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In This Issue

Telecom Overview: All Earnings, All the Time

As earnings season hits full stride, this week's edition of *The Telecom Connection* delves into even more action on the earnings front.

Three model portfolio companies reported this week; two of them beat expectations while the third's results were in line. Both **Microtune** (TUNE) and **Riverbed** (RVBD) provided upside surprises in their results for revenue and earnings per share. **Level 3 Communications** (LVLT) reported in line and continues the execution that is critical to its success.

All three companies added cautionary guidance relative to the December quarter, but that's to be expected in the current environment.

Three more model portfolio names are scheduled to report over the course of the next week as well. **Alvarion** (ALVR), **First Solar** (FSLR) and **Motorola** (MOT) will step up to the plate, and I've provided my thoughts on what to expect to see and hear from each.

This is the first week that the inventory data monitor has sufficient data to really mean something. Fortunately, we're seeing improvement thus far. Although still high, it's heading in the right direction. With a little luck, we may actually get to within shouting distance of "normal" before earnings season is complete.

Last, I've updated the model portfolio reporting schedule as appropriate and included it in its normal location at the end of tonight's newsletter.

Now, let's take a look at those earnings results.

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Model Portfolio Earnings Reviews

• **Level 3 Communications**: The company picked up where it left off in the June quarter with solid execution in a difficult environment. Level 3's revenue and the loss per share were in line with expectations. Free cash flow was slightly negative at $4 million -- it really needs to return to the black and stay there.

Within its Core Network Services group, the Wholesale Markets Group (or WMG, which accounts for 36% of total revenue) posted 5% year-over-year growth. However, the Business Markets Group (22% of total revenue) was essentially flat with last year's figure. The Content Markets and European Markets Groups both posted double-digit year-over-year revenue growth but from relatively small bases. The leverage from the network optimization came through with the incremental improvement in gross margin. Surprisingly, Level 3 was actually profitable at the operating income line.

Management noted that since September, they have seen a slowdown in the closure rate on deals, which is true for many other companies as well. The typical cautionary cloud that settles in at the start of any economic uncertainty manifests itself in extra scrutiny of every contract as approvals get bumped up to higher levels of the decision tree. Accordingly, Level 3 trimmed its growth expectations for its Core Communications Services business to 7.5% for 2008.

Level 3's stock reaction after the conference call could only be characterized as panic. It plummeted 40% on eight times normal volume as investors decided Level 3 is a bankruptcy candidate given its refinancing needs and a weakening market. As I noted in the preview, the assumption that Level 3 will not be able to refinance some of its 2010 debt is misplaced. Credit availability has been improving by the week and, in reality, bank credit is up 6% from its June low and up 3% in just the last four weeks. Unfortunately, interbank lending has not been improving (they don't trust each other anymore). Unchanged since June, it has gone down 3% over the last four weeks, and **Micron** (MU) had little trouble arranging its financing and it is not likely Level 3 will either.

Level 3 remains at the crux of the highest growth segments of the communications markets. Its own history has shown that in past downturns, demand for its services has actually increased as customers use technology to reduce operating expenses. There is no reason to expect that customers will do something completely different this time around either.

• **Microtune**: delivered a solid quarter with revenue and pro forma EPS well above expectations. The top-line surprise was driven by greater-than-expected demand from the company's converter-box customers in advance of the digital TV switchover scheduled for February 2009. However, these lower-margin devices helped keep gross margin below the 50% level for the period. The company continues to generate more than $2 million of cash from operations and management used some of that to repurchase about 700,000 shares of stock. The balance sheet remains quite strong with no debt, modest receivables and a materially reduced inventory balance.

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The Telecom Connection
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TheStreet.com

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Automotive revenue remained strong and at 24% of total revenue was up 46% vs. last year. However, management did note that it expects to see some softening from automotive customers in the December quarter.

My concerns relative to the cable business have remained unfounded thus far as well. Demand remained strong. Driven by DOCSIS 3.0 upgrades, revenue is up 16% year over. Interestingly, the company indicated that the overwhelming majority of its DOCSIS 3.0 business has mainly come from Japan and Korea with very little domestically. Some softening has been seen in Korea. However, with Microtune still the only tuner used in any of the CableLabs approved set-top boxes so far; therefore, the planned domestic rollouts by **Comcast** (CMCSA), **Cablevision** (CVC), et al., should be a boost in the not-too-distant future.

The one area that could become a positive surprise for Microtune in 2009 is the all-important TV market. The company has been working on a new product to attack the market in 2010. However, management noted that there's been a new catalyst that has caused a number of original equipment manufacturers (OEMs) to take a new look at the company's products: thinness! As I'm certain you've noticed with a number of the commercials advertising new TV sets, thin is in -- and the thinner the better. Apparently, the old can-based tuners are physically too large to continue shrinking the depth of the set. After years of attempting to crack accounts based on cost, reliability and/or quality, style issues may wind up being the winning formula for the company.

As expected, management provided cautionary guidance regarding its fourth-quarter outlook. Before the call, expectations for the December quarter were for revenue to be flat compared to the third quarter. Now revenue is expected to be in the $24.5 million to $26.5 million range, which is below the Street consensus and what I anticipated.

Microtune's net cash per share is now $1.51. This is now 75% of the company's market capitalization and it continues to generate cash. In this crazy market, we end up with yet another bizarre valuation circumstance. Given that, I'll just hold on to the stock at this point.

• **Riverbed Technology's** numbers came in above consensus for the September quarter as well with product revenue up 28% year over year and services up more than 100%. Gross margin was negatively impacted by a $2.3 million inventory charge that the company took with the introduction of new units. Excluding that charge and another $2.0 million to close out a litigation issue and pro forma EPS would have been 18 cents per share. Cash from operations remains very solid at $26 million. The balance sheet is also strong as the company is sitting on about $4.00 per share in net cash.

Riverbed continues to execute and added another 500 new customers during the period. The company's solutions provide real cost savings for IT managers during tough times. Management highlighted particular strength from its government vertical as well as the energy and insurance markets. Surprisingly, the financial services vertical was within its normal range of 8% to 12% and, according to management, we'd be surprised at some of the customers who are driving the growth.

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As I mentioned earlier, Riverbed came out with a new version of its Series 50 model and is expected to deliver more new models in the December quarter. Steelhead Mobile had an "OK" quarter but still produced only 4% of product revenue. So I was a little disappointed it wasn't stronger.

Management also talked about its upcoming Atlas product line. While Steelhead focuses on accelerating the performance of wide-area networks (WAN), Atlas will target accelerating the performance of storage subsystems. It is said to be in testing at eight locations currently and is expected to be introduced sometime in the first half of 2009. Given the success of Steelhead, Atlas could be another big winner for Riverbed.

The company's guidance was for revenue to be in the $87 million to $90 million range with pro forma EPS of 15 cents to 17 cents. This compares with the Street consensus at the time of $90 million in revenue and EPS of 16 cents. Management commented a number of times that the guidance is conservative, not based upon any weakness it currently sees in its end markets. Unlike a number of other companies, they indicated the month of September was like the third month of any quarter: Their pipeline remained robust, and they were not aware of any cancelations.

Given Riverbed's ability to save real dollars for its customers, I think its stock should be one of the better performers through any downturn. You may want to add it to your portfolio if you haven't already.

Earnings Expectations for Next Week

• **Alvarion** is set to report Monday and for the first time in the last year I believe investors are due for some "upside." No, business isn't booming, and the top line should be in line with expectations, but the September quarter will be the first time all year when foreign currency exchange is moving in the Israel-based company's favor.

Last quarter, the company's CFO commented that the shekel strengthened 7% in the second quarter alone and, despite attempts to mitigate its impact, it had a $2.2 million negative impact on operating expenses. That translated into 3 cents at the EPS line. With all the tumult in the world of finance the dollar/shekel rate has reversed course and essentially weakened by about 7% in the third quarter. I don't know if any of the second-quarter "hedges" were still in place, but some of this improvement should translate into better earnings for the company due to its lower operating expenses.

Beyond the foreign-exchange issues, it will be interesting to hear what the company can say about the integration with **Nortel** (NT) and the status of that venture. Nortel was scheduled to commence installing mobile WiMAX equipment for a carrier in Moscow by the end of the year. This could be a good test case for the state of the industry after the financial turmoil.

Alvarion is another of the market's valuation victims, as about three-quarters of its market capitalization is in net cash. Consequently, it's not going anywhere in our portfolio.

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• **First Solar** has been pummeled like the rest of the stock market, but with the alternative energy names extra pressure has been applied. Certainly some of that has been the result of the high valuations many in the group had, but also because of belief that lower prices for oil will dampen the push for alternatives. I don't believe that latter scenario will happen. If anything has become clear over the last 12 months, it's that domestically, we're held hostage to a product (oil) and a geography (the Middle East) that can place us in difficult circumstances financially, politically and militarily.

While there have been a rash of downgrades and estimate reductions on the solar power companies by a number of brokerage houses, we didn't see much to support that from **SunPower** (SPWRA/SPWRB) a couple of weeks ago. I don't expect to hear much negativity from First Solar either.

Also of concern has been the expectation of reduced incentives and/or subsidies. We've already seen the reductions in Spain; the domestic investment tax credit has been re-established here as well. Consequently, I think this is far less of an "issue" than some of the sell-siders make it out to be.

The main focus for First Solar investors will be how the top line is growing. If the company posts another triple-digit quarter and an outlook even close to that, I think a lot of investors will be rethinking the group once again.

• **Motorola** delivered a pleasant surprise in the prior quarter, and the question now is, "Was it a one-quarter wonder?" Its Home and Networks and Enterprise Mobility divisions both performed well. Even the Mobile Devices business contributed to the positive performance, and that was completely unexpected.

Unfortunately, we've heard quite a bit of negativity relative to the handset business from **Nokia** (NOK), LG, Samsung and Sony Ericsson (a joint venture between **Sony** (SNE) and **Ericsson** (ERIC)). Despite all the gloom and doom, it can be easy to look good from where Motorola's been in recent quarters. As a result, it won't shock me if the company's Mobile Devices business continues on a positive trend despite what the rest of the industry is saying. It's almost as if Motorola's contracted so much, it's not big enough to be relevant any more. Hopefully, that will change.

Over on the other side of the business, the Enterprise Mobility group is my choice for the business segment most likely to struggle anytime over the next several quarters. Much of that operation is based on the recent Symbol Technologies acquisition . The project orientation of its revenue stream is just the type of thing that gets postponed due to budgetary constraints when times are tight.

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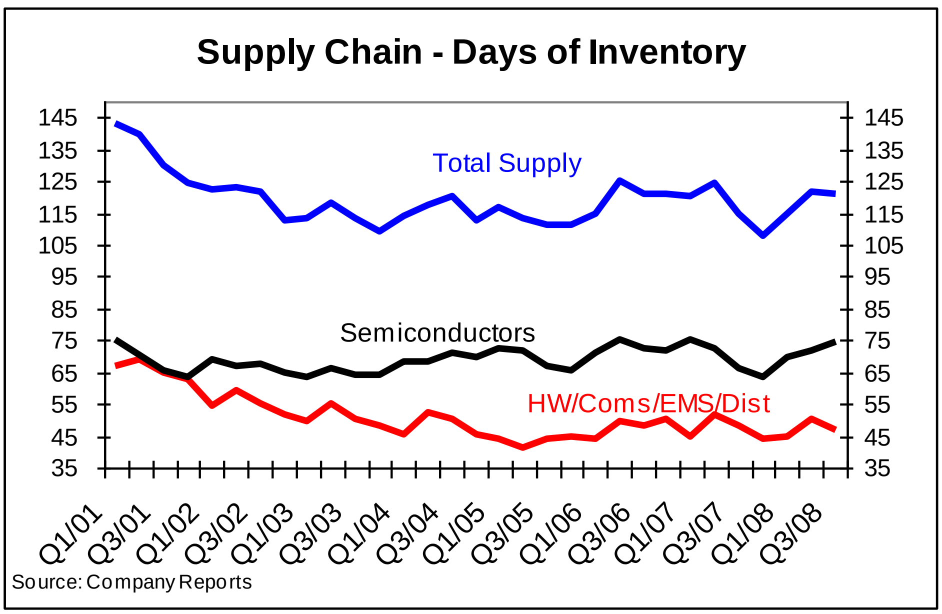
Inventory Monitor Ramps Up

With the flood of earnings over the past week, 30% of our monitored companies have reported, so we have our first reasonable look at the inventory situation. Last week, we had the traditional “spike up” that takes place at the start of every cycle. Now, as you can see below, it has started its decent to normalcy. Aggregate inventory days stand at 121 vs. 122 days exiting the second quarter and 115 days a year ago. That’s also down from last week’s 128 days metric.

Within the two components, semiconductor companies are at 74 days compared with 66 days last year, 72 days last quarter and 77 days last week. Over on the customer side of the house they are carrying 47 days of inventory presently vs. 48 days in the third quarter of 2007 and 50 days last quarter. At 47 days, this is almost back to the normal parameters of 44 days to 46 days.



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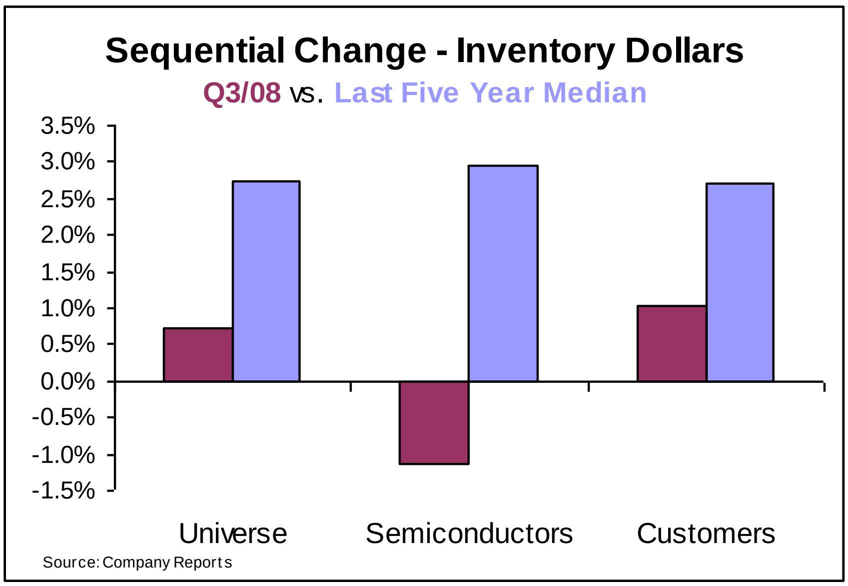
As you can see in the following graph, the inventory changes thus far remain well below what would constitute normal seasonality. Over the past five years, the median increase in inventory from the second quarter to the third quarter is 2.7%. That's understandable given the need to build for the holidays.

However, the ramp so far this year is only 0.7%. That may say more about the state of the economy and the uncertain outlook than anything. When the numbers are dissected into semiconductor companies and customers, you can see a decline of 1.1% for semiconductors vs. a normal gain of 2.9%. With the customers, the current increase is 1.0% vs. the historical 2.7% ramp.

The degree of softness in fourth-quarter demand is going to have a big impact on overall inventory. Those data are still months off, but for now at least the situation is improving.



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Model Portfolio Reporting Schedule and Results

As always, I've updated the reporting schedule with the available data and the results for the companies that have reported over the past week

Model Portfolio Earnings Reporting Schedule With Estimates, Results						
			Current Consensus Estimates		Actual Results	
	Date	Conf. Call Time (EDT)	Revenue	EPS	Revenue	EPS
Advanced Micro Devices (AMD)	Oct. 16	5:00 p.m.	$1.48B	($0.40)	**$1.78B**	**($0.11)**
Apple (AAPL)	Oct. 21	5:00 p.m.	$8.05B	$1.11	**$7.90B**	**$1.26**
Alvarion (ALVR)	Nov. 3	9:00 p.m.	$75M	$0.04	--	--
Clearwire (CLWR)	Nov. 10	11:00 a.m.	$56M	($0.96)	--	--
Cisco (CSCO)	Nov. 5	4:30 p.m.	$10.32B	$0.39	--	--
Cypress (CY)	Oct.16	11:30 a.m.	$575M	$0.30	**$600M**	**$0.30**
Dell (DELL)	Nov. 20	4:30 p.m.	$16.80B	$0.36	--	
First Solar (FSLR)	Oct. 29	4:30 p.m.	$339M	$1.02	--	
Google (GOOG)	Oct.16	4:30 p.m.	$4.06B	$4.82	**$4.04B**	**$4.92**
Level 3 Communications (LVLT)	Oct. 23	10:00 a.m.	$1.07B	($0.08)	**$1.07B**	**($0.08)**
Motorola (MOT)	Oct. 30	8:00 a.m.	$7.84B	$0.02	--	--
Micron (MU)	--	--		--	--	--
Netlist (NLST)	--	--	$29M	($0.03)	--	--
Qualcomm (QCOM)	Nov. 5	4:45 p.m.	$2.87B	$0.60	--	--
Research In Motion (RIMM)	--	--	--	--	--	--
Riverbed Technology (RVBD)	Oct. 23	5:45 p.m.	$84M	$0.14	**$86.5M**	**$0.15**
SunPower (SPWRA/SPWRB)	Oct.16	1:30 p.m.	$350M	$0.56	**$378M**	**$0.60**
Microtune (TUNE)	Oct. 23	5:00 p.m.	$29M	$0.06	**$31.9M**	**$0.08**

Source: Yahoo! Finance

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The Telecom Connection Portfolio

Company Name	Date Initiated	Cost Basis per Share	No. of Shares	Amount Invested	Current Price	% Gain/Loss	IXTC at Buy Date	IXTC Return
Apple **AAPL**	2/15/06	$100.56	300	$30,168.00	104.55	3.97%	235.36	-33.01%
Alvarion **ALVR**	2/22/07	$8.98	2,510	$22,538.00	3.14	-65.03%	244.90	-35.62%
Clearwire **CLWR**	11/12/07	$13.50	500	$6,750.00	7.19	-46.74%	257.91	-38.87%
Cisco Systems **CSCO**	3/30/05	$22.51	800	$18,009.00	17.87	-20.62%	223.36	-29.41%
Cypress Semiconductor **CY**	7/10/08	$5.36	2,000	$10,720.00	4.7	-12.31%	230.96	-31.74%
Dell (call options) **DLYAD – 20 contracts**	12/6/07	$6.80	2,000	$13,600.00	0.12	-98.24%	259.97	-39.35%
First Solar **FSLR**	8/28/08	$263.55	150	$39,533.00	115.75	-56.08%	239.62	-34.21%
Google **GOOG**	2/9/06	$494.76	75	$37,106.70	358.0	-27.64%	243.87	-35.35%
Level 3 **LVLT**	6/19/08	$3.76	3,000	$11,280.00	1.09	-71.01%	263.91	-40.26%
Motorola **MOT**	4/12/06	$23.20	1,000	$23,205.00	5.45	-76.51%	226.48	-30.39%
Netlist **NLST**	2/14/08	$1.46	3,500	$5,095.00	0.5	-65.65%	232.75	-32.26%
Qualcomm **QCOM**	8/14/08	$55.02	500	$27,510.00	37.92	-31.08%	256.15	-38.45%
Research In Motion **RIMM**	11/19/07	$113.82	200	$22,763.75	47.82	-57.99%	247.44	-36.28%
Riverbed Technology **RVBD**	7/26/07	$32.56	450	$14,654.25	12.96	-60.20%	244.32	-35.47%
SunPower **SPWRA**	2/14/08	$89.70	300	$26,910.00	37.67	-58.00%	239.54	-34.18%

(The model portfolio continues on the next page)

SunPower SPWRB	9/29/08	$70.95	548	$38,880.60	30.23	-57.39%	190.17	-17.10%
Microtune TUNE	2/8/07	$5.23	2,500	$13,075.00	2.18	-58.32%	244.96	-35.64%
Micron (call options) WGYAZ – 125 contracts	8/28/08	$2.26	12,500	$28,250.00	2.80	23.89%	251.83	-37.39%

The Telecom Connection Portfolio – Performance

Total Average Return	- 48.56%
2008 YTD Return	- 56.70%

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. Sales are taken from the most recent purchase of that stock unless otherwise stated. The 2008 YTD Return figures reflect changes since the beginning of 2008. The Total Average Return figures reflect changes since inception on 8/14/2001.

Nasdaq Telecom Index Performance

	Portfolio Inception	Open Level	Current Level	% Gain/Loss Since Portfolio Inception	2008 YTD Return
Nasdaq Telecom Index (IXTC)	8/14/2001	262.84	157.66	- 40.02%	- 38.51%

At the time of publication, Mr. Faulkner was long CLWR, CY, MU, TUNE, TUNE calls.

To see the full Telecom Connection model portfolio, including closed positions, visit http://www.thestreet.com/k/tc/portfolio.html

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