Taking Stock: Google and Microsoft just don't compute

by Malcolm_Berko

Dear Mr. Berko: In July, when it was selling at $550 a share I asked you about Google. You said not to buy it. But I bought 50 shares at $492 anyway. Also against your advice, I bought 900 shares of Microsoft at $27. Both stocks closed lower than my purchase price on the day I bought them. I guess that was a bad omen, because I'm down nearly 20 points, or $10,000, on Google. I am down 8 points on Microsoft, or $7,000. That's not all. Commissions, if I sell both stocks, will be about $1,000. But I did follow your advice on shares of the New York Stock Exchange and didn't buy the stock. I should have shorted 500 at $50 as you recommended in your column so I'd have a nice $15,000 gain. Please tell me if I should sell, hold or buy Google, and if I should sell, hold or buy Microsoft. â€” S.G., Harrisburg, Pa.

Dear S.G.: You will continue to lose money if you continue paying those outlandish commissions to your broker.

In July, Google Inc. (GOOG-$347) was trading at 44 times earnings, and nothing in the world is worth 44 times earnings, not even Mabel's Chicken Ranch in Las Vegas. Back then I didn't like GOOG because I think the company would suffer enormously if a competitor developed a superior search engine. And I continue to hear stories of several visionary, super-duper search engines that would relegate GOOGLE-SEARCH to abacus status. Back then, I didn't like GOOG because 70 percent of its key staff had become financially independent and today almost all of those folks are ready to cash in their chips. I didn't like GOOG back then because I believed its rapid growth in advertising revenues would soon begin to slake.

I didn't like GOOG back then because huge, expensive, capital investments like Google Earth or YouTube â€” while fascinating and perhaps even able to enhance GOOG's image, are revenue negative. And those massive investments are harmful to book value.

I didn't like GOOG back then because it was trading at 44 times earnings, which I thought smacked of the excessive hubris that was so prevalent during the dot-com days of the late 1990s. And I didn't like GOOG because I believed it was guilty of bad judgment when it purchased YouTube.

Today, I don't like GOOG for all the same reasons. And while the P/E ratio has crashed from 44 to 27, I still don't like GOOG.

Even at a price-to-earnings ratio of 27, its stock price is too high. While advertising revenues will increase this year, the rate of increase is decreasing rapidly.

A possible warning shot across the bow is GOOG's 2008 fourth quarter earnings report. Management reported $1.21, which missed prior fourth quarter earnings of 70 percent. Certainly, that was an aberration. But you know what they say about cockroaches. When you see one cockroach scurry across the kitchen floor, it's "almost" certain that others will follow. Sell GOOG.

I have a sport coat made from Microsoft fiber, an operating system by the same company and I don't care a tick or jot for either. Frankly, I haven't liked Microsoft since Bill Gates announced in December 1999 that he prefers Earl Grey tea to coffee. But Microsoft will continue to suck in billions of dollars because consumers continue to be suckered by Microsoft's (MSFT-$17.80) concept of "planned system obsolescence."

To 85 percent of MFST users, it doesn't matter a tinker's damn if they use Windows 95, Windows 96, Windows 97, Windows 98, Windows 99 or Windows 2000. Any operating system higher than Windows 98 is superfluous and overkill.

Though revenues and earnings have increased every year since 1990, this is the first time I've seen MSFT trade below $20 a share. Yet analysts on Wall Street treat this company like a whilom lover. And in spite of the fact that very few, if any, long-term investors or mutual funds have made money on this stock, legions of Wall Street chuckleheads with MBAs and Ph.D.s continue to recommend MSFT and covet the stock regardless of its sorry performance.

While revenues have increase nicely, in the past 16 years MSFT's operating margins have declined from 58 percent to an expected 39 percent this year. While earnings have increased almost every year since 1990, net profit margins have fallen from 35 percent to an expected 28 percent in 2009. So, considering its jejune performance, I can't find a compelling reason to own this discouraging investment.

I can't imagine why funds like Barclays, Vanguard, Fidelity, Wellington, T. Rowe Price, American, Franklin and others, for years, continue to own hundreds of millions of shares and have never earned a profit on their positions. MSFT might move back up to the low $20s in the next few months. And when it does, get rid of it.

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