the internet analyst[SM]

Thursday, July 12th, 2001 Issue #120

The Internet Analyst is a weekly publication from Multex.com Inc.

Strong Buys

AOL's Popularity Reaffirmed in Advance of Earnings

by Isabelle Sender

The Internet Analyst[sm] combed through research submitted to the Multex.com database this week, looking for Strong Buys. This column is intended as a starting point for investment ideas in the Internet industry, not as an ending point. The opinions expressed in this column are those of the firms mentioned, and not necessarily those of the author, The Internet Analyst, or Multex.com. In order to be included in this column, a stock must receive a firm's highest rating, and the valuation methodology must be included in the report, unless otherwise stated.

AOL-Time Warner (AOL) remains one of Wall Street's darlings at the approach of the release of its second-quarter figures. Analysts consensus is that the company will announce earnings of 29 cents per share next week, with a conference call planned for Wed., July 18.

In the last week, one analyst upgraded his firm's opinion on the stock, thereby revising earnings estimates upward (see table, next page), but the consensus did not change. And while the stock's ranking among the analysts has also remained unchanged over the last week, brokers continue to reiterate their highest opinions on the stock as the announcement date nears.

Currently rated by 22 analysts as a "strong buy," AOL's favored status was reinforced recently as new research documents contributed to the Multex database revealed pundits' undying reverence to the highly favored 'Net stock.

On July 9, Morgan Stanley reiterated its "strong buy-volatile" rating on AOL in a morning note. Analyst Mary Meeker and her team assigns the stock a $75 price target. She bases her year-end forecast earnings before interest, taxes, depreciation, and amortization (EBITDA) of $11 billion and her cash earnings per share (CEPS) of $1.27 on the first quarter's results. No further valuation metrics are explained. The company earned $508 million in the first quarter of this year.

Publishing Staff: *Isabelle Sender, Editor, Robin Barrett, Web Designer; Louis Soran, Production Associate, David Allikas, Consulting Editor, Shannon Swingle, Consulting Editor*

Name	Strong Buys (1)	Upward Revisions (2)	Average Recommendation (3)	Forward P/E/ (4)	Closing Price
AOL-Time Warner (AOL)	22	1	1.53	31.88	$50.18
USA Networks (USAI)	8	1	1.33	N/A	$25.86
Digex (DIGX)	6	1	2.00	N/A	$8

1 Number of analysts in the current quarter that are rating the stock as a "strong buy."
2 Number of analysts upwardly revising earnings for the stock in the last week.
3 "1" is the highest rating = "strong buy"
4 Projected price-to-earnings (P/E) ratio for the next fiscal year

Source: NetScreen Pro; data set July 10, provided by Market Guide Inc.
*Data as of July 10

Meeker says that her valuations are not only "justified" based on the company's first-quarter results, but that they are likely conservative since she does not assume that business conditions will improve. The analyst lists the weakening economy, merger execution, competition and exposure to advertising as the stock's risks. These conditions also explain the "volatile" designation given to the stock, which accompanies stocks "likely to become materially more volatile over the next 1 to 12 months compared with the past three years."

UBS Warburg analyst Christopher Dixon reiterated his "strong buy" rating on the stock based on more recent developments: a rumor that AOL and Sony (SNE) may merge their television channels in India. Dixon quotes the Asian Wall Street Journal in his July 5 report (available only to institutional members of MultexNet), which reported a possible combination between the two entities. The report suggests that the aggressive venture between AOL and Sony, if it actually occurs, spells trouble for other major media outlets in India, and may change the way those companies conduct business. The report also suggests that copycat deals between other media companies may result and names potential combos.

Dixon places a $67 price target on the AOL shares using the Internet industry standard valuation method, a pro forma discounted cash-flow analysis with a 17.5 percent discount rate and terminal estimated growth of 10 percent.

With regards to earnings, the UBS analyst estimates AOL will gain 28 cents a share for the second quarter, which is a penny below the consensus. His 2001 year-end estimate is $1.22 on revenues of $40.4 billion.

Although other analysts also like the stock, and reaffirmed their highest support for AOL shares in recent days, their support is not valuation-based.

In Merrill Lynch's institutional report from July 6, Jessica Reif Cohen takes a hard look at "Filmed Entertainment." In this second-quarter preview, the analyst concludes that ad woes will continue for AOL and its peers. But the analyst prefers AOL and other diversified companies, like Viacom (VIA), and both companies receive the firm's highest rating due to the diversity in their revenue streams.

On July 5, Barrington Research Associates reiterated its highest rating on AOL as well. The research was published once James C. Gross, CFA returned from spending the day with AOL executives learning more about the merger's potential to generate synergies and growth. Although he doesn't include his valuation metrics in the institutional-side report, he notes the company's strengths and weaknesses.

Upgrades & Downgrades

Enterprise Software Solutions Companies Fall Short

By Shannon Swingle

ART TECHNOLOGY GROUP (ARTG): On July 2, J.P. Morgan H&Q, responding to a preannouncement of a second quarter revenue and earnings shortfall, lowered its rating on Art Technology Group to Market Performer from Long-Term Buy. This provider of Web-based Internet customer relationship management (CRM) and e-commerce products and services expects second quarter revenues of $34 million to $35 million and a loss per share of between $0.17 and $0.19. The firm had forecast revenues of $41 million and a loss per share of $0.15. The company also announced a 20% reduction in its workforce. J.P. Morgan H&Q even lowered estimates for the subsequent quarter and the full fiscal year 2002, but it now believes that the estimate adjustments may not have been enough, since the preannouncement revealed the depth of the company's restructuring of its sales organization. Transition issues must be resolved before the stock can move upward, according to the firm, and the current share price has already absorbed the risk. J.P. Morgan H&Q now forecasts a loss per share of $0.44 on revenues of $170 million in 2001 and EPS of $0.10 on revenues of $235 million in 2002. The shares closed at $4.60 on July 3. Research about ARTG was accessed 326 times, and 19 new documents were added to the Multex.com database during the week of June 25 to July 1.

INTERNET SECURITY SYSTEMS (ISSX): Dain Rauscher Wessels downgraded its rating on the shares of this enterprise security management solutions provider to Neutral from Strong Buy on July 3. For its June quarter, the company preannounced a large revenue and earnings shortfall. It announced that it will see revenues in the $50 million to $52 million range, with a loss per share of $0.02 to breakeven. Compare this with Dain's previous estimates of $63.9 million in revenues and $0.15 in earnings per share, and you can see why the rating dropped two notches. The shortfall was attributed to a drop in perpetual license-based and non-core third party revenues. The firm states that greater competition and smaller deals had a significant impact on results. Excluding revenues from Internet Security's acquisition of Network Ice, which closed in the June quarter, the company's organic growth dropped 20% quarter-to-quarter. The company did not give guidance beyond the June quarter and withdrew the year-over-year guidance it had previously offered. Despite visibility concerns, the firm sees "encouraging signs in the long run." Internet Security saw a record number of deals (smaller in size) in the quarter and appears to have a growing customer base. Dain believes the company remains a "best-of-breed provider" in its space. Its new estimates for Internet Security are for $216.9 million in revenues and EPS of $0.16 in 2001 and for $288.3 million in revenues and EPS of $0.45 in 2002. The firm previously forecast revenues of $288.2 million, with EPS of $0.65 in 2001, and revenues of $410.1 million, with EPS of $0.95 in 2002. Reemphasizing near-term concerns, Dain points out that price-to-earnings-to-growth rate analysis reveals fair value for the shares within a range of $23 to $34. When the report was written, the shares traded at about $50; they closed at $29.99 on July 3. Research about ISSX was accessed 391 times, and 10 new documents were added to the Multex.com database during the week of June 25 to July 1.

PIVOTAL (PVTL): On July 2, Robinson-Humphrey lowered its rating on the shares of this CRM software solutions provider to Neutral from Outperform. Like many of its peers, Pivotal preannounced a revenue and earnings shortfall for its fourth quarter, citing weak license sales as the main factor. The company believes that it will report revenues in the $21 million to $22 million range, with a loss per share of up to $0.32. This compares with Robinson-Humphrey's estimates for $29 million in revenues and EPS of $0.02. The firm lowered its estimates to $96 million in revenues, with a loss per share of $0.28 for 2001, and, for 2002, $106 million in revenues, with a $0.12 loss. The firm believes that Pivotal is well positioned in its market for the long term, but it emphasizes that two to three quarters will continue to pose difficulties for the company. The shares closed at $13.99 on July 3.

Executives Zero In

InfoSpace

Naveen Jain,

Founder, Chairman, Chief Executive Officer and Chief Strategist

Interviewed by George S. Mack

InfoSpace (INSP) is in the process of re-inventing the portal business as it provides Internet infrastructure and private-label support to its customers, which include names like AOL Time Warner (AOL), Microsoft (MSFT) and Terra Lycos (TRLY). At the same time, the Bellevue, Wash.-based company is providing a similar portal technology to wireless service providers that include Verizon Communications (VZ), AT&T Wireless (AWE), ALLTEL (AT), PowerTel (Australian: PWT) and VoiceStream Wireless [a unit of Deutsche Telekom (DT)]. With InfoSpace know-how, these carriers offer their consumers a personalized set of services, including m- (mobile) commerce. InfoSpace's extensive carrier network also enables it to offer person-to-person and business-to-person short messaging system (SMS) technology that is now generating $1 billion in revenue per month globally, but which has yet to take off in the United States. Even with its innovative platform, InfoSpace has not escaped the wreckage of the Internet, advertising, telecom and information technology upheaval of the past 15 months. For the one-year period ending July 6, InfoSpace stockholders have suffered a greater than 90% decline in share price versus a 50% decline for the Nasdaq.

[THE INTERNET ANALYST — GEORGE S. MACK] Naveen, when you and I first spoke two years ago, you were a portal-in-a-box like Yahoo! (YHOO), supplying infrastructure to other companies. You've changed.

[NAVEEN JAIN] Actually, George, fundamentally we have not changed at all. InfoSpace is essentially a technology company that provides the underlying infrastructure that people can build a portal on top of, for any type of service — whether it's commerce services or consumer services. We provide the same technology to the consumer side that we distribute to our partnerships — companies like AOL, Netscape [a unit of AOL Time Warner], MSN, Cingular Wireless [a joint venture of SBC Communications (SBC) and BellSouth (BLS)] or Broadwing (BRW). These companies use several of our technology services. All of them essentially offer the consumer a complete and unique mobile experience, which caters to a particular device, whether it be a PDA [personal digital assistant], a cell phone or any other wireless device.

[GSM] So, whether it's wireline, wireless or broadband, you're an infrastructure provider.

[NJ] Yes. And on the merchant side, our infrastructure is directed at the local merchant. We distribute these infrastructure services through merchant banks, such as American Express (AXP), or through our partnerships with yellow page providers.

[GSM] Your business model has four different units that we've already spoken about — wireless and broadband (on a subscription model), your merchant unit (e-commerce and m-commerce transactions) and your wireline unit (per use or per query). Which of these is going to offer the biggest potential for InfoSpace?

[NJ] At this point, we obviously see our greatest potential in both the wireless arena and the merchant arena. On the wireless side, we provide the services that can be catered to the local merchant or the consumer. Our commerce services allow a local merchant to offer a promotion so that a consumer could purchase an item with a single click. The merchant could either be offline or online. The consumer can do anything from ordering coffee to ordering a book from his cell phone. In one case, the book could be shipped to the house, and in another, the consumer would go pick up the coffee at Starbucks (SBUX).

[GSM] Tell me about your SMS technology. You're having some success with this in Europe. Explain what it is, how it's working, and will it be a viable model in the U.S.?

[NJ] As a matter of fact, that's one thing we get really excited about, but it's not just in Europe. A large amount of usage on our existing phones is coming from SMS. It essentially allows people to get information that's relevant, personalized and actionable. So a person doesn't have to keep checking to see what the Mariners game score is. Anytime the score changes, it sends you a message with the new score. Or you can set an alert to let you know if your flight is going to be more than 15 minutes late. SMS allows people to get actionable information so they can control their lives better. SMS is evolving, and you can not only receive information, but you can also send a message and proactively get information based on certain criteria that you've set up. But even now people are able to use the phone for more than just voice. I'll be able to write and send a message to George on his cell phone.

[GSM] Why has SMS been slow in coming to the U.S.?

[NV] There's no inter-carrier operability on SMS today, such as in Europe, where there is the GSM system [global system for mobile communications] with signal interoperability. But InfoSpace has a relationship with all these U.S. carriers I've mentioned, and now we'll be able to offer interoperability between carriers for SMS. That means any person could send a message from any phone to any phone, and it will be delivered.

[GSM] SMS is a huge cash generator in Europe. How much can this mean to you in revenue?

[NV] It's hard to judge, but let's look at the potential. People today are sending billions —I think the number is something like 15 billion — messages a month. So there is tremendous potential for how people can use this SMS service. Today, more than 90% of phones are SMS capable, and 40% of phones are Internet capable. So essentially you take that to the next level.

[GSM] In July 2000, you acquired Go2Net, and with it came a payment-processing platform. You already had a payment-processing platform, but this was supposed to be something special. You've had it for a year now. How is it working for you?

[NV] First of all, we did not have a payment-processing platform before the acquisition of Go2Net. What we actually acquired was something called Authorize.Net. What it does is authorize the payment and provide fraud detection. We integrated that with our other commerce services for the local merchant, and today that business is growing extremely well for us. To give you an idea, you know that the fourth quarter is the seasonal high for the amount of transactions for merchants. We grew from $450 million in transactions in the fourth quarter to more than $500 million in transactions in the first quarter. And in the second quarter, it grew even faster than that.

[GSM] The migration to 2.5G and 3G [looming generations of wireless Internet protocol packet technology] has been a lot slower than we might have thought a year ago. But you're looking forward to this, I believe.

[NV] I think 2.5G is going to be a very successful initiative. I think 3G is still several years away, but most of the benefits of 3G really come with 2.5G. Those benefits include instant-on and packet-based technology. One of the biggest misunderstandings people have is that they think the slowdown in telecom spending will hurt InfoSpace. That's very far from the truth. When telecoms stop spending, they stop buying equipment, and they stop buying software. But they like us, because we are an ASP [application service provider]. That means they don't have to spend any money when they work with us. There's really no cost to them, and we allow them to generate more revenue. Every time we get paid two bucks, they make 10 bucks [laughing].

[GSM] But you were obviously hurt by the downturn in advertising this year.

[NV] Absolutely.

[GSM] This has caused you to redirect your energies away from consumers and to almost totally become a business-to-business company. Is that right?

[NV] What happened is that with the acquisition of Go2Net, we acquired some very good technology and some very good people. But it came with a package — a lot of direct-to-consumer properties that I think were hurt significantly in the advertising slowdown. And as we are an infrastructure company, we have been directing more of our efforts at building an infrastructure business. There's no two ways about it, while we have been doing that, we have lost a lot of the potential revenue we could have gotten from a direct-to-consumer effort. That has still not bottomed, in my opinion.

[GSM] Naveen, you have some major contract renewals coming up next year. I'm curious about what kinds of indications of interest you might have received. How do you feel about your upcoming renewals?

[NV] Well George, the way you look at this is if your partners come back to you and ask for more things while you're working with them, as opposed to fewer things, then that seems to be a good sign. To give you an idea, every single month or two months, we're launching a new set of services with Verizon, Cingular or with AT&T. In fact, in the last several months, we've signed several new agreements with the same partners. So, at this point, all I can say is that we feel really good about the partnerships.

[GSM] Regarding the size of your markets, I've heard figures like \$5.3 billion in 2005. And I'm looking at which companies are some of your customers — Verizon, Microsoft, Bloomberg, Charter Communications (CHTR) and other names. If they see your business model working, why would they really need your infrastructure, and why do they need you?

[NJ] Simply because our products and services are very complex. It's like saying anybody could start a portal like Yahoo!'s. Also, it requires a network, and for a company to do it alone would be very cost-prohibitive. To give you an idea, if you bought the software and hardware from Oracle (ORCL) and Sun Microsystems (SUNW), it would cost you \$80 million to \$100 million per year just to get started. The fact that we are able to take that cost and amortize it over 20 carriers, 3,000 Web sites and over 2 million merchants — that's what makes it a cost-effective network. That's not all. When a consumer is looking for a merchant, you have to have a merchant network. The fact that we have our own merchant network that brings them into contact with consumers, and the fact that we share that with the carriers, allows us to deliver these services much more cost-effectively than any carrier could do by itself. And as I said at first, this is very complex. You cannot just wake up one day and go and build this.

Vital Statistics
InfoSpace (INSP)

Market Cap:	\$1.09B
Shares Outstanding:	324.9M
Recent Stock Price:	(7/09/01)
52-Week Range:	\$54.75 — \$1.56
Price to Estimated (2001) Revenue:	4.6x
Price to Estimated (2002) Earnings:	3.3x

Years End In December	EPS	Revenue in millions
2000A:	\$0.12	\$214.5
2001E:	(\$0.02)	\$216.5
2002E:	\$0.09	\$302.6

Source: Morgan Stanley

[GSM] But couldn't Microsoft do it? [Note that in 1979, Jain joined Microsoft as a program manager on OS/2. He then worked on MS-DOS, Windows NT, and Windows 95, on which he holds two patents. He became a group manager for the launch of the Microsoft Network].

[NJ] It's not a core competency of Microsoft, which does the PC thing. And Microsoft is very good at that. It has not been able to build the set of services for mobile devices, because that would require a complete paradigm shift. Microsoft just doesn't know how to play in this area.

[GSM] A year ago, you had given up your role as CEO to former Vodafone (VOD) executive Arun Sarin, but you remained chairman and became the chief strategist. Your theory at that time was to divide the duties up between the two of you. Arun is not with InfoSpace anymore. What happened?

[NJ] Essentially nothing happened. I was focusing on things that were six to 12 months away rather than on day-to-day operations — the next generation of growth. Arun was taking care of more of the day-to-day things. As it turned out, the company felt that I needed to come back and execute some of the ideas we were looking at to make them a reality. Arun explained well that for a number of reasons — family reasons and commuting reasons — he would not be putting in the time that it would take to make this company successful.

[GSM] Last November, Ed Belsheim joined your company. In January, he became COO. He's had more than 25 years of experience in M&A (mergers and acquisitions), an area in which you've been very aggressive. Does this mean you're going to be as aggressive in acquisitions as you have been, or maybe more so?

[NV] What's happened is that acquisition costs, as you well know, have come down a lot [laughing]. So now the companies are coming to us and are willing to be sold for \$100,000 instead of the \$1 million that they wanted a year ago. These start-up companies that had VC [venture capital] funding that has now dried up are willing to sell all their intellectual property for pennies on the dollar. Every single week, we get somewhere between seven to 10 unsolicited business plans from companies that want us to acquire them. We're very, very actively looking for intellectual property that we can acquire for pennies on the dollar.

[GSM] Is that the reason you brought Ed Belsheim into the company?

[NV] The reason we brought him in is because he's very organized and operationally excellent. So while my strengths center much more on what's coming on the horizon, Ed Belsheim is much more of a day-to-day manager. He makes sure everything we've promised to customers is delivered.

[GSM] Even though you say InfoSpace is fundamentally the same as it was when you and I spoke for the first time more than two years ago, the Street has this image that you've changed your business model several times. Is this a failure to communicate?

[NJ] George, I think it's what people focus on. To give you an idea, we launched the wireless side of our business in 1996 with AT&T (T). But when we were on our road show in late 1998 and early 1999, people didn't want us to talk about wireless. Nobody wanted to hear it, even though we kept saying that's where the future was. Now that the future is here, people are saying InfoSpace is focusing on wireless. But the fact is that's what the people on the Street are now focusing on — wireless. Wireless is not something new to us in 2000 and 2001.

[GSM] But even the analysts are saying you've changed your business model and refocusing. Why?

[NJ] My opinion of analysts is very well known. I think these guys are obviously not very smart. They came into prominence during the bull market, but a lot of these people are 20-something kids who don't have a clue about how business is run, and they've never run a business. They've never seen a business, and they talk about how our business model has changed — not even knowing what a business model is.

The Real Deal

The Ugly American Stock Market

By Charles Payne, Wall Street Strategies

During the past week, Andre Agassi threw his racket at Wimbledon and Tiger Woods broke a club during the first round of the Western Open. Most observers say those reactions were in response to frustration with their on-the-field performance, but I believe it may have been more than that for both. I have a sneaky suspicion that both men probably battered their equipment to compensating for the battering taken by their portfolios.

Certainly it was an ugly week for anyone invested in American markets. Although many may have written off the week of the Fourth by rationalizing it as one price to pay for liberty, there was no such thing as a safe haven, and it was hard to overlook the fact that the Dow itself lost 227 points on Friday. In the summer of 2001, bombs aren't bursting in air, they're bursting on the floor of the exchange and in everyone's portfolio.

Indeed, last week has to be considered a salvo across the bows of all those invested in the stock market.

This newest battle, however, isn't like the one that raged between March of 2000 to March of 2001. That was a battle between rational and irrational, of fundamental versus fun, and of the Bulls versus the Bears, a crusade of time-honored truths against newer beliefs known as the "New Paradigm."

Unlike that earlier skirmish, the current battle is against a foe we've encountered before. Investors are fighting "fear," a stealthy opponent that strikes without warning (or in the case of equities, with the help of earnings warnings) and lingers on even after we think it's been defeated.

Fear (fir)
1.a. A feeling of agitation and anxiety caused by the presence or imminence of danger
b. A state or condition marked by this feeling: living in fear

Internet Security Systems (ISSX) issued the first in a series of early warnings, and saw its stock lose \$21 for the week, closing at \$27. This battering reinforced the notion that any company, regardless of its potential, is exposed to prevailing economic winds. That cold dose of reality was the underlying wake-up call that accompanied earnings warnings to follow. Even though tech stocks and warnings go together like the Fourth of July and fireworks, investors still seemed surprised. Any long-term holder of Rational Software (RATL) or BMC Software (BMC) should have known both were candidates to miss projections. Nonetheless, the shares of both dived after their respective warnings were received as if they had come completely out of left field.

However, the warning from Marconi (MONI) did come out of left field, since the European telecommunications company wasn't on the radar of most Americans. Now most tech investors know the name.

If the warnings were limited to names I've already mentioned, then "fear" wouldn't be the topic of this article. Unfortunately, the list of companies that issued warnings grew longer, and the week ended with warnings from BMC, Advanced Micro Devices (AMD), and EMC (EMC).

In all, last week featured over 80 earnings warnings.

Advanced Micro Devices shocked the Street with a warning that it would come in 88% below the consensus estimate. This was especially disappointing since the company had made many new believers, myself included, by making a dent in Intel's market share that seemed to presage an even brighter future. Industry tables have turned, though: now Intel is the company with inferior products but the cheapest prices.

The price war is similar to the skirmishes that are being fought throughout tech land. It's all about outlasting your opponents and, in theory, being in a position to pick up the pieces when the war comes to an end.

Barbarians at the Gate

Even worse than Advanced Micro Devices, the biggest letdown came from EMC, a company that had entered investor-lore for its ten-year investment return—as well as corporate-lore for the way it manhandled competitors with barbaric aggressiveness. I guess in the end even Attila had his comeuppance, and now we can add his modern-day heir, Michael Ruettgers, CEO of EMC to the list. The company began the year defiantly saying it would achieve revenue gains of $12 billion this quarter, but after its second warning in six weeks, the company is likely to find few believers in its future pronouncements. Last week, management warned of an earnings shortfall that will put actual results 77% below expectations, and the stock closed off $8.43 at $21.60 on Friday.

Those that didn't sell their positions in EMC are left to ponder the fact that past success is no guarantee of future potential; in this particular case, success brought forth a long line of would-be competitors, and new entrants are sure to nip away at the company's market share, eroding profit margins and limiting the upside potential of the share price.

The shoe now on the other foot, EMC must fend off attackers, and unlike times of old, the Street will need proof that the company is winning the war before affording it outsized valuations.

The warnings wouldn't have been too bad if they were limited to the tech sector, but warnings from the likes of Federated Department Stores (FD) and Harrah's Entertainment (HET) reminded us that the economy is an equal opportunity killer. In fact, companies in various industries including drug stores (CVS (CVS)), apparel (Guess? (GES)), electronic communications (Belden (BWC)), leasing (Aaron Rents (RNT)) and energy (Energen (EGN)) all warned of lower profits.

I think it is still safe to assume that if a company hasn't warned, they will meet their estimates, but the big problem has been guidance. The Street assumed that the worst would be over in terms of lower (or lowest) corporate profits in the second quarter. Now we know better. The best a company can do now is to say they'll reach the current level of expectations.

The Week Ahead

Unlike the rate cut on January 3, investors know that real solace must come from actual improvements in the economy, not additional rate cuts. And while many stocks may seem to have already discounted a worst-case scenario, we have learned that stocks can't reach a fair share price until all the unknowns are present.

The U.S. economy slowed to 1.4% from October 2000 to March 2001, the worst decline in a decade. Many observers assume that the economy has now it hit its nadir, and that given how recent economic readings are reminiscent of 1990-91 recession, the worse is past. Alas, that may not be the case. If interest rate cuts don't take hold soon, the economy may be compared to even less flattering times.

Much of the blame has to go to corporate America and the cut-throat business models that drive so many pricing decisions. Economists marvel at the strength in consumer confidence – how could it be otherwise? Heck, it seems like everything is always on sale. But there will come a point when industries will no longer be able to rely on job cuts to stay afloat, and when giving away the product will backfire. (I thought we learned that from the Internet bubble.) One has to wonder when the desire for pyrrhic victory gives way to business 101?

Many market watchers say a turnaround will occur when consumers come back. Well, I think the consumer hasn't left. A turnaround will occur when profits return, and that will not happen in today's climate. One only has to look at the airline sector as an industry that underperformed for years because of suicidal price wars. Forget the RICO act, unless there is some type of wink-and-nod among corporate rivals, share prices will continue to languish.

The Street needs a ray of hope that can only come from a general improvement in profits. There are a bunch of big names reporting during the upcoming week, but the indifference of observers could leave even the best reports in the shadows. Case in point, the results from Alcoa (AA) last week. The company beat the consensus estimate and the news going forward was generally upbeat. Still, the stock finished Friday's session off $0.98 after opening a point higher. True, AA isn't a bellwether issue, but the muted response to an otherwise excellent earnings report makes investors scratch their heads, makes investors nervous and leads to fear. Will a strong report from GE (GE) or Yahoo! (YHOO) generate as little excitement? It remains to be seen. First those companies have to deliver the goods, come in at the estimates, and then say something uplifting. The spirit of Jeff Bezos or Larry Ellison has to inhabit the bodies of Immelt /Welch and Semel/Mallet once the conference calls begin.

Venture Capital

The All Star Break is a Time to Reflect

By Stephen DeNichilo

Major League Baseball's All-Star break provides players and analysts with a three day respite from the season's grind, and offers everyone from fans to managers a breather in a marathon season. It's also a great time to check out the overall economic environment.

Much like the hopes of the once powerful New York Mets, projections of a mid-year economic revival are starting to fade. This realization is dawning on even the most inveterate optimists as it becomes clear that the Fed's aggressive policy has yet to spark our slowing economy. Recently, Alan Greenspan lowered short-term interest rates for the sixth time in as many months, citing declining profitability and capital spending, weak expansion of consumption, and slowing growth abroad. As if that news weren't hard enough for markets to digest, the unemployment rate rose to 4.5% in June, with the US economy shedding a hefty 114,000 jobs. Weren't things supposed to be getting better by now?

US GDP has grown, albeit slowly, thanks to fairly high consumer confidence and consumer spending, as individuals continue to believe that the worst is over. But while individuals are keeping the economy afloat, corporations are cutting back, missing earnings targets and, now, laying off more than ever. If unemployment continues to rise, confidence targets and spending will inexorably slow, preventing the economy from turning the corner anytime soon.

And while it's always tough to gauge how broad macro events affect the venture capital markets (since they are not tied to any major indices nor covered regularly by the mass media), I believe that the writing is on the wall – a slowing economy means a slower VC market in the coming months.

As we speak, investors worry about stalwarts such as IBM, let alone small startups in Silicon Valley; the economic landscape will have to change greatly before individuals ante up and dive back into VC waters.

Around the Globe

Worries surrounding the US and European economies have not stopped other areas from thriving. Asia (excluding Japan) has really entered into a hyper growth phase in 2001, and is starting to attract some serious VC capital. Walden International, an Asian technology fund, recently closed a billion dollar fund, H&Q Asia Pacific has $750 million to allocate to Asia, and the Asian Venture Capital Journal estimates that a total of $16 billion was allocated to Asian startup companies in 2000 – up from $7.4 billion in 1998. A solid wireless infrastructure and a plethora of skilled workers are part of the reason this area has improved. In addition, the new regime in Japan intends to address endemic problems in the country's debt markets, thus calming investor concerns.

Deal of the Day

MobilEye, which develops transportation system technologies for the automotive industry, said it raised $10 million from undisclosed investors in its latest round of funding. The firm develops on-board technologies that assist drivers in a variety of ways, ranging from congestion notices to alerting drivers if another vehicle is about to cut them off. But I wonder, if this hits the mainstream, how will New York taxi cab drivers ever deal with this???

Oh, and while I think that VC market/returns will eventually return to historical levels, I will officially predict that the Mets will be buried towards the bottom of the standings for a couple years to come.

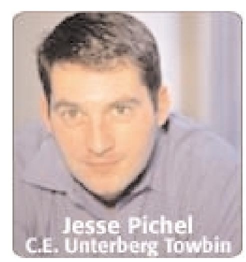
Analyst Spotlight

TMP Worldwide

Jesse Pichel, C.E. Unterberg Towbin

Interviewed by Nate Hardcastle

The Internet Analyst spoke recently with Jesse Pichel, who follows e-business services companies for C.E. Unterberg Towbin in New York. He has a "STRONG BUY" rating on shares of TMP WORLDWIDE (TMPW), which owns and operates online recruitment site Monster.com.



[THE INTERNET ANALYST – NATE HARDCASTLE] TMP WORLDWIDE recently announced that it would buy HOTJOBS.COM (HOTJ), Monster.com's largest competitor. What do you think of the deal?

[JESSE PICHEL] I think it's a great move for TMP WORLDWIDE. The e-recruiting industry is a land grab right now. The market will be huge: It will be a multibillion-dollar industry within a few years, and could be a $10 billion industry within 10 years. That growth is being driven by a scarcity of skilled labor and by the cost- and time-efficiencies offered by Internet recruiting.

I think the acquisition is smart for several reasons. I have been increasingly bullish on HOTJOBS.COM. The company has estab-

Vital Statistics
Jesse Pichel, C.E., TMP Worldwide

Education: B.S., Cornell University
Industry covered: e-business services
Companies covered: TMP WORLDWIDE, GP STRATEGIES (GPX), ON ASSIGNMENT (ASGN), PROFESSIONAL STAFF (PSTF)

lished itself firmly as the number two player in the e-recruitment market, and is on track to achieve profitability later this year. HOTJOBS.COM has been very successful in recruiting for the technology industry, and can provide TMP WORLDWIDE with strong appeal to that sector.

The acquisition of HOTJOBS.COM gives TMP WORLDWIDE a 72% share of the online recruiting market, if you include TMP's May purchase of FlipDog.com. The combined entity will list more than 650,000 jobs and 14 million resumes. What's more, Monster.com is the number one e-recruitment site in almost every European country, and recently has begun a site in India. The India site has great potential, because companies increasingly are looking to India's huge skilled-labor pool to alleviate the skilled-labor shortage in the United States.

The financial implications of this deal are very positive as well. For example, TMP WORLDWIDE will be able to write off HOTJOBS.COM's losses, resulting in an extra $10 million in cash flow per year from tax savings alone over the next four years.

[NH] What does the future hold for TMP WORLDWIDE?

[JP] I think we'll see the company move further into relocation services – a market that could be bigger than e-recruitment – and job training. Both areas offer tremendous synergies with the company's e-recruiting model.

[NH] What are your earnings estimates for the firm?

[JP] I don't currently have estimates. I am going to revise them after management explains how they will incorporate HOTJOBS.COM into TMP WORLDWIDE's business structure. My price target on the stock is $100.

IPO Update

July's IPO Market Looks Slow;
Typical Summer Month

By Jeffrey R. Hirschkorn, Senior IPO Analyst

A slow IPO market is nothing unusual for the summer months. Investment bankers are reluctant to kick off road shows while most of the investing public is on vacation. Therefore, action in the world of equity syndication has always been limited to a few issues per month. Currently, the IPO Monitor forward calendar reveals that nine firms have tentatively scheduled offerings for July. In addition, there are three other IPOs that remain under the to-be-announced section.

"After weeks of waiting for a rally, investors had to endure one more delay," said Renaissance Capital Management, managers of The IPO + Fund, in its weekly recount of the new issues market. "The question that awaits the new issues market for the third quarter is whether investors will remain patient or choose to fly standby in other asset classes."

Adds John E. Fitzgibbon Jr., co-author of The IPO Hardball, "Given the background of today's stock market, it isn't too surprising that the IPO calendar is a shadow of its former self. But take heart. You can always look forward to a summer rally."

July 2001: A Whole New Game

One year later, the IPO market represents a totally different picture, considering that issuers and underwriters have been extremely careful on launching highly risky IPOs. Last July, investment bankers paraded 48 issues to market. But now the landscape is totally different. Not to mention that investors are now demanding transactions that bring profitability and a scaleable business model to the Street at offering.

"Traditionally, IPOs go on vacation whenever earnings season kicks into full gear," noted George Nichols, dean of IPO research at Chicago-based fund tracker Morningstar.com. "Nowadays, the earnings warning season is grabbing plenty of headlines. Underwriters are careful not to bring out new issues when investors are focusing on other areas."

For most of the year, investors have stood by investments from the energy sector. That theory began to evaporate towards the end of the second quarter. After the abysmal debut of General Maritime (proposed ticker: GMR), American Eagle Tankers (proposed ticker: AEH) withdrew a 6.75 million-share underwriting because of market conditions. The real truth: General Maritime's devastating performance forced Salomon Smith Barney and AEH's parent to avoid public humiliation.

Accenture is Deal to Watch

Analysts are confident in predicting that there's only one deal to watch for July: Accenture (proposed ticker: ACN), the former consulting arm of Arthur Andersen formerly known as Andersen Consulting. The offering is slated to price 115 million Class A shares somewhere in the $13-$15 range, the proceeds of which have been earmarked for debt repayment and working capital. After completion of the IPO, the firm's partners will control 82% of the voting power.

Accenture is scheduled to debut during the week of July 16. Underwriters for the IPO include joint book runners Goldman Sachs and Morgan Stanley. Co-managers on the $1.6 billion transaction include Credit Suisse First Boston, Deutsche Banc Alex. Brown, JPMorgan, Salomon Smith Barney, Banc of America

Securities, Lehman Brothers, UBS Warburg and ABN AMRO Rothschild, a last minute addition to the team.

Based in Hamilton, Bermuda and with offices in Palo Alto, Calif., Accenture has more than 75,000 employees based in more than 110 offices in 46 countries delivering to clients a wide range of consulting, technology and outsourcing services. Accenture serves 84 of the Fortune Global 100 and more than half of the Fortune Global 500.

Action Items

The July IPO season is about to get under way today, as an underwriting syndicate led by JPMorgan is expected to price shares of Wright Medical Group (proposed ticker: WMGI). Co-managers on the estimated $94 million transaction include Credit Suisse First Boston and U.S. Bancorp Piper Jaffray. Wright, based in Arlington, Tenn., is a global orthopaedic device company specializing in the design, manufacture and marketing of reconstructive joint devices and bio-orthopaedic materials.

The firm plans to offer 7.5 million shares at somewhere in the range of $11.50 to $13.50; offering proceeds have been earmarked for debt repayment and future acquisitions. Intriguingly, the company was the subject of a buyout in Dec. 1999, when Warburg, Pincus Equity Partners led a group of investors who acquired control of Wright Medical and recapitalized it in order to reduce debt and provide the firm with investment capital.

Rants & Raves

Staring Down A Bear

by K.C. Grainger, Grainger Beaulac

While institutional investors are locked into positions that should bolster the stock market in the near term, other factors seem to presage a long bear market.

For the last fifty years the stock market has shown an average P/E ratio of between 14 and 16 times earnings, dipping to as low as eight times earnings during inflationary periods and recessions. Today, the S&P 500, which represents about 80% of total stock market capitalization, is trading at approximately 24 times earnings—well above the high end of this range, and high even if we assume the we are not in a recession now or anytime in the next 12 months.

Despite these vertiginous valuations, many fund managers must remain fully invested in stocks that they already own, often investing new cash into those same stocks. This will add support to the market.

Meanwhile, the Federal Reserve has allowed M3 money supply to grow by a whopping 18% on an annual basis over the last three months. Historically, M3 levels such as these, coupled with Fed rate cuts, has meant an average 29% increase for the large cap market within 18 months.

That leads me to expect another fast and possibly furious move up. The Dow Jones Industrials should reach new highs which, assuming those gains are sustained into mid-winter, should also drive a new high water mark for the S&P 500 and possibly lead the Nasdaq 100 close to 3200.

In the long term, however, even $2 trillion in money funds bolstering the market is not enough to offset the underlying fundamentals reflected by insider trading trends. In the reports of insider trading for the largest 2000 companies, only 64,000 shares (total, for all 2000 companies) were bought by corporate executives—an incredibly small amount. Selling as a percentage of total trades dwarfed buying; 4.9 million shares were sold by the world's most knowledgeable and informed investors, a very negative trend for the longer term, which leads me and Bob Morrow to conclude that we are soon heading into a bear market of long duration. And I hope that we are wrong. —*With Robert S. Morrow, Robert S. Morrow Institutional Advisory Service.*

Letter from the Editor

In order to ensure that we are delivering the highest value to our readers, we are currently reexamining our product and our market position.

While we continue publishing authors and columns that are familiar to you, we invite you to forward your comments and suggestions to senderi@multex.com.