

244 Fifth Ave., 2nd Fl., Ste. 2801 • New York, NY 10001 • Tel: (212) 726 1408 • Fax: (413) 215 0880**VOCALTEC COMMUNICATIONS (NASDAQ: VOCL)****Update: Need to increase diversification—Accumulate**

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KEY CONSIDERATIONS

- Vocal Tec is expanding its product offering within the e-commerce sector, increasing its diversification and brand recognition.
- The new service called TrulyGlobal provides communication services that telecom carriers and ISP providers can offer to attract and retain high-spending online customers.
- Vocal Tec is increasing its international exposure in Japan with Webway and Telia, and in Chile with Entel Chile.
- The market for IP telephony and software and applications is expected to top \$2.6 billion in 2003. (Frost and Sullivan)
- Less than 1% of worldwide voice traffic is transmitted over IP telephony-based packet-switched networks.

ONE-YEAR PRICE AND VOLUME GRAPH

Recent Price	\$7.19
52WK Low	\$3.50
52WK High	\$53.25
P/E	3.54
P/Sales	2.4
Market Capitalization	\$81.9 M
Shares Outstanding	12.1 M
Float	6.2 M
Daily Volume (3-month Average)	105.0 K
EPS	
1998A	\$2.08
1999A	\$2.47
2000A	\$2.39
2001E	\$0.63
Current Ratio	2.77
Total Debt to Equity	0.0
LT Debt	0.0
Total Cash	\$58.5 M

COMPANY PROFILE

VocalTec (www.vocaltec.com) develops and markets end-to-end communications solutions for global carriers, service providers, corporations and individuals. The company develops and markets software that enables multi-point audio, video and collaborative communications, and seamlessly integrates the traditional telephone network, PCs, the internet and corporate intranets. Apart from its IP telephony services, Vocal Tec has added more services under its subsidiaries. Surf and Call network service offers interactive, web-enabled customer service solutions for e-commerce, and Truly Global is an Internet based service for consumers that simplifies the use of multiple communication devices and networks.

This report was prepared by Anthony Alexander and Jonathan Zhang

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COMPETITION

Vocal Tec is a pioneer in the IP Telephony products arena. However it does face competition in this area. Clarent was recently named as the leader in Phone-to-Phone IP Telephony market by iLocus Report ahead of Cisco and Vocal Tec with 31% of the market. Net2Phone is a leader in PC-to-Phone technology according to Media Metrix. It experiences high margin revenue from international phone services, cross-selling of enhanced services, and sale of advertising. Vocal Tec will have to outperform its competitors in terms of product quality, features, cost and customer relationships. Vocal Tec will have to maintain, and keep increasing, its commitment to R&D in this infant industry.

STRATEGIES FOR GROWTH

The main strategies for growth are focused on expanding the product offering to offer more efficient forms of web-based solutions. It also involves establishing more brands and forming strategic alliances both domestically and overseas.

- **Strategic Alliances**

Infocast LLC and Surf&&Call. They signed a partnership agreement to allow Surf&Call Network Services to be the voice over internet protocol (VOIP) behind MediaVoice, part of the suite of technologies in InfoCast LLC's MediaHub.

Webway Communications Holding Inc. and VocalTec Communications Ltd. They announced the signing of a cooperation agreement. The terms call for Webway to purchase approximately \$1 million of VocalTec's IP telephony equipment to serve as the backbone of its IP telephony network. Webway, an Internet Telephony Service Provider (ITSP), intends to form a regional clearinghouse in Asia.

Telia Clearinghouse and VocalTec Communications Ltd. Telia International Carrier has selected VocalTec's technology to further develop its Voice Over IP (VOIP) platform. Through this collaboration, Telia Clearinghouse Services intends to target hundreds of Internet Telephony Service Providers (ITSPs) worldwide. VocalTec and Telia International Carrier have also agreed to approach customers jointly to increase the number of TCS affiliates using VocalTec technology.

Startec Global Communications Corporation and Vocal Tec Communications Ltd. Startec, a provider of IP services to emerging economies, announced the opening of its global IP network to equipment manufactured by VocalTec Communications Ltd. This expansion allows Startec to address nearly all of the VoIP market worldwide and supports the Company's recent migration of most of its retail traffic to its IP network.

Huawei Technologies Co. Ltd. and VocalTec Communications Ltd. Huawei, a telecommunications equipment manufacturer in China, has selected VocalTec's IP telephony platform for several major Provincial Telecom Authority projects in China.

ISF Corporation (ISF) and VocalTec Communications Ltd. They signed a cooperation agreement that includes marketing, financial and technical terms. The contract commits ISF, an ITSP in Japan, to use VocalTec's Internet telephony platform for its clearinghouse and to distribute VocalTec products to its affiliates. ISF has recently reached OEM bundling agreements with IBM Japan, Ltd. and other Japanese computer manufacturers to pre-install PCs for sale in Japan with VocalTec Internet Phone Lite. Starting in the fourth quarter of 2000, more than 1.5 million pre-installed computers are expected to be distributed in Japan per quarter.

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- **New Products.** TrulyGlobal, Inc., a wholly owned subsidiary of Vocaltec Communications Ltd., launched an Internet-based solution to simplify communications. TrulyGlobal is introducing a personal communications assistant that puts users in direct control of how and when they can be reached. Through a Web-based platform for voice, video and text messaging, users can automatically pre-screen and route specific incoming calls to any location or communication device.
 - **Global Expansion.** Vocaltec Communications Ltd. It is making strides to increase its global presence with partnerships in Chile, Japan, China and Hungary with partnerships affecting customer base, marketing and finance.

KEY RISK FACTORS

- The Company has a limited operating history and is in the early stages of development.
- The Company is increasing exposure in Asia which is in a recessionary period of its economic cycle. This can adversely affect the company's short-term attractiveness.
- There is intense competition due to low barriers of entry into the market, which could adversely affect the company's market share.
- Though substantial growth in the industry is predicted, it still depends on telecommunication companies and customers migrating from traditional circuit-switched telephone technology to IP-based packet-switching networks.
- The repeated net losses from operations, and stock price at approximately 10% of its 52-week high may make it difficult for Vocaltec to raise the capital necessary at reasonable terms for R&D and other strategic investments.

FINANCIALS

Revenue. Vocaltec is continually expanding its product offering to which reduces its exposure to fluctuations in market conditions in any one sector. Net losses are expected to decrease given the scope of its new contracts, strategic alliances, and interest in its new products. Vocaltec revenue has historically come from its IP Telephony products. However, Surf&Call Network is already generating interest and TrulyGlobal products will add to the diversification. Vocal Tec is becoming a one-stop-shop for IP telephony and e-commerce support systems.

Gross Margin. The gross margin is expected to increase in the short-run as Vocaltec is operating in a young and growing industry, and as they take advantage of external economies of scale that can be realized in this sector. Its internal economies of scale are expected to increase as the company invests in the necessary infrastructure; an investment justified by the steady growth of the sector. Gross margins will decrease in the long-run as the present growth rate will not be sustained as the industry matures.

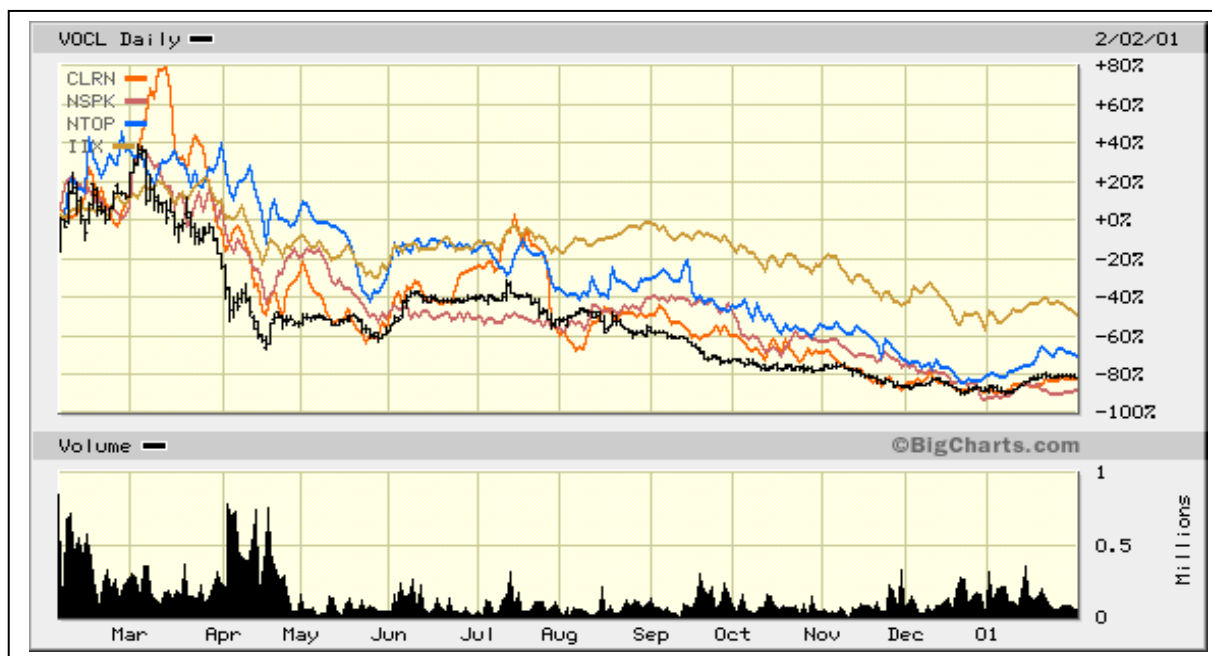
Research and Development Margin. The R&D expenses are expected to increase in the short-run as Vocal Tec attempts to increase market share and stay ahead of its competitors. Its partnerships with major telecommunications providers and users will help to educate the public about the technology and increase the scope of the potential market.

Sales/Marketing/Gen Admin Margin. In its thrust to compete for market share, Vocaltec has entered into some cooperative agreements with Huawei Technologies for example. Sales, Marketing and General and Administrative margin should remain above 70% range. This high margin is reasonable given the fact that they engage in significant R&D and hence need to market their new products e.g. TrulyGlobal.

Net Income. Net losses from operations have been incurred since the company's inception and we expect this to remain negative but improve with each successive period.

VALUATION

Internet Sector. The entire internet sector faced a serious correction beginning on March 10, 2000. This brought the prices down to a more realistic level and resulted in the market being more critical of the entire sector. Vocal Tec and its competitors have generally under-performed the IIX since this correction and have been trending below the index for the past year though showing a high correlation. This suggests that it Vocaltec would increase in its stock valuation if the entire sector shows improvements and would need to prove itself as a long-term value stock if it is to gain investor's interest. Given that economy may be entering a recessionary period, it will be a difficult for the internet sector to generate positive interest in this climate to affect a significant appreciation in price as this industry is seen as being relatively risky.



Value Comparison 02/02/01					
Company	\$ Price	Market Cap. In millions	Trailing 12 Month Sales in millions	P/S	Gross Margin %(TTM)
Vocal Tec	7.19	81.9	36.4	2.40	68.78
Clarnet	16.00	622.67	162.7	3.83	61.23
Netspeak	2.06	29.36	18.2	1.61	88.92
Net2phone	12.75	786.82	101.8	7.75	41.31
Average	7.6	304.15	66.22	3.12	52.05

Margins. Vocaltec has the second highest Gross Margin at 68.78 among its main competitors listed on the table above. Historically, its Gross Margin has been trending downwards from 86% in 1995 to 69% in 1999. This should increase to the 75% range for 2001 with the introduction of TrulyGlobal and the sale of ITXC Corp.

Price to Sales. In comparison with its competitors, Vocaltec has the second lowest P/S ratio. This valuation we believe to be fair considering the growth prospects of the company. This valuation should be viewed considering the downward trend of the entire technology sector, and should decrease in the short-run as investors wait for evidence of long-term growth. We believe that as the initiatives the company has in the pipeline takes effect this valuation will increase in the long-run.

Cash. Vocaltec's sale of ITXC Corp. for \$57.7M and issue of stocks has generated cash needed to fund future growth. These reserves should be enough to support future initiatives more so since half of Surf&Call Network operating expenses have been offset by participation in Deutsche Telekom's call center project.

Investment Opinion

We believe that Vocaltec is making progressive attempts to increase its market share and product offerings. Also, it creating strategic partnerships, which enhances it efforts to innovate, and provides distribution channels for its products. Vocaltec is making the right alliances to become a global leader in this space. Vocaltec will be a long-term player in the IP telephony and e-commerce solutions market. Its attempt to engage in more diversification with the addition of TrulyGlobal is a welcome move given the inherent risk in IP telephony mentioned above. However, the growth of the IP space must be taken with a healthy dose of skepticism given that consumers need to be educated about this new technology and the lack of regulation and unified standards present. There is also the fact that e-commerce and the internet sector on the whole have fallen out of favor with the market, which may see lower but more accurate valuations persist in the sector in the near future. Additionally, Vocaltec needs to be able to manage its growth. This may mean an infusion of capital, a risk that was discussed earlier.

We believe that the stock is slightly under-valued but that it will follow and under-perform the trend of the IIX in the near future. We thus give Vocaltec a ACCUMULATE recommendation.

Vocaltec Communications

Income Statement	1995A	1996A	1997A	1998A	1999A	2000A	2001E
Revenue:	2,500,000	8,500,000	15,700,000	24,600,000	26,600,000	42,041,000	70,208,470
Cost of Revenue	300,000	1,200,000	2,200,000	5,900,000	8,200,000	13,537,000	16,147,948
Gross Profit	2,200,000	7,300,000	13,500,000	18,700,000	18,400,000	28,504,000	54,060,522
Operating Expenses:							
Selling/Gen/Admin	2,700,000	11,200,000	16,600,000	23,700,000	33,800,000	38,182,000	51,954,268
Research and Dev.	800,000	3,200,000	5,500,000	11,200,000	13,200,000	13,401,000	14,205,060
Total Operating Exp	3,500,000	14,400,000	22,100,000	34,900,000	47,000,000	51,583,000	66,159,328
Operating Income	(1,300,000)	(7,100,000)	(8,600,000)	(16,200,000)	(28,600,000)	(23,079,000)	(12,098,806)
Unusual Exp. (Inc.)		1,300,000		9,700,000	800,000	(57,744,000)	
Interest Expense (Income)	-	(1,300,000)	(1,000,000)	(2,700,000)	(900,000)	(3,184,000)	(4,100,000)
Income before Tax	(1,300,000)	(7,100,000)	(7,600,000)	(23,200,000)	(28,500,000)	37,849,000	(7,998,806)
Income Tax	-	-	-	-	-	9,013,000	
Net Loss	(1,300,000)	(7,100,000)	(7,600,000)	(23,200,000)	(28,500,000)	28,836,000	(7,998,806)
Net Loss per share:							
Diluted	-0.22	-0.86	-0.88	-2.08	-2.48	2.39	-0.63
Weighted avg shares	5.93	8.29	8.62	11.14	11.50	12.08	12.62
Growth							
Revenue	N/A	240%	85%	57%	8%	58%	67%
Research and Dev	N/A	300%	72%	104%	18%	2%	6%
Gross Profit	N/A	232%	85%	39%	-2%	55%	90%
Operating Expense	N/A	311%	53%	58%	35%	10%	28%
Net Loss	N/A	-446%	-7%	-205%	-23%	201%	-128%
EPS	N/A	-291%	-3%	-136%	-19%	196%	-127%
Margin Analysis (% of Revenue)							
Gross Margin	88%	86%	86%	76%	69%	68%	77%
Selling/gen/admin	108%	132%	106%	96%	127%	91%	74%
Research and dev	32%	38%	35%	46%	50%	32%	20%
Operating margin	-52%	-84%	-55%	-66%	-108%	-55%	-17%
Net margin	-52%	-84%	-48%	-94%	-107%	69%	-11%