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**HearMe INC (NASDAQ: HEAR)**

**Update: The need to expand into other technologies—Accumulate**

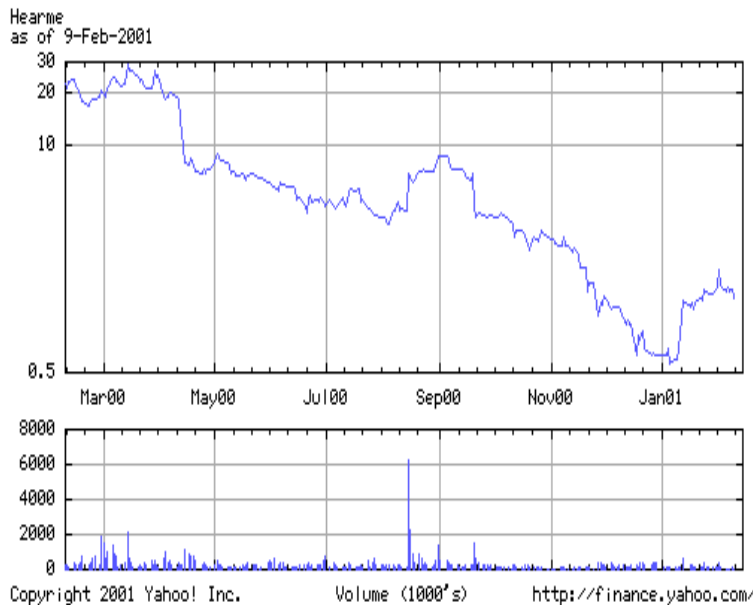
February 9, 2001

**KEY CONSIDERATIONS**

- The VoIP technology market has a strong long term outlook. Corporations look to VoIP technology to deliver a better customer interaction during the purchase process. Expectations for User and Usage rates are all strong.
- Although HearMe has a great award winning product line, it will need to expand into other technologies such as Voice Browsing to maintain revenues.
- HearMe deserves a higher market capitalization than the 35 million-dollar level expressed as of closing 2/09/2001.

Recent Price	\$1.56
52WK Low	\$0.50
52WK High	\$29.375
P/E	1.11
P/Book	0.28
P/Sales	2.55
Market Capitalization	\$38.9 M
Shares Outstanding	26.5 M
Float	18.8 M
Daily Volume (3-month Average)	0.17 M
<b>EPS</b>	
1998A	n/a
1999A	\$-0.31
2000A	\$-0.90
2001E	\$-0.63
Current Ratio	2.64
Total Debt to Equity	0.00
LT Debt	0.00
Total Cash	\$30.5M

**ONE YEAR PRICE AND VOLUME CHART**



**COMPANY PROFILE**

HearMe (Nasdaq: [HEAR - news](#)) develops and licenses next-generation VoIP application technologies that deliver increased productivity and flexibility in communication by integrating the capabilities of the telephone, mobile devices, and the Internet. The Company's industry-leading PC-to-phone, phone-to-PC, phone-to-phone, and PC-to-PC VoIP application technologies add value to a variety of business applications including customer relationship management and eCalling for telecom service providers. HearMe is already voice-enabling products and services from such leading companies as 3Com Corporation, QUALCOMM, oCen Communications, Macromedia, Evoke, Ask Jeeves, and eShare Communications. Founded in early 1995 as Mpath Interactive, Inc., HearMe is located in Mountain View, Calif., and can be reached at [www.hear-me.com](http://www.hear-me.com) or 650/429-3900.

This report was prepared by Wong Lee, and David R. Rivas

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## THE COMPANY

Through the divestiture of its Live Communities/Mplayer Business Unit, a twelve million dollar strong revenue source in fiscal 2000, HearMe Inc is now a lean provider of next generation VoIP application software with expected operating savings of "twenty four million in fiscal 2001." HearMe's ninety corporate buyers bought VoIP software both to save money on standard telephone charges and to generate more revenues by providing better services to their customers.

The company's eCalling packages, VoiceContact and Business Conferencing, save on long distance charges for companies by routing calls and connecting people utilizing the Internet. These applications perform the full complement of tasks as their software package names may suggest. VoiceContact, activated from a button inside the recipient's e-mails or a web page, makes it easy to begin Voice over IP conference without special installations. The recipient only needs the browser. The application, Business Conferencing, really get fancy with IP packets creating a system that allows groups of people to participate in elearning, and the application will record those lessons for later sharing and archival.

HearMe's Voice-enhanced E-mail and ClickAgent, allow corporate buyers entirely new ways to interact with their customers. Voice-enhanced E-mail can bring a smile to anyone's face; the product gives the dull but popular text based communication medium a voice, activated as a link as opposed to a file attachment. This avoids the need to attach large bulky audio files. The ClickAgent software "voice able" commerce sites so that with a simple click an irate customer can immediately speak to the customer representative through the computer without having to dial a phone.

VoiceSERVER is the platform or hardware that runs these software applications. In the fourth quarter of 2000, twenty-two new deals were consummated, and fourteen of which involved the VoiceSERVER product. The corporate buyer has a choice of owning the server within the comforts and security of an existing internal network, or have these applications hosted by HearMe.

## INDUSTRY OUTLOOK AND COMPETITION

In its Fourth quarter-end conference call, HearMe's CEO, Rob Csongor, announced, "while corporate revenue grew by 17 percent from Q3 to Q4, revenues directly related to VoIP [Voice over IP] technologies grew by 137 percent." Can we expect continued strong growth and strong demand for the VoIP technology industry? To answer this question, we need to look at the basic forces that drive this demand. More specifically we highlight the survey results by market analysts on E-commerce consumer satisfaction levels as a key catalyst for corporate adaptation growth, and we quote expected Internet Telephony user and usage growth rates. The idea is as online shoppers expect more human attention before the purchase, E-commerce sites will implement software to provide better customer services. This will drive revenue growth for a VoIP software provider like HearMe. Savings in long distance conversations will drive individual user and usage growth; similarly, increasing VoIP user and usage will influence the buying decisions of corporate buyers looking to take full advantage of every communication medium to reach the online user.

Of the roughly six or seven billion expected world population by 2005, according to Datacomm Research "more than 2 billion people will use Internet voice portals, voice-enabled Web sites, and Web-based interactive voice response systems by the year 2005." Does this seem exaggerated? Are net users really embracing PC to Phone and low cost long distance services? Just ask Dialpad, a VoIP retail service provider. Without doing significant marketing, Dialpad registers 30,000 new users every day and on its web sites boasts, "more than 12 million people are using Dialpad to make free, long-distance calls." Perhaps a more realistic outlook, from International Data Corporation, estimates that the 10 million Net telephony users as of late 1999 will grow to a whopping 301 million by the end of 2003. That is user growth at an annualized rate of 134 percent.

While individuals are rushing to take advantage of VoIP services, companies that operate E-commerce sites are also looking at ways to deliver better customer services using voice as another vehicle for interaction.

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According to TMCnet.com, "more than 250,000 e-commerce sites will adopt web-based customer interaction technologies, such as Voice over IP, chat and web collaboration by the year 2004." Several market analyst firms have surveyed customers and the result reveal a simple fact; in an important transaction a web site with graphics and links are just not enough. To consummate, customers want instant human voice intervention at the point of the question during the purchase process. In a Jupiter Communication study, ninety percent of online customers want customer interaction; online shopper's desire for human contact leaps when the purchase price exceeds 50 dollars. Another study by consumer behavior researchers, Yankelovich Partners, put the customer desire for more interaction around seventy percent.

It is clear the expectation for individual user growth is strong and the motivation for corporate adaptation also strong. But what is the market expectation for usage growth measured in number of minutes. According to Piper Jaffray, Inc, Internet telephony voice traffic on packet-switched systems will account for about 11.7 billion minutes in 2000, and this number is projected to grow to 81.8 billion minutes in 2003. This is an annualized growth of about 91 percent each year for three years. Frost & Sullivan said, "Three years ago, 35 million minutes of phone calls worldwide were routed through the Internet. By 2007, 3 trillion minutes of calls will be placed." All these numbers simply point to strong usage growth as people take advantage of long distance cost savings by placing calls through PC to phone service providers like Dialpad and other long distance service providers.

Based on surveys and expectations backed by some preliminary sales results, we believe demand growth for VoIP technology will be strong. "The question is no longer if. It is only an question of when," said Rob Csongor as he sized up the market in the HearMe 4Q conference call. We agree with Rob; however, knowing a great opportunity is coming is not enough, we next exam how competitors have positioned themselves in the VoIP industry.

In the comparison table, exhibit 1, we look at HeaMe's product offering and industry validation of that offering in a side by side comparison with a few of its competitors. Although every one of the nine companies operates within the same industry, each company through its product offering reveals a slightly different view of communication and how it expects to profit from it.

Since pioneering Internet Phone and telephony gateways in 1995 and 1996, Vocaltec and Netspeak, have developed product offerings targeting enterprise or carrier class solutions. Vocaltec sells these solutions to Asian telephone companies, but more recently competes with companies like HearMe through its Surf&Call Network Services offering.

CuseeMe Networks believe the future of conferencing is a combination of voice, video and data conducted from a personal computer as opposed to the current conference room to conference room model. The company offers desktop conferencing solution for both the IBM and Mac based computers for the individual and the business. In addition, the company operates, CuseeMe World, an Internet video communications portal and also hosts your video web events on their servers.

From a quality of service (QoS) standpoint, eYak's Teleconferencing Bridge delivers the best voice quality because it uses the traditional Public Switched Telephone Networks (PSTN) with the typical point to point dedicated channel for voice transmission while data is communicated using a IP data model. Lipstream has the same idea in mind when it achieves quality of service using Qwest's fiber data network. They both believe corporations are willing to pay a premium for better quality. HeaMe and other players in the sector use the Internet to move voice data packets from one point to another typically losing data packet along the way and suffering the associated loses in voice quality.

Net2phone is the leader in consumer Internet Telephony market, but has expanded into the corporate VoIP e-commerce market through a partnership with Webdialogs and also has an offering of enterprise gateways. In a recent press release, Net2phone announced a "Preferred Application Developer" partnership with HeyAnita and SpeechWorks. This alliance will allow customers to replace interactive voice response (IVR) systems with network based speech recognition and telephony solutions.

Exhibit 1

Companies	Product Offering	Industry Validation
<p>HearMe <a href="http://www.hearme.com">www.hearme.com</a></p> <p>distinction: presence detection and management; firewall penetration; fully browser based</p>	<p><b>ClickAgent</b> – voice able sites with eCRM application  <b>Enhanced E-Mail</b> - eCRM application; sound links in mail  <b>VoiceContact</b> - eCalling with presence detection  <b>Conferencing</b> - eLearning and playback  <b>SoftPHONE</b> - SIP standard phone  <b>VoiceSERVER</b> - hosting platform</p>	<p><b>12/2000</b> VoiceContact – Product of the Year by Internet Telephony  <b>12/2000</b> ClickAgent – Product of the Year by Communications Solutions.  <b>12/2000</b> SoftPHONE – CT Product of the Year 2000 by Computer Telephony  <b>09/2000</b> VoiceSERVER - Best of Show at Internet Telecom Expo</p>
<p>Lipstream <a href="http://www.lipstream.com">www.lipstream.com</a></p> <p>distinction: private VoIP network delivering quality voice</p>	<p><b>Lipstream Live Voice Network</b> – redundant private network over Qwest’s fiber system guarantees quality voice service  <b>Lipstream Live Voice Service</b> – 20 lines of HTML code integrates conferencing features onto customer web site</p>	<p><b>12/2000</b> Live Voice – CT Product of the Year 2000 by Computer Telephony  <b>09/2000</b> CuseeMe Networks – TMC Labs Innovation Award 2000 by TMCnet.com</p>
<p>Webdialogs <a href="http://www.webdialogs.com">www.webdialogs.com</a></p> <p>distinction: text to voice feature</p>	<p><b>WebInteract</b> - co-browsing, joint form filling, file transfer, highlighting, pointing; flagship product  <b>WebIntertalk</b> - voice able sites with a click me button.  <b>WebIntermeet</b> - escalate a voice, chat, e-mail or instant messaging session to a collaborative session on demand; to be released</p>	<p><b>01/2001</b> WebInteract – Winner of Editor’s Choice Award from Internet Telephony  <b>12/2000</b> WebInteract – Product of the Year by Communications Solutions.</p>
<p>Cuseeme Networks <a href="http://www.cuseeme.com">www.cuseeme.com</a></p> <p>Distinction: voice, video and data conferencing; operates portal and hosted services; targets consumers and corporations</p>	<p><b>CuseeMe Conference Server</b> – audio, video and data sharing enterprise software multimedia tool  <b>CuseeMe Pro</b> - desktop video collaboration software  <b>CuseeMe Mac</b> - iMac solutions  <b>CuseeMe Web</b> - developer kit to embed live audio, video and text chat to web sites.  <b>CuseeMe World</b> - Internet Video Communications Portal  <b>Hosted Services</b> - your web events and meetings hosted at CuseeMe</p>	<p><b>01/2001</b> CuseeMe Conferencing Server - Product of the Year by both Internet Telephony and Communication Solutions for fourth consecutive year  <b>11/2000</b> CuseeMe Networks – Standard of Excellence by Web Marketing Association  <b>07/2000</b> CuseeMe Networks – TMC Labs Innovation Award 2000 by TMCnet.com  1995-2000 several awards</p>
<p>Net2Phone <a href="http://www.net2phone.com">www.net2phone.com</a></p> <p>Distinction: consumer leadership with recent enterprise product line</p>	<p><b>Consumer Services</b> - PC to phone calling and phone card products  <b>e-commerce</b> - Click2Talk and ClickTogether software offering from Webdialogs’ partnership  <b>Gateways</b> - Heavy duty enterprise gateway and personal broadband gateway</p>	<p><b>01/2001</b> PC2Phone service named leader by Media Metrix for second straight month surpassing Dialpad and PhoneFree.com</p>

<p>Netspeak <a href="http://www.netspeak.com">www.netspeak.com</a></p> <p>Distinction: enterprise carrier class solutions</p>	<p><b>Netspeak iTEL Infrastructure</b> – A system of servers and gateways on which VoIP applications such as PC to phone, call waiting and voice e-commerce reside. The carrier grade infrastructure solution allows Internet Telephony Service Providers (ITSP) to span services across multiple geographic locations.</p>	<p><b>03/2000</b> – Frost &amp; Sullivan Market Engineering Product Line Strategy Award  <b>1999</b> NetSpeak Internet Call Waiting – Internet Telephony and CTI Product of the Year  <b>1998</b> NetSpeak WebPhone - Internet Telephony and CTI Product of the Year  <b>1996</b> NetSpeak Webphone and mini Webphone – PC Magazine Editor’s Choice</p>
<p>Vocaltec <a href="http://www.vocaltec.com">www.vocaltec.com</a></p> <p>Distinction: carrier solutions</p>	<p><b>Vocaltec Ensemble Architecture</b> – A combination of servers, gateways and software tools that enable PC to phone and web to call center integration.  <b>VoIP Clearinghouse</b> – this offering allows service providers all over the world to connect  <b>Surf&amp;Call Network Services</b> – ASP model allow e-commerce storefronts to have Voice over IP co-browsing, text chat and form completion features.</p>	<p><b>09/2000</b> Surf&amp;Call Network Services – Best of Show Award from Internet Commerce Exposition  <b>11/1999</b> Surf&amp;Call – Product of Year from Internet Telephony Magazine  03/1998 Telephony Gateway – Product of the Year from Network Magazine  07/1997 Frost &amp; Sullivan names Vocaltec IP Telephony leader  12/1996 Telephony Gateway software – Product of Year from Computer Telephony magazine</p>
<p>Eyak <a href="http://www.eyak.com">www.eyak.com</a></p> <p>Distinction: native IP bridge</p>	<p><b>Teleconferencing Bridge</b> – combines the best of Public Switched Telephone Networks with IP based one to deliver business conferencing and distances learning services</p>	<p><b>01/2001</b> eYak named to three “Companies to Watch” lists by Computerworld, localbusiness.com and boston.internet.com  <b>11/2000</b> eYak announces strategic partnership with Polycom</p>

## STRATEGIES FOR GROWTH

Examining product offerings of various competitors reveals different views on current and perhaps future communication needs.

After launching the VoIP industry with the introduction of the Internet Phone, it made sense for Vocaltec to enter the carrier solutions market in a time of long distance deregulation to take advantage of the expected demand increase for carrier solutions; that was 1995. Today, CuseeMe Networks has an offering that says the future of conferencing is with the desktop. Its software allows video conferencing from the IBM compatible desktop, and there is an iMac version as well. However, with 40 percent of American homes already connected to the net and the recent jaded PC sales numbers what kind of growth rate can it expect from the consumer desktop sector? CuseeMe Network also operates other net and hosting solutions. For eYak and Lipstream voice quality is above all else, so its subscription-based services are built on top of dedicated PSTN and fiber networks, respectively. From a growth standpoint, does it make sense for HearMe to follow the path of any of these competitors?

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HearMe is currently narrowly focused on corporate demand for customer relationship management, eCalling, elearning, and conferencing solutions. The company's offering is distinguished by its presence management capabilities. Knowing your IP activity and other signs of actual usage and hence presence, the software is able to determine if the callee is there. Perhaps leveraging insight in presence detection and strength in software development, as evidenced by the 3COM SIP SoftPHONE deal, HearMe can develop a capability in voice browsing, which is just VoiceXML combined with a voice recognition engine. The company can form partnerships with Phillips, a global leader in speech recognition, and Dialpad.com, a consumer PC to phone leader with no corporate product offering. The relationship would be similar to what Net2phone has done with SpeechWorks and HeyAnita.com. Depending on whom you ask, the market size for voice browsing varies between 1 billion and 50 billion by 2005, and it gives HearMe a play in both desktop VoIP voice browsing and the cellular phone voice browsing markets.

### **Investment Risks**

HearMe has a limited operating history. Expectations of future growth should not be based on past performance. Substantial losses have been incurred since HearMe's inception. It cannot be assured that HearMe will ever become profitable.

HearMe has completely divested its advertisement revenue sources. HearMe is now completely dependent on the sales and license of its Technology Products through a few licensing agreements. The loss of a few customer agreements will directly result in revenue declines.

The lengthy product review by prospective customers can cause operating results to shift significantly from period to period. Even after a decision to buy is made deployment time can be long, depending on the complexity of the customer's system architecture or on the customers' expertise.

Continued success of HearMe is more dependent than ever on its ability to develop and introduce future products and services that will achieve market acceptance. However, development and delivery of cutting edge software products involve long development and rigorous testing cycles. Despite this, failure to deliver quality "bug" free products will have adverse effect on the business.

As demand for HearMe's product and service ramp up, it becomes necessary to enter reseller arrangements with Web development firms, application vendors and OEM partners to increase product distribution. Such arrangements may limit HearMe's ability to build and expand its own distribution network.

### **FINANCIALS MODEL**

**Revenue.** The company expects revenues of 10 to 12 million in 2001. Given technology revenue of 14 million in 2000, we expect HearMe to be able to achieve the high end of this guidance range.

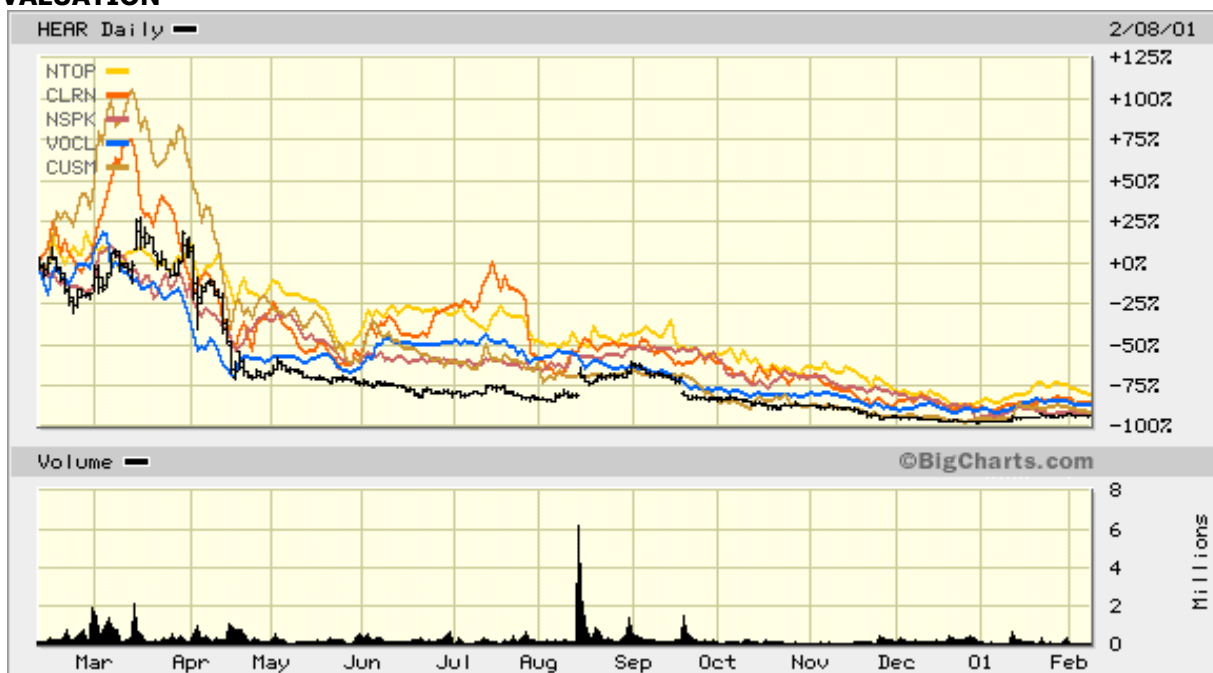
**Gross Profit.** The Technology Products business is naturally a high Gross Profit business. This is expected to continue going into 2001.

**Research and Development.** The company has repeated its intention to invest heavily in R&D. Given this guidance, we will maintain the dollar R&D spending level in fiscal 2000 as in fiscal 2001. Since the company has guided lower revenues in 2001, R&D spending margin will increase.

**Sales and Marketing Margin.** Sales and Marketing spending consists of branding campaigns costs, employee-related expenses, sales commissions, etc. The management expressed the need to continue spending in this area, but we believe with the divestiture sales and marketing margin will be greater than 1999 levels, but certainly lower than that of fiscal 2000.

**General and Administrative Margin.** We are projecting a rather generous level of general and administrative expenses for 2001, for we expect strategic partnership activities over fiscal 2001.

## VALUATION



Every company in the VoIP technology sector has taken an incredible beating in stock valuation levels for the last 12 months. The stock market is no longer pricing companies on expectations; cash is king and only earnings will bring higher long-term stock valuation levels.

Company	Ticker	Price 2/09/01	Market Cap. 2/09/01	Current Assets 12/31/00	Gross Profit 12/31/00	P/S	Gross Margin	Q/Q Growth
HearMe	HEAR	1.34	35,622,720	42,902,000	12,245,000	2.56	88%	17%
CuseeMe	CUSM	2.06	25,155,781	16,429,000	8,202,000	2.08	68%	8%
Netspeak	NSPK	2.06	28,851,055	37,625,000	15,909,000	1.61	89%	-64%
Clarent	CLRN	13.25	464,584,750	351,053,000	91,734,000	3.06	61%	17%
Vocaltec	VOCL	5.94	78,690,376	66,821,000	28,504,000	1.87	68%	9%

**Margins.** Margin for the 4<sup>th</sup> quarter of 2000 was over ninety percent. Management expects Gross Margins to be in mid to low eighties in 2001.

**Price to Sales.** HearMe has a rather high Price to Sales ratio. Although HearMe has an awarding winning product line with real customers, based on the P/S ratio alone the company may be over valued.

**Cash:** As of December 31, 2000 HearMe has about 30 million dollars in cash. With this and strength of the existing VoIP business line, there should be enough cash to sustain necessary expenses until the company becomes cash flow positive. In the 4<sup>th</sup> Quarter conference call, management believes cash burn rate will be about 3 million by the 4<sup>th</sup> quarter of 2001.

### Investment Opinion

Based on the closing price of 1.34 on 2/09/01, we place a two month ACCUMULATE short term rating on HearMe, and a price target of 2.00 dollars on the stock for December 2001. Although the P/S ratio implies it may be over priced already. With cash and short-term investments of 30 million on its balance sheet

ending 12/31/2000, we feel the company deserves a market capitalization better than 35 million dollars. The business is certainly worth more than 5 millions dollars.

With its current product offering and its management guidance, we do not see HearMe trade above its peer group. However, this may change with new product offerings and partnership announcements. Currently, we are comfortable with a long term perform rating of 5, pending better sense of product strategy from management.

Exhibit 2

**HearMe Inc. Statement of Income**

(\$000, except per share data)

	Dec 2000 10k required					
<b>Year Ending December 31,</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001E</b>
<b>Net Revenues</b>	124	2727	8027	7100	13919	12000
<b>Cost of revenues</b>	125	2428	3011	1118	1674	1674
<b>Gross profit (Loss)</b>	-1	299	5016	5982	12245	10326
<b>Operating expenses:</b>						
Research and development	5261	2436	3132	5644	10236	10236
Sales and marketing	3937	6906	7847	3126	17794	7800
General administrative	2877	2841	3274	5111	11165	9000
In-process research and development				850	550	550
Stock based compensation	383	1676	2601	2111	1967	1000
Acquisition related amortization costs	12876	0	0	2175	40598	0
<b>Total operating expenses</b>	<b>25334</b>	<b>13859</b>	<b>16854</b>	<b>19017</b>	<b>82310</b>	<b>28586</b>
<b>Loss from operations</b>	<b>-25335</b>	<b>-13500</b>	<b>-11838</b>	<b>-13035</b>	<b>-70065</b>	<b>-18260</b>
<b>Interest and other income (expense),net</b>	291	-93	-111	1865	3115	1500
<b>Loss before provision for income taxes</b>	-25044	-13653	-11949	-11170	-66950	-16760
<b>Loss from discontinued operations</b>				-13911	-9349	0
<b>Loss from disposal of discontinued operations</b>				0	-7510	0
<b>Provision for income taxes</b>	-1	-1	-2	0	0	0
<b>Net loss</b>	<b>-25045</b>	<b>-13654</b>	<b>-11951</b>	<b>-25081</b>	<b>-83809</b>	<b>-16760</b>
<b>Pro forma diluted loss per share</b>			-0.95	-1.29	-3.16	-0.63
<b>Number of shares (for pro forma calculation)</b>			12643	19503	26505	26505
<b><u>Margin Analysis (%age of revenue)</u></b>						
Gross Margin	-1%	11%	62%	84.3%	88.0%	86.1%
Research and development	4243%	89%	39%	79.5%	73.5%	85.3%
Sales and marketing	3175%	253%	98%	44.0%	127.8%	65.0%
General administrative	2320%	104%	41%	72.0%	80.2%	75.0%