



Issue 4: Wednesday, March 6, 2002

## In This Issue

- Page 1    Telecom Overview : A Walk Down the Teleonomy Path
- Page 3    Portfolio Updates : AFCL, Cisco, Enterasys, Micromuse, Rational, SBC, Verizon, Tellabs and Comcast
- Page 5    The Telecom Connection Portfolio

This week, we're offering a special preview of The Telecom Connection by Cody Willard. If you are involved in, or you invest in the telecommunications industry, this is a must-read. If you want to keep reading Cody's in-depth analysis, you will need to sign up for a subscription to The Telecom Connection. To sign up, visit [www.thestreet.com/r/telecomtrends](http://www.thestreet.com/r/telecomtrends).

## Telecom Overview: A Walk Down the Teleonomy Path

Most of the stocks in The Telecom Connection portfolio remain at rather compelling levels. Funny how it's always much easier to like a portfolio when the market's moved up, and we somehow want to believe that the **Nasdaq's** 8% run over the last week-and-a-half validates much of our bullishness. In any case, let's take a quick swim down our trickle-down teleonomy and explore the trends and valuations in each sector.

### Enterprise

End-user demand, particularly on the enterprise side, remains weak. **Dell** (DELL:Nasdaq), **EMC** (EMC:NYSE) and **Verizon** (VZ:NYSE) are all indicating that corporate IT and telecom purse strings remain rather closed. Military, defense, and other government spending has offset some of that weakness, and **Cisco** (CSCO:Nasdaq) in particular continues to keep some focus on the government dollars. The economy, however, really is beginning to pick up some steam, and sources tell me that despite continued cloudiness, wireline demand has begun to stabilize in many NFL cities (major cities, to non-sports fans out there). Such a trend bodes well, of course, for both the ILECs and surviving CLECs.

### Wireless

Wireless growth, on the other hand, while still growing at an impressive clip, is not exactly a bright spot here in the U.S. or abroad. Overhyped and too expensive, the transition to 2.5G or 3G platforms remains a pure debacle here in the US. And the not quite as overhyped next generation of mobile phones – from **Handspring's** (HAND:Nasdaq) Treo to **Ericsson's** (ERICY:Nasdaq ADR) camera phone – come across to consumers as not quite ready for prime time. Not to mention that most models aren't ready for general availability yet either.

### Cable

Cable, however, is showing some bright spots. Upsales to digital cable from analog continues to plug along and average revenue per user (ARPU) continues to rise. Furthermore, video-on-demand (VOD)

(Continued on next page)

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Issue 4: Wednesday, March 6, 2002

trials, including HBO on demand, are going quite well, and VOD promises to provide yet another source that will push ARPU higher. Layer the increasing success of cable telephony in both technological and end-user adoption terms on that, and cable has some real promise for growth. Cable telephony provides traditional telephone voice services carried over the same pipe that your cable TV uses and is typically offered as a secondary line, or 'teenage' line. **Cablevision** (CVC:NYSE), AT&T Broadband, and most of the other players are becoming increasingly serious about cable telephony.

### Capital Expenditures

So what about these carriers' appetite for capital expenditures? Are they finally going to resume spending real dollars, or will their capex budgets continue to diminish as swiftly as the New York Knicks' playoff hopes? Interestingly enough, the answer is that capex budgets are stabilizing and will likely be higher by the end of this year. The CLEC industry will not be a force any longer, as these companies must continue to focus on keeping budgets tight and generating some (any!) cash flow. Sources at both the ILECs and the equipment suppliers tell me those budgets are finally beginning to shift toward stabilization. I'm also becoming increasingly convinced that the evermore incumbent-friendly regulatory environment will spur further spending by the ILECs.

Wireless capex remains a question mark, though. There's no easy answer to how the wireless industry will play out over the next year, and I'm not a believer in any rosy scenarios that might be offered. Most of the wireless carriers will need more money, and I just don't know how they're going to get it. Burnt as they are from the CLEC implosion, the capital markets just aren't willing to look past next week any longer. I'm working hard on getting these answers and will keep readers abreast of any conclusions.

Cable capex is still a relative bright spot. Cable companies, by and large, remain rather well capitalized and continue to spend accordingly. Companies like **Nortel** (NT:NYSE) are really beginning to make a push back into cable, as they see potential revenue in selling equipment to the cable companies.

As for the component suppliers, I still can't get excited here. The good news is that inventory levels are finally coming down, although no one can be sure quite how far (more on that next week). The bad news is that just as they were the last to see the bubble pop, these guys will be the last to see the stabilization in demand. I think their eternally optimistic mindsets will help here, as these companies are now desperately looking for the uptick, after having ignored so many downticks in the last few years. When still-ridiculous valuations, such as **JDS Uniphase** (JDSU:Nasdaq) trading at some 8.5 times annualized revenue, are thrown in, I just can't help but stay away. There are too many much more compelling opportunities out there.

Now let's look at the companies in The Telecom Connection's portfolio.



Issue 4: Wednesday, March 6, 2002

## Portfolio Updates: Advanced Fibre, Comverse, Cisco, Enterasys, ITXC, Micromuse, Rational, SBC, Verizon, Tellabs and Comcast

**Advanced Fibre Communications** (AFCL:Nasdaq) – Sources indicate that business remains stable here, and that maybe there have even been a few upticks over the last week or so. But I'm not convinced these are anything more than anecdotal at this point. Regardless, the company remains dominant in much of the U.S. (particularly in rural areas), and its biggest competitors – **Lucent** (LU:NYSE) and **Alcatel** (ALA:NYSE) – just aren't making any headway. I think some of the uptick might even be coming from market share-taking. Advanced Fibre is a good story with a compelling valuation and a great balance sheet. I think the stock's headed higher.

**Comverse** (CMVT:Nasdaq) – As I mentioned in the overview, the wireless end-market is in disarray. This area remains vitally important to Comverse's growth. The flipside, though, is that wireless growth does continue, and those wireless customers need voicemail. Comverse is doing well in that regard. I am still looking, and hoping, for the company to successfully spin off (or sell) its Verint security tech division, as such a transaction would catalyze the stock's move higher.

**Cisco** (CSCO:Nasdaq) – Man, this is a tough one. There's little doubt that business remains tough in the enterprise market, but Cisco management has been one of the first and most aggressive pushers into the larger U.S. government budgets, particularly defense. Shares have been moving here, as big money looks to get exposure into liquid tech stocks, but enterprise demand has to improve for this stock to get back to \$20. Watch for acquisitions soon too, as sources tell me that the company is getting more serious about sniffing around some privately held equipment vendors.

**Enterasys** (ETS:NYSE) – This one remains as muddled as ever. We need to find out more about the depth and severity of the fraud at the Asia-Pacific unit and the seemingly separate SEC probe. Former Cisco executive Gary Jackson's Feb. 15 decision to back out of taking over the Asia-Pacific unit less than a month after publicly accepting the job, and the burial of the decision deep in a personnel press release certainly raises more red flags. Spokeswoman Kristen Sheppard's recent assurance that the company is "very confident at this point that these discrepancies in revenue recognition are contained to the Asia-Pacific region" isn't exactly the formal and transparent assurance I'm looking for. Until we get more answers, I'm leery of buying any more of the stock. But I still think the SEC probe is a routine information-gathering exercise after all the recent transactions the company faced as it separated and reformed out of Cabletron.

**ITXC** (ITXC:Nasdaq) – Business remains robust for this international Internet telephony carrier. India is opening its long-distance market in April, and ITXC is well-positioned – make that incredibly well-positioned – to benefit. If India works out one-tenth as well as the very similar situation in Bolivia did, this stock will rock. This is still a very good one, although we're likely still a quarter or two from hitting double digits.

(Continued on next page)



Issue 4: Wednesday, March 6, 2002

**Micromuse** (MUSE:Nasdaq) – Boy, what a nice move in this stock over the past week. The company's hitting on all cylinders, but like its biggest partner Cisco, Micromuse needs enterprise demand to pick up to get this stock back to the high teens. If the stock ramps up much further too quickly, I'll likely lock in some profits in the portfolio.

**Rational Software** (RATL:Nasdaq) – I still think this one stinks, although the initial selloff from our Catapult transaction expose has subsided and the stock's back to where it was. I'm worried that if the markets shake their Enronitis, this story loses its impact. I'm as sickened as ever by this story, and the Feb. 27 report that Chairman Paul Levy filed to sell yet another 100,000 shares keeps the red flags flapping. We have to hope this one gets more attention soon.

**SBC** (SBC:NYSE) and **Verizon** (VZ:NYSE) – Forget about the long-distance push. The moves by the FCC and Congress to reshape the 1996 Telecommunications Act in the ILECs' favor are the story here. These are huge developments, and SBC and Verizon are taking no prisoners.

**Tellabs** (TLAB:Nasdaq) – Sacrificed a little Tellabs lamb to the market gods last week and the stock popped. The company's Titan 5500 series digital cross connect remains its bread and butter, and it is still selling. As wireline demand grows over the next few quarters, so will Tellabs. But competition is knocking on the door. The company's other lines of business just stink, so there's enough risk that I'm glad we took a little off the table.

**Comcast** (CMCSK:Nasdaq) – Another big mover in the last few weeks, Comcast is up nearly 20% from its recent lows. AT&T Broadband, which Comcast recently agreed to purchase, announced that its business is hitting on all cylinders, and that its cable telephony service would break even ahead of plans, which surprised even this cable telephony bull. What a coup this AT&T Broadband purchase is! Other cable companies are taking note, which will help push adoption of the technology by the consumer and the critical mass needed to drive down the costs of deployment. This is a great story.



Issue 4: Wednesday, March 6, 2002

## The Telecom Connection Portfolio

Company Name	Date Initiated	Purchase Price	Number of Shares	Amount Invested	Recent Price	Value	% Gain/Loss
ITXC (ITXC:Nasdaq)	Aug. 14, 2001	\$3.10	12,903	\$40,000	\$5.85	\$75,483.87	89%
Cisco (CSCO:Nasdaq)	Sept. 26, 2001	\$12.23	3,271	\$40,000	\$16.51	\$53,998.36	35%
Enterasys (ETS:NYSE)	Sept. 26, 2001	\$6.38	6,270	\$40,000	\$4.42	\$27,711.60	-31%
Micromuse (MUSE:Nasdaq)	Sept. 26, 2001	\$6.02	6,645	\$40,000	\$10.44	\$69,368.77	73%
Tellabs (TLAB:Nasdaq)	Sept. 26, 2001	\$10.45	1,914	\$20,000	\$12.48	\$23,885.17	19%
Advanced Fibre (AFCI:Nasdaq)	Oct. 8, 2001	\$16.51	2,423	\$40,000	\$18.45	\$44,700.18	12%
Converse (CMVT:Nasdaq)	Oct. 8, 2001	\$17.71	2,259	\$40,000	\$16.78	\$37,899.49	-5%
SBC Communications (SBC:NYSE)	Dec. 4, 2001	\$38.30	1,044	\$40,000	\$38.77	\$40,490.86	1%
Verizon (VZ:NYSE)	Dec. 4, 2001	\$47.50	842	\$40,000	\$47.40	\$39,915.79	0%
Comcast (CMCSK:Nasdaq)	Feb. 13, 2002	\$33.74	1,186	\$40,000	\$35.10	\$41,612.33	4%
Rational Software (RATL:Nasdaq)	Feb. 19, 2002	\$21.06	(1,899)	\$40,000	\$20.99	\$40,132.95	0%
Cash				\$80,000		\$80,000	
<b>Total</b>				\$500,000		\$575,199.38	15%

### Closed Positions

Company Name	Date Sold	Purchase Price	# of Shares	Purchase Date	Sale Price	Sale Value	% Gain/Loss
Tellabs (TLAB:Nasdaq)	Feb. 27, 2002	\$10.45	1,914	Sept. 26, 2001	\$10.72	20,518.08	3%

\* Prices are as of previous day's market close

The Telecom Connection Model Portfolio is a model portfolio of telecom industry stocks chosen by Cody Willard. The Model Portfolio will initially be comprised of the nine (9) stocks that Cody selected in his columns on TheStreet.com's RealMoney between Aug. 14, 2001 and Dec. 4, 2001. Please be advised that Cody does invest in stocks himself, and at any given time may or may not own one or more of the stocks included in the Model Portfolio. Although his personal holdings may or may not match the Model Portfolio, the Model Portfolio is intended to give subscribers Cody's view of what a well-rounded telecom industry portfolio would look like. Equal weighting is given to each stock in the Model Portfolio, and Cody will inform subscribers in The Telecom Connection each time a stock is added to or removed from the Model Portfolio. Please keep in mind that this is a model portfolio and does not necessarily account for the different risk tolerances, investment objectives, and other criteria used by each individual investor when making an investment decision. You are encouraged to conduct your own research and due diligence, and to seek the advice of a qualified securities professional, before you make any investment.



Issue 4: Wednesday, March 6, 2002

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