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NETNOTES

The much publicized collapse of internet stock prices has overshadowed positive developments in the industry. A number of firms have become profitable and margins are expanding sharply. Although volume gains will decrease from the rates achieved on small sales bases during the past few years, they will still remain at strong levels. Most importantly, the negative factors seem more than fully discounted by current stock valuations, after a year or more of deteriorating prices.

The focus at this point should be on identifying firms which are likely to register substantial sales and earnings growth for the next five to ten years.

Unlike the past two to three years, current price levels seem to present attractive investment opportunities – in large part due to the publicity regarding the deterioration of many online companies. Earnings results during the next several quarters are likely to clarify the large gulf between leaders and laggards.

The following is a list of ten internet or internet related firms with estimated revenues of more than \$100 million this year. This is not an all-inclusive listing of online companies with sales exceeding this threshold. Firms such as Microsoft (MSFT – 59 13/16), Oracle (ORCL – 21 15/16) and Cisco Systems (CSCO – 24 1/4) are also excluded, since internet-related business currently accounts for only a small portion of total revenues.

		Estimated Revenues Calendar 2001 <u>(millions)</u>
AOL Time Warner	(AOL – 44.25)	40,000
Amazon.com	(AMZN – 11 3/4)	3,500
Ariba	(ARBA – 18 5/16)	900 ¹
Commerce One	(CMRC – 19 1/2)	1,000
Double Click	(DCLK – 13 1/2)	550
Ebay	(EBAY – 42 5/8)	700
Macromedia	(MACR – 29 1/2)	650 ²
Register.com	(RCOM – 5 27/32)	120
Verisign	(VRSN – 50)	1,000
Yahoo	(YHOO – 23 13/16)	1,300

¹ Includes acquisition of Agile Software (AGIL – 24 5/16)

² Includes proposed merger with Allaire Corporation (ALLR – 8 13/16)

We recommend that earnings and cash flow, rather than company size or growth rate, be emphasized in taking investment positions. Maturation of this industry is not likely to be achieved on a global basis for between five to ten years, at which time it will be possible to calculate sustainable growth rates. In contrast to other opinions, we consider slowing of growth at this stage as a natural rather than an adverse development.

The current valuation of internet stocks seems to have more than corrected the excesses of the mania which peaked in late 1999 and early 2000. However, the immature nature of this business creates above-average risks, particularly as new technology is introduced or more widely adopted.

A powerful trend toward cost cutting by use of internet-powered software and marketplaces is probably the most important factor impacting this industry. Consequently, the business-to-business segment will be stimulated significantly for at least the next three to four years. Specific firms which stress cost-cutting technology include Ariba, Commerce One, IBM (IBM – 103.90) and Oracle.

On balance, purchase of the stocks of viable firms with strong cash flows seems likely to produce above-average investment returns during the next several years.

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