# Investors drawn to exploding social media

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For every powerhouse like Google, there are dozens of Internet companies that flop. Still, a decade after the dot-com bubble that burst, there is no shortage of investors trying to get a piece of the next online blockbuster.

Lately, much of the hype has centered on social media.

While many of the big names - Facebook, LinkedIn and Twitter - may sell stock publicly through IPOs one day, they have been raising capital by selling stakes to institutional investors, venture capitalists and wealthy investors. Mom-and-pop investors - and users of social media - also are angling for ways to invest in these private companies.

Earlier this month, California investment company NeXt BDC Capital Corp. started a closed-end mutual fund to buy shares in fast-growing private tech startups, which could include Facebook and other social media. That would give the public, who can buy closed-end shares that are traded like stocks, a chance to get in on the action.

And some mutual funds are reporting stakes in social media, though those investments are often only a fraction of a fund's portfolio. Baltimore's T. Rowe Price Group was one of several companies reportedly in talks to buy stakes in online deal site Groupon. T. Rowe Price is not commenting, but after avoiding the tech fads during the Internet bubble, the company has dabbled in the social media space through several of its funds.

But while early investing can mean the potential payoff is greater, so are the risks.

"The question for investors is: When you look at some of the private companies out there, are they the next Google or not?" said Jordan Rohan, an Internet analyst at Stifel Nicolaus. "There's no easy answer to that."

With little public information about the financial performance of social media, it's difficult to put a value on these private companies and many other tech startups, analysts said. And questions remain about whether the hot startups can turn a profit and sustain it.

"One of the major issues - this goes back to the dot-com crisis and the bubble effect - is everything is based on an estimation," said Roger Staiger, an adjunct professor of finance at Johns Hopkins University's Carey School of Business. "It's not really based on real cash projection."

Investors also need to consider the fluidity of social media - where technology, trends and consumer interest can swiftly change, analysts said.

Just a few years ago, MySpace was the dominant social networking website, and it was snatched up by News Corp. for $580 million in 2005. But Facebook has now taken over, and MySpace announced plans last week to lay off nearly half of its work force.

"Sustaining a social network allure is difficult to achieve," said Rohan of Stifel. "So far, Facebook and a handful of others have done so. The allure of MySpace has faded."

But unlike the buying frenzy during the 1990s dot-com boom, which pumped up the stocks of many companies, today's investors are putting up the cash for a more select group of private startups, said Harry Weller, a general partner of venture capital firm NEA, an early investor in Groupon.

"People are more focused on investing in the winners because of the lessons learned during the Internet bubble," said Weller, who sits on Groupon's board.

Indeed, venture capitalists and other big investors are pouring hundreds of millions of dollars into recognizable names.

Goldman Sachs, which bought a stake in Facebook for $450 million a few weeks ago, has offered wealthy international clients an opportunity to buy shares of the social networking site now valued at $50 billion. Groupon raised $950 million during its most recent private fund-raising. Groupon is pushing ahead with plans for a public offering that could value the company at $15 billion, according to published reports late last week.

Wealthy individuals can buy private stocks of Facebook, Twitter and other tech startups on secondary trading markets like SecondMarket and SharesPost.

Individuals must have income exceeding $200,000 or $1 million in assets to trade stocks on these secondary exchanges. On SecondMarket, for instance, the average transaction size is $2 million, according to spokeswoman Aishwarya Iyer.

Such trades have drawn the attention of the Securities and Exchange Commission, which is looking into whether it enables some firms to avoid public financial disclosure requirements. SecondMarket said this month that it received a request for information regarding "pre-IPO pooled investment funds" and is cooperating with the regulator's inquiry.

Staiger of the Carey business school said such private investment should be limited to wealthy individuals because "common shareholders are not going to understand the complexity of the product."

"I don't actually mind the fruits going to the high-net-worth investors because they're taking the high risks," he said.

But retail investors aren't completely out of the loop.

T. Rowe Price bought shares last year in Twitter through some of its mutual funds, allowing ordinary retail investors to own a piece of the popular microblogging site, albeit a tiny slice.

T. Rowe Price's New Horizons Fund, for instance, bought Twitter shares in September 2009 valued at $15.3 million, representing less than half of 1 percent of the fund's assets as of the third quarter, the latest information available. The fund also owns shares of social-networking company Ning and online review site Angie's List.

Katie Rushkewicz, a Morningstar analyst who follows the New Horizons Fund, said the fund isn't taking a "huge bet" on these private startups, though if they were to go public at some point, "that would obviously be quite a boost in returns."

"Given T. Rowe Price's reputation for really focusing on research, they're just not randomly picking the small companies and throwing money into them," she said. "It's obviously something they believe in."

Some of today's hot social media startups will eventually sell stock to the rest of the investing public, but right now they haven't needed to because they have been able to raise capital privately, said Weller of NEA.

For average investors, it makes sense to wait for an initial public offering, he said.

"People greatly underappreciate the risks that venture capitalists take," Weller said

Weller recalls the IPOs of the dot-com era: "What happened was the institutional and individual investor base got so excited about a fundamental movement, the Internet, that they took bigger and bigger risks letting early-stage companies do IPOs. That's what created the Internet bubble."