

THINK POINTS

- Discounted cash flow/P/E to growth and price-to sales are the two primary valuation techniques for growth companies.
- Price-to-sales is particularly useful for a fast-growing, unprofitable (or barely profitable) emerging company.
- Long-term earnings growth is what determines stock performance, but in the short term, a number of factors influence share price, including interest rates, debt valuations, investor sentiment, money flows, and multiple trends, among others.

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Sources and Resources— Finding Ideas

"The person that turns over the most rocks wins the game.
And that's always been my philosophy."

—PETER LYNCH

SO WE HAVE A PHILOSOPHY—*earnings growth drives stock price*. We have some core principles to guide our investment process—the *10 Commandments*. We have a framework for looking at industries that are benefiting from secular tailwinds—*megatrend analysis*. We have a discipline for analyzing the core fundamentals of a great growth company—the *four Ps*. We have a valuation methodology that gives us a perspective on the relative value of a company—the 6 Is, P/E to growth, and P/S versus margins and growth.

But we still need to find ideas to funnel into our process.

To locate great ideas on where tomorrow's stars will be, you need a systematic and strategic process, just like you do to analyze these ideas once you find them. In a world of information overload, what's the best way to prioritize your time and resources?

There is no getting around it; the harder you work, the more good ideas you are going to find (the harder I work, the luckier I get)! But it's important to work smart.

The Internet is the world's most efficient research tool, and Google is the engine that drives it. In the old days, subscribing to dozens of regional newspapers and observing magazines was a way to flag ideas early. Now, Google will push relevant articles onto your desktop.

Reading newspapers and magazines, listening to industry experts,

knowing what smart public and private investors are doing, and asking the right questions when doing your homework (who is your toughest competitor and why?) are all part of the idea toolbox.

I read four newspapers a day, including the *New York Times* for the news, *USA Today* to get a pulse on what the average American is thinking, the *Wall Street Journal* to know what the investment community is thinking, and the *San Jose Mercury News* so I'm not clueless in my community (it also has a very good business section). I've tried to read the *Financial Times* for a global perspective, but aside from the famous Lex Column, I find it not worth my time or \$1 newsstand price.

I read, or I should say scan, those four papers in no more than 20 minutes. But if I were going to read one newspaper, it would be *Investor's Business Daily* (*IBD*). It's 50 times more useful for growth ideas than the four others combined. *Investor's Business Daily* is systematic about providing valuable data that I can use to examine companies and industries that could be of interest.

I first go to the "Daily Graph" section that highlights companies that are experiencing investor interest. Increased investor attention can be an early indicator that something is going positive in a company; good financial numbers often follow.

Next, I look at companies making the "New Highs" list—again a fertile ground for identifying companies whose fundamentals are good and getting better. The "buy cheap stocks" crowd laughs at people like me who are looking at companies that are making new market highs because all the smart people know that "you buy low and sell high." However, my simple brain knows that Wal-Mart, Starbucks, Dell, and Yahoo! were by definition making new highs routinely. Wal-Mart, on its way to a \$200 billion market cap, made "new highs" at \$500 million, \$1 billion, \$5 billion, \$25 billion, and so on. Conversely, most of the companies that were in the bargain basement were never heard from again. I agree with Peter Lynch—I don't mind buying high and selling higher.

I then go to the "Earnings News" section, looking for rapidly growing companies, preferably those with accelerating revenue and earnings growth.

Next I read the "New America" section, which often highlights small, emerging companies. The articles on these companies are unlikely to re-

ceive a Pulitzer Prize, but "New America" highlights emerging companies well.

The "Internet & Technology" and "Health & Medicine" sections often highlight emerging trends and new leaders. I always review the recent and upcoming IPO table to see what's new and what's hot. IPOs are a gold mine to identify new potential leaders.

The last table I look at daily is the top-performing industry groups. *IBD* ranks 197 industry groups daily with leading groups often signaling strong underlying fundamental growth.

On Friday there is a special "Weekend Section" showing stock charts with fundamental data such as historic earnings growth, relative strength, and earnings momentum for dozens of companies.

Mondays' *IBD* (which you can pick up on Saturday) ranks the 100 strongest growth companies by sales momentum, earnings growth, margins, and ROE.

Does it seem ridiculous that I just walked through how to read a newspaper? The funny thing is, if investors searching for tomorrow's big winners just did what I described in a disciplined fashion, they would have a decent chance for success. All it takes is 20 minutes and \$1.25. The online version, investors.com, is good, but I like the actual paper.

Key Features of *Investor's Business Daily*

- "NASDAQ Stocks in the News"
- "New Highs and Lows"
- "Earnings News"
- "New America"
- "Internet & Technology"
- "Health & Medicine"
- "Industry Groups"
- "Friday's Weekend Graphs"
- "Monday's *IBD* 100"
- "New Issues"

I get dozens of magazines to get a general pulse for business. Tim Mullaney, who writes on technology trends in *BusinessWeek*, has an excellent nose for ideas.

I think *Newsweek* does the best job of general news reporting, and its “Conventional Wisdom” summary gives an edgy perspective on newsmakers of the day. The political cartoons provide a pulse on what society is thinking.

Fortune has very good business articles, and *Forbes* has some interesting profiles, but it’s rare to find anything terribly insightful regarding where the future winners will be.

If I could read only one business or news magazine, there is no question it would be *The Economist*, which is incredible. Besides providing well-written, well-reported global insights on business, politics, and society, *The Economist* has very well researched quarterly industry pieces that are chock-full of great information.

Will we find great investment ideas in any of the general periodicals? Not often, but it helps to create a worldview that ideas need to be filtered through.

Wired and *Business 2.0* provide a forward-looking approach and both often highlight cool new technologies and offer a window to the future.

The blogosphere is without question the place where the best dialogue on tomorrow’s winners will take place. The hard part will be to sort through the noise and engage in smart conversation.

I am a contributor and fan of Tony Perkins’s *AlwaysOn Open Media*. It’s early in terms of the richness in dialogue, but there are already some outstanding contributors and great ideas.

On ThinkEquity’s blog (*ThinkBlog*), we link to some of our favorite blogs, which include Bill Gurley’s *Above the Crowd* as well as Bill Burnham’s blog.

Some of the blogs I love include:

- AlwaysOn Network* (alwayson-network.com)
- Bill Burnham (billburnham.blogs.com/burnhamsbeat)
- Bill Gurley (abovethecrowd.com)
- Business 2.0 Blog* (business2.blogs.com/business2blog)
- Canslim Investing* (canslim.net)
- Capital Spectator* (capitalspectator.com)
- Engadget* (engadget.com)

- Gizmodo (gizmodo.com)
- Hidden Gems (investorideas.com)
- Jonathan Schwartz’s *Blog* (blogs.sun.com/jonathan)
- Mark Cuban’s *Blog Maverick* (blogmaverick.com)
- PIMCO’s *Investment Outlook* from Bill Gross (pimco.com)
- Seeking Alpha* (seekingalpha.com)
- The Big Picture* (bigpicture.typepad.com)
- The Healthcare Blog* (thehealthcareblog.com)
- ThinkBlog* (thinkequity.com/blog)
- VentureBeat* (venturebeat.com)
- VentureBlog* (ventureblog.com)
- Wired* (blog.wired.com)

I also track leading growth investors and venture capitalists in terms of investments they are making. This may not sound terribly original, but if you’d bought the stocks Warren Buffett listed in the must-read Berkshire Hathaway Annual Report every year, you would have dramatically outperformed the market.

STAR GAZER

RICHARD PERKINS

Founder, president, top portfolio manager, and director of Perkins Capital Management

Richard (Perky) Perkins has been investing in emerging growth companies for more than 50 years. Prior to founding early stage Capital Management, Perky was head of Institutional Sales and Research at Piper Jaffray. Perky started his career as a portfolio manager for the Mayo Clinic Foundation, and later as a full-time analyst with Plana. Perky is a frequent speaker at industry events.



venture capital, firms with previous success have an unfair advantage because an entrepreneur with a hot idea will want one of the leading venture groups to invest to give his or her company the Good House-keeping Seal of approval.

Kleiner Perkins and Sequoia were allowed to invest in Google. Undoubtedly, there were other VCs that may have paid three times the price, but the Google management team wanted the imprimatur of the gold-plated VC firms.

Some of the venture capital firms we focus on are Kleiner Perkins (the New York Yankees of venture capital, with legendary partners John Doerr and Vinod Khosla); Sequoia (the Boston Red Sox, with Michael Moritz and Don Valentine); Benchmark (with Bruce Dunlevie, Kevin Harvey, and Bob Kagle); NEA (with Dick Kramlich); Battery; Bain; Warburg Pincus; MPM; Versant; Redpoint (with Geoff Yang); and Draper Fisher Jurvetson (with Tim Draper and Steve Jurvetson).

By no means is this a comprehensive list of venture firms that have great portfolio companies, but by just monitoring this handful of firms, an investor will be on top of many of the important trends and ideas over the next 10 years—because that's the time frame for which great VCs are investing. Similarly, if I wanted to spot the next blockbuster film, I'd track what Steven Spielberg was working on.

The government puts out some great information as well. The U.S. Department of Labor provides data on where the market job growth is, what cities are booming, hot careers, and good general economic indicators. The U.S. Department of Energy gives great info on alternative energy and initiatives in energy technology. The U.S. Bureau of the Census provides information on everything you could want to know about the U.S. population and demographic trends. The Centers for Disease Control and Prevention (CDC) has tremendous information about health, medical, and safety issues.

Similarly, tracking what all-star emerging growth portfolio managers have invested in can be a great source of ideas.

Investors we track include Richard Driehaus of Driehaus Capital Management; Joe McNay from Essex, Ron Baron and Cliff Greenberg of Baron Asset Management, Dick Gilder of Gilder Gagnon, Art Samberg of Pequot, Drew Cupps of Cupps Asset Management, and Jack Laporte of T. Rowe Price. These investors have shown a consistent ability to be early and right in many of the big winners in the market.

I track the following public growth investors:

Art Samberg, Pequot	Jim Callinan, RS
Cliff Greenberg, Baron	Joe McNay, Essex
Asset Management	Mark Waterhouse, The Hartford
Dick Gilder, Gilder Gagnon	Richard Driehaus, Driehaus
Dick Perkins, Perkins Capital	Capital Management
Drew Cupps, Cupps	Rick Leggett, Arbor Capital
Asset Management	Ron Baron, Baron Asset
Hans Utsch, Federated	Management
Kaufmann	Tom Press, American Growth
Jack Laporte, T. Rowe Price	Century

It's a bit more difficult to get this information for free, but Yahoo! Finance lists shareholders at no cost and Bloomberg, Thomson, William O'Neil (the publisher of *Investor's Business Daily*), and Big Dough are all services that provide institutional portfolio holdings.

On the venture capital side, there are more than 500 venture capital firms, but relatively few are routinely involved with the huge winners. In

VCs WE TRACK		NAME	PAST	FUTURE
Maveron	eBay, Quellos	Cranium, Pqibelly's, EOS, Good Technology, El Dorado Marketing		
Mobius	Yahoo!	Sling Media, Pay By Touch, Postini, Reactrix, LR Learnings		
MPM	Accorda, Idenix, Pharmasset	Affymax, Elixir Pharmaceuticals		
NEA	Foxhollow Technologies, Juniper Networks, Salesforce.com, WebEx, WebMD	Ion America, Allen Technology, Glu Mobile, United Platform Tech, IP Unity, Visto		
Redpoint	Askjeeves, Foundry Networks, Netfix, Polycm, Sybase, Tivo, Myspace.com, MusiCMatch	MobITV, Fotinet, BigBand Networks, Calix Networks		
Sequoia Capital	Apple, Atari, Oracle, Symantec, Electronics Arts, PayPal, Google, Yahoo!	GameFly, Digital Chocolate, eHarmony, FON, LinkedIn, Plaxo, Podshow, WeatherBug, Zappos.com, Netezza, ProSoght		
TCV	Altiris, Expedia.com, Netfix, Real Net-works, CNet	eBags, eHarmony, Liquidnet, Thinkorswim, TechTarget		
Versant	CombiChem, Coulter Pharmaceutical, CV Therapeutics, Onyx Pharmaceutical, Symyx, Tularik, Valentis	Jazz Pharmaceuticals, Novacea, Pharmion, Reliant, Salmexid, Syrx		
Warburg Pincus	BEA, Neustar, Kyphon, Avaya	4GL School Solutions, Aspen Education Group, The Cobalt Group, Kineto Wireless, UGS		

VCs WE TRACK		NAME	PAST	FUTURE
Accel	Veritas, Walmart.com, Macromedia, Wiley, Perabli, Polycm, RealNetworks	JBoss, Xensource, facebook.com		
Bain	Shopping.com, Web Methods, Taleo Corp	El Dorado Marketing, UGS, M-Gube		
Battery Ventures	Akamai	Arbor Networks, Ruckus Network, IP Unity, Bladologic, Netezza, Aurora Networks		
Benchmark	Red Hat, Palm, Jamdat, AOL, Nordstrom.com, eBay	Jamba Juice, Nansolar, Tropos Networks, Kalido, Logoworks, Good Technology, Tellme, CollabNet, eBags, Koniki		
The Carlyle Group	Align Technology, Blackboard, ctrp.com, Duratek	Ingenio, Pacific Telecom, Target Media Network		
Crescendo Ventures	Ciena, Digital Island, Aljety, Elasant, Lightspeed	Broadsoft, Esilicon, Envivio, Tropic Networks, Pure Digital		
DFJ	Skype, Baidu, NetZero, Hotmail, Focus Media, Overture	Epocrates, Nano Opto, Nanosting, ZettaCore, Ingenio, Techoratti, Zars, Visto, Molecular Imprints, Neophotonics		
General Atlantic	MarketWatch, Daksh, E*Trade, Managistics, Staples.com	SSA Global, Hewitt Associates, webloyalty.com, Lenovo, Zagat.com, ProPay		
Kleiner Perkins	Amazon, Google, Genentech, Netscape, Sun, Symantec	Good Technology, Tellme Networks, Podshow, Visible Path, Zazzle, Digital Chocolate, IP Unity, Zettacore, ZVR		