Issue 59: Wednesday, April 9, 2003

In This Issue

Telecom Overview:
Two Baskets of Telecom

Remarkably, since the tech and telecom markets put in their October bottoms, the stocks of many of the shakiest companies have far outperformed the well-capitalized members of the teleconomy. Take, for example, **Lucent** (LU:NYSE) and **Corning** (GLW:NYSE) (please!). Both of these companies are burdened with billions of dollars of debt, and, more relevant to this story, both companies have issued lots of convertible debt that can be turned into stock if the stock price ever gets above a certain level.

Those converts and the telecom rally since October present an opportunity for the model portfolio. I'm going to establish two baskets of stocks in the portfolio, one long and one short, that will take advantage of the valuation disparities between those telecom companies that have stable balance sheets and those that offer studies in leverage.

Leveraged to Lose
During the past few years, convertible debt issues have accelerated the collapse of many telecom stocks. The companies issued the converts to raise cash for their expansion plans, but arbitragers would buy the converts and short the stock against those positions. The convertible issues in most cases pay interest to the holders, ensuring a return on the holders' investments so long as the company doesn't go bankrupt. And the fact that the holders can convert the bond to stock at a certain level means that shareholders have a defined loss limit on their common stock short.

Let's lay out a simple example. Say XYZ is trading at $30. The company issues some five-year convertible bonds that pay 5% and are convertible to common stock at $40. So an investor can buy the convertible and short the common. No matter how high the common stock runs, the investor's loss is capped at $10 ($40 - $30), and as long as the company doesn't go bankrupt, the investor will get that 5% for the life of the bond. (Companies like **Allegiance** (ALGX:Nasdaq) that might very well default on their bonds often see plain-vanilla bondholders hedge themselves by shorting the common stock.)

So we've seen an interesting dynamic play out since October, when many of these stocks were down as much as 99% from their highs. The arbs began unwinding their trades, partly because what's the

(Continued on the next page)

PLEASE SEE IMPORTANT LEGAL DISCLAIMER ON LAST PAGE

Issue 59: Wednesday, April 9, 2003

point of being short a 50-cent stock? As they unwound the trades, these investors had to buy back the common stock they had been short. That started the stocks moving higher. Then the climbs became self-perpetuating because the more the stocks ran, the quicker these hedgies moved to get unwound, making the stocks move up even faster.

This massive amount of unwinding has driven the valuations of these leveraged companies to the moon. But in fact these companies are in much worse shape than their counterparts with clean balance sheets. Pick most any metric – whether price to sales, price to earnings, and especially enterprise value to sales or enterprise value to EBITDA – and the valuations of the leveraged companies are much higher than the stable companies.

Think about that for a moment. The companies with the weaker prospects and all the problems that come along with being deep in debt -- decreased access to capital, extensive debt-service costs, etc. -- are valued more highly than companies that in some cases have healthy sales and manageable debts. That scenario simply cannot last forever, but that type of disconnect can last for months, or even years. Still the risk/reward in these names is especially high vs. the cleaner companies.

An obvious example: There's much more risk in Corning's $7 billion equity capitalization and negative $1 billion in net cash and investments than there is in **JDS Uniphase's** (JDSU:Nasdaq) $4.5 billion equity cap and positive $1 billion in net cash and investments.

The bottom line is that I think the disconnect is extreme at these current levels. If we're actually starting another bull market, the chances are that the clean and cheaper companies will run further and faster from current levels than the highly leveraged, expensive companies can. If market collapses or grinds lower from here, the clean companies will hold up better than their leveraged counterparts. Keep in mind, these baskets likely won't break tomorrow, but the risk/reward is right to establish the positions.

So without further ado, here are the baskets. I'll add each to the model portfolio at roughly $5,000 per position.

Short the Leveraged Basket:

- **American Tower** (AMT:NYSE)
- **Corning** (GLW:NYSE)
- **Lucent** (LU:NYSE)
- **Alcatel** (ALA:NYSE ADR)
- **Nextel** (NXTL:Nasdaq)
- **Broadwing** (BRW:NYSE)
- **Nortel** (NT:NYSE)
- **SBA Communications** (SBAC:Nasdaq)

Long the Clean Basket:

- **IDT Corp.** (IDT.c:NYSE)
- **Integrated Device Tech** (IDTI:Nasdaq)
- **Bookham Tech** (BKHM:Nasdaq ADR)
- **Aware** (AWRE:Nasdaq)
- **Polycom** (PLCM:Nasdaq)
- **New Focus** (NUFO:Nasdaq)
- **Interwoven** (IWOV:Nasdaq)
- **Palm** (PALM:Nasdaq)

Issue 59: Wednesday, April 9, 2003

The Telecom Connection Portfolio

Company Name*	Date Initiated**	Cost Basis per Share	Number of Shares	Amount Invested	Current Price	% Gain/Loss	IXTC at Buy Date	IXTC Return
Advanced Fibre AFCI	10/08/2001	$ 16.40	1923	$ 31,543.73	$ 15.40	-6.12%	$ 200.80	-41.25%
Applied Micro Circuits AMCC	09/26/2002	$ 3.35	3000	$ 10,038.00	$ 3.41	1.91%	$ 93.06	26.78%
AOL Time Warner AOL	04/10/2002	$ 19.39	491	$ 9,520.49	$ 12.51	-35.48%	$ 158.98	-25.79%
Comcast Corp New CMCSK	02/13/2002	$ 31.61	622	$ 19,661.42	$ 28.23	-10.69%	$ 183.16	-35.59%
Cisco Systems CSCO	09/26/2001	$ 11.28	1271	$ 14,339.33	$ 13.21	17.09%	$ 200.00	-41.01%
Extreme Networks EXTR	02/12/2003	$ 4.10	6000	$ 24,580.00	$ 4.03	-1.63%	$ 109.72	7.53%
Sprint FON	11/20/2002	$ 13.53	(2500)	$ 33,825.00	$ 11.60	-14.26%	$ 115.31	2.32%
ITXC Corp. ITXC	08/14/2001	$ 3.09	18903	$ 58,399.30	$ 1.25	-59.54%	$ 270.32	-56.36%
JDS Uniphase JDSU	09/26/2002	$ 2.13	8000	$ 17,040.00	$ 3.17	48.83%	$ 93.06	26.78%
Microsoft MSFT	09/26/2002	$ 23.33	800	$ 18,658.00	$ 25.06	7.44%	$ 93.06	26.78%
Micromuse MUSE	09/26/2001	$ 4.26	1645	$ 7,007.70	$ 6.04	41.78%	$ 200.00	-41.01%
Verizon VZ	12/04/2001	$ 42.05	1306	$ 54,915.60	$ 33.94	-19.28%	$ 248.25	-52.48%

The Telecom Connection Portfolio – Performance

Total Average Return	-12.77%
2003 YTD Return	-1.99%

Performance results listed here reflect values of stocks as of the close of the most recently completed trading day, and do NOT take into account dividends paid, interest earned or commissions. Results are updated overnight and posted prior to the market open the following business day. The 2003 YTD Return figures reflect changes since the beginning of 2003. The Total Average Return figures reflect changes since inception on 9/26/2001.

Nasdaq Telecom Index Performance

	Date Initiated	Open Price	Current Price	% Gain/Loss
Nasdaq Telecom Index (IXTC)	8/14/2001	$ 270.32	$ 117.82	-56.36%

At the time of publication, the buy-side firm in which Mr. Willard is a partner was long AFCI, AMCC, AOL, CMCSK, EXTR, ITXC, JDSU, IDT.c, IDTI, BKHM, AWRE, IWOV, VZ calls, and PALM; and short GLW, LU, ALA, FON, and NXTL.

To see Cody's full portfolio, including closed positions, visit http://www.thestreet.com/k/tc/portfolio.html.

Issue 59: Wednesday, April 9, 2003

Contact **Info**

- **Customer Service:**
  Please email ***members@thestreet.com***, or call 1-800-562-9571 Mon. – Fri. 8 a.m. to 6 p.m. ET.
- **Reader Feedback and Questions:**
  Please email Cody directly at cwillard@thestreet.com. Again, please direct all account-related inquiries to customer service.

Legal **Information**

This information is confidential and is intended only for the authorized Subscriber. Please notify us if you have received this document in error by telephoning 1-800-562-9571.

Cody Willard is a partner in a buy-side firm and a contributor to TheStreet.com's *RealMoney*. TheStreet.com is a publisher and has registered as an investment adviser with the U.S. Securities and Exchange Commission. We are not a registered broker-dealer. The firm in which Mr. Willard is a partner may, from time to time, have long or short positions in, or buy or sell the securities, or derivatives thereof, of companies mentioned in *The Telecom Connection*. In such cases, appropriate disclosure is made, although positions may change at any time and without notice. At the time of publication, the buy-side firm in which Mr. Willard is a partner was long AFCI, AMCC, AOL, CMCSK, EXTR, ITXC, JDSU, IDT.c, IDTI, BKHM, AWRE, IWOV, VZ calls, and PALM; and short GLW, LU, ALA, FON, and NXTL.

The Telecom Connection contains Mr. Willard's own opinions and is provided for informational purposes only. You should not rely solely upon *The Telecom Connection* for purposes of transacting securities or other investments, and 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. None of the information contained herein constitutes, or is intended to constitute a recommendation by Mr. Willard or TheStreet.com, Inc. of any particular security or trading strategy or a determination by Mr. Willard or TheStreet.com, Inc. that any security or trading strategy is suitable for any specific person. To the extent any of the information contained herein may be deemed to be investment advice, such information is impersonal and not tailored to the investment needs of any specific person. Past results are not necessarily indicative of future performance.