Google Tops Fifty Billion Market Cap With Innovation

By Mike Banks Valentine

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Yahoo See, Yahoo Buy Strategy Makes Them Number Two

by Mike Banks Valentine © October 26, 2004

Google market value has topped $50B, so now they're worth more in dollar value than Yahoo. That goes right in line with being worth more in search value and relevance. (CBS MarketWatch)

I've written before that Yahoo has their fingers in so many pies that they don't have the necessary attention on search that Google does. Google only buys companies that offer services, software and add−ons which increase the value of the Google search experience.
http://www.website101.com/arch/archive140.html

Yahoo buys companies when they think they might be able to squeeze some extra bit of profit from them and add to the already confusing array of services which take an alphabet soup of 109 Yahoo "properties", broken down alphabetically.
http://docs.yahoo.com/docs/family/more/

Yahoo bought up all the available search "properties" within the last couple of years and, as I said in mid−July of 2003, "Well if it is a horse race, Yahoo may gain on leader Google if they are able to integrate their Inktomi and Overture (and by extension, Altavista and Fast/AllTheWeb) purchases into relevant search results that searchers trust. But all of the

Jockeys on those horses will be whipping their charges toward the finish line with an eye to the winning purse."
http://searchengineoptimism.com/Yahoo_acquire_Overture.html

The fact is − Yahoo search is no better than Google now that they have bought up all real competitors. Referred traffic from Yahoo search results to web sites is still only one fifth that of Google at 70% versus Yahoo's anemic 15 to 20%.
http://searchengineoptimism.com/Google_refers_70_percent.html

The new MSN search may pose a threat to Google if they continue on their current path toward relevant search results. As of

October 2004, Google market capitalization of $52 billion with shares hovering around $160 per share price, reflects the true value of Google.

Yahoo is kind of like a WalMart, a "Portal" with everything under one roof and over a hundred wildly diverse "properties" that don't contribute to search relevance or search value.

Google confirmed today that they have no intention of becoming a portal, but instead intend to keep the laser focus on search that made them number one. This focus was underlined by CEO Eric Schmidt's comment in the Financial Times of London, "We are not building a browser," to stop that circulating rumor. (Financial Times)

Yahoo! Search has introduced a Google clone search page but who will see it? If you visit the Yahoo home page, you'll see a couple of hundred links to all their services such as Yahoo Jobs, Yahoo Dating, Yahoo Finance, Yahoo Mail, Yahoo Movies Yahoo Stores, Yahoo News, Yahoo Web Hosting, "More Yahoo" and "Even MORE Yahoo" links near the bottom of the home page, blah blah blah, etc. But they've put up an elegant Google clone for their search page at search.yahoo.com. That nobody will ever see unless it is bookmarked or typed directly into the browser address bar!

Yes, you can search from the Yahoo home page and that is the most prominent of all the Yahoo's glut of stuff, but I'll bet they posted this spare little copy of Google's home page to appease those who don't want to wade through the rest of the mess to get to search. This placement means that only those of us that purposely AVOID their home page and jump right to

search by typing http://search.yahoo.com/ into the address bar
will find that page.

That's the equivalent of MSN of course where you must type in
http://search.msn.com to see THEIR spare search page. But MSN
has at least kept some elements of branding in the design of
that page, while Yahoo has made their page LOOK like the Google
home page with a Yahoo logo. I can't wait to see how they'll
integrate Yahoo Desktop Search into the browser ... the same
way Google did.

Yahoo enters the Desktop Search race how? Buying a company!
According to Mike Grehan in a Pandia Search News article
"Yahoo! may also be joining in the race for Total Search. They
recently acquired the e−mail software company Stata Labs which
sells an e−mail application called Bloomba that lets people
search message text and attachments."

Today the market has confirmed what searchers already know,
that Google now tops Yahoo in financial relevance as well as
in search relevance. Google leads and Yahoo follows. Google
develops new technology while Yahoo buys it.

Google envisions & innovates but with Yahoo it's more like
"Yahoo see, Yahoo do" done by buying another company.

−−Mike Banks Valentine
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on the latest search news.−−−

An Analysis Of Overstock.com (OSTK)

By Geoff Gannon

Why is a value investor writing about an unprofitable internet company? Because value investing is about finding dollars that trade for fifty cents; with a market cap of less than 75% of sales, Overstock.com (OSTK) looks like it may be exactly that.

But isn't it too risky?

The greatest risk in any investment is the risk of overpaying. So, the real question is: what is Overstock worth? I think it's worth at least $1.5 billion. With Overstock's market cap currently sitting around $500 million, my valuation certainly looks far fetched. But, there's only one way to know for sure. Let's take apart my argument piece by piece, and see if any of my assumptions are unreasonable.

First Assumption: Over the next five years, Overstock will neither generate truly free cash flow nor consume cash. In other words, its free cash flow margin will average 0%. Cash generation in some years will exactly offset cash consumption in other years. Obviously, this assumption is unreasonable, because there is almost no chance the cash flows will exactly offset.

That's not a problem if it turns out Overstock does generate some free cash flow over the next five years. In that case, my assumption simply errs on the side of caution. If, however, it turns out Overstock actually consumes cash over the next five years, there is a problem - possibly a very big problem. So, which scenario is more likely?

Overstock's revenues are growing quickly. Gross margins look solid at 13.3% in 2004 and 14.9% over the last twelve months. Overstock's unprofitability is the result of its selling, general, and administrative expenses (SG&A) which have been growing exponentially. Will these expenses continue to grow? Yes, but not as fast as revenues. Over the last twelve months, Overstock's spending on cap ex has been 5.6% of sales. That number is an aberration. In the long run, spending on cap ex should not exceed 3% of sales. Considering the business Overstock is in and the expected sales growth, the company will, more likely than not, generate some free cash flow over the next five years. Therefore, the assumption that Overstock will be cash flow neutral over the next five years is not overly optimistic.

Second Assumption: Over the next five years, Overstock's sales will grow by 15% annually. Is this an unreasonable assumption? Again, I don't think it is. Very few industries are expected to grow as fast as eCommerce. Overstock's revenue growth in 2003 and 2004 was over 100%. In the past year, that growth has slowed. However, it is still closer to 50% than it is to 15%. Overstock isn't in a cyclical business. So, there is no reason to believe current sales are abnormally high.

Also, all that spending on advertising is increasing consumers' awareness of Overstock. A review of Overstock's traffic data shows it has not only been gaining more visitors; it has also been climbing the ranks of the most popular web sites. While it is a long, long way from the Amazons, Yahoos, and eBays of the world (and will never reach those heights) Overstock is becoming a well known internet destination. This fact was most clearly evident in the weeks leading up to Christmas. Shoppers who visited Overstock during the holiday season obviously know it exists, and may very well return at some other point in the year. Analysts are predicting very high growth rates for Overstock; however, they are also recommending you sell the stock. I don't put any weight in their estimates. But, for the other reasons given, I believe the assumption that Overstock will grow sales at 15% a year for the next five years is not unreasonable.

Third Assumption: Six to ten years from today, Overstock will have a free cash flow margin of 3%. Ten years from today, Overstock's free cash flow margin will rise to 4% and remain at that level. Now, of all the assumptions I've made, this one is the most questionable. Sure, Amazon has that kind of free cash flow margin, but Overstock isn't Amazon, and it never will be Amazon. Overstock's gross margins are less than Amazon's. In fact, Overstock's gross margins are less than Wal - Mart's. However, Overstock's fixed costs will eat up a much smaller portion of its sales than is the case over at Wal − Mart.

If you compare Overstock to other online retailers, you will see that if Overstock does experience strong sales growth, a 3% free cash flow margin six years from now is not unreasonable. I assumed Overstock's sustainable free cash flow margin will be 4%. There's a case to be made that 4% is too high. I won't make that case, because I don't believe in it. Remember, that 4% number comes ten years out. That gives Overstock plenty of time to grow sales and thus reduce SG&A as a percentage of sales.

Fourth Assumption: Six to ten years from today, Overstock will be growing sales by 12% a year; eleven to fifteen years from today, Overstock will be growing sales by 8% a year; thereafter, Overstock will grow sales by 4% a year. Let's see what this really means. According to these assumptions, Overstock's sales will be as follows:

Today: $707 million

2011: $1.59 billion

2016: $2.71 billion

2021: $3.83 billion

2026: $4.66 billion

2031: $5.67 billion

2036: $6.90 billion

Seven billion dollars is not an unreasonable target - if you have thirty years to achieve it. To put that figure in perspective, Amazon.com currently has sales of about $8 billion. So, even after thirty years, these assumptions don't lead to Overstock reaching the same size as today's Amazon. Don't forget these numbers assume some inflation. For instance, if inflation averages 3% a year over the next thirty years, Overstock's projected $6.90 billion in sales only translates to $2.84 billion in today's dollars. So, these assumptions only lead to a fourfold increase in Overstock's real sales over a period of thirty years. I think that's pretty reasonable.

If you take these four assumptions together, you get a value of $1.5 billion for Overstock. Today, Mr. Market is offering it for $500 million - that's why I'm writing about an unprofitable internet company.

Geoff Gannon is a full time investment writer. He writes a (print) quarterly investment newsletter and a daily value investing blog. He also produces a twice weekly (half hour) value investing podcast at:

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