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High-tech rollercoaster is risky but life-changing

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Some people will say Reid Hoffman has made the most of the technology craze. Others will simply be envious of the man who last week listed his social networking company, LinkedIn, and made a swift \$2 billion.

The success of the LinkedIn IPO has prompted warnings of another technology bubble looming. Many are questioning how a company earning a profit of just \$3 million from \$250 million of revenue could be valued at \$9 billion.

LinkedIn is without doubt a successful company with 100 million members in 200 countries. It has differentiated itself as a sort of Facebook for professionals, where members go to search for jobs, find employees or just look at other people's resumes.

LinkedIn supporters say that its valuation is justified because Facebook, the world's largest social network, is trading on the secondary market at \$90 billion. But that could just be an example of the 'greater fool' theory. For LinkedIn to justify its lofty share price, the company is going to have to keep growing rapidly and start to make spectacular profits.

That's the thing about technology companies. They are notoriously difficult to value because their value is all about what they might achieve in the future.

I have generally steered clear of technology companies because I struggle to understand what sustainable competitive advantage they have. So many technology companies have been pipped at the post by a competitor who was quicker to launch, or who offered more bells and whistles. And given the speed of technological developments, even those companies with established businesses can get gazumped by competitors launching similar products, only better.

I used to invest in Rakon, who this month was recognised as the New Zealand Trade and Enterprise Hi-Tech Company of the Decade (2000 – 2010). Rakon make satellite navigation components for smart phones and laptops. Rakon shares had an enormous valuation when we bought, and they were still relatively expensive when we sold. It is a company that should be successful, and it was pleasing to see them return to profitability in last week's profit result. But how do you value a technology company when it falls short of its targets and operates in a fiercely competitive and ever-evolving sector?

Rakon's revenues are not too much lower than LinkedIn's revenues at \$189 million, and given its market valuation of just \$200 million, it may be that Rakon is a screaming bargain. But how would you know?

Reid Hoffman knows how difficult it is to value technology companies. He made 80 early stage investments in technology start-ups before launching LinkedIn. Not all have been successful – that's the nature of technology investing. But when they are successful, they can be life-changing.

Hoffman was also an early investor in Facebook and when that company lists in the next year or so, his LinkedIn windfall might look like play money. You can't help but be a little envious, even if the numbers make absolutely no sense at all.

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