



pip coburn's
waypoints – a journey through technology and change

Sell Ideas ...

Waypoints Release 4.0

October 7, 2005

- **Sell Themes:** 7 Negative themes we're playing.
- **Stocks Featured:** New York Times and Altiris.
- **Change:** Over 70 conviction statements that apply our Change Framework to tech, media, devices, convergence, software, wireless, Google-world, and more...
- **Always On:** More on Apple's Retail Stores...

"The significance of crisis is the indication they provide that an occasion for re-tooling has arrived..." ... Thomas Kuhn, The Structure of Scientific Revolutions

Thanks for joining us!

This is the final beta version of Waypoints...

We hope you decide to subscribe going forward. We would love to have you with us.

To subscribe, visit us at www.coburnventures.com and click on "Subscribe to Waypoints"

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Waypoints Release 4.0: Short questions...short answers

“A full price ad in the {Wall Street} Journal costs more than a house in Buffalo... One morning, with time to kill at a fine hotel, I interrupted a few people who were reading the Journal over breakfast. I waited until they had finished the first section, and then asked them if they could name just two of the companies that had run full page ads. Not one person could.” ... Seth Godin, Purple Cow ...

Q: You making any big bets on tech into year end?

A: Nope ... often a volatile time but estimates look ok for the group overall. We'll continue to focus on stock ideas as opposed to sector or macro bets.

Q: Any broader lessons to be learned from MERQ?

A: Don't get involved – long – in stocks if there's an accounting issue / investigation. No idea how they'll turn out, but it's rarely good. Our jobs are hard enough as it is!!! We'll stay on the sidelines...

Q: The hottest issue in technology over the next 3 years?

*A: Two ... The “ubiquitous cloud” as the infrastructure starts to become ever present ... Also “convergence” will look much more like a “Big Collision”. Everyone wants a part of the cloud ... and many many folks will be part of the collision... ask Intel, Google, KPN, Telefonica, Yahoo, eBay ... more conviction statements in **Change**...page 5...*

Q: What do you do with Apple here?

*A: Comfy having it as a core position in our Buy list. Also comfy with next 2-3 months into holidays ... Nano's hot. But at 32x and 1.32x its 200 day it ain't our largest position. More on Apple's Retail Stores in **Always On** ... page 27...*

Q: Where do you see the best “Sell” opportunities?

A: We list 7 core themes inside as well as companies that are exposed. Things like “Death of Software” ... “The Big Collision” ... “Steamrolled: Too Small to Survive” ... and “New Technologies Threatening the Old Way of Life”, where radio, advertising, and newspapers are feeling the pain of new technologies. We've added New York Times – NYT – to our Sell list ... page 14...

Q: What events do you care most about in the next 3 weeks???

A: Ciena Analyst Day – webcast – October 11th ... Red Hat analyst day – New York, NY – October 11th ... Gartner IT Expo – Orlando, FL – October 16th – 21st ...more on page 24...

Yi Tan Technology Call:

**Topic → Muni Wireless
with Esme Vos**

**** Tuesday **
Oct 11th**

Time: 10:30 PDT, 1:30 EDT

**Dial-in: 1-800-615-2900
1-661-705-2005**

Passcode: 778778

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In case you missed it on the front cover, this is the last of four planned Beta releases of Waypoints. After this issue, we'll be moving to a paid subscription basis. To subscribe, come visit us at www.coburnventures.com ...

*What we at Coburn Ventures really do at for a living is aim to understand all we can about **change** and then apply our insights toward investing in our area of domain expertise -- tech, telecom and media. We want to identify changes important enough to change valuation → situations where major positive or negative fundamental change significantly alters the relation of money going into the "box" to money out.*

*Our **Change Function** focuses on **user experience** when assessing one critical type of change – the likely adoption of new technologies. Inside our Change Function, we assess a user's current pain versus their perceived pain of adopting a solution. We think the **supply** of new technologies is a necessary but not sufficient part of the adoption process. We focus **our** energy on the users...*

About Change ...

*"A crisis can be defined as a severe change. It is interesting that the Chinese do not have a word for crisis. What they do have, however, is a two-word idiom: crisis equals danger and opportunity..."... Bennett Goodspeed, *The Tao Jones Averages**

The Change Function meets Everything...

...well, a little bit of everything

So... a couple weeks back when we were prepping for our first conference call with folks in a while, we thought that a bit of an update on our thinking across a wide swath of topics was in order so I started to make a short list of some of the topics that have been rumbling through our head since we started up Coburn Ventures and to this we must thank our friend Andy Kaplan again who recommended we hire our COO David Harvey with nothing short of the highest recommendation...

...cuz without David Harvey in organization we would have spent the first three months figuring out steadily that we needed a COO as crisis after crisis arose and then we would have cried wolf and started a frantic desperate search for a needle in a hay stack...

... instead we have had a lot of time to read, think, write... lots of time to review data, convert data to information and most importantly information into insight... data point

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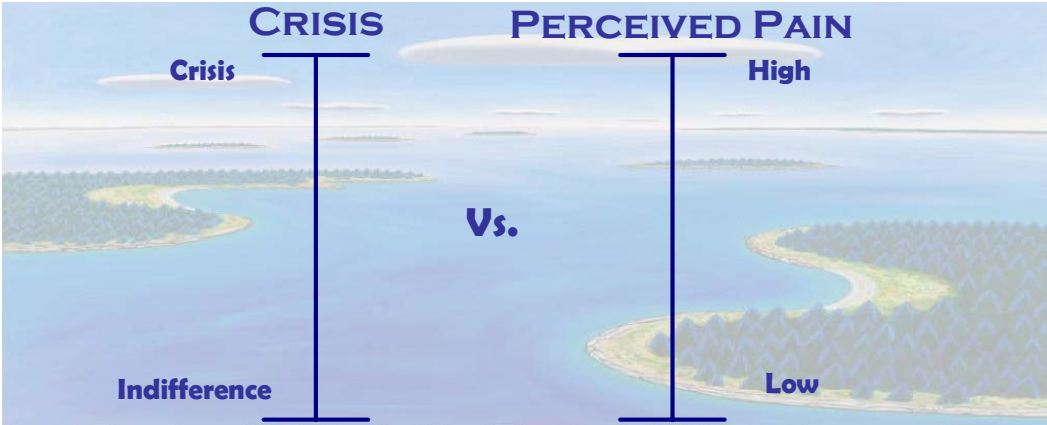
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investing is tough work out there since the traders in the crowd seem to flush out data point “investing” faster than investors can at any rate – I was a trader long long ago and I just don’t see many investors that have both sets of skills...

Insight investing is tough for a different reason in that you would need to develop some mental models or filters to assess all the data and information – data put into a context – so as to have confidence in how to interpret the whole mess. This is the game we aim to play at. Insight investing helps generate deep deep conviction on why the world will do whatever it will do and is predictive as opposed to reactive...

Data point “investing” does not generate conviction. Insight investing can. Building high convictions in our investments is our goal.



Very very importantly -- you will be the judge as always on whether anything we blabber out about our convictions seems insightful for your purposes...

...well, we have had so many bottled up thoughts that when we started to jot down a thing or two it turned into a quasi-monstrous list...

So below... is a quasi-organized list of our convictions with some more spelled out and supported here than others... the emphasis is on efficiency and since this is the final Waypoints Beta for investors before we hope you choose to sign up as a member we decided to bring you all up to speed with our hallucinations... feel free to call or email during the next week if you would like greater clarification... Dave, Faye, Pam and I are happy to round out the thinking for you....

Finally... we cover, perhaps, a mere 25% of the tech landscape with these views below so sorry if we did not address the one you were interested and beware of more views ahead...

Like most everything we conjure up our compass somehow or another, from this angle or that is the *Change Function* that says users change habits when the current state is more painful than their perception of an alternative... “users” can be anyone in the food chain...

The *Change Function* is a tool that acts as our compass... Here we go...

THE BIG BIG PICTURE

- Getting to **the next billion users** will largely be about ease of use as with many industries that aim to extend themselves... there will be approximately 2bn mobile phone users globally by year end so the next billion could be thought of as getting from 2bn to 3bn or 33% penetration of Earthlings to 50%. Those are big big numbers.
- **The next billion users will be about emerging markets and lower economic groups** as is the case in many industries that aim to extend themselves... net adds in mobile users in Wall Street forecasts call for 330m in 2005 and another 300m in 2006.
- Digital demographic changes help all products become less onerous since the addressable market of users is filled with more digital natives and digital immigrants that are more adept and less scared of technology in general. **This Digital Demographic shift is the biggest change of all since it systematically reduces the total perceived pain of adoption of ALL technology products.**
- The key ingredients of success for the next decade will be practical → simplicity, ease of use, security, integration... **Gee whiz technology will be lampooned.**
- Themes – these are inherent wants/needs of users – remain steady for long periods of time: **mobility, integration, virtualization, communication, digital consumer revolution, reducing total perceived pain of adoption...** personalization and security are prominent sub-themes...
- Maturing companies will keep consolidating but many tier two and three players will fail to be consumed by others.
- Major changes in research and development will occur during the next five to ten years → R&D as a percent of sales will drop and projects will become more practical in general carrying the banner “ease of use”...

“All truths go through three stages. First, it is ridiculed; second it is violently opposed; and third, it is accepted as self-evident”... Schopenhauer

THE BIG PICTURE

- I do NOT think we are entering a decade of **converged** services so much as one gigantic **COLLISION** among previously separated peers... this “COLLISION” concept is not mine but I forget who introduced it to me about four months ago... From my standpoint “collision” says it all much better since “convergence” might be mistaken as somewhat serene relative to what we will likely witness...
- Everyone will seemingly be part of the **COLLISION**: ask Intel, Microsoft... Telefonica, KPN, Vodafone...
- **The “ubiquitous CLOUD” will be the hottest topic in technology inside three years...** this notion will include everything from public Wi-Fi zones to fixed:mobile convergence in the enterprise and VoIP as well... In the old days – like 1996 – everyone would show organized diagrams of how all “communication” fed into a fluffy cloud and came out neatly on the other side... Now I think more in terms of all of us continually inescapably inside the cloud... there is no “connecting to” so much since we are “continually in” the CLOUD... kinda like fog and it

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all may feel very foggy... “The FOG” may be more appropriate similar to “collision” but look for spin doctors to retain the “cloud” metaphor since “fog” doesn’t come off so well...

- ***The lead indicator of the CLOUD/FOG is daytime traffic at Starbucks between the hours of 10an-Noon and 2-4pm...*** these outlets are getting more crowded at those times with people finding a “third place” to work not just chat... If people start changing their work habits before long they will demand always-on connection to the network. The CLOUD/FOG will be a response to changing work/life patterns.
- The key issues surrounding the CLOUD/FOG will not be technological or price but rather cultural readiness... we did see one report that 20%+ of business travelers use Wi-Fi capabilities when they travel... encouraging number frankly...

Convergence?
No.

Collision?
Yes

WIRELESS

- 3G → I must be weird or something but ***I am still waiting for the compelling apps*** as opposed to getting more availability of cheaper handsets or better hyping – I mean marketing, of course... estimates for wcdma are approximately 45m this year and another 90m in 2006... may be a bit aggressive...
- ***Data to the mobile phone is compelling and addictive but much of it doesn’t require 3G bandwidth*** – EVDO will thrive and set the stage for a cultural shift toward 3G usage... users are open minded to using bandwidth hogging apps if we can figure out what they are... 60 second video clips will eventually emerge as an important one...
- ***Presence*** will be important but we ain’t ready culturally and it won’t be presence in a typical PUSH sense of jamming McDonalds ads at unsuspecting geographic intruders.
- ***Qualcomm → seems to be turning the corner*** with rising estimates and will likely do fine as the promise of 3G royalty streams taking off are perpetually “just around the corner” making it a very difficult short on 3G delay and it is too early to get frightened of how 4G might change the game against Qualcomm though on some days folks hyper-ventilate about the distant future → 4G is a ways ways off so betting on whether Qualcomm will be there then is a low conviction activity...
- ***The Chinese will keep waiting for the home grown TD-SCDMA before issuing 3G licenses...*** there is no vital hurry and while the 2008 Olympics are a big driver to change in China the 3G selection process is not hostage to the timing of the games.
- There is a market for over the air music downloads at high prices but phones won’t need that much music storage on a handset – Folks pay for convenience of having the song downloaded immediately... this market is already established in Japan and presaged by the ring tone market globally.
- Music over the air to a cell phone is similar in nature to the camera phone... In Korea each is a standard feature but neither are best of breed in that form factor.

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- **TV? No... Short video clips? Yes** (answers the important question “what will I do with the next 60 seconds while I am waiting for fill-in-the-blank” much as the Blackberry does)
- **WiMax will be used in very limited fashions as opposed to becoming a broadly deployed revolutionary technology** – Intel will struggle in selling WiMax to carriers to a degree reminiscent but perhaps harsher than Cisco approaching the carriers with IP in the mid-to-late 1990s.
- WIBRO in Korea will be a lead indicator for WiMax success → the need for voice to assist in creating broadly powerful economics will become more obvious. **We don't expect WIBRO to be a hit any time soon.**

The “ubiquitous CLOUD” will be the hottest topic in technology inside three years ...

DEVICES

- I do NOT like the notion that a converged device will arrive → instead, I expect **we will continue to carry more and more devices** and favor best fit products as opposed to those that consider our broken backs and swelling pockets.
- **I do NOT think the smart phone is smart at all** but mobile email will help stimulate some interest though Windows Mobile won't.
- I think the Intel Handtop concept is way way off base just as the smart phone and the Tablet were.
- **I think the iPod and satellite radio will both thrive in the car...** just cuz you can't do each simultaneously doesn't mean you won't want your option to choose from the two whenever you want!!!
- **I think satellite radio outside of the car will struggle to make a wide impact on its own** – the wearable/portable radio market will likely be modest.
- Though I am not a fan, I expect Howard Stern's entrance into satellite radio will be a gigantic deal.

“Every act of creation first of all is an act of destruction, because the new idea will destroy what a lot of people believe is essential to the survival of their intellectual world...”... Pablo Picasso

SERVICES

- **We are entering the early stages of the “ubiquitous CLOUD/FOG”**
- Mid day traffic and habits at Starbucks are a fantastic lead indicator for demand for the **“ubiquitous CLOUD/FOG”** – without changing work habits including working from “third places” there will be little demand for the ubiquitous cloud more broadly.
- As more folks change business habits/practices they will demand Wi-Fi and actually use it – as opposed to Intel simply jamming it thru the channel into our laptops.

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- **Churn rates will go up, not down, during the next 10yrs** although the idea behind triple play is to keep churn low – the broader collision will make the attempt to keep churn down futile as each provider will demand you choose between Us and Them.
- Cables in the U.S. will play pricing tit-for-tat on a market by market basis as telcos rollout television services.
- **IPTV is not compelling... folks will steadily but slowly respond to package pricing from all parties.**
- Estimates for year end triple play customers on Verizon recently dropped... Life outside the initial test market of Keller, Texas will be substantially different when focus needs to be reduced in order to test economics... **investors will be stunned how long it might take to go from a test market to a broader effective roll out.**
- Telcos are NOT dumb but they have different incentives than publicly imagined... these are organizations first and foremost with a duty to their shareholders as opposed to community servants... anyone thinking differently about what these companies should do in creating a better society will be disappointed → telcos will use regulation/lobbying/stalling as defense number one and they are good at all three.
- **Embedded wireless broadband from Verizon in Dell laptops is interesting in lowering the total perceived pain of adoption** but will likely fail in its first go round as the crisis for this service is far lower today than the total perceived pain of adoption.
- **DVR technology – digital video recorder -- will be quickly given away.** In comparing pseudo-verbs: society is not broadly ready to TiVo as they are to iPod...
- BBC's iMP plan to let shows go to the Internet with a short delay is well worth watching even without all the features of a TiVo – regulation on TV thru Europe is also worth keeping close tabs on.

*“People hate change...
And that’s because people
hate change... I want to be
sure that you get my point.
People really hate change.
They really, really do.”...
Steve McMenamin Atlantic
Systems Guild*

MEDIA

- Key questions for media players without answers are advertising and DRM → for all of us mad at the media folks delaying progress and not developing a model in sync with the Internet we sure haven't heard many good suggestions... **regulation/lobbying/delaying seems like a reasonable approach when looking from their shareholders interests** – every eDonkey that folds allows folks at media companies and their shareholders to live an extra day...
- Libraries are OK but Intellectual Property value seemingly falls off with a shorter and shorter half life on “content” in sync with a more and more near-term societal orientation...
- **“Content is not king”** and neither is “the network”... users are king... remember the old days when we all hallucinated that someone other than users was in charge? Neither do we.
- **Advertising is in a whole lot of trouble → ad agencies guru-like status has vanished.**

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- **3 changes: online for newspaper, satellite radio for radio, PVR for TV will create a traumatic and unstoppable change across the next 5-10 yrs...** unlike the RIAA representing the music industry the advertising ecosystem is devoid of superb lobbying efforts that can force advertisers to advertise on their mediums even if they don't want to!
- Data points from Federated Department Stores shift in ad spend and the NY Times' routine earnings misses are part of the new normal.

GOOGLE WORLD

- **EBay and Skype** will be looked at as an odd asterisk at \$4.1bn since Microsoft paid likely no more than perhaps \$30mm for Teleo.
- I do not see the synergies or hear a crisp elevator story from EBay management about this deal that I can quickly get behind – I wrote a lengthy always on piece on all this www.always-on-network.com
- The Google world conspiracy theory is well premature if it is at all remotely on target – the company is planning to roll out 1000 WiFi nodes in SF if the city chooses them... will be free service -- other bidders and the WSJ makes it sound like they are set to take over the planet ... but there's a big difference between taking over one's home town and taking over the planet.
- VCs are again excited and sense there are exit strategies if something of value is created though that strategy is not likely to be an IPO.
- **Google may be less liked in industry than Microsoft inside 12-months.**

SOFTWARE

- **No relief in sight to the steady demise of software** – just tactical steps to slow down the slow moving car accident... we are happy shorting baskets of mediocre tier two and tier three software companies... the 8-15% premium on takeouts are modest punishment – most companies will not get bought but, rather, will become irrelevant.
- Software's demise is faster than I thought two years ago.
- Numerous changes: ASPs, service-oriented architectures/web services, Indian offshoring, open source, maintenance negotiations – **steady threats.**
- **End-to-end plays** against the majority of software companies pleading for survival.
- **Maintenance fees will come under greater and greater pressure** so best of luck buying software companies for take out predicated on those contracts being solid.
- **Salesforce is "about" their culture in selling low and co-design/iteration as opposed to "just" an ASP play.**
- Salesforce's name is being dropped a LOT in many venues! Huge lead indicator that it will be a standard in this space.

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- Salesforce's customer relationship management opportunity is **way way under understood!** Ten years from now most folks will feel stupid at a cocktail party if they don't employ some form of CRM in their business life. Today the market is, maybe 6mm installed seats but in ten years it might be 60mm.

Oracle/Siebel is great for Salesforce – period.

- **Will IBM lose the Siebel relationship?** Kinda – across time no one is gonna play nice if they don't have a really great reason.
- Oracle/Siebel does make sense from Oracle's perspective – **crush R&D and sales.**
- **"Service-oriented architecture"** talk is now serious BUT still requires a massive cultural pain in adoption to run thru organizations.
- **Deal mania** will continue at small premiums WHILE reality grows that there are only a few successful models.

Steady threats to the software industry's current model ...

*Open source
Offshoring
ASPs
End to end
Maintenance Price
Decline
Dual Core
Virtualization*

BIG TRENDS

3 Things Andy Kessler reminds us about in *Running Money...*

Find monstrous markets

Where one competitor has an unfair advantage

And has a business model to leverage the unfair advantage

We want to add here that we work to avoid getting bored because we have heard a story more than say a couple times... great stories can work for a long time...

"Don't fret if you can't identify hot products during the early adopter phase. For the truly great companies, you can miss a surprising amount of the early growth without missing the big returns. Consider the case of Microsoft. The company went public in 1986. Between 1986 and 1990, when Microsoft introduced windows 3.0 -- the version that caused windows to become a standard -- the stock went from \$21 to \$71.50 after two two-for-one stock splits. If you bought the stock at the end of 1990, six months after windows 3.0 shipped, your return over the next decade would have been 2067 percent..."... Roger McNamee in The New Normal

7 Gigantic Trends many investors are already bored with but will run for years... ☺

Flat Panels – Corning

CRM market – Salesforce.com

Enterprise Mobile Email – RIMM

Satellite Radio – XM Radio

Digital Demographic Shift -- Apple

Indian offshoring – Infosys, TCS

BI -- Business Objects -- Hyperion

Broad Tech

- **Valuations:** The big companies are in line with the mkt multiple as has been the case much of this year -- no problem
- **Valuations:** Smaller caps and semis still trade as though we are truly special
- **Earnings are not THE thing** -- stable... technology is about stock picking not merely having huge up draft like 90s hedge funds enjoyed
- The tech market will work in tandem with the rest of the stock market but with slightly greater volatility... tech will not move to its own drummer as it did during the 1994-2002 period.
- Like VCs needing now to build real companies investors may have an opportunity to invest in real companies (and short those likely to fall)
- **Tech stocks generally now follow the market** with a tad greater volatility but not much! These stocks do NOT march to their own drummer
- **Not worried about the consumer** -- credit cards are secular and secular tech helps out

*“Now that we have progress so rapid that it can be observed from year to year, no one calls it progress. People call it change, and rather than yearn for it, they brace themselves against its force...” ...
Stewart Brand, *The Clock of the Long Now**

And finally as an important note: Those folks who a few years ago said that while the Internet stock bubble was bursting that the Internet economy was just beginning have been completely right! We are still in the early stages of a major economic shift including globalization at a richer level. As one indicator of the separation of stocks from reality, far fewer people today than I sit next to on airplanes want to give me their stock picks so much as they want to tell me what they are doing with technology!

Waypoints 4.0: Sell Ideas...

Today we're primarily gonna talk about how we pick our Sell ideas...

First, a tad more about why we're spending so much time and energy focusing on *stock ideas*, as opposed to making sector or macro bets ...

So ... the last **big** sector / macro opportunity came in 1Q 2003 when tech's estimates finally bottomed. Back then, making just about any bet on *operating leverage* – semis, semi equipment, EMS, components – was a winner.

Problem is ... we haven't had a similar opportunity in almost 3 years ...

...and....

... we don't expect to have another broad opportunity like it – on the upside or down – for another 3-5 years. Growth is slow ... estimates are neither too high nor too low ... and volatility is relatively low.

The upshot → Today – unlike the 1990s – tech investing is about picking stocks.

So, how do we pick'em??

Well, we talked about this in Waypoints 1.0 ...so we won't re-hash it all, but while reading Andy Kessler's *Running Money* last week, we thought of a new wrinkle that's proven helpful for us in our investment meetings, and we wanted to share...

In the interest of time, we're going to skip any discussion of how we pick **Warren Buffett** large cap names or **Successful Restructures** and instead focus on how we identify the more exciting **Growth stories**.

... oh ... and yes ... all this stuff will eventually lead to a discussion about sell ideas...we promise...

OK ... so ... to identify growth stories, we ...

- **Step 1:** Using our Change Framework as a guide, we identify **Themes** we believe in ... themes that users have a demand for...
 - *6 favorites: Communication addiction, User Experience, Mobility, Integration, Virtual Org, Content/Digital Home*
- **Step 2:** We then identify **Products** that are plays off this theme.
 - *Examples: BlackBerry, Flat Panels, Satellite Radio, Offshore Outsourcing...*
- **Step 3:** We then find **Companies** that are exposed to these products.
 - *Examples: RIMM, Corning, XM Satellite Radio, Infosys, Apple and Salesforce.com for "user experience" ...*

If you missed our discussions about top picks

RIMM
Apple
CRM
XMSR

... and are interested, please come visit at

www.coburnventures.com

- **Step 4:** Looking into the financials of such companies, we then ask “*does this company make for a good stock?*”

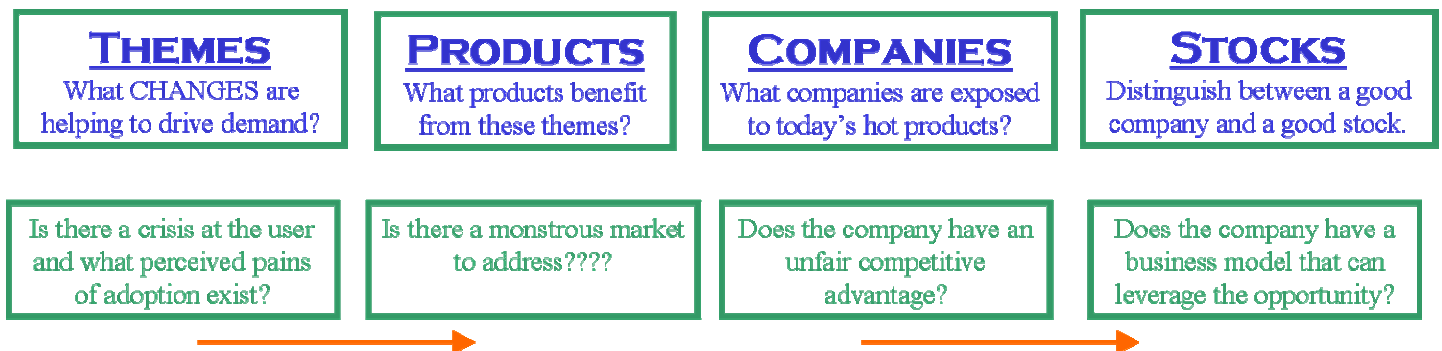
Now ... back to Andy Kessler and *Running Money*... Andy cites an investment philosophy of Don Valentine that essentially says we want to own stocks that:

→ *have a monstrous market to address ...*

→ *have an unfair competitive advantage*

→ *have a business model that effectively takes advantage of these opportunities.*

In an investment meeting this week, we layered Andy’s framework on top of ours ... and it helped crystallize our thinking a bit more ...



Now ... what companies fit this framework? Who are our top buy ideas?

In Waypoints 1.0, 2.0, and 3.0 ... we spent a good deal of time talking about four of our favorite buy ideas that fit this framework -- *RIMM, Apple, Salesforce.com, and XM Satellite Radio* – and even dug into their financials to see what type of leverage they had in their models.

Great ...now how ‘bout the Sells? ... How do you pick them?

Ah yes...

Sell Ideas...

Well, at the risk of oversimplifying things, let’s see what happens if we just invert Don Valentine’s framework. So ...we ask ... what stocks ...

→ *Address markets that are either shrinking or have expectations that are too high?*

→ *Have no competitive advantage ...or worse yet, increased competition?*

→ *Have business models where such negative fundamental change materially affects earnings or valuation?*

... makes sense... let's dig deeper.

What we did next was spend some time identifying some "Sell" themes that fit points 1 and 2 above – *shrinking markets and increased competition* – and then we modeled some companies to see what how the themes might affect financials. We'll hit New York Times and Altiris today... and come back to plenty more down the road...

Sell Theme #1: Death of software

Our take: Lotsa secular Cold Tech themes will eat away at the overall software revenue pie over the next several years. Things like:

Offshore outsourcing
Open Source
The ASP model
Maintenance pricing renegotiations
The shift toward "end-to-end" from best of breed

The upshot → growth is slowing in the software industry and small cap software names are mispositioned. There will be acquisitions – a clear risk of being overly negative on the group – but premiums are lowwww. ORCL / SEBL → 16%; SSA / EPNY → 8% premium; BEA / PLUM → 13%.

Software names we have in our Sell or Sell candidates list → SonicWall, RSA, WebMethods, Altiris, BMC, Serena, RSA, Novell, Viisage, JDA

Sell Theme #2: Un-natural end-to-ends

Here, we include faultily designed roll-ups.

Our thinking → when a management team is faced with an desperately shrinking revenue base, they can either shrink their business model and become much more process efficient – in the spirit of James Utterback's Mastering the Dynamics of Innovation – and maybe someday sell themselves ...

... or ...

... they can go on a buying spree with all that cash left over from the bubble to become a "super company" with a gazillion messy, small businesses that rarely end up creating value.

Companies affected: ACS, SSA Technologies, Ciena, JDSU is a candidate after their Acterna deal...

Sell Theme #3: Steamrolled → Too small to survive

Kind of an offshoot of theme #1: the whole "*slowing growth leaves small caps mispositioned*" theme isn't reserved only for software. Unless there's a well-defended barrier to entry, small caps are mispositioned all across tech. Our sell list is littered with smaller comm. equipment companies that are bumping heads in the sandbox with powerhouses like Cisco...

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Companies affected: Ciena, 3Com, Foundry, Extreme, McData, Software, Via...

Sell Theme #4: New technology is threatening old way of life ...a.k.a. the big collision.

Who's still kinda stuck in the 90s? Who's slow to adapt? Who is threatened by disruptive technologies?

... commercial free radio is threatening radio broadcasters; Google and on-line advertising is threatening newspapers; Cable operators are threatening telcos ...and vice versa; and anyone slow in participating in the shift to India is mispositioned.

Companies affected: Newspaper co's → NY Times, Knight Ridder, Journal Register,; Radio broadcasters ...Cumulus, Clear Channel; Others ... Keane, SBC...

We'll reserve some space on our sell list for those who are stuck in the 90s → those who spend too many calories innovating products, not processes – the opposite of Dell's model

Sell Theme #5: Competitive advantage vanishing

What happens when a customer that represents 25% of your revenues offloads its PC division to a company that is based near some of your closest rivals some 7000 miles away? Uh oh. Bad news for Sanmina in the case of IBM / Lenovo.

...or ... in the case of Altiris ... when a customer that represents 30% of revenues – HP – actually buys one of your close competitors in Peregrine?

...or ...when a trend that you realllly depend on is slowly declining – like, UT Starcom and the PAS cell phone market in China.

Companies affected: NTAP, Sanmina, Altiris, UT Starcom, Lexmark ...

Sell Theme #6: Serial restructurers

Some companies have found themselves in a poor position for years ...and have tried several times to re-engineer their way out of it ... to no avail. If they haven't been able to get it right in the past 5 years ...and management hasn't changed ... will they get it right now?

Companies affected: Sun, Lenovo, Lucent, Gateway ...

Sell Theme #7: Like trend, not company...

Some companies are exposed to favorable trends and will therefore be treated like “darlings” by the Street when in fact there are some troubling signs bubbling under the surface. We think of *Avaya* here. Much as we like the prospects of IP-based PBX's, we don't think the market will take off fast enough to save the company's business model...

That's it for Sell Themes ... now for some good old fashioned modeling...

Modeling NYT → The New York Times

So ... *why are we modeling NYT?*

'cuz ... well, we study change ... and when seemingly every newspaper company in the country is missing #s, we get a sense there just *might* be some big changes taking place ...

So ... zooming out ... the *change* → advertising spending – the lifeblood of the industry – is shifting from print to on-line.

Newspaper ad revenues are expected to grow about 2% in 2005 vs on-line advertising's 30%+...

"Internet advertising sales rose 33% in 2004, to \$9.6b, according to PricewaterhouseCoopers LLP. This is still a fraction of the \$141b US advertising market... so far, most of the online audience has been captured by the big internet players, not the big media companies. In August, Yahoo attracted 122m unique visitors ... by comparison, the entire range of NewsCorp Web Sites – FoxNews.com, FoxSports.com – attracted just 12m visitors ... Walt Disney ... 31m ... Viacom 40m." ... Wall Street Journal

Now ... zooming in a tad...

→ NYT derives 67% of its revenues from advertising. ☹

→ NYT has pre-announced negatively each of the last 5 qtrs. Yikes.

→ NYT's 2005 EPS estimates have fallen from about \$1.90 to \$1.60 since the beginning of the year.

→ ...and ... Some sell side notes we've seen suggest the estimate revisions are nearly over ... and that valuation wise, the bad news is priced in... ugh.

Our take? Sounds a tad like the arguments we heard about soooo many of our darling tech stocks in late 2000 when the Nasdaq was still at 3500, or late 2001 at ...um ... 1700, or .. well ... mid 2002 at 1400.

Our strong sense ...

This is not cyclical.

This is secular.

... and this seems like just the beginning.

So, the upshot: Steps 1 and 2 for our inverted version of Andy and Don's framework are intact. NYT is exposed to a market that is experiencing secular demise ... and it has no competitive advantage to fend off the fast growing on-line ad space.

Now, let's take a peek at their business model to see how much their earnings can be affected by the negative secular change...

Some observations...

- **Top line is feeling impact of secular trends: Slow growth.** Revenues grew just 2.4% in 2004 and are expected to grow under 2% this year. Looking ahead, Street consensus calls for 3.5% growth in 05 with some analysts as high as 5%. Why the recovery?
- **Revenue by segment:** Advertising makes up 67% of revs and is growing 2-3% y/y. Circulation makes up another 25% of revs and has been trending flat to down over the past few years.
- **Cash flow is fine.** NYT generates a ton of free cash flow... but typically spends it on dividends, share buybacks, or pension contributions and consequently exits each year with a relatively small amount of cash on their balance sheet. The point – we may not like the secular trends and “cash” looks low on the balance sheet – but *cash generation is not a worry.*

“A full price ad in the {Wall Street} Journal costs more than a house in Buffalo... One morning, with time to kill at a fine hotel, I interrupted a few people who were reading the Journal over breakfast. I waited until they had finished the first section, and then asked them if they could name just two of the companies that had run full page ads. Not one person could.”...Seth Godin, Purple Cow. Are advertisers waking up to this???

So ... what are our key questions and concerns?

Question #1 → First thing that we notice is that 2006 growth number of 3-5%. Why are folks expecting a rebound? Why will NYT grow faster in 2006 than 2004 or 2005?

Answers? → We haven't found a real good one other than things like “*easier comps*” or “*NYT will outgrow the industry*” or “*there's an extra week in 2006*” or “*ad spending will recover*” ... none of which are that compelling to us. **Industries don't “recover” when on the short end of secular demise. They recover when there in a cyclical trough...**

Question #2 → How sensitive is NYT's model to the negative change in this model? If the secular slowdown continues, can that 2006 EPS # go from \$1.60 to ...say ... \$1.00 or merely to \$1.50???

Let's have a look ...

→ **Base case:** Current consensus: 3.5% top line growth in 2006, gross margins of 54% and SG&A of 41% → EPS of \$1.62.

→ **Bear case #1:** If 3.5% top line turns out to be 1% and gross margins and SG&A as % of revenues are unaffected → EPS drops from \$1.62 to \$1.57.

→ **Bear case #2:** If the 3.5% top line turns out to be 1% and because of lower revenue growth, gross margins and SG&A are both negatively affected by 50bps → EPS drops from \$1.62 to \$1.43.

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	2004	2005	Base 2006	Bear Case 1 2006	Bear Case 2 2006
Revenue Growth	2.4%	1.6%	3.5%	1.0%	1.0%
Gross Margin	55.4%	54.0%	54.0%	54.0%	53.5%
SG&A	39.9%	41.1%	41.0%	41.0%	41.5%
EPS	\$1.98	\$1.54	\$1.62	\$1.57	\$1.42
Current P/E		19x	18x	19x	20x

The upshot: as far as volatility goes, NYT's op model is maybe a 6 on a scale of 1-10. Despite pre-announcing 5 consecutive quarters, its EBIT margins have "only" fallen from 17% in 2003 to 13% in 2005... certainly enough to see earnings take a hit ...but we don't get the sense further top line shortfalls are going to **completely crush** NYT's model ... not like, say, UMC in the tech space which saw gross margins fall from 40% to 0% during rough stretch from 2000 to 2002.

Can NYT management control gross margin and op ex enough to offset declining revenues?

Question #3 → Is NYT equipped with the tools to adapt and manage through secular demise? How is management addressing it?

Let's see... Recently, they've announced some layoffs to cut costs. Makes sense ... but we've seen too many tech companies trim and trim and trim and trim from 2000 to 2003 and still watched their business models decay ...

Other measures to fend off the secular threat of on-line? In last year's 10-K, we found this: *"In order to generate revenue growth going forward, the Company plans to increase the # and color capacity of the New York Times' national print sites, redesign key editorial sections and enhance its content, as well as grow the IHT and NYT.com."*

So what? We have NO idea what we'd do if we were NYT management's shoes, but this strikes us as (a) not really an effective and (b) a potentially expensive way to battle the secular threat of on-line advertising

Question #4 – What do we make of the "rapidly growing" on-line business that NYT has in-house?

In their 3Q earnings release, NYT noted that their Internet advertising business grew a healthy 28% y/y with About.com growing 41% in August.

Good news...but how much can this move the needle?

Answer → Not much. About.com makes up less than 1% of total revenues, and despite not breaking out other Internet related revenues for a year, as of last 3Q – *when NYT last broke it out* – on-line advertising comprised roughly 3% of revenues and 7% of overall operating profits...

So what? What do we do with all this?

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Well ... on one hand, we have high conviction that this secular demise ain't gonna slow down any time soon; we think there's room for 2006 #s to go down further; and we don't get the sense that the company can re-engineer itself out of this any time soon.

However, we don't get the sense that #s will crater for NYT like tech's #s did in 2001 and 2002. That is, if 2006 top line growth comes in at 0-1% instead of 4%, NYT's bottom line will feel some pain, but it likely isn't gonna get cut in half...

Net net, we're comfortable adding NYT to our "Sell" list as a core long term name, but we see NYT's future more resembling a slow moving car wreck than something falling off a cliff...

Altiris Model

Altiris is a \$430m market cap software company that helps organizations manage their IT assets more effectively. Sounds interesting since helping to manage complexity is a *major crisis* inside the typical enterprise these days ... and as of January 2005 ATRS was a high flyer, fresh off 68% top line growth in 2004 ... and a stock price at \$35 after a 1Q02 IPO at around \$8.

So why are we negative?

Well, despite a strong 2003 and 2004, today ATRS is looking more and more like a victim of our Death of Software theme ... a small, "point-solutions" company who's butting heads with larger "end-to-end" bullies in the sandbox ... and losing. As if that's not scary enough ... its largest customer – HP – recently acquired a competitor – Peregrine – putting the 31% of revenues Altiris received from HP in serious jeopardy.

All this was not lost on the Street, of course, and Altiris's share price has fallen from a January high of \$35 to \$15 today.

So ... time to call of the dogs?

Or can it go lower?

We think it can go lower... and here's why:

- **Point 1** → Despite the 50%+ share price decline in the past 9 months, ATRS shares are still trading at 26x 2006 EPS... Yikes. We'd be ok paying 26x for a fast grower if we thought estimates were going higher. But 26x for a company that has seen 2005 EPS estimates go from \$1.05 to \$0.48 over the past few months? Hmm... seems rich...
- **Point 2** → Despite seeing things deteriorate with a 30% customer, the Street still has ATRS growing 7% next year. We'll want to know how they'll pull that off ...

Red flag?

We also see that management changed the way it will report "revenues by segment" so we can't see how newspaper revenues are growing versus how on-line is growing. As of 3Q04, the segments have been merged together.

... now it's starting to feel so much like tech in 2001/2002 it's almost eerie...

- **Point 3** → On the bottom line in 2006, from that 7% top line #, earnings are expected to recover 25% in 2006. Hmm...
- **Sub-point to Points 1, 2, and 3** → Our initial instinct says that when a company experiences such a dramatic negative change – like, say, losing business from a 30% customer – the bad news ain't fully “priced in” in just one negative press release. Our initial instinct also says the ever-optimistic sell-side typically takes a few quarters to really price in negative change...

Remember in December 2000 ... when folks were expecting “tech’s” 2001 earnings to grow 25% y/y and for the next 12 months we watched them fall ...ultimately ending down 60%? So what did the Street do? By December 2001, sell siders had pegged 2002 estimates at +60% y/y ... cuz ... well, we had easy comps from 2001... and we watched that 2002 # come down to ... oh, about ... 0%. Agggghhhh....

Seems like a similar situation... but let's have a look at Altiris's model and see how the #s shake out.

Lot's to talk about ... so if you're a coffee drinker ... might not be a bad use of time to grab a cup ...

... We can wait...

OK ... so ... 2 key questions:

Question 1 → How can Altiris grow revenues 7% in 2006?

Some facts ...

- **Recent bad news:** Altiris just fell well short of 2Q estimates and 2005 revenue expectations fell from roughly \$210m to \$188m with 2005 EPS estimates falling from about \$0.86 to \$0.48.
- **HP business:** Ugh → In 1Q05, HP was a 31% customer. In 2Q, 20%. Backing into some #s, that means HP business fell from \$14.5m in 1Q to \$9.2m in 2Q... which represents a 32% y/y decline from 2Q04. Yikes.
- **Dell business: Growing** → In 1Q05, Dell was a 18% customer. In 2Q, 27%. For 1H 2005, Dell revenues have grown 8% y/y for Altiris. But it's tough to find a trend line for the Dell business → in 1Q05, it fell 13% y/y ... then grew 29% in 2Q05...
- Playing with more numbers, we see that Altiris's **non Dell and HP business** grew at roughly 50% in 1H 2005.

So, the upshot →

... as the HP business declines, Altiris will depend on continued growth from both Dell and others...

How much will it depend on non-HP business? Here's a quickie for the data junkies among us, a sensitivity shows that →

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...if the HP biz declines 30% in 2H05 and another 20% in 2006, Altiris's non-HP business would have to grow 22% in 2H05 and 13% in 2006 in order to hit current estimates.

	1Q04	2Q04	3Q04	4Q04	2004	1Q05	2Q05	Y/Y Growth		1H05
								1Q05	2Q05	
HP	\$12.7	\$13.6	\$11.4	\$13.9	\$51.6	\$14.5	\$9.2	14%	-32%	-10%
Dell	\$9.7	\$9.6	\$9.4	\$12.9	\$41.6	\$8.4	\$12.4	-13%	29%	8%
Other	\$15.0	\$16.8	\$19.9	\$21.6	\$73.0	\$23.9	\$24.7	60%	47%	53%
Total	\$37.4	\$40.0	\$40.7	\$48.4	\$166.2	\$46.9	\$46.3	25%	16%	20%

Doable?

Given the current growth trajectory in their non-HP business, it seems plausible... but the bigger question is whether the HP troubles are limited to HP or whether Altiris's difficulties run deeper...??

Tough one.

OK, before we move onto that 25% 2006 earnings #, we have one more angle to share on top line. We thought an equally interesting sensitivity involved – not ATRS's *customer base* – but their *software vs services mix*...

The basis for the discussion → any growth Altiris is experiencing at the moment is on the services front.

The numbers ...

→ for the first 6mo's of 2005, ATRS's *licenses* grew 9% while *services* grew 41% ...

→ but looking at just the 2Q, *licenses* grew 2% with *services* growing 40%...

So what?

So ... if licenses ain't growing, it's likely just a matter of time before service growth comes down. Playing with some more numbers, we find that if we assume 0% license growth in 2006, services would have to grow 16% to generate the Street's 7% top line bogey. ... maybe doable given services are growing at a 40% clip now ... but it raises an entirely separate question →

... why do we want pay 26x for a company with 0% license growth and a declining services stream...

...and this raises an even MORE interesting question...

What's going to happen to gross margins if Altiris's services business – with roughly 65% gross margins – is driving growth instead of the software biz and its 99% gross margins???

Hmmm...seems like a good time to talk about that 25% growth expected in earnings in 2006...

25% EPS Growth ...

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Now ... we suspect the coffee is starting to wear off, so we'll make this quick.

We're not going to try to determine exactly what margins will be in 2006. We just think they're gonna come down unless ATRS can start growing licenses again... so we're just going to check and see (a) what the Street's expecting and (b) how much leverage there is here...

- **Base Case approximates the Street's consensus #s** ... 7% top line, 84% gross margins, a whopping 53% SG&A as a % of sales, and R&D of 19% → getting us \$0.59 EPS.
- **Case #1 Below** → All other assumptions being equal, we slightly lower gross margin expectations – from 84% to 82% ... resulting in a \$0.49 EPS and a 30x multiple at today's prices.
- **Case #2 is more bearish** → We assume 3% top line growth – no science behind this, it's just playing with #s – and 80% margins ... and see EPS fall to \$0.39 and P/E rise to 38x. Yikes.
- **Case #3 is more bullish** → Altiris grows the top line 10%, holds margins at 84%, and manages to drop SG&A to 51% ... driving earnings to \$0.70...

	2005	Base 2006	Case 1 2006	Case 2 2006	Case 3 2006
Revenue Growth	13%	7%	7%	3%	10%
Gross Margin	85%	84%	82%	80%	84%
SG&A	53%	53%	53%	53%	51%
R&D	21%	19%	19%	19%	19%
EPS	\$0.47	\$0.59	\$0.49	\$0.39	\$0.70
Current P/E		26x	30x	38x	21x

So what do we do with all this?

Well, we're adding Altiris to our Sell list. We'll warm up to the story if ... say ... ATRS's non-HP business continues to grow at a 30-40% clip in the next few quarters ...or if licenses pick up ... or if management starts slashing costs and drives SG&A down further... But as things stand now, we ...

→ have very little conviction in 2006 top line estimates...

→ have even less conviction in 2006 EPS growth given Altiris's product mix trends...

→ don't think a 26x multiple is merited...

Upcoming Catalysts ...

Events to watch:

- Oct. 11 – Ciena Analyst Day – webcast
- Oct. 11 – Red Hat analyst day – New York, NY
- Oct. 16-21 – Gartner IT Expo – Orlando, FL

“I’d rather do something interesting, solve and interesting problem, than do something boring and get rich.” – Louis Monier.

As we type away here for release 4.0, we couldn’t help but wish we were at the Argent Hotel in San Francisco, where Web 2.0 conference kicked off yesterday. The speakers and panelists at the gathering include Barry Diller, Bran Ferren, Ray Ozzie and Omid Kordestani – the man responsible for ringing the cash register at Google... not surprisingly, the event is SOLD OUT... as in they can’t fit another person in without violating the fire safety code... will the phrase “the second wave of the internet” catch on?

You bet!

The trade show/investment conference circuit cools down a tad these next few weeks as quarterly earnings kicks off.

On Earnings: we are of the view that earnings in general is not at risk, and that minor downside/upside to numbers do not generate nearly the volatility such event used to in the bubble era – so while we will pay attention for those that fall outside 2x standard deviations of consensus, we’ll leave the guestimate nudging to the sell side.

Events to Watch

October 11 – Ciena Analyst Day ...

Is it time to call off the dogs?

We’ve been negative on Ciena for the last few years as the company continuously pushed out the time line to break even. We’ve seen some encouraging signs in the last few months, including a significant improvement in operating margins +1000 bp y/y and +800 bp q/q - and key contract wins from France Telecom and British Telecom for next gen networks.

What would we like to hear from the company on the 11th to get more positive?

- **Gross Margin improvement:** can management sustain the gross margin gains achieved in the July quarter and maintain mid 30% gross margin for the full year '06? For perspective, Ciena’s margins in FY2000 was 45%, while it’s hard to replicate the demand conditions in 2000, 45% is a

Key Events

Oct. 11: Ciena Analyst Day

Oct. 11: Red Hat Analyst Day

Oct. 16-21: Gartner IT Expo

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reasonable gross margin target for a company like Ciena... so great improvement, but still long way to go.

- **Cash flow/cash burn:** Ciena reduced the annual interest expense to \$26 from \$35 million and bought back some debt in the last year.. Can management provide a plausible plan to get to breakeven sooner than expected?
- **Top line visibility:** The contract wins at BT and France Telecom are a great shot of confidence for Ciena's turn around, though the business is lumpy from quarter to quarter. So while we think no company really has any visibility into demand, we ought to see if Ciena at least has some checks and balances especially with ADC's miss fresh on our minds.

Oct. 11 – Red Hat Analyst Day – New York

Similarly on Red Hat, the company has a history of controversial quarters and in our view an unclear business model. This last quarter looks different, where operating margins and cash flow generation were both ahead of expectations.... Is this a one off upside or is it a sustainable trend? Management promised to be more loquacious on the long term business model at the analyst meeting – we're interested... we think the analyst day will be the first step toward taking a more definitive position on Red Hat.

Oct. 16-21 – Gartner IT Expo – Orlando, FL

There will be roughly 4,000 IT folks running around Disney next week. Most of the value in attending Gartner is in roaming the halls and the impromptu show of hands surveys conducted in the small break out sessions. Our questions will be related to our "demise of software" theme:

- *What is the uptake of service oriented architectures? Will this make us feel better or worse about our strategy of shorting a basket of software stocks?*
- *Are buyers pushing back on maintenance pricing? How does this line up with the valuation assumptions behind the recent slew of installed base/maintenance focused acquisitions?*
- *How does ORCL/SEBL stack up against salesforce.com? Or are talking apples to oranges?*

Key Earnings

Oct. 10 – Apple

Oct. 11 – LG Philips

Oct. 14 – Samsung

**Oct. 18 – CDW, MOT,
YHOO**

**Oct. 19 – EMC, NYT,
JNPR**

**Oct. 20 – NOK, SBC,
ACS, GOOG**

Oct. 21 – ERICY, XRX

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Always On ...

Apple: It's the Stores, the Stores, the Stores!

For Apple, it's not about "location, location, location" or even the hottest products.

It's **The Experience** that counts.

So I am sitting here wrapping up some work and thinking on an October Saturday-afternoon in Cape Porpoise, Maine, before I retreat to a television set somewhere around the seventh inning of the Indians vs. White Sox baseball game. I am rooting for the Indians. The folks at the Wayfarer restaurant had us tuned to channel 179 on their freshly purchased XM Satellite Radio receiver to get a quick update in inning five: 0-0. Hopefully it all ends well. (Afterword: It didn't. ☹)

But, right now, let's talk about the Apple stores....

My partner Dave Bujnowski wrote more extensively and provided richer analysis in last week's *Waypoints*; ping us at www.coburnventures.com if you want the original release. Dave's a Red Sox fan by the way. My one son Tucker also likes the Red Sox. Eamon is a Yankees hold-out. I have clearly failed as a parent.

So, the point: the Apple stores more exemplify the heart and soul of Apple than the Nano, and better represent the power in the earnings model.

Yikes!

That is quite a claim. I mean, well, the **Nano** is hot!

But I can't pay too high a multiple for Apple if it is just a "hot product" company, since "**hot product**" companies often either fail to have more hot products or go through droughts.

The Apple stores, on the other hand, reflect a company that more generally caters to technology cowards, and even makes these cowards feel cool, and does so without insulting the Digital Natives in any way. Apple—the brand—can be loved by children and grandparents alike. Apple—the stores—can be loved by children and parents as well.

I interviewed Janis Nakano at Reactrix this past week for the later stages of a book I am finishing on technology and change. Janis is the leader of Reactrix's "experience design" group. "Experience Design." In the old days this would be called "content" or "creation" but experience is *much, much* vaster. The smartest companies out there on the planet are participating. The suggestion of "experience" is that users live and buy holistically and if you wanna succeed you better go to that space.

Starbucks thinks this way.

Borders thinks this way.

My public library does *not* think this way.

Apple thinks this way. Hence all the bright white stuff and crisp black graphics and genius bars and all...

Note to self: Start selling Starbucks coffee in public libraries. Allow just a little bit of talking. Watch the community center shift to the previously stale book museum.

Janis suggests that folks are thinking of "**experience design**" as a new level of competition in satisfying customers, since the market place is awful darn crowded. Remember when everyone thought the malls would be shuttered since we could certainly buy everything more *efficiently* using the Net and a telephone? Didn't happen. Efficiency is only a part of experience.

When I first heard about Apple's stores I thought: "You gotta be kidding.... Haven't the nutty folks at Gateway more than adequately and convincingly demonstrated what a monstrously terrible idea this is?"

I was totally wrong.

Gateway was selling a bunch of me-too product in distribution formats.

Apple is selling an experience to folks with differentiated products.

Apple is selling technology as friendly and not overwhelming at a store where sales folks—not tied to commissions—and "genius bar" helpers most of the time make the whole migration from Analogist to Digital Immigrant reasonably painless. The stores exemplify the broader Apple brand. The Nano represents hot products. Nothing wrong with that—and the iPod should be acknowledged as supercharging the company—but now the broader brand is more powerful than the hot products.

Apple's brand works to not have you feel stupid. Folks at Apple stores work to not have you feel stupid.

Ever hear complaints about the wait at the genius bar? Me too. Know another store that even bothers to have such a help desk?

So... if Apple were just a hot product company, we could rest assured that they would eventually suffer a drought and the share price would crash. But if Apple is a conduit for friendly "experience design," the multiple can go up since Apple is then a repeatable conduit in a world without other such conduits.

I am reading a wonderful book by Andy Kessler titled *Running Money*. He reminds us of one basic approach to finding great stocks that he learned from Sequoia's Don Valentine:

· Find monstrous markets.

· Find companies with an unfair advantage in that market...

... That also have business models that take advantage of the unfair advantage.

Apple fits this thinking and so do their stores....

Monstrous market?

Yes.

Consumer electronics and personal computers bought by those who are afraid of tech—big market. And Apple has virtually zero share today in the grand scheme of things.

Unfair advantage?

Yes.

Apple has an uncopyable culture that is attuned to a large portion of Earthlings—some large portion of which cares about what we are talking about. We see no other company likely to fill this special role...

Business model?

Yes.

The stores are a *very compelling* chunk of the overall branding of Apple, as this conduit makes a lot of money.

You may wanna take a look at this: In 2003, Apple averaged 55 stores for the year and did \$9 million in revenue per store. In 2005, Apple will average 105 stores with revenue at approximately \$22 million per store. Great, great trend. In 2003, the stores accounted for 10% of Apples revenues, and in 2005 that will look more like 16%.

But even more important: In 2005, the stores will account for approximately 35% of operating income: \$575 million of the estimated \$1.6 billion total.

There are over 700 Best Buys in North America—and over 3000 Gaps—so Apple is far from saturated at current levels. If Apple continues to cater to tech cowards—that monstrous market—and adds a mere additional 55 stores during the next two years—getting the tally up to 160 stores on average—it could hit operating income growth targets just from selling Apple products through these new stores.

That is a big deal....

If Apple already had 90% share of the market and had set up stores, we would know those sales were cannibalizing what would have happened anyway. But Apple stores are creating sales that largely would never have happened. The stores are a new conduit that will likely transcend the hot products they sell.

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Global tech stocks – Our “Buys”

RIMM FY 2006 P/E now 26x ... but CY 2006 P/E down to 19x... we'd be adding here...

Buys	Mkt Cap (\$US)	1wk %	1mo %	3mo %	12mo %	vs 50day	vs 200day	Rev Grw '05	Rev Grw '06	P/E '05	P/E '06
Activision Inc	\$4,119	1	-12	23	107	0.97	1.17	43%	9%	31	28
Apple Computer Inc	\$44,603	1	10	42	173	1.12	1.32	69%	20%	38	32
Cognizant Technology Solutions Corp	\$6,213	0	-2	-5	46	0.98	1.02	50%	40%	45	33
Corning Inc	\$28,337	4	-4	15	69	0.99	1.29	19%	17%	24	20
Salesforce.com Inc	\$2,561	1	17	22	41	1.07	1.31	81%	75%	nmf	nmf
Dell Inc	\$80,050	-2	-6	-16	-8	0.92	0.86	19%	15%	26	21
Hyperion Solutions Corp	\$1,944	6	9	14	31	1.08	1.09	13%	7%	26	23
Infosys Technologies Ltd	\$19,760	0	1	-5	25	1.02	1.04	50%	33%	48	37
Motorola Inc	\$55,109	0	0	21	18	1.02	1.24	15%	8%	20	18
Qualcomm Inc	\$74,363	3	12	36	11	1.10	1.20	16%	21%	39	32
Research In Motion Limited	\$12,554	-15	-16	-11	-12	0.89	0.89	128%	53%	32	26
Tata Consultancy Services Ltd	\$16,183	2	7	13	38	1.09	1.13	36%	31%	30	24
Texas Instruments Inc	\$51,954	-3	-4	11	40	0.98	1.16	6%	13%	23	20
XM Satellite Radio Holdings Inc	\$8,079	7	4	5	24	1.05	1.11	126%	79%	nmf	nmf
Average of All	\$25,074	2	2	16	46	1.03	1.16	44%	30%	34	26

Top 5 Core Holdings → XMSR, AAPL, RIMM, CRM, GLW

Global tech stocks – Our Buy “candidates”

... doing work on flat panel plays GNSS and Trident – monstrous market, yes. But do they have a competitive advantage? ...more work to do...

Buy Candidates	Mkt Cap (\$US)	1wk %	1mo %	3mo %	12mo %	vs 50day	vs 200day	Rev Grw '05	Rev Grw '06	P/E '05	P/E '06
Adobe Systems Inc	\$14,718	5	9	7	17	1.08	1.00	18%	14%	27	24
ATI Technologies Inc	\$3,355	-5	4	14	-20	1.04	0.87	11%	1%	47	39
Cognos Inc	\$3,457	2	1	13	3	1.01	0.96	19%	14%	28	25
Computer Sciences Corp.	\$8,679	4	4	6	-5	1.04	1.01	11%	1%	15	14
Telefon AB L.M.Ericsson	\$58,515	4	10	13	23	1.07	1.24	13%	8%	20	18
Genesis Microchip Inc	\$759	3	-15	17	51	0.91	1.24	-6%	37%	97	30
Google Inc	\$86,845	-1	8	5	125	1.05	1.29	79%	42%	55	41
Hon Hai Precision Industry Co Ltd	\$8,112	3	2	13	53	1.04	1.19	43%	29%	17	14
Juniper Networks Inc	\$12,645	0	-3	-9	-10	0.96	0.94	52%	21%	32	26
Logitech International SA	\$3,578	1	5	25	66	1.04	1.23	15%	17%	27	22
Marvell Technology Group Ltd	\$13,032	5	-1	17	59	1.02	1.18	49%	33%	56	36
Navteq Corp	\$4,801	14	18	40	47	1.17	1.27	25%	20%	55	44
SAP AG	\$53,455	1	-2	1	6	1.00	1.04	39%	9%	28	25
Sapient Corporation	\$772	1	-13	-24	-26	0.88	0.82	22%	24%	23	18
Tietoener Corp	\$2,561	-2	-1	7	12	1.00	1.06	11%	7%	18	15
TomTom NV	\$4,826	10	28	125	nmf	1.30	1.60	218%	64%	44	30
Trident Microsystems Inc	\$837	2	-5	34	181	0.97	1.42	32%	93%	nmf	36
Average of All	\$17,115	3	3	18	36	1.04	1.14	38%	26%	37	27

BETA

Waypoints Release 4.0 ... October 7, 2005

Global tech stocks – Our "Sells"

Added New York Times this week ...

Sells	Mkt Cap (\$US)	1wk %	1mo %	3mo %	12mo %	vs 50day	vs 200day	Rev Grw '05	Rev Grw '06	P/E '05	P/E '06
3Com Corp	\$1,590	4	21	18	-7	1.16	1.16	-7%	18%	nmf	nmf
Altiris Inc	\$447	8	18	10	-50	1.14	0.77	13%	6%	34	27
ACS	\$6,414	-4	-3	0	-15	0.99	0.98	5%	26%	16	15
BMC Software Inc	\$4,442	-1	-1	12	21	1.00	1.16	3%	3%	33	22
Electronic Data Systems Corp	\$11,687	2	0	15	11	1.02	1.08	-2%	0%	41	23
Extreme Networks Inc	\$551	3	0	9	-11	0.99	0.87	9%	7%	43	25
Foundry Networks Inc	\$1,828	5	10	53	27	1.11	1.26	-7%	13%	41	32
Lenovo Group Ltd	\$3,541	4	12	58	36	1.15	1.43	3%	296%	24	22
New York Times Co	\$4,209	-3	-10	-6	-27	0.91	0.84	2%	3%	19	18
RSA Security Inc	\$931	4	3	11	-37	1.01	0.93	1%	8%	26	21
Sanmina-SCI Corp	\$2,271	7	-11	-22	-42	0.92	0.79	-4%	1%	18	14
SonicWall Inc	\$409	0	8	17	-12	1.07	1.09	7%	11%	33	27
Sun Microsystems Inc	\$14,322	10	9	15	-2	1.09	1.04	-1%	10%	nmf	nmf
Utstarcom Inc	\$934	-2	3	7	-59	0.98	0.72	17%	3%	nmf	13
Via Technologies Inc	\$887	7	10	-3	3	0.99	1.15	-14%	16%	nmf	nmf
Webmethods Inc	\$365	4	-2	27	18	1.03	1.16	6%	3%	nmf	50
Average of All	\$5,774	2	2	8	-12	1.01	0.98	10%	19%	26	22

Global tech stocks: Our "Sell candidates"

Added a few radio and newspaper names this week – KRI, JRC, CCU, CMLS ...

Sell Candidates	Mkt Cap (\$US)	1wk %	1mo %	3mo %	12mo %	vs 50day	vs 200day	Rev Grw '05	Rev Grw '06	P/E '05	P/E '06
Avaya Inc	\$5,080	8	7	34	-23	1.06	0.95	20%	7%	19	16
Brocade	\$1,098	4	0	5	-32	1.00	0.82	-4%	7%	18	18
Clear Channel	\$17,625	1	0	5	1	0.98	1.00	-1%	0%	26	22
Cumulus Media Inc	\$835	2	-1	7	-14	1.00	0.95	3%	4%	29	23
Gateway Inc	\$1,054	11	9	-19	-42	0.90	0.73	8%	11%	22	15
Jda Software Group	\$421	-2	3	28	28	1.02	1.15	-1%	8%	28	22
JDS Uniphase Corp	\$3,717	3	45	50	-33	1.34	1.23	11%	60%	nmf	nmf
Journal Register Co	\$657	-2	-17	-12	-17	0.88	0.90	20%	3%	14	13
Keane Inc	\$692	3	-1	-18	-27	0.96	0.88	6%	9%	21	17
Kemet Corp	\$751	7	5	33	5	1.06	1.14	-3%	10%	nmf	76
Knight Ridder Inc	\$4,271	-1	-10	-6	-13	0.93	0.90	1%	3%	16	15
Lexmark International Inc	\$5,165	-27	-30	-31	-50	0.70	0.60	3%	5%	11	10
Lucent Technologies Inc	\$15,246	11	12	15	10	1.13	1.14	5%	6%	19	18
Marconi Corporation	\$1,175	5	11	9	-46	1.10	0.78	-17%	-4%	nmf	99
McData Corp	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf
Minebea Co Ltd	\$1,712	5	5	12	4	1.05	1.08	10%	0%	44	27
Network Appliance Inc	\$8,492	-4	-2	-19	-7	0.96	0.82	36%	26%	37	30
Novell Inc	\$2,815	5	7	22	6	1.12	1.20	1%	4%	82	52
Palm Inc	\$1,401	0	-13	-1	-10	0.88	1.02	34%	20%	19	18
Red Hat Inc	\$3,629	21	39	41	49	1.32	1.57	56%	38%	86	68
Sbc Communications Inc	\$79,162	1	-1	-1	-12	0.99	1.00	46%	7%	15	14
SMIC	\$3,087	8	-16	-20	-17	0.85	0.83	22%	35%	nmf	40
Serena Software inc	\$825	2	6	3	11	1.04	0.98	106%	15%	17	15
SSA Global Technologies Inc	\$1,203	nmf	15	44	nmf	nmf	nmf	11%	6%	18	16
Unisys Corp	\$2,302	1	1	6	-38	1.02	0.94	2%	3%	nmf	31
Viisage Technology Inc	\$195	-2	-10	-17	-37	0.88	0.82	14%	15%	nmf	nmf
Average of All	\$5,549	4	4	6	-11	1.02	0.98	14%	10%	28	29

Tech Safari: Growth Stories - 30% growth expected in 06

Communication	Mkt Cap (\$US)	1wk %	1mo %	3mo %	12mo %	vs 50day	vs 200day	Rev Grw '05	Rev Grw '06	P/E '05	P/E '06
Audiocodes LTD	\$462	5	16	9	-8	1.16	0.99	40%	23%	38	27
Broadcom Corporation	\$16,036	6	6	30	62	1.09	1.34	5%	21%	37	30
F5 Networks Inc	\$1,596	-4	1	-10	30	1.03	0.91	63%	27%	33	26
Juniper Networks Inc	\$12,645	0	-3	-9	-10	0.96	0.94	52%	21%	32	26
Marvell Technology Group Ltd	\$13,032	5	-1	17	59	1.02	1.18	49%	33%	56	36
Netgear Inc	\$754	-5	6	20	86	1.02	1.26	19%	14%	22	20
NetLogic Microsystems Inc	\$402	13	5	28	216	1.09	1.47	68%	15%	27	26
Sonus Networks Inc	\$1,403	9	21	20	14	1.14	1.18	14%	25%	93	36
Content / Digital Home	Mkt Cap (\$US)	1wk %	1mo %	3mo %	12mo %	vs 50day	vs 200day	Rev Grw '05	Rev Grw '06	P/E '05	P/E '06
Avid Technology Inc	\$1,673	-2	-9	-26	-17	0.99	0.76	31%	33%	19	15
Creative Technology Ltd	\$598	-7	-12	12	-36	0.94	0.74	nmf	nmf	nmf	nmf
MediaTek Incorporation	\$8,158	5	8	22	52	1.06	1.34	5%	23%	16	14
Scientific-Atlanta Inc.	\$5,608	1	-6	8	36	0.98	1.10	11%	14%	23	20
Sirius Satellite Radio Inc	\$9,070	5	-1	3	104	1.01	1.10	250%	141%	nmf	nmf
Tessera Technologies Inc	\$1,353	5	-10	-10	20	0.93	0.86	31%	30%	33	20
Trident Microsystems Inc	\$837	2	-5	34	181	0.97	1.42	32%	93%	nmf	36
XM Satellite Radio Holdings Inc	\$8,079	7	4	5	24	1.05	1.11	126%	79%	nmf	nmf
Integration	Mkt Cap (\$US)	1wk %	1mo %	3mo %	12mo %	vs 50day	vs 200day	Rev Grw '05	Rev Grw '06	P/E '05	P/E '06
Autodesk Inc	\$10,725	7	7	36	85	1.15	1.33	28%	24%	54	37
Autonomy Corporation PLC	\$702	0	-3	44	64	1.04	1.44	42%	31%	26	20
Business Objects SA	\$3,274	2	-1	30	41	1.04	1.24	13%	8%	29	25
Cognos Inc	\$3,457	2	1	13	3	1.01	0.96	19%	14%	28	25
Google Inc	\$86,845	-1	8	5	125	1.05	1.29	79%	42%	55	41
Hyperion Solutions Corp	\$1,944	6	9	14	31	1.08	1.09	13%	7%	26	23
Mercury Interactive Corp	\$3,196	-2	-1	-3	-3	0.97	0.88	25%	16%	25	21
Microstrategy Inc	\$961	1	-11	28	53	0.95	1.11	16%	10%	16	15
Network Appliance Inc	\$8,492	-4	-2	-19	-7	0.96	0.82	36%	26%	37	30
Trend Micro Inc	\$4,462	8	-11	-2	-27	0.96	0.85	nmf	nmf	nmf	nmf
Wind River Systems Inc	\$1,070	1	-4	-22	-6	0.88	0.87	15%	15%	nmf	43
Mobility	Mkt Cap (\$US)	1wk %	1mo %	3mo %	12mo %	vs 50day	vs 200day	Rev Grw '05	Rev Grw '06	P/E '05	P/E '06
ARM Holdings PLC	\$2,762	0	-5	-1	29	0.96	1.01	174%	19%	28	22
Gameloft	\$476	10	10	36	180	1.14	1.55	92%	54%	82	35
Garmin Ltd	\$7,478	11	16	57	58	1.17	1.36	28%	17%	28	24
High Tech Computer Corp	\$4,407	13	14	69	274	1.15	1.82	81%	35%	17	13
Hittite Microwave Corp	\$600	1	4	nmf	nmf	1.04	1.05	27%	19%	33	31
Jamdat Mobile Inc	\$451	-12	-21	-30	-27	0.78	0.84	119%	53%	24	19
Navteq Corp	\$4,801	14	18	40	47	1.17	1.27	25%	20%	55	44
Qualcomm Inc	\$74,363	3	12	36	11	1.10	1.20	16%	21%	39	32
Research In Motion Limited	\$12,554	-15	-16	-11	-12	0.89	0.89	128%	53%	32	26
Texas Instruments Inc	\$51,954	-3	-4	11	40	0.98	1.16	6%	13%	23	20
TomTom NV	\$4,826	10	28	125	nmf	1.30	1.60	218%	64%	44	30
User Experience	Mkt Cap (\$US)	1wk %	1mo %	3mo %	12mo %	vs 50day	vs 200day	Rev Grw '05	Rev Grw '06	P/E '05	P/E '06
Amazon.Com Inc	\$18,507	4	3	32	10	1.03	1.18	24%	18%	60	45
Apple Computer Inc	\$44,603	1	10	42	173	1.12	1.32	69%	20%	38	32
Applied Films Corporation	\$308	-1	-9	-21	9	0.89	0.87	-21%	11%	46	43
ATI Technologies Inc	\$3,355	-5	4	14	-20	1.04	0.87	11%	1%	47	39
Corning Inc	\$28,337	4	-4	15	69	0.99	1.29	19%	17%	24	20
Cree Inc	\$1,891	5	-2	-2	-23	0.97	0.96	27%	13%	21	23
Ebay Inc	\$54,426	3	0	20	-14	1.00	1.01	35%	29%	48	39
Genesis Microchip Inc	\$759	3	-15	17	51	0.91	1.24	-6%	37%	97	30
Kopin Corp	\$475	1	4	23	73	1.08	1.55	2%	17%	68	47
Logitech International SA	\$3,578	1	5	25	66	1.04	1.23	15%	17%	27	22
NVIDIA Corp	\$5,864	5	14	28	129	1.14	1.32	10%	18%	67	23
Virtual	Mkt Cap (\$US)	1wk %	1mo %	3mo %	12mo %	vs 50day	vs 200day	Rev Grw '05	Rev Grw '06	P/E '05	P/E '06
Citrix Systems Inc	\$4,318	6	2	16	29	1.05	1.09	18%	14%	24	22
Cognizant Technology Solutions Corp	\$6,213	0	-2	-5	46	0.98	1.02	50%	40%	45	33
HCL Technologies Ltd	\$3,303	6	12	30	32	1.12	1.31	8%	30%	25	20
Infosys Technologies Ltd	\$19,760	0	1	-5	25	1.02	1.04	50%	33%	48	37
Rightnow Technologies Inc	\$446	5	17	26	-2	1.16	1.19	37%	29%	87	56
Salesforce.com Inc	\$2,561	1	17	22	41	1.07	1.31	81%	75%	nmf	nmf
Satyam Computer Services Ltd	\$4,920	7	8	17	25	1.09	1.23	39%	35%	34	25
Tata Consultancy Services Ltd	\$16,183	2	7	13	38	1.09	1.13	36%	31%	30	24
Wipro Ltd	\$14,930	5	5	3	6	1.07	1.03	-97%	29%	42	34
AVERAGE OF ALL	\$10,453	3	3	16	45	1.04	1.15	43%	30%	39	29