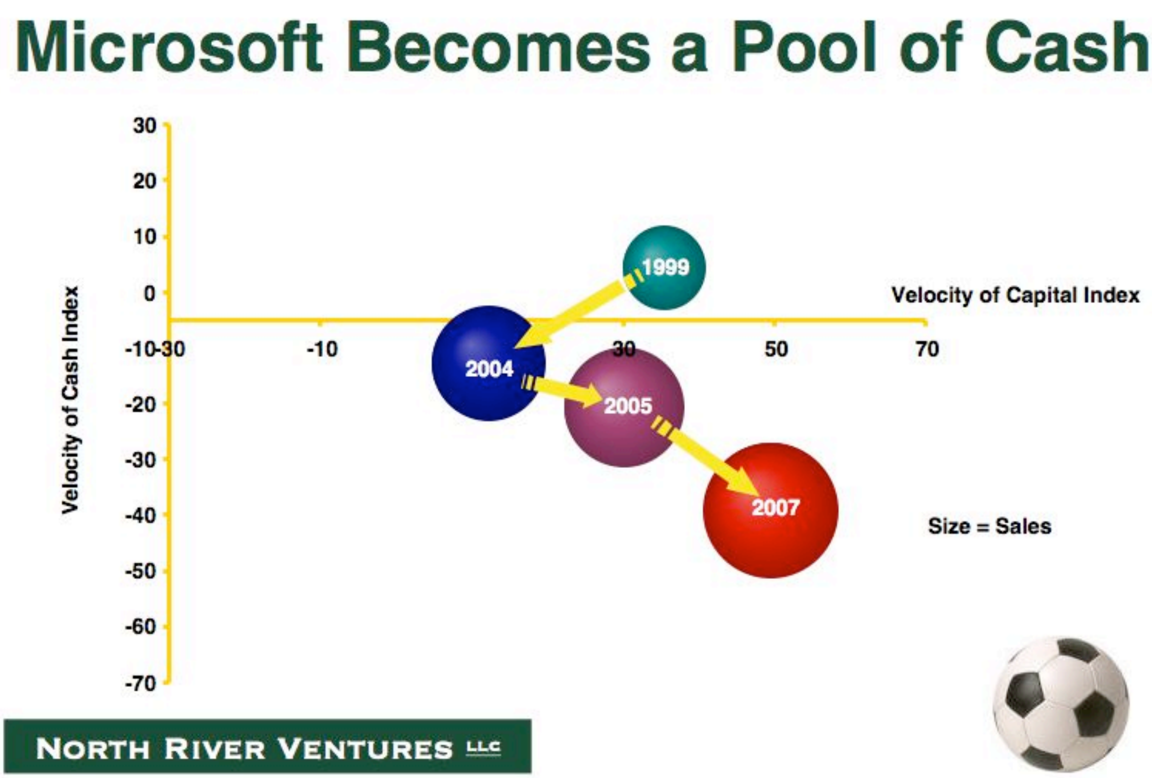
[Course Corrections]()

Microsoft Stumbles

New York — Here's one you can call me on: if **Microsoft** acquires **Yahoo,** as it intends, it will write down Yahoo's full value within five years.

Why? Microsoft has become what Michael Dell calls "a pool of cash." Its all-important **North River Velocity of Cash Index** has fallen steadily since 1999, when it was 5, to -39 today. That indicates a significant and steady decline in management controls. Which in turn gives you a precise indication of its ability — or inability — to make sizable acquisitions accretive.



There is no doubt whatsoever from these data — and CEO Steve Ballmer should know this — that Microsoft will have to write down the deal. My data have not been wrong in the past and to bet against them you would have to have some very powerful reasons. Ballmer has yet to offer any.

The market gets this. At the end of Microsoft's 1999 fiscal year, when the **North River Velocity** data began tracking the company, MSFT traded for $43 and the **S&P 500** was 1,329. Today the S&P 500 is exactly where it was then but MSFT is trading 30% lower. In effect, nothing MSFT has done since 1999 has been accretive. Not Vista, not Xbox, nothing. That's a lot of zeros. Minuses actually.

How far off base is MSFT management? Ballmer was quoted in the New York Times on Saturday as saying, "If we don't get it right at first, we'll just keep coming and coming and coming and coming." This is precisely what he does NOT want to do. The lesson of **North River Velocity Management** is that you only have time in these markets to do it once and to do it right. Coming back again and again is a fools game. The data are remorseless and this was the core principle of Lou Gerstner's reorganization of **IBM** and of Kirk Nakamura's reorganization of **Matsushita**.

If Microsoft wants to compete with **Google** — its putative target — it must first fix its core **Velocity of Cash Index.**

I said the same in my August 2003 **North River Advisor,** GRADING MICROSOFT MANAGEMENT which you can download here. Much of it is eerily prescient.

Here are some current data: MSFT has 81 days in receivables while Google has only 39. To deal with this, MSFT carries 111 days in payables while Google carries only three. It doesn't take much arithmetic to see that if Google pushed its payables out to 40 days, which the CFO could do at the push of a button, it is a negative working capital engine.

But for Microsoft to get to the same place it would have to cut payables by 71 days and receivables by 50 days. That means complete restructuring, which in my experience would take 2-3 years.

So, the conclusion is inescapable: this deal is DOA. Good luck guys.

Course Corrections