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Dot.coms have their own math

A flood of publicity recently heralded the return to Canada of an entrepreneur who had been involved with a U.S. Internet company and now plans to establish a Canadian Internet incubator.

One newspaper reported that he was returning from a "wildly successful" Internet company. The use of that phrase seemed odd: After all, here was a company that had sales in the most recent quarter of only $2-million (U.S.), a loss of $6-million and a market capitalization of $2.6-billion.

We all know that Internet stock values can be wacky. But in reading this article, as a long-time chartered accountant, I realized I've been missing the picture. Sometime in the past five years, those crafty folks in the "dot.com" world have invented a new method of analyzing and valuing companies.

When I grasped this, I undertook a lengthy research project into the new math associated with dot.com companies. Study the results of this research closely, since it will be the best way to understand how a company in the Internet world is judged to be "wildly successful."

The key is that dot.com companies sometimes use the same acronyms or financial phrases as old economy companies, but they mean something else altogether. In other cases, they've invented entirely new financial measures. Here's what the research reveals:

Revenue or sales. For dot.com companies, this is a widely unused and unnecessary financial number. Ideally, if such a financial measure yields a number, it should be as close to zero as possible.

Of course, this can be a problem for many old economy companies eager to transform themselves into dot.com companies.

Gross profit/loss. With a dot.com company, the word profit doesn't even show up on the radar screen. You'll only ever see the word loss. As a measure of success, the bigger the gross loss, the better. This will indicate that the dot.com company has fortitude and courage.

EPS. In the old economy, this means earnings per share. A meaningless statistic for dot.com companies, given the distinct lack of earnings. However, the meaning of EPS can be slightly altered to become an important measure to judge the potential success of a dot.com company. Closely examine the EPSM, or earrings per squaremetre ratio. If this number is above 2, it indicates that the company employs few people over the age of 30, which will help ensure that the company isn't contaminated by any old economy ideas.

Cash flow. For old economy companies, this was a useful measure to determine if the company was successful as a business. A positive number was a good thing. But for a dot.com company, make sure this is a negative number.

Keep in mind that dot.com companies use a new measure of cash flow, known as DBNIPO — which stands for, days before next initial public offering. Similar to the concept of cash flow, this measure is useful to dot.com staff, which needs to determine how they can pay for all those shiny new Porsche 911s in the parking lot.

Assets. You've got to be kidding. Dot.com companies don't believe in such an archaic concept. The only assets might be a few computers, and a fridge stuffed full of Twinkies and Jolt Cola.

A better measure is the PRAISE ratio, (which stands for, PR agencies with Internet startup expertise). If this number is high, it means that the company has hired the best agencies to help build hype about the company's potential.

SE. Old economy companies refer to it as shareholder equity. Dot.coms refer to it as "suckers equity."

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