

Posted to the Gilder forum - February 25, 2000

First Kid on the Block

There is great interest among Gilderites to be the first to discover each new promising Telecosmic company. The current rage is a wireless optical miracle that is going to put NextLink and other spectrum owners out of business. It probably will happen, but my question is: "When?" Cisco is Crisco, but: "When?" To paraphrase Mark Twain: "The prompt demise of many companies is highly exaggerated." Also, the prompt market cap growth of these miracle companies is also highly exaggerated.

Don't get me wrong, I'm not bashing Gilder. And I'm also not telling people not to be the first kid on the block to own these future blockbusters. All I'm saying is that, for me, it is not a sound investment strategy. Could be that I'm way too conservative.

Gilder's job is to tell us about technology and he certainly does that to perfection. But it is our job to invest our money to the best effect and, in my opinion, being the first kid on the block to invest in a company is not the best strategy unless you are a venture capitalist (which I am not). Venture capitalists do a lot more detailed Due Diligence than we individual investors can accomplish and they get to have a say in the companies's management which we don't.

As individual investors we need different data that what venture capitalist use. We do not have inside information so we need public information. For me, the best public information, besides Gilder's blessing, is strong revenue and earnings growth and, at the very early stages, neither exists in these future IPOs.

My bias is not restricted to investing. My computers never have the latest operating system or the latest version of any program. After all, why should I debug all those programs for free? There are plenty nerds out there willing to do it! They make Bill Gates and Steve Jobs very happy! But I just want my computer to run and not crash. And it seems to work well for others too: Microsoft, IBM, Ford, and GM sell tons of obsolete technology and make tons of money off it. :)

The usual response to the above is that you can make more money by investing early. I'm not sure that reality bears this out. There are two reasons: Future miracles are more likely to bite the dust than players with solid revenues and earnings so the risk is higher. The second reason is the technology adoption "S" curve. According to Harry Dent, the life cycle of any technology can be divided into three equal time lapses. During the first third, the early adopters, the nerds, buy into the technology. During this first phase, there is about a 10% market penetration. During the second phase, which also accounts for about a third of the life time of the technology, the technology goes mainstream and market penetration quickly grow to 90%. During the last third of the life of the technology, the mature phase, 100% market penetration is achieved. It is quite clear that revenue and (hopefully) earnings growth will be strongest during the middle third of the technology's life time. It is also the time when the

herd discovers the technology, or rather, the companies that sell the technology. IMHO, the best time to invest is after the nerds have bought in and before the technology goes mainstream.

The Gorilla Game also supports this idea. According to the authors, there is a Tornado phase where several competitors vie for leadership position but the situation is usually chaotic and there is no way to foretell the eventual winner and gorilla.

Happy investing!

Denny