exciting story, and the hope these things are "different," somehow. But where the rubber meets the road, these companies depend largely on one thing: selling ad space….like oh so many other companies.

Hey, this isn't intended to knock social media companies unnecessarily. However, when people ask what in the heck is going on with a visible company, like they have, I want to be able to have a good reason AND a good reason why we didn't participate in the pre-order period of the IPO. So, maybe you could say: "Norris, man, you ain't doing nothing more than covering your behind."

However, a long time ago, in Atlantic City of all places, I learned a valuable business lesson about the difference between gambling and investing. Sure, sometimes you can gamble your money and come out ahead; but the odds are eventually in the casino's favor. On the other hand, investing means stacking the odds in YOUR favor, and being patient and prudent.

In the end, IPOs generally happen for two reasons: 1) the company needs more capital and cash to either grow OR to stay alive, or; 2) the initial investors want a liquidity event. Given Twitter's balance sheet prior to the IPO, it would appear as though the company was/is more interested in a liquidity event for its insiders, other executives, and first round investors. As such, the IPO was a way to get these people and the investment bankers a little change in their pocket to go "jing a ling a ling." In essence, the odds were in THEIR favor when the bell rang, and not John Doe's.

I think you can guess where I stand on gambling and investing in this instance. To that end, if you are still holding onto Twitter shares you bought at $45/share yesterday when the first lock up period ends in February, you deserve what the market is going to give you…

;;;;one way or another.