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Fall and redemption

"The strange thing about technology," said Martin Hale, founder of Hale Capital Partners, a private-equity company devoted to nursing fallen companies, especially tech companies, back to health, "is it is a badge of honor to get completely wiped out as long as you come back."

Oracle Corp., EMC Corp., Apple, Inc. and Amazon.com, Inc. are among the famous fallen that picked themselves up, dusted themselves off and made their patient investors a bundle. At one point or another, each stock had lost more than 80% of its value only to rally from the bottom by more than 50-fold, thus leaving the faithful ahead by tenfold: "It is a distinct aspect of tech investing that one can have these massive rebirths."

To set the scene, Hale remarked on the bifurcation of tech-stock valuations. "Generally, the larger you get, the more they've gone up, and the smaller you get, the less they've gone up," he said. The upper deciles of the technology universe have been more expensive in only one point of history, and that was the six-month thrust to the March 2000 peak. Nor is the S&P 500, of which 31% of today's market cap comprises technology stocks, far behind the Nasdaq 100 in valuation. Said Hale: "Everything is expensive, and everything is near its peak."

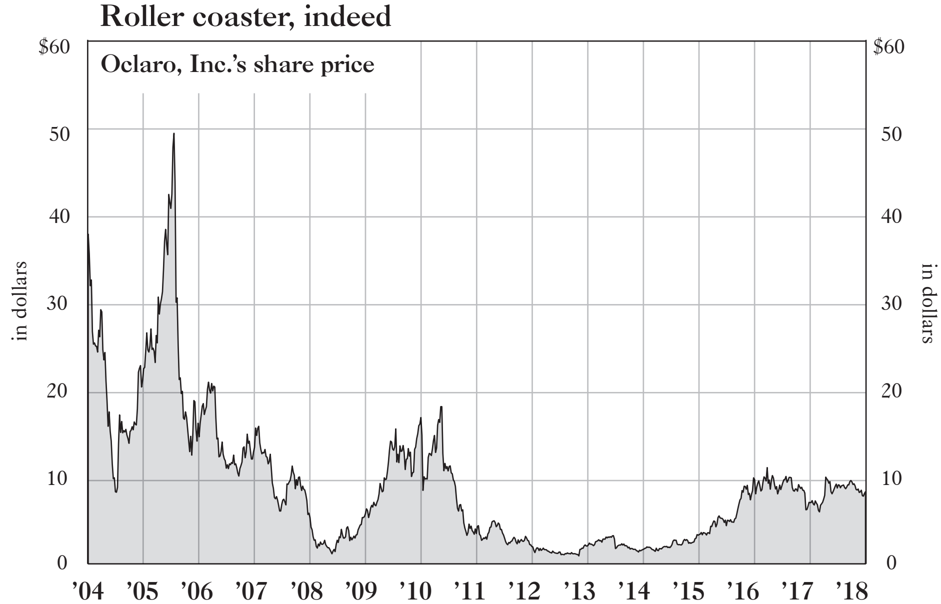
All the more notable, then, that 30% of all publicly traded tech companies are changing hands 70% off their highs. Nor will the percentage of bottom-dwellers likely decline in the next downturn. In the prior two recessions, said Hale, "70% of all tech companies lost 70% or more of their value."

Some, in fact, lost 90%—only to rebound by a factor of 10 or more (that's about 25% of the minus-90% cohort). Others, having lost that 90%, subsequently leapt by 50-fold (they represented 6% of the down-bigtime club). "This is why I am in this business," said Hale. "This is why I moved from normal series-A venture capital to investing in these deeply down-and-out public companies. When tech stops growing, it gets incredibly cheap. When it starts growing you can get way overrewarded."

You might suppose, Hale continued, that the winners suffer no more than a drawdown or two on the road to finally taking all. To illustrate the error of that supposition, he put up a price chart of Oclaro, Inc., the optical-products maker which is now a division of Lumentum Holdings, Inc. "Somewhat amazingly," said Hale, "this is a log chart from 70 cents at the bottom to $70 at the top. You will notice three periods of 80%-plus losses. A couple of them were in the high 90s—followed by periods of five times to 18 times gains." Oclaro isn't alone, Hale added—Emulex Corp. had six such loss-and-recovery events in a 34-year corporate lifespan. "Tech is a roller coaster, ladies and gentlemen."

Hale contended that poor governance is "endemic" to tech: "I happen to be on a lot of public company comp committees. I have one company where just last week I was arguing strenuously for return on invested capital for a long-

Roller coaster, indeed



source: The Bloomberg

term comp metric. I got a lot of blank stares. They are really good board members, too. Their response was 'show me another company that has ROIC metrics in tech.' I took the challenge. I went on the EDGAR website and searched for 'ROIC,' and lo and behold I came up with 12 companies in technology. Only 12."

The "first mover/first loser" effect is a tech trap to beware of—think Myspace before Facebook, said Hale. The "Tesla syndrome"—the blithe willingness to burn cash—is one more. "Then, finally, another common failure factor is just the swing in expectations. An example of this would be Amazon. It is a great company, and people got really excited by it. Then we hit the 2000 bubble and it lost 90% of its value, and it is still a great company."

"The down-and-out make an excellent hunting ground if approached actively and with a focus on loss aversion," Hale wound up. "There are some examples, like Avid Technology, Inc. (AVID on the Nasdaq)—we don't buy that much common stock, but that looks like one that could work. New management team, horrible value destruction over many years. We happen to like the CFO, he is an old CFO of ours. It seems like you have a couple hundred million software businesses stuck inside a hardware business. To us it looks pretty cheap at these prices. It is quite overleveraged and it looks awful, but of course it does at this stage."

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