EDITORIAL

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About a year ago investors were willing to ante up $33 for a Guitar Center share. At just under $10 as this issue goes to press, Guitar Center shares have declined 71% over the past 12 months. In the same time frame shares of Mackie Designs and Steinway & Sons have also been hammered, sliding over 30%. Guitar Center, Mackie, and Steinway are the three highest-profile, publicly traded music companies, so it's worth asking, "What's going on here?" (Harman International, parent of JBL, DOD/DigiTech, and AKG, although public, isn't a pure music play because over 50% of sales come from divisions selling consumer audio products.)

Space limitations preclude a detailed financial analysis, but suffice it to say that the fundamentals of the three companies haven't shifted anywhere near as much their stock price. Retailers around the country would surely attest to the fact that Guitar Center is not a 70% less effective competitor than it was a year ago. Mackie hasn't seen a 33% slide in market share, consumer appeal, or growth rate, and Steinway is in the midst of reporting record financial results.

"Efficient market theorists" argue that stock prices are the result of the rational analysis of scores of investors, and are always a fair, or efficient, reflection of a company's underlying value. As far as we're concerned, efficient market theorists haven't spent much time looking at companies like Guitar Center, Mackie, and Steinway. We're not presumptuous enough to offer an opinion on what their "fair value" should be, but based on the recent price gyrations, we feel confident in saying that investors have been suffering from severe bouts of irrationality, either in paying too much a year ago or currently passing up on the chance to "buy low."

Given that the booming stock market has continued to propel retail sales to new heights, this evidence of investor irrationality should give everyone pause. If the guys moving money could suddenly sour on Guitar Center, they could also lose their affinity for the Dow Jones Industrial Index, and the larger impact could be troublesome. More immediately, the sell-off of music-related shares will have a significant impact on growth plans of a number of industry companies.

As we've noted before, over the past century music companies have traditionally financed growth through a combination of retained earnings, vendor credit, and bank debt. Public financing through the stock market, which allows for much faster growth, is a relatively new phenomenon. With music companies out of favor on Wall Street, Mark Begelman, who is on record saying that his MARS chain will go public in 2000, is one of several who may have to rewrite a business plan.

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