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VOLUME 2 - ISSUE 19 - MAY 14, 2001

EPOCH DIRECT

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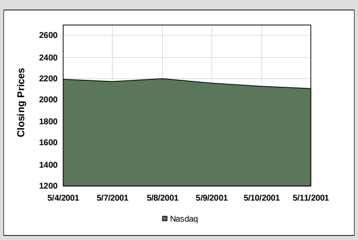
Epoch Indices for the Week

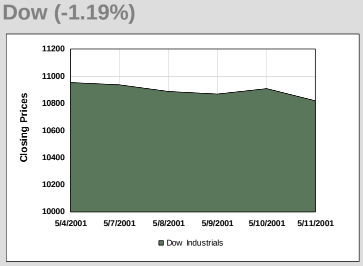
Broadband & IP Svcs:	-6.16%
Comm Equipment:	-4.35%
Internet:	-1.17%
Software:	-2.66%

Market Statistics (5-Day)

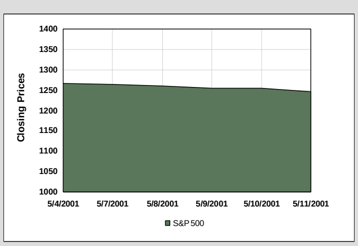
Nasdaq (-3.84%)



Dow (-1.19%)



S&P (-1.65%)



Handheld Devices: Relief Is in Sight

By Matthew Adams, CFA

Vice President, Analyst

Bad news has followed bad news lately. On the heels of Palm's gloomy results for April, which showed sales slipping more than 20% from March, Handspring cut prices to match Palm's similar reductions. Even Research in Motion, the high flyer of the three pure-play personal digital assistant (PDA) stocks has been grounded by the news that reseller partner Aether Systems has excess inventory. Aether may have to sell the RIM 950 at half price to clear the way for new devices. The PDA industry is clearly feeling some growing pains. The questions arise: Is relief coming, and, if so, from where?

Are New Devices the Answer?

Some may see a solution in the recent release of new products. However, PDA manufacturers are offering incremental improvements rather than revolutionary devices. In the last six months, Palm's and Handspring's new products marked notable improvement in their own product lines, but merely edged ahead of competitors' existing models.

Handspring released the Visor Edge, which is a sleek business PDA, à la the Palm Vx. Palm launched its m100 (a low-price device) and m500 series (with expansion slots), which compete with Handspring's low-price Visor Basic and its Springboard expansion platform. Although these new devices have received many glowing reviews, they offer nothing original to the market.

In addition, the new models only modestly improve on the features and display of their predecessors. For example, the Sony Clie PEG N710C has a better display than its predecessor, with sharper color resolution (320x320). But I hardly find better color a reason to dump my Palm V. Besides, Sony's target users have probably noticed that the Palm m505 and Handspring Prism -- which have equally crisp displays -- have been on the market for some time, and at the same price or lower.

A few years ago this strategy of introducing a new device every six months worked because the primary market was made up of early adopters looking for the latest new thing. I myself have been through three Palm devices in fours years, ever searching for a sleeker model with better input and graphics. However, the PDA market has moved from incubator status and makers are now peddling their wares on Main Street. Similar to Microsoft's problems selling Windows 2000 to enterprises a few years back, consumers are not biting at new devices that offer only modest improvements over existing products.

[more]

At the moment, there is no revolutionary PDA device on the market. Instead we find the current inventory glut threatening to stall sector growth in the coming months.

Stocks in Tenuous Position

The good news for investors is that most of the bad news is already priced into PDA manufacturers' shares. PALM is trading near its 52-week low and the company expects flat revenue growth for 2001. Handspring is bordering on its 52-week low. However, Wall Street still projects almost 100% annual revenue growth for calendar 2001, compared to our 4% estimate for Palm. Lifecycle disparities aside (Palm is larger and more mature, hence its slower revenue growth) this is a huge difference for companies competing in the same retail channel.

Research in Motion (RIM) trades at twice the forward revenue multiple (8.2x) of the other two companies and seems to be the most expensive stock of the three. Wall Street also expects more than 100% revenue growth for calendar 2001, and RIM's margins (at 40%) are 1,000 basis points above those of Palm and Handspring. RIM is not competing in the fickle retail market, but the first cracks in the enterprise market are now appearing. Reseller Aether is having a tough time moving older RIM 950 devices. This does not affect RIM right now (it has already been paid for these devices), but it could portend a softer enterprise market ahead.

Facing the specters of a slowing consumer market, seasonal softness, and weakness in the enterprise market, PDA stocks may see further downside soon -- especially HAND and RIMM. We recommend that investors avoid these stocks for the next three months and then check in again.

What Is the Answer?

We think that current problems will put pressure on PDA stocks in the near term and see more settling to be done. However, we are bullish on the industry's long-term prospects and see brighter days ahead in the latter half of 2001. We think the introduction of new, genuinely novel wireless products that could set off another round of buying.

While recent devices are not strong enough to help PDA manufacturers weather the current downturn, there are more robust devices on the horizon. Handspring, Palm, and RIM are developing new devices that will integrate wireless connectivity without clunky modem sleds or antennae. These devices will not only improve access to Internet and other wireless data, but also seamlessly combine voice and data.

Research in Motion has announced plans to release its general packet radio service (GPRS) device this summer, with BT CellNet serving as the first customer. We have tested the device and think the integration of personal information management (PIM) functions with easy dialing makes for a winner. Palm has also talked about releasing its new integrated wireless device, the m700, later this year. Supposed pictures of the device have been appearing on PDA cult sites like PDABuzz, and Friday's Palm VIIx price reduction is most likely a proactive step to clear the way for this device. Handspring usually keeps its cards close to its vest, but we assume it is on a similar trajectory. We think the introduction of new wireless PDAs will lure entrants to the market and entice current device owners to trade up.

The trick for investors, naturally, is to be ahead of the curve and to get into these stocks before the devices hit the market. We think the buzz will begin late-summer or early fall in anticipation of the new releases. By that time we should know the full impact of inventory problems and have the latest round of price cuts behind us. All of which should clear the decks for positive catalysts to create a nice rebound from the current lows. Stay tuned.

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Top 10 Stocks Bought*

IBeam (IBEM)	+15.20%
Kana (KANA)	+9.26%
Priceline.com (PCLN)	+8.07%
WebMethods (WEBM)	+7.97%
Niku (NIKU)	+7.56%
PurchasePro (PPRO)	+7.18%
Interliant (INIT)	+6.73%
CMGI (CMGI)	+4.87%
Sycamore (SCMR)	+4.41%
Bookham (BKHM)	+4.27%

Top 10 Stocks Sold*

UTStarcom (UTSI)	-10.92%
Finisar (FNSR[3])	-3.72%
RF Micro Devices (RFMD)	-3.61%
Digital Lightwave (DIGL)	-3.34%
i2 (ITWO[4])	-3.34%
Vignette (VIGN)	-3.24%
Cypress Comm. (CYCO)	-3.07%
Redback (RBAK)	-3.03%
Foundry (FDRY[4])	-2.46%
Vitria (VITR)	-2.44%

*Notes

Percent change from the prior week in the number of technology-related shares held by customers of our brokerage partners.

This Past Week at Epoch

5/07/01 **Epoch Launches the Vendor Matrix**

The Vendor Matrix is a tool built by Epoch's team of communications industry analysts that can be used to quickly gauge the impact of telecommunications events on vendors and service providers. The Vendor Matrix is designed to help investors monitor relationships between communications service providers (including AT&T, Level 3, and SBC Communications) and communications equipment vendors (such as Cisco, Ciena, and Nortel). Epoch's analyst team tracks contract developments between communication companies and incorporates new announcements into the Vendor Matrix.

5/07/01 **Handspring: The Downward Spiral Begins?**

5/08/01 **AETH: Cost Controls Yield Solid Bottom Line**

5/08/01 **Cisco 3Q01: The Outlook Has Not Improved**

5/09/01 **Aether 1Q: Work To Be Done**

5/09/01 **Finisar Announces New Products**

5/10/01 **Openwave Goes IM**

5/10/01 **i2: eDay and Analyst Meeting**

5/11/01 **UTStarcom: First Metro Deal**

Heard on the Desk

Communications Equipment Still Out of Favor

Communications equipment stocks took another dive this week among retail investors. Six of the top 10 stocks sold the week ending May 4 were communications-equipment and networking related. Three of them --UTStarcom (Nasdaq: UTSI, $22.71), Digital Lightwave (Nasdaq: DIGL, $42.68), and RF Micro Devices (Nasdaq: RFMD, $28.71) -- topped the list again.

Among the stocks retail investors chose to support last week, a number of software and Internet companies made the short list. Three of the top 10 stocks bought were repeats from the previous week. Our investors showed confidence in B2B integrator webMethods (Nasdaq: WEBM, $22.80) and B2B e-commerce services provider PurchasePro.com (Nasdaq: PPRO, $2.61).

Retail investors also showed enthusiasm for companies that demonstrated market growth. Our investors increased their holdings in Sycamore (Nasdaq: SCMR, $10.19) by 4.41% after it announced it had achieved number-one market share in the European Metro dense wave division multiplexing (DWDM) market.

While some investors bought shares based on company fundamentals, a larger number of retail investors are still bargain hunting. The number-one stock bought last week, iBEAM (Nasdaq: IBEM; $0.40), is trading below a dollar. Investors increased their positions in iBEAM by 15.20%. Another seven stocks are trading at less than $5.00 per share, making them ripe for the picking.

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Company Highlight: Aether Systems (AETH)

Investment Thesis

Aether[4] is a one-stop, full-service solution for enterprises leaping into the wireless-data industry. We believe the company's broad product offering, multi-industry expertise, and strategic investments make Aether a core holding in the sector. Aether continues to shift from a pure service business model toward a software model, with scalable synchronization products and high-margin license fees. Aether Fusion will help this transformation with the first customers expected in 3Q01. If successful, this move will have positive effects on the business model, adding more recurring and high-margin revenues. Aether needs this transition to improve its gross margin and operating expenses and reach its cash-flow breakeven goal of 3Q02. Despite the risk, we are encouraged by the stock's value relative to its cash position and believe the potential for upside outweighs the company's negative attributes at these price levels.

Company Description

Aether provides services and software to corporations that enable the wireless delivery of data and Web content. Aether's services include connectivity, hardware, application design, consulting, and hosting.

Key Investment Points

- **Build vs. Buy.** The increasing number of mobile workers, combined with the complexity of the wireless landscape, makes Aether's service a valuable proposition. Large enterprises are leaning towards outsourced solutions because they lack wireless expertise and want fast deployment.
- **Cold Fusion.** During its recent Analyst Day in April, Aether announced that its Aether Fusion platform would integrate its Aether Intelligent Messenger (AIM) platform with software from the RTS and Riverbed acquisitions. The company will gradually roll out the new platform with the first customers expected in 3Q01.
- **Work Ahead.** Aether posted sound March quarter numbers, meeting our revenue estimates of $30.7 million with net loss of $1.16 per share, beating our $1.22 loss per share estimate. Going forward, the company has to firm up gross margins and continue to show operating expense reductions.
- **Strong Cash Position.** Aether had $18 per share in cash at the of end March and expects to reach cash breakeven in 3Q02, with $13 in cash per share left after management's expectations for spending until that time. Our model calls for cash breakeven one quarter later, in 4Q02, with $12 per share in cash on the balance sheet, leaving minimal downside at these price levels.

Companies mentioned: Aether (Nasdaq: AETH, $13.45), Handspring (Nasdaq: HAND, $10.95), Palm (Nasdaq: PALM, $7.73), Research in Motion (Nasdaq: RIMM, $28.37)

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1) Epoch Securities and/or its officers own options, rights or warrants to purchase shares of the company.

2) Epoch Securities has been an underwriting manager or co-manager of the company in the last three years.

3) Ameritrade, a minority shareholder of Epoch Partners, has been an underwriting manager or co-manager of the company in the last three years.

4) The analyst(s) involved in the preparation of this report has an investment position in the subject security.

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