Heard on the Street

Some Net Stocks Have Plunged From Their Dizzying Heights

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There has been an e-quake rumbling lately in some corners of the Internet sector.

While Internet stocks overall have corrected only slightly -- down about 5% since their breathtaking rise at year end -- some have plummeted since their highs. High-profile cyberstars such as iVillage, eToys and theglobe.com all have plummeted 75% or more from their 52-week highs.

Yes, micro-sections in the Internet sector have gone through severe corrections before. And, for many months now, Internet investors have strongly preferred shares of infrastructure and business-to-business Internet companies over so-called e-commerce Internet stocks, which depend on advertising.

But some Street specialists say there has recently been a drastic change of heart among investors about the Internet sector that could signal the start of a long-predicted winnowing of Internet companies by investors.

"It's definitely happening," says Henry Blodget, Merrill Lynch's Internet analyst. "You've seen some valuation compression, and Internet companies are not unusual and unique anymore. Now investors can pick and choose carefully and decide which companies are around for the long haul and which only came public because there was such a rage for anything Internet," Mr. Blodget adds. "There is not a reason to own the stock of a weak Internet company anymore."

Indeed, investors already have begun tossing aside those they see as weak. Consider this: Shares of more than one-third of the 47 leading Internet companies across a broad range of business lines have slumped more than 50% from their 52-week highs, according to Laszlo Birinyi, who runs an investment-research firm.

Says Mr. Birinyi: "The market is starting to mature, and there is a discrimination going on between viable companies and those that got a free ride."

Already, the fallout is showing up. Beyond.com, an e-commerce company, said Wednesday it will restructure its businesses, cutting 20% of its work force and search for a new chief executive. The move came after a recent earnings disappointment and a long slide in its stock, to $8.50 Wednesday from a high of $37 in April. And Value America, an Internet superstore, announced a major reorganization in January. Its stock has sunk to $5.50 from an April high of $74.25.

For many onetime darlings, such as iVillage and theglobe.com, the recent stock slide has been at e-speed. What has changed? Investors have sharpened their focus on individual business models and begun asking when -- and if
profits will enter the picture. iVillage has lost more than half its stock-market value in the past month and a half alone, down $1, or 6.2%, at $15.25 Wednesday in 4 p.m. trading on the Nasdaq Stock Market, compared with $32 at the end of November. It is now down 88% from its high of $130 last April 13.

Investors fret that the day iVillage will become profitable keeps getting pushed further and further out. The company says it hasn't changed anything about its message to investors concerning its timetable for profitability. Chris Monaghan, iVillage's chief financial officer, says he believes there is another issue at work: "Some investors are saying that other groups have a chance of breaking even more quickly than a media company like us."

There has been another big sea change. America Online's proposed merger with Time Warner has caused Internet investors to re-examine the entire sector. Now, some investors are being jolted into the realization that, if some smaller Internet companies are forced to choose a merger partner to survive, the offer may not come at a premium. Indeed, in the case of AOL, news of the merger has taken the stock down, from around $72 when the deal was announced to $64.50 in 4 p.m. trading Wednesday on the New York Stock Exchange, up $3.625.

An even bigger problem is the specter of dwindling cash reserves, in addition to questionable business models. Indeed, the Internet craze was born partly out of investors' willingness to allow Internet companies to raise vast amounts of capital to support their cash-hungry businesses. But, says Merrill's Mr. Blodget: "It's clear the market will be less willing to give them money to exist."

Many companies, he says, are going to need to raise additional capital to remain in business this year and, "for some of those, raising capital is going to be difficult." Mr. Blodget declines to name those Internet companies that are seen as cash-starved.

Cautions hedge-fund manager Seth Tobias: "The venture-capital market is going to shut down to companies whose business models are not seen as viable."

Make no mistake: The Internet sector in general, and many individual companies in particular, has shown odds-defying resilience. It is tricky business predicting any company's fall, especially one in a dynamic, growing industry like the Internet.

It is a situation Mr. Birinyi understands first-hand. On Tuesday, he says, he decided to do some "bottom fishing" in FreeMarkets, a business-to-business online auction company. "It plunged 10 points after I bought it and I thought it was the worst investment I've ever made," he says. FreeMarkets closed at $240.9375, up $69.6875, at 4 p.m. on Nasdaq.

Take a look at Amazon.com. Its shares have had a dozen rallies of 20% or more since mid-1997. On average, its rallies have taken the stock 150% higher. Its average decline, on the other hand, has taken the stock only 34% lower, for a shorter number of days.

Currently, Amazon is down about 37% since Dec. 10. "This correction has been a little longer and a little steeper than the average," says Mr. Birinyi. "But it's not off the charts."

Still, investors are less and less enamored of Amazon's, and other e-consumer companies', "spend now, spend later" strategies. "Many companies haven't given any visible indication of when they expect to earn a profit, and still they have ambitious spending plans," says Mitchell Rubin, co-manager of Baron Opportunity fund, a soon to be launched Internet fund with a, somewhat oxymoronic, "value" approach to the Internet sector.

An Amazon spokesman says: "We have been aggressively consistent in what we've said about our business."
We've said this is a pure play on long-term investing. We think that we are in a critical category-formation time, and it will only become more difficult in the future to build a brand in e-commerce.” But, the spokesman adds: "We have never put a date on calendar for profits.”

Another case in point: Webvan Group. While the idea of building a nationwide network for grocery deliveries sounded nifty to investors in the fall, they since have reconsidered. Now, the prospect has some investors wondering if the company's planned $1 billion build-out is worth waiting for.

"We have a unique business model," says Clarence Grebey, a Webvan spokesman. "We are redefining e-commerce, and a large infrastructure component needs to be built out to support our model.” But, he says, the $1 billion build-out has always been part of the plan.

Where the rubber will meet the road is unclear. But Merrill's Mr. Blodget says the shake-out, when it hits, will likely take a different form compared with other industries. Internet companies will begin to "throw in the towel, cut three-quarters of their work force and reorganize their strategy," he says.

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