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

**Update Report: Analysis of current status and new products- Strong Buy**

July 13, 2000

**KEY CONSIDERATIONS**

- Phone.com pioneered the convergence of Internet and mobile telephone 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 announced the immediate availability of a new product, FoneSync Essentials, that allows two way synchronization of names and phone numbers between mobile phones and personal computers. The existing FoneSync can be upgraded to FoneSync Essentials over the Internet by using the integrated update wizard in Version 3.1
- Phone.com recently announced that it expects the shipping of the UP.Link™ Server Suite Release 4.2 to begin during early 2<sup>nd</sup> quarter 2000. Release 4.2 provides continuous product improvements as well as additional features such as more detailed billing and the ability to automatically register new subscribers.
- Currently, there exist over 400 members of the WAP Forum, representing the world’s largest operators, software developers, and handset manufacturers. According to Strategy Analytistics, Inc, it is likely that 80% of all phones shipped in 2001 will be equipped with a WAP browser increasing to 95% by 2003. The UP.Browser presently resides in over 100 unique phone models.

Recent Price	\$62.38
52WK Low	\$19.81
52WK High	\$208.00
P/E	NA
Price to Book	3.6
Price to Sales	73.43
Market Capitalization	\$4.26B
Shares Outstanding	68,333
Daily Volume	3.26M
<b>EPS</b>	
1996	\$(0.53)
1997	\$(1.69)
1998	\$(2.03)
1999	\$(2.98)
2000E	\$(0.42)
2001E	\$(0.62)

**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 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>.

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## I. DESCRIPTION OF THE COMPANY

**Services.** Using Phone.com's software (UP. Link Server Suite, UP.Browser, UP.SDK, UP.Smart and MyPhone), wireless subscribers gain access to Internet- and corporate intranet-based services, which may include Email, news, stocks, weather, travel and sports. Subscribers also have access via wireless telephones to network operators' intranet- based telephony services, which may include services such as over-the-air activation, call management, billing information, price plan subscription and voice message.

**Additional Services.** Phone.com plans to expand its relationship with wireless operators by selling additional applications such as:

- \* **MyPhone** is a turnkey wireless Internet portal platform for wireless carriers.
- \* **OneBox** is a unified messaging service that includes over-the-air synchronization, implementation of location technologies and WAP provisions.
- \* **Infrastructure applications** that includes identification of cookies (stored on network and not on the phone), fax services (allowing fax to become a printer), push alerts, and content translation.
- \* **Voice activated browser** that should become available toward the end of 2000.

**Additional Products.** Phone.com now enables its users to obtain names and numbers from their PC onto their mobile phones and backup their phones' memory. The new product, FoneSync Essentials, is compatible with over 250 mobile phones and with leading personal information managers (PIMs) such as Microsoft Outlook, ACT!, Goldmine, Lotus Notes or Lotus Organizers. Changes or additions to contact numbers appear simultaneously on phones and PC, keeping both up to date. Additional features include ability to search for numbers in Web-based directories and the ability to drop and drag details from electronic business cards (vCards) to phone lists.

## II. INDUSTRY

**WAP.** At present, more than 30 wireless phone manufacturers have deployed WAP-based microbrowsers in their mobile phones, majority using Phone.com's UP.Browser. More than 60 wireless operators worldwide have implemented WAP gateways onto their networks, which maximizes the exchange of information between the Internet and WAP-based mobile phones. These wireless carriers collectively hold half the world's wireless voice subscribers, which is over 200 million. It is likely that by 2002, the number of mobile Internet subscribers will exceed 220 million and that Phone.com will be the solution used by 24% of those end-users.

**Market Shares.** Phone.com's WAP-based software development kit have been registered to 100,000 developers as of June 2000. These wireless operators' subscribers currently account for 42% of total worldwide wireless subscribers. This implies that Phone.com has roughly 60% of the market share.

**I-mode.** A new competitor for WAP has emerged. Based on I-mode technology, Japanese wireless operator NTT DoCoMo have deployed wireless Internet services. Since the service was launched in February 1999, DoCoMo experienced tremendous success. It generated nearly 7.5 million customers, which represents 25% penetration of DoCoMo's wireless customer base to 6% of the Japanese population. This belittles the number of customers using WAP-based phones, which at the end of March 31, 2000 was roughly 2 million. According to WR Hambrecht + Co, I-mode's success in Japan is due to a combination of: 1.) packet transmission on DoCoMo's personal digital cellular packet (PDC-P) network, which enables always-on connectivity; 2.) strong demand for Internet services in Japan and 3.) Japan's society which is very "gadget-centric", meaning they are often quick to try and adopt new technologies.

## III. COMPETITION

Phone.com expects that it will compete primarily on the basis of price, time to market, functionality, quality, and breadth of product and service offerings. The market for their products and service is becoming increasingly competitive. The widespread adoption of open industry standards such as the WAP

specifications may make it easier for new market entrants and existing competitors to introduce products that compete with the company's software products.

**UP.Link WAP Gateway Competitors.** Companies like Nokia, Ericsson, Motorola and CMG Telecommunications have gradually accumulated roughly 35% of the WAP gateway market. Telecom equipment manufacturers like Nokia, Ericsson and Motorola have the ability to obtain much larger equipment orders from wireless carriers. These companies also are more experienced as well as have greater financial, technical, marketing and distribution resources than Phone.com. Furthermore, Nokia is marketing a WAP server to corporate customers and content providers. This WAP server is designed to enable wireless telephone subscribers to directly access applications and services provided by these customers rather than through gateways provided by network operators' WAP servers. If Nokia's WAP server is widely adopted by corporate customers and content providers, it could undermine the need for network operators to purchase WAP servers.

**Microsoft Corporation.** Microsoft has announced its intention to introduce products and services that may compete directly with UP.Link, UP.Browser and UP.Application products. In addition, Microsoft has announced that it intends to enable its Windows CE operating system to run on wireless handheld devices, including wireless telephones. Microsoft has announced its own browser, called Mobile Explorer, for these devices.

**Other New Competitors.** As Phone.com enters the Unified Messaging market, they will face competition from established voicemail providers such as Converse and internet-based unified messaging providers such as Critical Path. In the Portal Framework market, a number of companies have introduced products and services relating to mobile portals that compete with MyPhone service. These existing and potential competitors may include telecommunications companies (such as Lucent Technologies), traditional Internet portals (such as AOL, InfoSpace and Yahoo!), Internet infrastructure software companies and several private mobile Internet portal companies. FoneSync synchronization product will face competition from Motorola's TrueSync products and products from Puma, as well as from emerging synchronization companies such as Fusion One.

**Table I Comparison of Main Competitors Over the Past 12 Months**

	<b>Phone.com</b>	<b>Microsoft</b>	<b>Nokia</b>
<b>Total Sales</b>	\$47 Million	\$23,677 Million	\$22,501 Million
<b>Total Income</b>	-\$160 Million	\$9,214 Million	\$2,973 Million
<b>Sales Growth</b>	497.00%	29.70%	64.10%
<b>Income Growth</b>	NA	25.60%	71.40%
<b>Price/Earnings Ratio</b>	NA	47.40	82.50
<b>Net Profit Margin</b>	NA	47.40	82.50
<b>Debt/Equity Ratio</b>	0.00	0.00	0.04
<b>12-Mo Share Price Change</b>	61.3%	-20.4%	115.3%
<b>12-Mo Industry Price change</b>	-38.90%	-1.90%	45.50%
<b>12-Mo Strength Relative to all Stocks</b>	86	37	92

**Weaknesses.** Because the current UP.Link Server Suite and related server-based software have enhanced features and functionality that are not currently covered by the specifications promulgated by the WAP Forum, subscribers currently must use UP.Browser-enabled wireless telephones in order to fully utilize these features and functionality.

**Strengths.** We believe that Phone.com's greatest strengths have been its software expertise. Adding on to the company's momentum is their first-to-market advantage and broad partnerships with operators. Other strengths include:

- \* **One time subscriber fees.** Licensing revenue from network operators is obtained from one-time per subscriber fees. Licensing revenue should directly scale with the growth of wireless Internet subscribers, putting Phone.com in the best position to benefit from the rapid emergence of the wireless internet.
- \* **Strategic acquisitions.** Due to strategic acquisitions of companies (such as OneBox and Paragon Software Ltd.) and strategic alliances with other companies, Phone.com is in the best position to leverage its relationship with network operators to sell additional wireless Internet infrastructure services. By doing so, Phone.com can move up the ladder to the end users themselves.
- \* **Revenue backlog.** Phone.com's revenue recognition policy requires a carrier to be commercially launched before the company recognizes revenue. At present, the company has \$160 million of committed revenue backlog. This backlog is based on the minimum amounts that committed wireless operators have agreed to pay and does not depend on the signing up of wireless Internet subscribers by the company's network operators. We believe that if this revenue backlog is used wisely, it should support the company's revenue growth for the next few years as well as keep the incremental cost of rolling out data services to subscribers at a minimum.

#### IV. STRATEGY OF GROWTH

We believe that the large market share of Phone.com's WAP gateways are due to the change in the company's strategy. Instead of focusing on proprietary technology, as it did in the early stages, Phone.com is now focusing on the development of WAP products and the selling of additional services to its network operators. The company's strategy begins with selling of WAP gateways, spreading enhanced services and infrastructure applications, and eventually encompassing end user applications. The company's strategy of licensing its UP.Browser to mobile phone manufacturers free of royalties, induces manufacturers to include the microbrowser in their handsets. Currently, the UP.Browser is being ported to over 150 wireless phone models and is likely to reach 200 by the end of 2000. The company also plans to expand sales by operating new offices worldwide.

#### V. ACQUISITIONS AND PARTNERSHIP

As of May 2000, the WAP Forum membership included over 400 companies. These companies represent all sectors of the industry, including leading wireless network companies, infrastructure providers, handset manufacturers and software providers.

**Table II Important Phone.com Events for the Year 2000**

<b>Date</b>	<b>Acquired:</b>	<b>Announced agreement with:</b>
Feb. 8	AtMotion, Inc	Intel Corporation
March 4	Paragon Software Ltd.	
March 9		British Telecommunications
March 15		Air Touch Cellular, Star Hub
April	OneBox	
May 10		Dobson Communications Corp, BarPoint.com
May 16		Conversa
May 18		AT&T Wireless Group
May 22		Telesp Celular
June 28		ALLTEL
July 3		Invertix
July 10		Air Tel India

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## VI. KEY RISK FACTORS

**History of Losses.** Investors usually favor companies with earnings and not those lacking near-term profitability. Phone.com also expect to continue incurring losses due to significant product development, sales and marketing and administrative expenses.

**Revenue Model.** Although it is very likely that wireless Internet will eventually see substantial penetration of mobile phone subscribers, it is still too early to tell. The combination of I-mode and WAP subscribers only add up to about 10-12 million mobile phone Internet subscribers worldwide, which represents only 2% penetration of roughly 500 million total wireless subscribers worldwide. Phone.com's revenue model is based solely on the growth and success of the wireless Internet. Majority of revenues have come from annual support service fees paid by wireless telephone manufacturers and there exists only a small number of network operators worldwide. The future success of the company depends on the ability to increase revenues from sales to new customers.

**Increase in Competition.** Phone.com's competitors come from both established infrastructure providers like Nokia as well as upstarts like Ztango.com and Dr. Materna. Also, it is possible for larger players to sell WAP gateways at a reduced cost (so as to realize profits elsewhere) since Phone.com's platform sits at a strategic point in the wireless Internet value chain.

**Convergence of XML, HTML, and WAP.** As HTML and WAP unite under the umbrella of XML, the line drawn between HTML and WAP could become vague to the point that HTTP servers incorporate the functions of WAP gateways.

## VII. EXPLANATION OF FINANCIALS

**Total Revenue.** 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 network operators either directly by Phone.com or indirectly through resellers. Our expected total revenues for the years 2000 and 2001 are \$64.2 million and \$172.3 million respectively. We believe that the large increase in total revenue are due to: 1.) increase licensing of products to new company's such as AT&T Wireless Services, Sprint, DDI, IDO, Shinsegi Telecom and Cegetel/SFR; 2.) new network operators in Europe, Korea and Hong Kong; and 3.) recognition of the company's revenue backlog.

**Total Revenue Growth Rate.** Over the past few quarters, the revenue growth rate has been falling. Third quarter growth rate is reported at 46% and it is likely that it will fall to 30% in the fourth quarter. We believe the fall in the growth rate is primarily due to the March-April fall in tech stocks, causing investors to favor companies with earnings and disregard those lacking near-term profitability. Other reasons for the fall include increased competition as well as low worldwide penetration of wireless Internet subscribers. Growth rate will likely be 378% for the year 2000 and 168% for the year 2001.

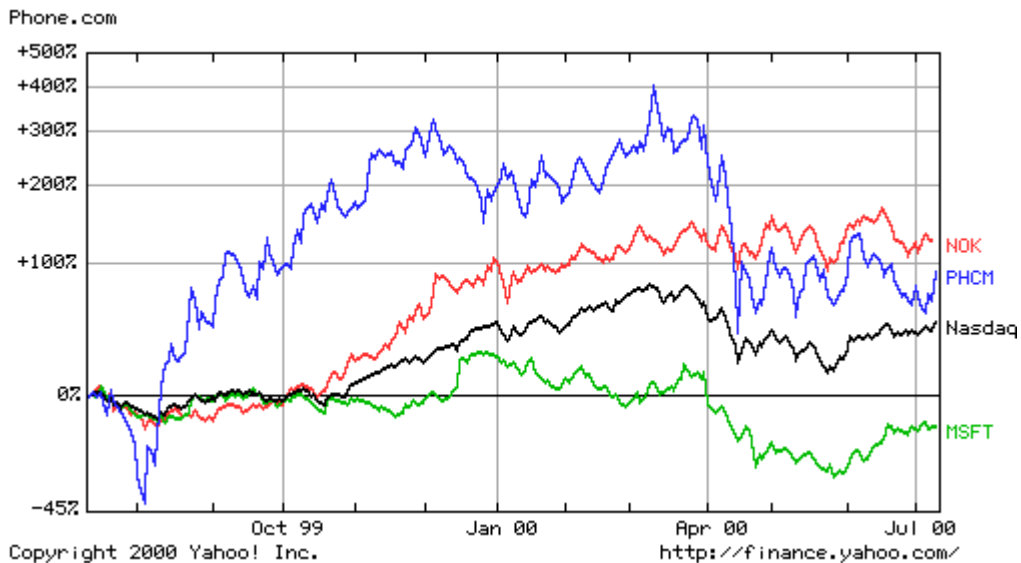
**Sales & Marketing Margin.** Sales & Marketing is expected to increase from \$10.8 million in 1999 to \$36.5 million in 2000 and \$78.9 million in 2001. This increase is largely due to the company's new strategy of focusing on the development of WAP program and selling additional services. As new products and services are developed, more money will be spent on their market awareness. As revenues increase, Sales & Marketing Margins will decrease as Sales & Marketing Expenses become a smaller percentage of total revenues. Sales and Marketing Margin will fall to 56.8% in 2000 and to 45.7% in 2001.

## VIII. VALUATION

Because the future of Internet companies is very difficult to predict, it would be impractical to value them using the discounted cash flow pricing model. Also since Phone.com is incurring losses, it is also impractical

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to give a valuation of the company using the price to earnings ratio. Therefore the comparative analysis approach will be used to determine the valuation of Phone.com.



The price of Phone.com's stock has traveled a similar path as the NASDAQ Index and two of its main competitors, Nokia and Microsoft. A decline for April can be seen for all 4, with Phone.com having the steepest decline. This is due to the March-April fall in the tech stocks. Both Nokia and Microsoft were not greatly affected due to the fact that they are already established with a history of earnings and have the ability to attain near-term profits. On the other hand, Phone.com has a history of losses and lacks near-term profitability. Although this was a big blow to the company, Phone.com is recovering slowly. Through its strategic acquisitions (which is adding on greatly to total revenue) the company is again gaining investors confidence. Another factor that may increase confidence in the company is the recent company guidance for break-even operating income to occur in December 2001, rather than in the first half of 2002.

The share price of Phone.com is \$62.38, which is trading at an average price compared to Microsoft at \$82 and Nokia at \$54. The Price to Sales ratio indicates that the current price and the company's stock are at a reasonable level. But it is our belief that the company should have a higher valuation because it has some competitive strengths relative to its competitors. The main comparative advantage of Phone.com is its strategic acquisitions, broad partnerships and alliances and its revenue backlog.

Our long term rating for Phone.com is that it will continue to outperform NASDAQ. We consider Phone.com a "Strong Buy" and anticipate its stock to trade near \$120 by year-end 2000.

Income Statement  
(In millions)

Year Ended June 30

	1995	1996	1997	1998	1999	2000E	2001E
<b>Revenues:</b>							
License	0	0	0.08	0.522	5.229	40.4	115.9
Maintenance & Support Service	0	0	0.212	1.683	5.921	13.9	31
Consulting Services	0	0	0	0	2.292	9.9	25.4
Total Revenues	0	0	0.292	2.205	13.442	64.2	172.3
<b>Cost of Revenues</b>							
License	0	0	0.087	0.95	0.371	4.8	21.6
Maintenance & Support Service	0	0	0.266	1.063	3.022	9.9	20.5
Consulting Services	0	0	0	0	1.146	6.1	16.9
Total Cost of Revenues	0	0	0.353	2.013	4.539	20.8	59
Gross Profit (Loss)	0	0	-0.061	1.047	8.903	43.4	113.3
<b>Operating Expenses:</b>							
Research & Development	0.092	1.387	3.959	5.732	13.082	39.5	79.7
Sales & Marketing	0.006	0.757	3.198	5.011	10.84	36.5	78.9
General & Administrative	0.005	0.522	1.237	1.801	4.432	12.5	28
Stock-Based Compensation	0	0	0	0.108	1.011	2	1.2
Total Operating Expenses	0.103	2.666	8.394	12.652	29.365	90.5	187.8
Operating Income ( Loss)	-0.103	-2.666	-8.455	-11.605	-20.462	-47	-74.5
Net Interest Income	0	0.196	0.464	0.982	1.803	20	25.3
Loss Before Taxes	-0.103	-2.47	-7.991	-10.623	-18.659	-27	-49.1
Income Taxes	0	0	0	0	2.104	1.7	2.6
Net Loss	-0.103	-2.47	-7.991	-10.623	-20.763	-28.7	-51.8
Basic & Diluted Shares Net Loss/Share	-0.02	0.53	-1.69	-2.03	-2.98	-0.42	-0.62
Shares Outstanding	4671	4704	4776	5221	6966	68,333	83,548
<b>Margin Analysis</b>							
Gross Margin	0	0	-21%	47%	66%	68%	66%
Sales & Marketing	0	0	1095%	227%	81%	57%	46%
General & Administrative	0	0	424%	82%	33%	19%	16%
Research & Development	0	0	1356%	260%	97%	62%	46%
Operating Margin	0	0	-2896%	-526%	-152%	-73%	-43%
Net Margin	0	0	-2737%	-482%	-154%	-45%	-30%
<b>Growth</b>							
Total Revenue Growth	0	0	0	655%	510%	378%	168%
Gross Profit	0	0	0	-1816%	750%	387%	161%
Operating Expenses	0	2488%	215%	51%	132%	208%	108%
Operating Loss	0	2488%	217%	37%	76%	130%	59%