



A dot-com rocket



CHALMERS

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Abstract

The aim of this report is to give an account of and analyse the company Xcelera and its extraordinary valuation on the AMEX-stock exchange during the dot-com boom. At the peak, Xcelera was valued at \$11 billion based on a revenue of \$37 000. The reason behind this high valuation were, among others, numerous releases of disputable information by the CEO Alexander Vik and general market frenzy caused in part by herd behaviour. Furthermore it was concluded that risk associated with high valuations can be reduced for private investors if regulators enforce more extensive filings of financial figures and limiting stock splits. But general market bubbles are difficult to avoid without restricting the free market.

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1. Introduction

Stock bubbles and unsubstantiated valuations of different securities has always been a part of the modern financial markets. From the crash of 1929, to the oil crisis, black monday and more recently the financial crisis of 2008, these events have all been subjects of significant market volatility. But perhaps the most interesting bubble of all was the dot-com bubble. This bubble led to companies without working business models to rise tremendously in value on the basis of future potential. The businessman Alexander Vik saw the opportunities in this boom and created the IT-company Xcelera. This company managed to reach a market valuation in excess of \$11 billion without working technology or any substantial sales. How this was possible and how overvaluation can be avoided will be discussed in this report.

1.1 Aim

The aim of this report is to present and analyse the rise and fall of the dot-com company Xcelera and draw conclusions associated to market risk and how to reduce it.

2. Methods

In order to make this study, information from different sources has been gathered and analysed. Since the events were around the year 2000, the database Retriever Business has been used to find articles from newspapers and financial reports at that time period. This was mainly used to understand the timing of events. These sources has been complemented using newer information and the documentary “Konsten att bli miljardär”, produced by Hill (2008).

3. Course of events

3.1 Background to the dot-com bubble

In the second half of the 1990's the investors of the world went obsessed with internet stocks and IT-companies. The general background to this is that companies active on the web are exposed to the entire global market and investors therefore thought that companies on the web had huge upside potential. Further major contributing factor includes that the number of Americans owning a PC had more than doubled in under a decade, and that low interest rates fueled the availability of capital (Department of labour, 1999), (Business Insider, 2016). This resulted in a boom and rise of market capitalization of internet stocks, with very high valuations during the end of the 1990's until the beginning of the year 2000. In the spring of 2000 the market crashed and many internet stocks lost most or all of their value.

3.2 The Scandinavia Company and Alexander Vik

Alexander Vik was born 1955, son to a Norwegian businessman and he grew up in Stocksund, Stockholm. Alexander went on to study at Harvard University and soon distinguished himself as a talented and motivated young man. He also showed proficiency in sports and twice won the Ivy League golf championship.

After he graduated from Harvard 1978 he went on to work as a stockbroker on Wall Street. He soon started to make business deals on his own accord. His first big success came in the middle of the eighties when Alexander, with help from his father, acquired a controlling stake in S-E-Bankens Scandinavia Fund. After a series of maneuvers and equity issuance he managed to outmaneuver the other owners and secure his family sole control of the company. He converted the fund into an operating company and renamed it The Scandinavia Company. The company had two attributes that proved essential for Alexander's later endeavours, it was listed on the American Stock Exchange and it was based on the Grand Cayman Islands, which meant more relaxed rules for financial supervision (Hill, 2008).

Alexander went on to do business in the insurance industry where he managed to make money by timing the shifts in the market successfully (Vardi, 2014). On one occasion he seemed to be in trouble as Nordbanken decided to call his loans when the market went sour. But Alexander responded by suing the bank for breach of contract and managed to reach an advantageous settlement where his company got rid of the loans and at the same time he managed to acquire a hotel on the Canary Islands. The operation of the hotel was put under the Scandinavia Company (Hill, 2008).

Alexander's business deals was characterized by a high level of risk-taking and aggressive behavior towards partners and other shareholders. But due to good wits, controversial tactics and sometimes luck Alexander always seemed to end out on top. His reckless style in business seemed to characterize him on a personal level as well. As an example, Alexander liked to go heli-skiing in Canada, and on one occasion he and some friends was caught in an avalanche and they were buried alive. Two companions was killed in the accident but Alexander survived unscathed as he managed to make a breathing space in the snow for himself when he was buried and could later be saved.

In the late nineties the dot-com bubble started to gain momentum which caught Alexander's attention and soon a small Swedish tech-company proved to be the perfect opportunity for Alexander to ride the wave of expectations that started to build up (Hill, 2008).

3.3 Xcelera.com

In the year 1999, Alexander Vik discovered a small Swedish IT-Company called Mirror Image. Their idea was to speed up the internet, via local servers stationed around the world that would in essence cache parts of the internet. When Vik discovered the company, they were looking for new investors, since they had ran out of cash. Vik was very interested in the technology and background of the company, generally because of the hype around IT-stocks at the time and saw potential in Mirror image. Vik decided to invest in the company and obtained a majority share of the stocks.

In order to take advantage of the ongoing hysteria, Vik incorporated the company on the Cayman Islands and made it a subsidiary of The Scandinavia Company, which was listed on the American Stock Exchange (AMEX) at the time. In order to capitalize on the stock market boom he renamed it from the The Scandinavia Company to Xcelera.com.

The reason to place Xcelera on the Cayman Islands is that their tax code does not require corporations to report any financial figures until after 18 months of first being registered. This meant that Xcelera could push out press releases and “hype” Mirror Image’s technology without publishing any financial figures. Some significant press releases includes that Hewlett Packard and Exodus (a major internet company at the time) made investments in Xcelera, and this made the stock soar to new heights (Hill, 2008).

After a few months, in the spring of the year 2000, Xcelera had a market capitalization in excess of \$11 Billion USD. This was more than the market value of big Swedish companies such as Investor AB and AB Volvo. Because of the high valuation and big uncertainty of the company's financials, the stock was very volatile. In March and April of 2000, several dot-com corporations filed for bankruptcy which lead to a big decline in popularity among internet stocks. Inevitably, this also lead to the collapse of Xcelera, which lost more than 95% of its market value within a year (Xcelera Inc, 2003).

3.4 Aftermath

After the Xcelera stock had collapsed, private investors in the US got together and filed a class action lawsuit against Xcelera and the Vik brothers. The private investors had lost a considerable amount of money due to the collapse of the market value. They filed for misleading information and stock manipulation and required compensation for economic loss. The lawsuit went on for several years, but eventually the case was dropped since a witness was viewed as untrustworthy by the investigators. Also, while under investigation of the SEC (Securities exchange commission), the files of the case were destroyed during the terror attacks of 9/11 and some parts of the investigation were dropped.

To this day, none of the Vik brothers have been judged guilty to any criminal activities regarding Xcelera. Since they continuously sold shares of their company during the spring of year 2000 when the market moved upwards, it is believed that they managed to retrieve more than \$500 million in cash (Sandberg, 2006).

4. Analysis

When the stock price of Xcelera reached its peak in the spring of 2000 the price had soared 74 000 percent in a year and it may be the fastest rising stock on any major American stock exchange in history. After the dot-com crash and the publication of the financial reports for Xcelera, the stock lost all its value in the coming years. Left behind were a multitude of small savers that had been drawn in by the hype. This story is in this sense not different from many others of the dot-com era but the thing that stand out is the way that Alexander Vik in a seemingly deliberate way pushed the stock price higher so he could sell and take out cash for himself.

So, how is it possible for a stock to rise so much without fundamental reasons, on a market consisting of the aggregate knowledge of millions of investors that should in theory make the pricing of stocks pretty fair? There are a number of factors that coincided to make this possible.

First of, the company positioned itself perfectly in the prevailing market climate. After the acquisition of Mirror Image in March 1999 The Scandinavia Company was renamed to Xcelera.com and it's focus was shifted to information technology. At this time internet was relatively new and it's seemingly endless opportunities made tech-related stocks soar on stock exchanges all over the world. This hysteria among market actors during the dot-com boom created an ideal breeding ground for a stock like Xcelera. A modern day parallel is the boom in cryptocurrencies. For instance, Eastman Kodak Co announced that they would launch a cryptocurrency of their own called KodakCoin which made the stock jump more than 200% in two days (see 6. Further reading).

Another component was that the market was presented with erroneous information and other important information was withheld. This was possible because the company was registered on the Cayman Islands with more relaxed rules for financial supervision. Also in the very bullish market environment people was very reluctant to ask critical questions. The market was on the contrary very receivable for positive information and when Alexander Vik presented questionable information in news shows and well known journals it's was quickly accepted by the market. Numerous stock splits was also undertaken and people seemed to feel the price got lower initially which seemed to further boost the price even though no value was created.

When markets are bullish or bearish, they tend to overreact with more positivity or respectively more negativity than what the market is actually going to be. These overreactions are a typical example of herd behaviour (Phung, 2018). Herd Behaviour was predominantly occurring during the dot-com boom, since investors gather around opportunities they believe will make them the most money. Since Xcelera kept rising in value, other investors saw this as an opportunity and bought shares as well. This went on and on and partly explains the high valuation.

In the end Xcelera and Mirror Image proved to be a hopeless venture. The company had lost money for many years before Alexander Vik entered as an investor. After the acquisition and despite all the hype the company never got any real revenues or customers. For the year 1999 the turnover from the Mirror Image operation landed at \$37 000. For 2000 the revenues was \$300 000 and at the same time the expenses was \$64.7 million (Xcelera Inc, 2003). The only operation in the Xcelera company contributing any substantial revenue was the hotel on the Canary Islands with revenues around 10-11 million USD but this was sold in the year 2000. Xcelera was kept running a couple of years by new investment and equity raises. The business itself was not long term sustainable.

5. Conclusions

The story about Xcelera is just one among many similar from the dot-com boom. The things that distinguish it is the magnitude of the hype around the stock and the seemingly deliberate way this was built up. Alexander Vik himself managed to make a considerable profit from the endeavour while many other lost their money.

What lessons can be learned from a story like this? Can and should a speculation bubble as absurd as this be hindered in some way? We think it's not the right thing to try to restrain the free market, but one very important thing is to make sure the market participants always have access to unbiased, true and up to date information. This was one of the central things that faltered and made it possible for Alexander to make his company skyrocket on the stock exchange. The financial regulations should be updated continuously to minimize loopholes. Xcelera bypassed the regulations about financial reporting by registering their company offshore and also made splits in a reckless way, behavior like this could probably have been avoided.

However, the main reason for the rise in the Xcelera stock price was because of the market frenzy at the time, and risks imposed by the general market is difficult to reduce in general. An investor must always be conscience that their position is at risk and that they can be subject of losing some or all of their original investment.

The dot-com boom is one of the most infamous example of a speculation bubble. But one thing to be remembered is that most new disruptive technology go through a phase of over

enthusiasm or “irrational exuberance” and maybe some of this mania is needed to make investors put in money and lay the groundwork for the future even though much capital will be misinvested (Evslin, 2005).

6. Further reading

For the interested reader, we recommend watching the documentary “*Konsten att bli miljardär*”, produced by Daniel Hill (2008) for SVT and Affärsvärlden.

Other articles and websites of interest:

- https://en.wikipedia.org/wiki/Dot-com_bubble
- <http://web.retriever-info.com/services/archive/displayDocument?documentId=050856199911021904432&serviceId=2>
- Kodak launches KodakCoin:
<https://cryptona.co/kodakcoin-token-sale-targets-raising-50-million-us-dollars/>
- <https://www.forbes.com/sites/nathanvardi/2014/03/05/the-riddle-of-alexander-vik/#5735cb5c6460>

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