



**>: Salesforce-Dot-Bomb (Part II) Â»**

*Wednesday, June 7, 2006 / Wayne Mulligan*

Sometimes I hate it when I'm right ? Especially when I know that some people didn't take my advice when I gave it to them.

I never want to be that "I told you so" guy. I merely want to help you protect your portfolio from any more *unnecessary* losses.

And just for the record, this isn't a "pat myself on the back" article either - my objective here is to help - to help you understand exactly why I recommended selling a particular stock a couple of months ago. This way, you'll know exactly what to look for going forward.

I'm not sure if you recall, but on March 14th I wrote an article for The Tycoon Report titled, "**SalesForce-Dot-Bomb.**"

In that article I laid down a very logical argument as to why SalesForce.com (Nasdaq: CRM) was not only overvalued, but also at risk of getting crushed by the competition.

Like I said, sometimes I hate it when I'm right.

At the time I wrote the article, SalesForce.com's stock was trading at \$40 per share.

For Fiscal Year 2005, the company had earned about \$7 million, and in 2004 it earned roughly \$3.5 million.

Like I said in my original analysis, doubling earnings is certainly impressive - that's a 100% growth rate, year-over-year. But, as I also mentioned, that was only for 2 years: In 2003 the company was still losing money.

### **It's All About a Track Record**

This is why a track record of consistent profitability is so important when investing in the technology sector.

Many of the areas technology businesses operate in are in their early growth stages. Why roll the dice on a company that has yet to prove that it can navigate the murky waters of a new industry?

The answer is: YOU SHOULDN'T!

If you pull up a quote for CRM right now, you'll see that the stock is trading closer to \$30 per share - a 25% drop in about 10 weeks!

The stock obviously didn't drop as soon as my finger hit the last letter on my keyboard - my timing on the call to unload any SalesForce.com shares in your portfolio was pretty much luck.

But the important thing to take from this is that my analysis was correct, and now I want to let you in on what went into that analysis.

### **What to Ask BEFORE Buying a Stock?**

No matter how great a company's business model is, or how "hot" its industry happens to be, you still have to ask yourself two very serious questions before ever purchasing a stock:

1. What is the company worth?
2. What do I have to pay for it?

On \$7 million in earnings, was SaleForce.com worth 4 billion dollars?

That's how high the company's market cap (Stock Price x Shares Outstanding) was when the stock was trading at \$40 back in March.

Those are big numbers, and I can understand if you don't see how insane that correlation is, so let's make this really simple ? I always like to use a lemonade stand as a basic business example.

Let's say your son or daughter had a lemonade stand in front of the house, and that he or she was charging \$.50 per cup of lemonade. It costs about \$.25 to make and sell each cup - so, profit per cup is 25 cents.

So on the first day, your kid sold 4 cups - Net Profit: \$1.00.

The next day he sold 8 cups - Net Profit: \$2.00.

At the end of the 2nd business day your child says, "Hey Dad (or Mom), I'm doing so well, I think I'll retire and sell my lemonade business - wanna buy it?"

So you decide to humor him and you say, "Ok sure, how much do you want for it?"

Your child replies with, "Well, since SalesForce.com just doubled its profits, I'll take the same multiple as they do, **152** times my profits for today - so you should pay me about **\$300** for my lemonade stand."

First, let me make one thing clear, if you have a young child that ever uses a line like that, stay extremely close to them, because they'll be worth a billion dollars by the time they're 25.

But now, would you ever seriously pay \$300 for a lemonade stand that did \$1 in profits for a day, and \$2 in profits on another day?

I sure hope not! Who's to say that this track record will continue? What if every kid on the block starts to set up a lemonade stand - won't your kid's business suffer?

These are all great questions. As a matter of fact, these are the EXACT questions you need to ask before investing in ANY company.

More importantly, these are the questions you should ask about every single company you have in your portfolio right now!

With the way the market has been trading, and with all of the rapid advances in technology, it only makes sense to reevaluate your portfolio on a regular basis.

Go through it. Find those overvalued "lemonade stand" stocks - and seriously consider taking some profits off the table. Otherwise, you might be looking at a 25% (or worse) loss before you know it.

Until next time ?



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Chief Investment Officer

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