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Insight on Valuation

By Peter L. Martin

Valuation is the topic we get the most questions on: What metrics do we use? How did we arrive at that target price? Valuation is an art not a science. There's no exact formula. You have to assess many factors to determine fair valuation for an industry, a sector, or a company—the top-down approach. We think the best valuation metrics are earnings or cash flow. Sometimes, other metrics are used depending on the situation, such as no earnings or poor industry fundamentals. Such metrics include total enterprise value, net asset value, discounted cash flow, and revenue multiples.

The key to valuation is finding a

common ground between all of the companies in a universe for the purpose of a fair evaluation. Typically, we work our way up the income statement until we find common ground to compare all of the companies in a particular sector. In the end, valuation is only one person's opinion and can differ from individual to individual; hence, the efficient market theory as all opinions are aggregated. A look at the collaboration sector should provide some insight into how valuation can differ within a sector.

Currently, the collaboration sector is top on the minds of most portfolio managers as the 9.11 tragedy has cut business

travel and prompted the use of Web and phone conferencing.  "Training in the Post-Terrorism Era on page 24.

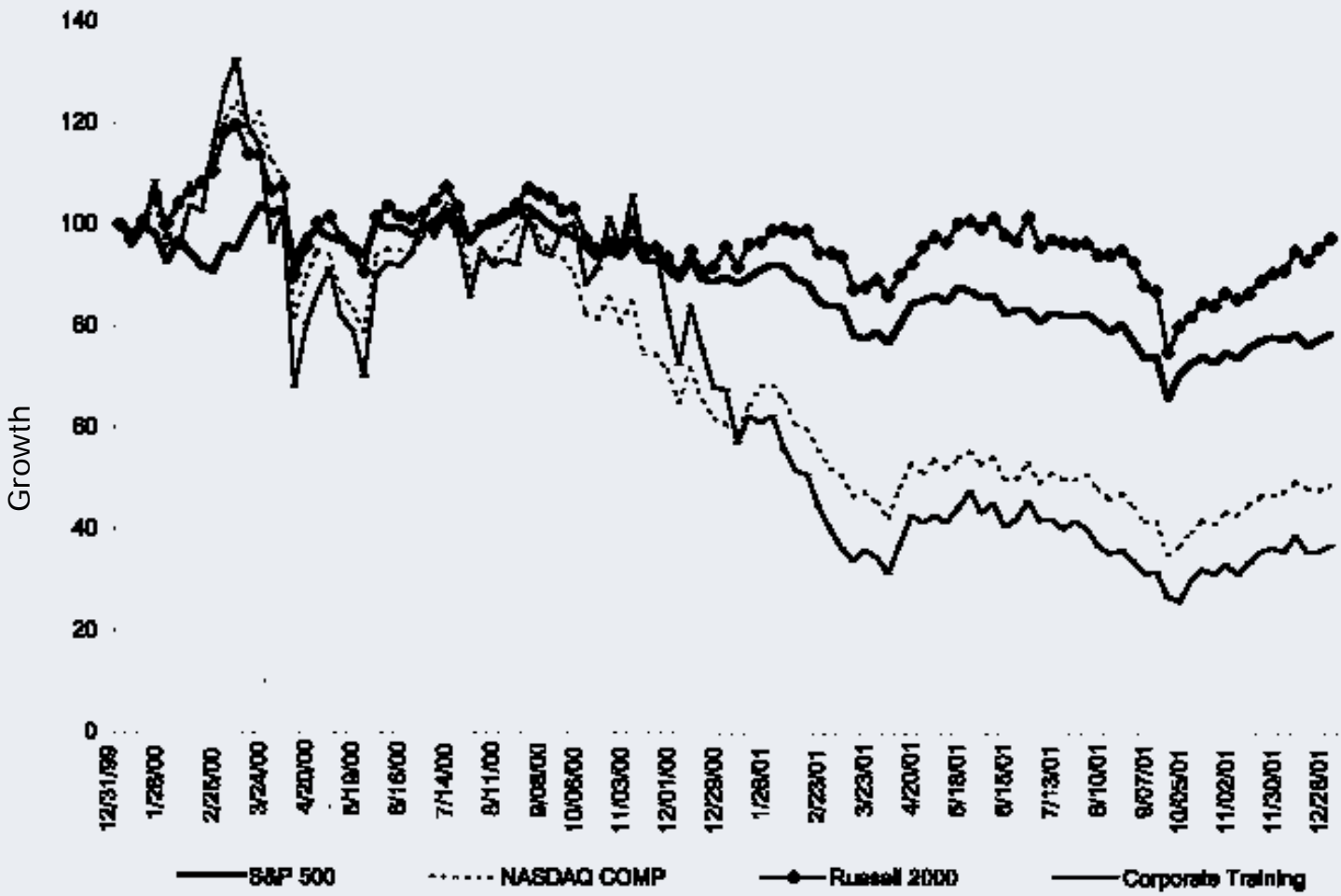
Centra, Genesys, Raindance, and WebEx are expected to benefit, so expect strong stock performance and greater valuations based on earnings upside. With strong industry and sector dynamics, the market and analysts must then focus on individual companies and their business models to gauge appropriate valuation—such as, client base, competitive positioning, sales channel, pricing power, reoccurring revenue stream, margins, and management. In the collaboration sector, there are three business models: phone conferencing, integrated phone and Web, and Web-conferencing. The traditional phone model has the lowest mar-

gins and least pricing power compared with Web-conferencing, which has the highest margins and best pricing power.

Regarding valuation metrics on individual companies, WebEx and Centra have the highest multiple based on product offering and positioning (Web-based); growth opportunity; pricing power; margins; and, most important, confidence in path to profitability. Traditional teleconferencing companies such as Genesys and Act Teleconferencing, who have modest Web offerings, have received lower valuation due to price-cutting among competitors and subsequently lower margins. Raindance, an integrated solution provider, finds itself in the middle in terms of valuation as it continues to improve margins closer to the Web pure-plays.

Web-conferencing companies have gross margins in the range of 75 to 80 percent and expectations of rapid bottom-line growth, whereas more traditional providers generate margins of 50 to 60 percent and moderate EPS growth. Those strong metrics enable Web providers such as WebEx to trade at a premium total enterprise value (TEV) to EBITDA multiple range of 30x to 45x versus the traditional audio providers, which trade at TEV/EBITDA multiple range of 5x to 10x. We use TEV to EBITDA to make an apples-to-apples comparison of all of the providers, which in several cases don't have earnings now or won't in the near future.

December performance for the corporate sector was extremely positive, rising 7.1 percent versus the S&P 500 and



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Company	Ticker	Price	52 Week		Mkt	3-Mon Avg	
		12/31	High	Low	Cap (mm)	Trdg Vol	
Infrastructure Software and Service							
Click2learn.com	CLKS	\$3.00	\$10.25	\$1.00	\$72.31	177,192	
Docent	DCNT	\$3.17	\$12.50	\$1.48	\$133.82	292,286	
RWD Technologies	RWDT	\$2.59	\$5.25	\$1.70	\$39.46	24,943	
Saba Software Systems	SABA	\$5.22	\$17.94	\$1.52	\$248.70	561,223	
Vcampus Corp.	VCMP	\$0.44	\$2.75	\$0.21	\$6.29	35,283	
					Average	\$100.12	218,186
Content Providers							
DigitalThink	DTHK	\$10.80	\$18.38	\$5.34	\$433.66	238,943	
Dow Jones & Company	DJ	\$54.73	\$64.30	\$43.05	\$3,503.81	344,855	
FactSet Research Systems	FDS	\$34.95	\$47.49	\$17.80	\$1,169.46	148,705	
John Wiley & Sons	JWa	\$23.03	\$24.10	\$17.90	\$1,140.28	44,486	
ProsoftTraining.com	POSO	\$0.98	\$15.00	\$0.29	\$23.49	145,215	
Skillssoft Corp.	SKIL	\$25.92	\$38.94	\$13.63	\$422.55	190,977	
SmartForce Public	SMTF	\$24.75	\$46.56	\$13.40	\$1,400.65	1,239,271	
					Average	\$1,156.27	336,065
Collaboration and Communication							
Act Teleconferencing	ACTT	\$7.65	\$11.97	\$3.89	\$65.94	117,398	
Centra Software	CTRA	\$8.00	\$17.14	\$3.44	\$202.18	452,102	
Eloquent	ELOQ	\$0.63	\$1.88	\$0.45	\$12.28	52,082	
Genesys	GNSY	\$6.50	\$15.29	\$4.55	\$174.20	29,698	
Mentergy	MNTED	\$2.97	\$18.00	\$0.92	\$9.01	11,853	
Nuance Communications	NUAN	\$9.10	\$58.38	\$5.65	\$299.22	534,686	
Polycm	PLCM	\$34.07	\$42.60	\$10.75	\$3,066.10	2,745,297	
Raindance Communications	RNDC	\$5.71	\$7.40	\$0.74	\$272.59	944,871	
Speechworks International	SPWX	\$11.25	\$56.00	\$4.10	\$363.68	364,394	
WebEx	WEBX	\$24.85	\$37.87	\$5.06	\$977.33	1,622,964	
Wire One Technologies	WONE	\$6.22	\$10.22	\$1.44	\$156.24	435,032	
					Average	\$508.98	664,580
Content Management							
Actuate Corp	ACTU	\$5.27	\$24.13	\$2.80	\$317.21	773,251	
Adobe Systems	ADBE	\$31.05	\$62.00	\$22.20	\$7,364.81	4,182,754	
Broadvision	BVSN	\$2.74	\$18.50	\$0.68	\$778.28	6,405,635	
Documentum	DCTM	\$21.72	\$57.47	\$5.88	\$831.42	695,851	
Imanage	IMAN	\$7.89	\$8.50	\$1.50	\$185.88	91,188	
Innodata	INOD	\$2.97	\$9.25	\$1.26	\$63.57	49,926	
Insightful Corporation	IFUL	\$2.31	\$4.44	\$1.25	\$26.14	20,598	
Interwoven	IWOV	\$9.74	\$38.63	\$3.11	\$1,016.25	2,729,539	
Macromedia	MACR	\$17.80	\$64.25	\$11.30	\$1,034.43	1,286,454	
Stellent	STEL	\$29.56	\$58.00	\$13.24	\$656.47	422,018	
Vignette Corp.	VIGN	\$5.37	\$19.50	\$3.08	\$1,319.69	5,370,464	
					Average	\$1,235.83	2,002,516
Instructor Led Training							
Corporate Executive Board	EXBD	\$36.70	\$43.60	\$22.85	\$1,277.71	448,652	
Learning Tree International	LTRE	\$27.90	\$59.75	\$14.50	\$528.43	141,089	
New Horizons Worldwide	NEWH	\$11.50	\$18.70	\$8.30	\$117.09	17,655	
Provant	POVT	\$0.55	\$6.94	\$0.32	\$11.71	103,042	
					Average	\$483.73	177,610
Average Corporate Education Companies					\$782.17	881,365	

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	Return (%)				YTD
	1-Mon	3-Mon	6-Mon	12-Mon	
	17.6	15.4	85.2	-69.2	
	46.1	53.1	-68.3	-63.8	
	7.5	35.6	-15.9	-15.4	
	-9.2	163.6	-68.2	-66.9	
	4.8	-21.4	-72.2	-47.9	
	13.3	49.3	-27.9	-52.6	
	28.3	39.7	53.8	-36.7	
	8.1	20.5	-8.3	-3.3	
	16.6	44.1	-2.1	-5.7	
	-0.7	10.3	-2.6	7.1	
	44.1	53.1	-21.6	-91.9	
	8.4	62.2	-24.3	38.2	
	11.0	51.3	-29.7	-34.1	
	16.5	40.2	-5.0	-18.1	
	-21.9	-7.8	22.4	7.4	
	20.5	-6.5	-52.9	106.5	
	5.0	-28.4	-48.8	-65.2	
	15.0	-7.1	-37.3	NA	
	-4.8	125.0	-25.8	-62.9	
	-6.6	40.0	-49.5	-78.9	
	-1.3	39.8	47.6	5.8	
	5.4	164.4	296.5	226.3	
	35.7	128.2	-28.3	-77.1	
	-22.6	17.0	-6.8	19.0	
	-10.0	1.8	15.2	36.3	
	1.3	42.4	12.0	11.7	
	10.7	25.8	-44.8	-72.4	
	-3.2	29.5	-33.9	-46.6	
	-9.0	201.1	-45.2	-76.8	
	14.9	165.2	68.1	-56.3	
	22.9	97.3	116.2	72.9	
	-1.0	48.5	-3.6	-46.0	
	-1.3	-2.9	-14.4	44.9	
	8.5	152.3	-42.4	-70.5	
	-19.8	47.0	-1.1	-70.7	
	25.6	105.3	-22.3	-42.0	
	-0.7	51.7	-39.5	-70.2	
	4.3	83.7	-5.7	-39.4	
	10.3	40.7	-12.6	-7.7	
	16.4	37.4	21.5	-43.6	
	5.7	-0.2	-23.0	-17.1	
	-8.3	44.7	-69.4	-87.2	
	6.0	30.7	-20.9	-38.9	
	7.1	53.6	-5.0	-23.3	

NASDAQ, which rose 0.7 percent and 2.1 percent. Since October, the group is up almost 54 percent off its bottom following the 9.11 sell-off. That strong performance is due to stocks being extremely oversold (cheap) heading into October because of the poor economic environment after 9.11. Investors with patience and foresight are positioning their portfolios in anticipation of an economic recovery in the back half of 2002.

Corporate training stocks are a great way to leverage an economic recovery as businesses rekindle training projects because of rising confidence within the economy, so expect an improved earnings outlook for training vendors. In December, the content stocks led the group with a 16.5 percent increase; Prosoft Training was up almost 44 percent. The infrastructure stocks continued their strong performance, with Click2learn up 18 percent after raising almost \$10 million in capital for growth purposes. The collaboration sector moved up slightly—1.3 percent.

The momentum behind the group continues to wane due to the lofty valuation of the group as a whole. These stocks will have to provide strong earnings outlooks for 2002 and 2003 to justify current valuation.

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