

## ***SELL OR KEEP: OLD FAVORITES***

We've all got at least one of them: a former pride of our portfolio, that is now actually priced below our purchase price. But we have kept it, not wanting to sell for a loss. This is probably one of the most common investing errors: holding onto a loser with the hopes of achieving a 0% return on your investment, which is essentially what you're doing when you're just holding on till it gets back to what you paid for it.

So when do you give up and sell? There are really only four reasons or situations that should [trigger a sell](#):

1. When your security has reached your predetermined selling price (for profit or loss).
2. When you need the money for something else.
3. When you decide that you made a mistake in buying it in the first place.
4. When your opinion on the outlook for the security, the market, or the economy has changed; your original reason for buying is no longer valid.

The first three changes are fairly easy to recognize and act on, and they don't need to be elaborated on. The last reason, **the outlook change**, is the toughest to identify and/or admit, especially a change of view on an individual company you've held for a long time. The following situations best describe an outlook change that should trigger a sell:

- The **economy** is headed drastically downward, and your stock will go with it.
- Your stock is in an **industry** that is headed downward.
- A **negative event** or change at the company will negatively impact the stock price.
- It's obvious the stock is "**dead money**"—the price is not going up any time soon. Since this is difficult to admit, ask yourself if there is another, more profitable investment you'd make if you had the funds to pay for it. If yes, refer to reason #2.

Using these guidelines, I will try to make a Sell or Keep judgment on the following seven stocks, which I have recommended in the past. Not surprisingly, almost all are tech stocks, each one currently selling at a mere fraction of its former selling price. Here are summaries of each stock's outlook Then and Now, along with my judgment:

### **AOL**

**Then:** Three years ago I thought AOL management was visionary. They blanketed the country with CDs of free online minutes, accompanying every cereal box and newspaper, resulting in 20.5 million (narrowband) subscribers in 1999 and 25 million in 2000, although this last number admittedly may have been inflated. They bought Netscape in 1998 and later Time Warner, an enormous, if old-fashioned, media company. But they also overpaid for a number of dot-com companies that had no revenues.

**Now:** Management has failed to create an attractive broadband service, losing subscribers by the hundreds of thousands (more than 800,000 last quarter). They are now trying to attract customers by charging an add-on fee (\$15) to your monthly DSL or cable fee, in order to

receive AOL Broadband. In addition, good assets, e.g. Comedy Central and its DVD manufacturing unit, have been sold too cheaply in an effort to reduce debt. S&P assesses an intrinsic value of \$18 - \$20 per share; the stock is trading at \$16.

**Sell:** dead money: if they haven't figured out yet how to profit from the most subscribers . . .

## **CISCO SYSTEMS**

**Then:** Three years ago Cisco stock was in the 60s, down from over 100 earlier in 2000; but by spring of 2001 its price was down to where it is now, the high teens. But its P/E was over 100! (The S&P 500 P/E at that time was 30. Cisco was in the habit of acquiring companies to gain new technologies. In the late 90s and 2000 Cisco bought several companies with innovative technologies, paying billions of dollars for each.

**Now:** Cisco's current P/E is about 38, almost the same as the S&P's 36, even though the 5-year projected growth for Cisco is 17% versus the market's 13%. The company has no debt, \$21 billion in cash and investments; S&P expects revenues to grow about 8% in 2004, and they still dominate their industry. The latter is true because they still acquire companies to control new technology. Most recently they bought Linksys, a wireless fidelity component maker. "Wi-fi" is considered by many to be the next big thing.

**Keep:** They continue to dominate and increase market share, but growth is more modest.

## **CORNING**

**Then:** In 2000 Corning's stock price went from 40 all the way to the low 100s. At this time optical networking, which uses particles of light instead of electrons for the transmission of information, was going to create a "bandwidth paradise." Corning's superior technology allowed super speed and mass quantity of data transmission. In September 2000 Corning paid almost \$4 billion to acquire an optical company; in October 2000 Corning reported 3Q earnings of \$317 million, and the stock went from 101 to 71. The math speaks for itself: it's easy to see now the unreality of that purchase price. But investors themselves continued to overpay for stocks. One year later (fall 2001), the average P/E for communications equipment stocks was 46.9.\*

**Now:** Corning is still the technology leader and low-cost producer in optical fiber. But EPS have not been positive since 2000, and debt to equity is 110%. Corning's restructuring is going well. The firm has retired almost \$1 billion in convertible debt. S&P believes there is excess dark fiber available to carry traffic, indefinitely postponing the need to lay new optical fiber. The stock is trading at \$8; fair value is \$6.70, according to S&P.

**Sell:** The optical industry may see no demand for several years.

## **IBM**

**Then:** Three years ago the stock price was about \$120. CEO Lou Gerstner turned the presumed-dead technology company around during the 1990s. They bought Lotus and Tivoli Systems to energize growth in their software business. It became the IT one-stop shop, with its wide range of hardware, software, services, and partnerships with third-party vendors. Its diversity of products and its stable revenue stream from service contracts protected the firm from the devastation other tech firms experienced during the last couple years.

**Now:** \$20 billion in long-term debt is a definite negative, but the firm has \$8 billion in free cash flow, which somewhat offsets. The Services division has grown in double digits the last several years, and the company said last month that the software division could be up double digits in Q3. Losses in microelectronics were greater than expected, and their complex accounting has prompted an SEC investigation.

**Toss-up:** will probably do fine, but could be sold in order to buy something better

## ***INTEL***

**Then:** Three years ago Intel was trading in the 70s (P/E in the 50s). They dominated the microprocessor industry for PCs (80%+ market share), as well as for servers, and workstations. Intel's management, headed by Andy Grove, was very strong.

**Now:** They still dominate the PC microprocessor market, but that market has matured, stifling growth. S&P expects 9% revenue growth for 2003, and 15% for 2004. In March the company introduced their Centrino product, which allows wireless internet connectivity in laptops, considered the next big growth arena. Management is still strong. They recently raised guidance for the current quarter's revenues and profit margins. The stock is trading at a 52-week high around \$28, with a P/E again in the 50s.

**Keep:** Like Cisco, they continue to dominate, but growth is not what it once was.

## ***SUNMICROSYSTEMS***

**Then:** Three years ago Sun was trading in the 40s. Revenues increased 16% to 34% each year from 1998 to 2001 during the internet explosion, driven by demand for servers from the dot-coms and telecom companies. Sun invented the workstation and the Java object-oriented programming language, which can run on any kind of system. Since 2000 Sun also invested heavily in storage solutions.

**Now:** Its dot-com customers are gone, and the telecoms have so much unused capacity, it will be a couple more years before demand returns from that sector. IBM and Dell are successfully competing for the high-end and low-end server markets respectively. S&P expects 6.7% revenue growth in 2004, values Sun at \$3—it's currently trading above \$3—and rates Sun a Hold, even though its outlook rating is only 2 on a scale of 1 to 5, where 5 is the best. The company has plenty of cash, about \$2.6 billion, but not much else to be encouraged about.

**Sell:** dead money, unless they invent the next big thing soon

## ***TYCO***

**Then:** Three years ago I thought of Tyco as a one-stock mini-mutual fund, because of the conglomerate's four diverse divisions: health care, electronics, security/protection systems, and water flow/pipes and valves. The company increased revenues each year, and management was very reliable and accurate at revenue and earnings guidance. Early in 2002 the stock was near \$60, and then, due to questions about accounting practices with respect to their many acquisitions and the CEO being accused of tax evasion, the stock price plummeted to \$13 over the next six months.

**Now:** The company's businesses are electronics, health care, fire and security services, plastics and adhesives, and engineered products. The company has brought in respected executives from Motorola (Ed Breen) and United Technologies (David Fitzpatrick), and almost

all senior executives and the board were fired or replaced. Acquisitions are out of favor, limiting growth to about 5% over at least the next two years, according to Morningstar and S&P. The stock is trading around \$20, near S&P's fair value of \$22.70.

**Toss-up:** company has decent fundamentals and has eliminated debt, but without acquisitions growth is modest; with acquisitions accounting will continue to be suspect

**Final Comments:** I apologize for the two cop-outs (IBM and Tyco). You have to consider your own circumstances, and you may have valid reasons for disagreeing with my Sell or Keep judgments. Please understand that "Keep" does not mean "buy".

\*Briefing.com, Pricing Tech Stocks, 2/26/01

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