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**Phone.com, Inc. (NASDAQ: PHCM)**

**Initiating Coverage: STRONG BUY**

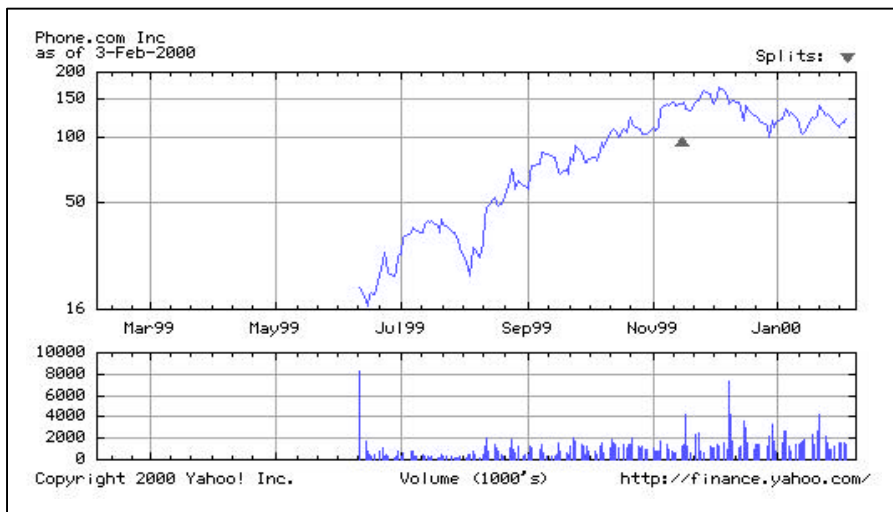
February 7, 2000

**KEY CONSIDERATIONS**

- Phone.com pioneered the convergence of Internet and mobile telephony by founding a worldwide standard (wireless application protocol forum - WAP) with Ericsson, Motorola and Nokia for the delivery of Internet-based services to mass-market wireless phones.
- Phone.com recently announced version 4.1 of its UP.Browser based on the WAP. Phone.com's UP.Browser has been licensed by more than 25 leading wireless handset manufacturers to enable users to wirelessly access Internet and Intranet data through wireless carriers who have licensed the Phone.com UP.Link WAP gateway.
- According to the latest estimations, by 2003, shipments of "smart" phones and handheld Internet devices will exceed 350 million units. Wireless data users in enterprise segments will multiply more than tenfold to nearly 9 million. And total wireless subscribers will hit 1.26 billion by 2005, triple current figures.
- Recently, Air Touch Cellular announced that it has licensed the Phone.com UP.Link Server Software for use in its U.S. CDMA network. Hong Kong, Switzerland and Israel-based mobile phone companies also recently announced they would launch WAP services for Internet access on mobile telephones using Phone.com technology.

Recent Price	\$133.125
52WK Low	\$16.125
52WK High	\$175.00
P/E	N/A
Price to Book	83.62
Price to Sales	180.1
Market Capitalization	\$8.624b
Shares Outstanding	65,100
Daily Volume	1,658,090
<b>EPS</b>	
1995	\$(.02)
1996	\$(.53)
1997	\$(1.67)
1998	\$(2.03)
1999	\$(2.98)
2000E	\$(.52)

**ONE-YEAR PRICE AND VOLUME GRAPH**



**COMPANY PROFILE**

Phone.com, Inc. is a leading provider of software and services that enable the delivery of Internet-based information services to mass-market wireless telephones. Using its software, wireless subscribers have access to Internet- and corporate intranet-based services including email, news, stocks, weather, travel and sports. In addition, subscribers have access via their wireless telephones to network operators' intranet-based telephony services, which may include over-the-air activation, call management, billing history information, pricing plan

subscription and voice message management. Phone.com is headquartered in Silicon Valley, California and has several regional offices. Phone.com's web site: <http://www.phone.com>.

This report was prepared by Adam M. Gross and David R. Rivas, Ph.D.

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## I. DESCRIPTION OF THE COMPANY

### Products

Phone.com's software platform enables the delivery of Internet-based services to mass-market wireless telephones. Using their software platform, Network operators can provide Internet-based content, applications and services to their wireless subscribers, and wireless telephone manufacturers can turn their mass-market wireless telephones into mobile Internet appliances.

#### **The software platform consists of:**

*UP.Link Server Suite* - a means of exchanging data between the Internet and mass-market wireless telephones, commonly referred to as a gateway; a service platform that performs subscriber management and service provisioning functions, as well as communicating with the network operator's customer care and billing systems; and Internet-based applications such as email and personal information management software.

*UP.Browser* - a browser and messaging software product that is designed and optimized for mass-market wireless telephones. A variety of third-party content is currently available for wireless telephones equipped with UP.Browser, including information from ABCNews.com, Bloomberg, Reuters, Quote.com and ESPN Sportszone.

*UP.SDK* - a software development kit that Internet content providers and third-party developers use to create WML-compliant applications. As of August 1999, approximately 10,700 third-party developers had registered to use this software development kit

*UP.Smart* - a suite of software applications that augments UP.Browser with a set of popular functions commonly found on personal digital assistants. It includes address book, calendar, to-do list and memo functions. UP.Smart also utilizes Puma Technology's synchronization software to enable a user to synchronize UP.Smart with PC-based personal information management applications by connecting the UP.Smart-equipped wireless telephone to a personal computer through a serial cable. The information is stored both on the wireless telephone and personal computer, making it accessible even when the wireless telephone is not connected to the network.

**MyPhone** - mobile Internet portal platform that enables network operators to rapidly deploy branded portal sites for their wireless subscribers. With **MyPhone**, network operators can provide their subscribers with a customized set of information services and applications that are optimized for the mobile user, thereby enhancing subscriber loyalty and capturing new revenue opportunities.

Network operators that offer Internet-based services by using Phone.com's UP.Link Server Suite generally seek new value-added applications to offer to their subscribers.

#### **Currently, Phone.com offers the following Internet- based applications:**

*Up.Mail*, which delivers email to wireless telephones; *Up.Organizer*, a personal information management application; and *Up.Web*, which enables subscribers to access, manage and update their personal information and configuration for UP.Mail and UP.Organizer from their personal computers.

### Services

Phone.com provides its network operator customers with consulting services that help shorten software license sales cycles, accelerate deployment of technology and deepen their understanding of their customers' networks. Phone.com's consulting services focus on those areas where its products interface with the network operators' internal systems such as billing, provisioning and customer care. Phone.com also provides its network operator customers with assistance in choosing the appropriate content and applications for their subscribers and creating the promotion and pricing strategies for their service.

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## II. INDUSTRY

**The Internet.** The Internet has emerged as a global communications medium enabling millions of people to share information and conduct business electronically. International Data Corporation, or IDC, estimates that there were approximately 159 million users of the Internet worldwide at the end of 1998 and that the number of users will grow to 410 million by the end of 2002. The dramatic growth in the number of business and consumer Internet users has led to a proliferation of useful information and services on the Internet, including email, news, electronic commerce, educational and entertainment applications and a multitude of other value-added services. As a result, the Internet has become a primary and ubiquitous daily resource for millions of people.

**Worldwide Use of Wireless Telecommunications.** Worldwide use of wireless telecommunications has grown rapidly as cellular and other emerging wireless communications services have become more widely available and affordable for the mass business and consumer markets. Advances in technology, changes in telecommunications regulations and the allocation and licensing of additional radio spectrum have contributed to this growth worldwide. Dataquest estimates that there were approximately 187 million digital wireless subscribers worldwide at the end of 1998 and that the number of subscribers will grow to 590 million by the end of 2002.

**Competitive Environment.** As a result of deregulation, new radio frequency spectrum licenses, privatizations and rapid network expansion by new entrants, the competitive environment among network operators in major markets worldwide has become intense. Efforts to attract and retain subscribers have resulted in significant price-based competition. Increased competition has in turn raised the costs associated with acquiring new subscribers, has lowered average revenues per subscriber, and has increased the propensity of subscribers to switch from one network operator to another. For these reasons, network operators are looking for new revenue sources in the form of value-added services they can deliver to their wireless subscribers. They are also looking for ways to differentiate their product offerings in an effort to retain subscribers. Finally, they are focused on finding and deploying solutions that enable them to deliver and support their services in a more cost-effective manner.

**WAP.** As people have become increasingly dependent on email services, remote access to corporate Intranets, and other Internet-based services, mass-market wireless telephones that provide mobile access to these resources have become increasingly useful tools. To provide a worldwide open standard enabling the delivery of Internet-based services to mass-market wireless telephones, Phone.com, Ericsson, Motorola and Nokia formed the Wireless Application Protocol Forum. WAP is needed because cellular phones don't have enough power or space to handle HTML, the protocol currently used on the Internet. Critics say that it is a short term solution that will become obsolete once power and bandwidth increases in hand-held devices.

In 1998, the WAP Forum published technical specifications for application and content development and product interoperability based on Internet technology and standards. By complying with WAP specifications, wireless telephone manufacturers, network operators, content providers and application developers can provide Internet-based products and services that are interoperable.

**WML and XML.** In 1998, the WAP Forum published the Wireless Markup Language, or WML. WML is compliant with the Extensible Markup Language, or XML, specification published by the World Wide Web Consortium. XML is a programming language that provides a means of describing and exchanging data in an open format. Content providers and application developers use WML to optimize the display of, and interaction with, Web-based data on wireless telephones. Based substantially on technology that Phone.com contributed to the public domain, WML is optimized for delivery of Internet content to mass-market wireless telephones, which have numeric keypads instead of full keyboards, small screens, and limited memory capacity, processing power, battery life and bandwidth. In the same manner that the programming language known as Hypertext Markup Language, or HTML, has provided an open standard that has fueled the development of Internet applications and content for personal computers, WML is designed to be an

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industry standard that will encourage the development of Internet applications and content for wireless telephones.

**Phone.com's Significance.** In response to an increasingly competitive environment, network operators are seeking to deliver Internet-based services to their wireless subscribers as a means to generate revenues from new sources, differentiate their service offerings, and reduce subscriber turnover and operating costs. To do this, network operators require a scalable turnkey software and services solution to deliver Internet-based services and content to their wireless subscribers. Phone.com provides a leading software infrastructure platform that enables the delivery of Internet-based services to mass-market wireless telephones. Using Phone.com's scalable platform, network operators can provide Internet-based content, applications and services to their wireless subscribers, and wireless telephone manufacturers can turn their mass-market wireless telephones into mobile Internet appliances. Wireless subscribers thus have access to Internet- and corporate intranet-based services, including email, news, stocks, weather, travel and sports. In addition, the MyPhone service, Phone.com's mobile Internet portal platform, is designed to enable network operators to rapidly deploy branded portal sites for their wireless subscribers and deliver Internet content and applications optimized for the mobile user.

### III. COMPETITION

The market for Phone.com's products and services is becoming increasingly competitive. Phone.com doesn't own a patent on WAP. WAP is an open industry standard making it easier for new market entrants and existing competitors to introduce products that compete directly with Phone.com's software products. As well, as cellular phones become more powerful, WAP may become obsolete.

**Its current and potential competitors include the following:**

- 1) *Wireless Equipment Manufacturers*, such as Ericsson and Nokia, which are developing and marketing competitive server, browser and application software products. These companies already sell billions of dollars of wireless telephones and other telecommunications products to network operators, which are their existing and potential customers.
- 2) *Microsoft*, which recently announced plans to deliver a wireless portal designed to work with handheld devices, wireless telephones and interactive pagers via Microsoft's MSN network of Internet services. Nextel is Microsoft's first customer for these services. Nextel plans to use a co-branded version of Microsoft's MSN portal to enable Nextel customers to access a customized set of Internet services. This arrangement also provides for Microsoft to invest \$600 million in Nextel to support Nextel's development of wireless Internet services. In addition, Microsoft has announced that it intends to enable its Windows CE operating system to run on wireless handheld devices, including wireless telephones, and to develop and market its own browser for these devices.
- 3) *Wireless Knowledge*, a joint venture of Microsoft and Qualcomm, which has announced its intention to introduce products and services that may compete directly with Phone.com's UP.Link and UP.Browser products, as well as its UP.Applications.
- 4) *Systems Integrators*, such as CMG and APiON, and *Software Companies*, such as Oracle Corporation, are developing and marketing server software that is compliant with the specifications promulgated by the WAP Forum.
- 5) *Providers* of Internet software applications and content, electronic messaging applications and personal information management software solutions, any of whom could offer products and services that compete with Phone.com's.

As Phone.com enters new markets and introduces new services, such as the MyPhone service, it will face additional competitors. These competitors may include telecommunications companies such as Lucent Technologies, traditional Internet portals such as AOL, InfoSpace, Microsoft and Yahoo!, Internet infrastructure software companies and several private mobile Internet portal companies.

Many of these existing and potential competitors have substantially greater financial, technical, marketing and distribution resources than Phone.com has. Several of these companies also have greater name

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recognition and more well established relationships with target customers. Furthermore, these competitors may be able to adopt more aggressive pricing policies and offer more attractive terms to customers than Phone.com can.

**Phone.com's Strengths.** Phone.com expects to compete primarily on the basis of price, time-to-market, functionality, quality and breadth of product and service offerings. As well, Phone.com's performance depends significantly on its ability to protect its proprietary rights to the technologies used in its products. If it is not adequately protected, its competitors could use the intellectual property that it has developed to enhance their products and services, which could harm Phone.com's business significantly. As of August 1999, Phone.com had three issued United States patents. It also had one United States patent application with allowed claims and 73 pending United States patent applications, as well as foreign counterparts with respect to many of these applications. In addition, Phone.com relies on a combination of copyright and trademark laws, trade secrets, confidentiality provisions and other contractual provisions to protect its proprietary rights.

#### IV. STRATEGY FOR GROWTH

Phone.com's objective is to be the leading supplier to network operators of software and services that enable the convergence of the Internet and mobile telephony. Phone.com's strategy is also to make WAP the industry standard for wireless Internet devices today and in the future. Since this will depend on the volume of WAP usage in the industry, the company is trying to cement numerous distribution deals with phone makers. In addition, the company has other **key element of their strategy**:

- 1) *Focus on Providing Products and Services to Network Operators.* Phone.com focuses on providing comprehensive solutions that enable network operators to deliver Internet-based services to their wireless subscribers. Its close working relationships with network operators provides it with a valuable understanding of its customers' technology and operations, which it intends to leverage to accelerate time to market of its products and identify new sales opportunities.
- 2) *Utilize Direct and Indirect Sales Channels.* In order to drive revenues from its UP.Link Server software and related services, Phone.com utilizes direct and indirect sales channels. Its direct sales force focuses on selling products and consulting services and assists its indirect channel partners in selling its products and services. Its sales partners sell its products and services as an integral part of their product and service offerings to network operators primarily in international markets. Phone.com intends to add new partners to its indirect sales channel to serve customers in key markets and expects that sales through its indirect sales channel partners will represent an increasing portion of their revenues.
- 3) *Invest in the Development of New Mobile Internet Applications and Services for the MyPhone Service.* Phone.com intends to market its MyPhone service aggressively through its existing sales channels. Phone.com believes that the adoption of its MyPhone service by network operators will accelerate the adoption by subscribers of Internet-based services using their wireless telephones as well as the development of new WAP-compatible information services and applications.
- 4) *Continue to Invest in its Technology.* Network operators have stringent requirements for server software performance, scalability and reliability. Extensive technical expertise is required to integrate these solutions with the network operators' complex systems. Phone.com also expects that network operators will demand regular upgrades that include new functions and features. Consequently, it intends to continue to invest heavily in research and product development. It also intends to maintain its technology leadership by leveraging its role in prominent industry standard-setting organizations such as the WAP Forum and the World Wide Web Consortium.
- 5) *Drive the Sale and Development of Internet-Based Applications and Services.* Network operators that offer Internet-based services by using Phone.com's UP.Link Server Suite generally seek new value-added applications to offer to their subscribers. Phone.com currently offers the following Internet-based applications: *Up.Mail*, which delivers email to wireless telephones, *Up.Organizer*, a personal information management application, and *Up.Web*, which enables subscribers to access, manage and update their personal information and configuration for UP.Mail and UP.Organizer from their personal computers. Phone.com is continuously enhancing its existing products and developing

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new applications and services to provide additional functionality for network operators and wireless subscribers.

- 6) *Propagate Widespread Use of UP.Browser in Mass-Market Wireless Telephones.* Phone.com believes that increasing the number of wireless telephone manufacturers that incorporate UP.Browser into their mass-market wireless telephones enhances the attractiveness of its UP.Link server software to network operators. As well, as more cellular phone manufacturers utilize WAP, the more likely it is to become the industry standard. Therefore, in order to drive widespread adoption, Phone.com licenses UP.Browser to wireless telephone manufacturers, free of per-unit royalties. As of September 1999, Phone.com has licensed UP.Browser to 25 wireless telephone manufacturers.
- 7) *Promote the Development of Internet-Based Services Over Mass-Market Wireless Telephones.* To encourage the growth of Phone.com's business, it actively encourages Internet content and application developers to create WML applications. In connection with this activity, Phone.com provides its UP.SDK software development kit and support to Internet content and application developers free of charge. As of August 1999, there were approximately 10,700 registered developers in Phone.com's Developer Program.
- 8) *Research and Product Development.* Phone.com continues to enhance the features and performance of its existing products and introduce new products. For example, it has recently released in beta version the fourth generation of its UP.Link Server Suite and UP.Browser products. These products are expected to be compliant with version 1.1 of the specifications promulgated by the WAP Forum. Phone.com is currently developing other applications, including a secure provisioning server, which enables network operators to automate customer provisioning, and compatibility with two-way short messaging service systems. In addition, Phone.com continues to develop the MyPhone service to provide outsourced application development and services to its network operator customers.
- 9) *Investments in Research and Product Development.* Phone.com's success depends on a number of factors, which include its ability to identify and respond to emerging technological trends in its target markets, develop and maintain competitive products, enhance its existing products by adding features and functionality that differentiate them from those of its competitors and bring products to market on a timely basis and at competitive prices. As a result, Phone.com has continued to make investments in research and product development. Its research and development expenses were \$4.0 million, \$5.7 million and \$13.1 million for the years ended June 30, 1997, 1998 and 1999, respectively.

Phone.com made two acquisitions recently: Angelica Wireless and APiON. The company is also in the midst of making a third acquisition of @MOTION. Phone.com is utilizing its rising stock price to make strategic acquisitions. APiON, for example, is a provider of WAP software products to GSM network operators in Europe and has expertise in GSM Intelligent Networks, wireless data and WAP technology. @MOTION is a software and services company that currently has an alliance with Phone.com.

## **V. Alliances and Partnerships**

### WAP Forum - Board Members:

Phone.com, Alcatel, CEGETEL/SFR, DDI Corp., Ericsson, IBM, Matsushita, Motorola, Nokia, NTT Mobile, SBC Communications, Sprint PCS and Telestra Corporation.

### Network Operators:

AT&T Wireless, Bell Atlantic Mobile, Bell South Cellular, Bouygues Telecom, Cable & Wireless, Cellnet Communications, CoCoNet Global Interchange, Connect Austria, Deutsche Telecom, FarEasTone Telecom, Giesecke & Devrient, Hongkong Telecom, IDO Corp., Japan Telecom, KPN, LG, Mannesmann, Nextel Comm, Omnitel, One 2 One, Orange Comm, Radiolinja, Rogers Central Mobile, SK Telecom, SWISSCOM Ltd., Toyko Digital Phone, Telecom Italia Mobile, Telenor Mobil Group, TU-KA Cellular Tokyo, Vodafone and Telecom.

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Device and Equipment Manufacturers:

Acer Peripherals, Bosch Telecom Denmark, Bull CP8, CMG Telecom & Utilities, De La Rue Card Systems, DENSO, Gemplus, HP, Hitachi, ICO Global Comm, Intel, LG Informations & Comm, Logica Aldiscon, Lucent, Mitsubishi Wireless Comm, NEC Technology, Nissan Communications Systems, Nortel, ORGA Kartensysteme GmbH, Philips Consumer Communications, Pioneer, Qualcomm, RTS Wireless, Samsung, Schlumberger Industries, Sema Group Telecom, Sharp, Siemens AG, Sony International, Tecnomen Oy, Telital S.P.A., Toshiba, Uniden and Unisys.

Software and Services Companies:

@MOTION, Advance Systems Ltd., Aether Systems, Agency.com, APION, AU-System Mobile, Baltimore Technology, BEA Systems, Bussan Systems Integration Co., Certicom, Charles Schwab & Co., Converse Network Systems, CCL, CTC, Cyclelogic, Dr. Materna GmbH, Digital Mobility, Diversinet, Dolphin Telecom, Evolving Systems, Fantastic Corp., Fujitsu Software Corp., Geoworks Corp., Glenayre Tech., Lexacom, LPG Innovators, MapQuest.com, M.D. Comm, Merita Bank, Microsoft, Mobile Services, Myalertcom, Oracle, Peramon Tech, Proxinet, Puma Tech, RSA Data Security, Saraide, Sendit AB, Scandinavian Softline Tech, Spyglass, Symbian, Systems Engineering Consultants, TANTAU Software, Tegic Comm, TWS, Union Bank of Switzerland, Usha Comm Tech, VTT Info Tech, VeriSign, Visa International, WapIT and Wireless Knowledge.

Wireless Telephone Manufacturers that have Licensed UP.Browser:

Alcatel, Bosch, Casio, Ericsson, Hitachi, Hyundai Electronics, IGS, Kyocera, LG information & Communication, Mitsubishi, Motorola, NEC, Neopoint, Nokia, Panasonic, Phillips, Qualcomm, Sagem, Samsung, Sharp, Siemens, Sony, Toshiba and 3COM.

Internet content providers that currently deliver content for wireless telephones equipped with UP.Browser include: ABCNews.com, BizTravel.com, Bloomberg, Data Broadcasting Corporation, ESPN Sportszone, InfoSpace.com, Quote.com, Reuters and Sportsfeed.

Phone.com sells its products through both a direct sales force and 3<sup>rd</sup> party resellers. 3<sup>rd</sup> party resellers: Alcatel, Itochu Techno Science Corp., Sema Group and Siemens.

Phone.com also maintains a sales and marketing relationship with Lucent Technologies.

Phone.com actively recruits content and application developers to its platform and provides to them free of charge its software developer's kit, UP.SDK. Phone.com also provides them with free membership in its Developer Program, free email-based support and the opportunity to participate in its Alliances Program. As of August 1999, approximately 10,700 registered developers in its Developer Program have downloaded UP.SDK including:

724 Solutions, biztravel.com, Broadvision, Cable Data, Converse Network Systems, Data Broadcasting Corp., eDispatch.com, InfoSpace.com, Internet Travel Network, KLELine, Lightbridge, Lotus, Mapquest.com, NewsAlert, Reuters, SmartServOnline, Sportsfeed.com, StockTips, Vantive, The Weather Underground and Webraska Mobile Tech.

Phone.com's Alliances Program is comprised of a select group of its content and application developers. It screens applications to its Alliances Program based on the availability and quality of the content or applications produced by the partner. Phone.com performs joint marketing activities with the partner, as well as provides introductions between its wireless network operators and its Alliances Program members.

## **VI. Key Risk Factors**

Phone.com's future profitability is uncertain because it has a limited operating history. It commenced operations in December 1994 and commercially released its first products in June 1996. Phone.com may not continue to grow or achieve profitability as it faces a number of risks encountered by early stage companies in the wireless telecommunications and Internet software industries.

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**Some of these risks:**

- 1) need for network operators to launch and maintain commercial services utilizing its products
- 2) the uncertainty of market acceptance of commercial services utilizing its products
- 3) substantial dependence on products with only limited market acceptance to date
- 4) need to introduce reliable and robust products that meet the demanding needs of network operators and wireless telephone manufacturers
- 5) need to expand its marketing, sales, consulting and support organizations, as well as its distribution channels
- 6) ability to anticipate and respond to market competition
- 7) need to manage expanding operations
- 8) dependence upon key personnel.

Phone.com's quarterly operating results are subject to significant fluctuations, and its stock price may decline if it does not meet the expectations of investors and analysts. Its quarterly revenues and operating results are difficult to predict and may fluctuate significantly from quarter to quarter due to a number of factors, some of which are outside of its control.

**These factors include:**

- 1) delays in market acceptance or implementation by its customers of its products and services
- 2) changes in demand by its customers for additional products and services
- 3) lengthy sales cycle - typically between nine and twelve months
- 4) Phone.com's concentrated target market and the potentially substantial effect on total revenues that may result from the gain or loss of business from each incremental network operator customer
- 5) introduction of new products or services by Phone.com or its competitors
- 6) delays in developing and introducing new products and services
- 7) changes in its pricing policies or those of its competitors or customers
- 8) changes in its mix of domestic and international sales
- 9) changes in its mix of license, consulting and maintenance and support services revenues
- 10) changes in accounting standards, including standards relating to revenue recognition, business combinations and stock-based compensation

**Risks inherent in Phone.com's international business activities include:**

- 1) failure by Phone.com and/or third parties to develop localized content and applications that are used with its products
- 2) costs of localizing its products for foreign markets
- 3) difficulties in staffing and managing foreign operations
- 4) longer accounts receivable collection time
- 5) political and economic instability
- 6) fluctuations in foreign currency exchange rates
- 7) reduced protection of intellectual property rights in some foreign countries
- 8) contractual provisions governed by foreign laws
- 9) export restrictions on encryption and other technologies
- 10) potentially adverse tax consequences
- 11) the burden of complying with complex and changing regulatory requirements.

**VII. EXPLANATION OF FINANCIALS****Revenues**

Phone.com generates revenues from licenses, maintenance and support services and consulting services. It receives license revenues from licensing its UP.Link Server Suite software directly to network operators and indirectly through value-added resellers. Maintenance and support services revenues also include engineering and support services provided to wireless telephone manufacturers. Consulting services revenues are derived from consulting services provided to network operator customers either directly by Phone.com or indirectly through resellers.



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Currently, Phone.com's revenues are growing rapidly. In the first two quarters of fiscal year 2000, the company generated revenues of \$5.26M and \$12.8M, respectively. The company is projecting revenues to grow 20-25% per quarter over the next two quarters, bringing fiscal 2000 revenues to roughly \$52M. Approximately, 60% of their revenue is generated through licensing fees, 28% via maintenance and support services and 12% via consulting.

### **Gross Margin**

Gross Margin was 66.2% last year and the company expects a blended Gross Margin in the mid-60's this fiscal year. Through the first two quarters of fiscal year 2000, gross margin was 67%. The cost of revenue has decreased as a percentage of revenue each year over the last three years. The cost of licensing has dropped to 7% of licensing revenue, the cost of maintenance and support services has declined to close to 50% of maintenance and support service revenue and consulting costs are 50% of consulting revenue. Phone.com is intent on building upon its growing consulting revenues and will spend money on this business sector to do so. The company expects consulting costs to increase as a percentage of consulting revenues over the course of fiscal year 2000. The other costs may vary from quarter to quarter as a percentage of total revenues, but changes should not be significant.

### **Sales & Marketing Margin**

Sales & Marketing Expenses have increased dollar wise every year since inception and will continue do so as the company adds personnel to its sales and marketing organizations, as well as spends more money to develop market awareness of its products and services. As revenues increase, Sales & Marketing Margin will decrease as Sales & Marketing Expenses become a smaller percentage of Total Revenues.

### **General & Administrative Margin**

General & Administrative Expenses have increased dollar wise every year since inception and will continue to do so as the company adds personnel and incurs additional expenses related to the anticipated growth of its business and operation as a public company. As revenues increase, General & Administrative Margin will continue to decrease as General & Administrative Expenses become a smaller percentage of Total Revenues.

### **Research & Development Margin**

Research & Development Expenses have increased dollar wise every year since inception. The company anticipates to continue increasing its research and development spending significantly as it continues to search for new products and services to offer its customers. As revenues increase, Research & Development Margin will continue to decrease as Research & Development Expenses become a smaller percentage of Total Revenues.

### **Cash**

At the end of the 2<sup>nd</sup> quarter, fiscal 2000, Phone.com had \$506 million of cash, cash equivalents and short-term investments. This figure is up \$388 from the previous quarter due to the completion of a secondary offering during the 2<sup>nd</sup> quarter which raised an additional \$390 million. The company generated \$1.9 million in positive cash flow from operations during the 2<sup>nd</sup> quarter -- its 3<sup>rd</sup> consecutive quarter of positive cash flow from operations. The company, however, expects negative cash flow from operations for the rest of fiscal 2000 as it plans to invest more heavily to solidify its leadership position in the market. If cash generated from operations is insufficient to satisfy its liquidity requirements, Phone.com may seek to sell additional equity or debt securities or to obtain a credit facility.

## **VIII. VALUATION**

The market for wireless devices is growing fast. Estimates show that shipments of smart phones and handheld Internet devices will exceed 350 million units by 2003. Wireless data users in enterprise segments will multiply more than tenfold to nearly 9 million in 2003. Total wireless subscribers will hit 1.26 billion, up from 469 million at year-end 1999.

Phone.com is right in the middle of this wireless boom. We are witnessing first hand a push toward putting the Internet in people's pockets through the use of wireless devices. The company was able to raise \$390 million in a secondary offering this past quarter, proving that investor confidence is high. The price of Phone.com's stock received a rapid boost off its initial public offering, but has since traveled a similar path to the NASDAQ Index and two of its main competitors, Nokia and Microsoft.



Phone.com's revenues have increased 655% and 509% over the last two years, respectively. Revenues for fiscal year 2000 are projected to increase by another 288%. The company has yet to turn a profit but will significantly reduce its loss per share this fiscal year from \$2.98 to \$.52.

Phone.com's Price to Sales and Price to Book ratios are significantly higher than their competition's. Its Price to Sales ratio of 180.1 is over 7 times that of its industry sector and its Price to Book ratio is more than 4 times greater. Investors believe that Phone.com has tremendous room for growth and are willing to purchase shares now in expectation of future revenue streams and earnings.

Additionally, Phone.com is using its strong stock price to make strategic acquisitions further enhancing its place as a dominant leader in this booming industry.

Phone.com has some tough competition in companies like Microsoft and Nokia, to name a few. But, the company has a strong advantage in that it has already licensed its UP.Browser to over 25 mobile phone manufacturers. As well, Phone.com pioneered the convergence of Internet and mobile telephony by founding a worldwide standard called WAP for the delivery of Internet-based services to mass-market wireless phones.

We consider Phone.com a "Strong Buy" and we expect the stock to appreciate rapidly, in-line with Nokia, Ericsson and Motorola -- the other mobile phone companies painting the wireless Internet landscape. We anticipate Phone.com's stock to trade near \$150 by March 1 and then climb to \$200 by year-end 2000.

<b>Income Statement</b>							
(In thousands, except per share data)				Year ended June 30,			
		1995	1996	1997	1998	1999	2000E
<b>Revenues:</b>							
License		----	-----	80	522	5,229	31,300
Maintenance and support services		----	-----	212	1,683	5,921	14,600
Consulting services		----	-----	-----	-----	2,292	6,259
<b>Total revenues</b>		----	-----	292	2,205	13,442	52,159
<b>Cost of revenues:</b>							
License		----	-----	87	95	371	3,687
Maintenance and support services		----	-----	266	1,063	3,022	7,947
Consulting services		----	-----	-----	-----	1,146	5,103
<b>Total cost of revenues</b>		----	-----	353	1,158	4,539	16,737
<b>Gross profit (loss)</b>		----	-----	(61)	1,047	8,903	35,422
<b>Operating expenses:</b>							
Research & Development		92	1,387	3,959	5,732	13,082	36,511
Sales & Marketing		6	757	3,198	5,011	10,840	26,079
General & Administrative		5	522	1,237	1,801	4,432	11,475
Stock-based compensation		-----	-----	-----	108	1,011	1,500
<b>Total operating expenses</b>		103	2,666	8,394	12,652	29,365	75,565
<b>Operating loss</b>		(103)	(2,666)	(8,455)	(11,605)	(20,462)	(40,143)
<b>Interest income, net</b>		-----	196	464	982	1,803	3,482
<b>Loss before taxes</b>		(103)	(2,470)	(7,991)	(10,623)	(18,659)	(36,661)
<b>Income taxes</b>		-----	-----	-----	-----	2,104	2,927
<b>Net loss</b>		(103)	(2,470)	(7,991)	(10,623)	(20,763)	(33,734)
<b>Basic and diluted net loss/share</b>		(0.02)	(0.53)	(1.67)	(2.03)	(2.98)	(0.52)
<b>Shares Outstanding</b>		4,671	4,704	4,776	5,221	6,966	65,100
<b>Margin Analysis</b>							
Gross Margin		----	-----	-20.9%	47.5%	66.2%	67.9%
Sales & Marketing		----	-----	905.9%	432.7%	238.8%	155.8%
General & Administrative		----	-----	423.6%	81.7%	33.0%	22.0%
Research & Development		----	-----	1355.8%	260.0%	97.3%	70.0%
Operating Margin		----	-----	-2895.5%	-526.3%	-152.2%	-77.0%
Net Margin		----	-----	-2736.6%	-481.8%	-154.5%	-64.7%
<b>Growth</b>							
Total Revenue Growth		----	-----	100.0%	655.1%	509.6%	288.0%
Gross Profit		----	-----	-----	1816.4%	750.3%	297.9%
Operating Expense		----	2488.3%	214.9%	50.7%	132.1%	157.3%
Operating Loss		----	2488.3%	217.1%	37.3%	76.3%	96.2%