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Financial Post: Technology

**Beware the VOIP hype: it looks a lot like dot-com deja vu: Valuations being made on potential rather than fundamentals**

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Financial Post

795 words

15 January 2004

National Post

FINP

National

FP10

English

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If and/or when Vonage Holdings Corp. announces plans for an initial public offering, it will be the ultimate indication the hype surrounding voice-over-Internet-Protocol technology has finally spun out of control.

This should not be taken as a direct assault on Vonage, which has convinced 90,000 people to sign up for telephone service that uses a high-speed Internet connection.

While Vonage has proven that VOIP technology works, investors should be leery about Vonage's business prospects because most of its partners are second and third-tier cable players, and it is only a matter of time before carriers and cable firms get into the market themselves.

For whatever reason, investors seem to believe VOIP is the next high-tech gold rush. There is a troubling parallel between how investors regard VOIP and the way they enthusiastically threw themselves into dot-com stocks.

Investors are jumping at the potential of VOIP rather than fundamentals. And this optimism is being buoyed by a growing amount of research that suggests the VOIP service and equipment markets will explode over the next four years.

All these elements were in place during the dot-com boom. Everyone bought into the belief that e-commerce would become so big, it would make bricks-and-mortar retailing an anachronism. While e-commerce is alive and well, it is nowhere near as big as many research firms and e-commerce players envisioned.

This is what makes the buzz about VOIP so puzzling. IP technology is interesting to carriers and cable firms because they can use it to efficiently send voice, video and data traffic over the same network. This could lower operational and maintenance costs by 20% to 50%, which is good news to carriers looking to boost the bottom line at a time when sales growth is stagnant.

The other key component of the IP equation is that carriers, cable firms and third-party service providers can provide new applications such as VOIP and unified messaging to generate more revenue. This is where a company such as Vonage comes into play, by using high-speed networks to create a "virtual" business with a modest amount of capital investment.

The potential of new services and more revenue are a compelling proposition that has captured the imagination of investors. The problem, however, is it is difficult to determine how much demand there will be for these services from corporate and residential customers, and how these services will be priced in a competitive market with low barriers to entry.

It is entirely possible that while IP will be a successful way for carriers to lower their network costs, companies that use the technology to roll out new services will operate in a low-margin, commodity market with far too much competition for anyone to be highly-profitable.

This is why investing in Vonage is such an uncertain proposition. For Vonage investors, including those who injected US\$35-million of private equity recently, the game is about having first-mover advantage. By establishing itself as one of the leading VOIP players, Vonage aims to cash in when the market is red hot. If Vonage turns into a viable business, that would be a bonus.

Investors, however, have bought into the idea that all VOIP-related companies are going to thrive. It explains why firms such as 8X8 Inc., Z-Tel Technologies Inc., VocalTec Communications Ltd., Net2Phone Inc., Nortel Networks Corp. and Lucent Technologies Inc. have touched 52-week highs recently.

8x8, which makes IP-based telephony and video equipment, symbolizes the disturbing disconnect between reality and investor mentality. The Santa Clara, Calif.-based company posted a loss of US\$800,000 on revenue of US\$4 million over the first half of fiscal 2004 but sports a market capitalization of US\$170-million after a two-month, four-fold rally.

After having a bird's eye fool of the dot-com boom, I can only decide this is deja vu over again. Ill-informed, speculative Investors are thinking with their hearts rather than their heads. If they believe VOIP is going to make them rich and revive the struggling telecom sector, there will be just as many broken hearts as when the dot-com bubble burst.

The only companies benefiting from the IP/VOIP hype are equipment makers such as Juniper Networks Inc., Nortel and Cisco Systems Inc., and carriers such as Telus Corp. and Verizon Communications Inc., which are using IP-based technology to lower costs.

For investors, the benefits are dramatically less real.

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Document FINP000020040115e01f0005p

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