



## DISCOVERING VALUE WHITNEY TILSON JOHN HEINS

### The Case for Old Tech

In what seems like eons ago in Internet time, Rupert Murdoch's News Corp. paid \$580 million in 2005 to buy Myspace, then the phenom of the social-networking world. Commentators lauded Murdoch for his masterstroke in snatching the prize from other eager suitors, including Viacom chairman Sumner Redstone, who called losing out

on Myspace "humiliating."

Redstone should be thanking his lucky stars. With decidedly less fanfare, News Corp. agreed in June to sell Myspace for \$35 million to a little-known firm that helps businesses target their ads. Even that price appears generous, given that the business segment of News Corp. that largely consisted of Myspace reported operating losses of as much as \$150 million in the quarters leading up to the sale. Humiliating, indeed.

**Beware hot trends.** We bring this up not to kick Mr. Murdoch when he's down, but as a cautionary tale about betting heavily on the next new thing (for more on Murdoch's latest travails, see "How to Cash In on Scandal," on page 41). Investors have a time-honored pattern of surging toward the latest trend or the most buzz-worthy new product. We see this trend today as investors jump through

hoops to get a piece of the action in hot Internet companies such as LinkedIn (symbol LNKD), Facebook and Groupon (the last two have not yet gone public).

As bargain hunters, we have little appetite for next-new-thing stocks. That's not to say some won't turn out to be fabulous successes. It's just that we find it difficult to determine the fair value of such companies when so much of that value rests on highly uncertain future performance. Even if we could make a reasonable estimate of value, it's unlikely that any high-flying stock would trade at a large enough discount to that value for us to invest in it.

We tend to like older technology companies from which investors flee when hotter products come along. A perfect example today is in the computer-storage business. Makers of hard-disk drives, such as **SEAGATE TECHNOLOGY (SYMBOL STX)** and Western Digital (WDC), are

considered passé with the arrival of solid-state drives (SSDs), which are now the storage medium of choice for mobile devices, such as smart phones and tablet computers.

Although SSD technology offers advantages in speed and portability, it remains 10 to 15 times more costly for a given level of capacity than traditional hard-drive storage. Plus, skyrocketing demand for smart phones, iPads and the like will continue to soak up nearly all of the worldwide production of SSDs for some time, which means that virtually

that won't result in permanently higher profitability.

Seagate shares plunged recently after the company disclosed that a spike in the price of rare-earth elements, which are used in hard drives, was squeezing profit margins. The shares fell further during the market's summer turmoil. But we believe Seagate can generate earnings at a rate of \$2 to \$3 per share within a year. At \$11 (as of August 8), the stock trades at a ridiculously low 3.7 to 5.5 times potential earnings and yields a hefty 6.5% (Seagate has also bought back more than

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all computers will continue to use hard drives for a number of years.

Bolstering the hard-drive makers will be ever-rising consumer demand for additional storage capacity to maintain libraries of photos, music and video. Both Seagate and Western Digital should also benefit from a dramatically changed industry. After years of consolidation, they now hold roughly 90% of the global hard-drive market. It's hard to imagine

12% of its stock over the past three quarters). That's plenty cheap for us, so we have been adding to our position. We also think Western Digital is cheap, but we favor Seagate because of its lower price-earnings ratio and because it is returning cash to shareholders via dividends and share repurchases faster than Western Digital is. ■

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