



# THE WAKE UP CALL

## Software, Electronic Commerce

April 12, 2001

724 SOLUTIONS INC. (SVNX US\$10.66, NASDAQ; SVN C\$17.25, TSE)

CERTICOM CORP (CERT US\$8.40, NASDAQ; CIC C\$13.25, TSE)

DIVERSINET CORP. (DVNT US\$1.83, NASDAQ SC)

INFOWAVE SOFTWARE INC. (IW C\$2.74, TSE)

INTRINSYC SOFTWARE INC. (ICS C\$1.55, TSE)

Farhan Syed, CFA (416) 864-3689; fsyed@yorkton.com

### *Multiple Reduction Based on Environment. Lowering Targets Across Wireless Software Names.*

**EVENT:** We are lowering the valuation multiples for our group of wireless and infrastructure software companies by approximately one third. We are maintaining our relative recommendations but note that we expect further potential short-term weakness within the wireless sector. For many of the companies we follow short-term revenue risk is mitigated by the low revenue expectations given the early stages of these businesses and already depressed share prices. Our forecasts for the next quarter of each of the firms below range from US\$1.1 million to US\$13.0 million. Short and medium term risk does exist and it would be naive to not acknowledge this. Our recommendations and more precisely our targets are intended for approximate one-year horizons and presume technology companies rally to a degree within that timeframe.

**COMMENTS:** The wireless sector has been hit hard on two fronts of late, weakness in technology spending related to the uncertainty of the current economic environment and an admission by many infrastructure providers that the timeline for launches of next generation services were overly optimistic. We believe this difficult-to-quantify revision of short and long term growth rates has been largely priced into many of the wireless software and services stocks and in some cases has been overdone. We are confident that wireless delivery of data including mobile Internet applications is beginning to take hold. We believe there will be a slow and steady migration path towards next generation wireless services and "S" shaped consumer and enterprise adoption curves. Investors must build a reasonable timeframe into their expectations.

Our target reductions are a reflection of investor sentiment and willingness to pay for growth and not a statement on company operations, which for the most part continue to move forward positively as described below. We note that each of the following firms presents a unique value proposition, business model, core competency and focus and that although we group them as wireless infrastructure software companies, they are more different than alike from those perspectives and should be viewed as such.

One commonality in each of the companies is that all are building infrastructure and applications optimized for use in today's 2G network environments. We believe the early infrastructure leaders will carry their respective leads into future technology generations. Thus when choosing which stocks to own, investors should focus on management, technology lead, distribution channels, business models and outlook including revenue visibility and balance sheet strength. We briefly examine each of these in the context of our target reductions.

### SUMMARY:

Summary of recommendations US\$, unless denoted otherwise								
Company	Ticker	Share Price 12-Apr	52-Week		Market Cap. (\$mm)	Recommendation	Target	
			High	Low			Previous	Revised
724 Solutions	SVNX	10.66	125.38	7.75	603	2-Buy	\$ 40.00	\$ 25.00
Certicom	CERT	8.40	71.00	5.01	256	2-Buy	31.00	21.00
Diversinet	DVNT	1.83	18.00	1.00	48	2-Buy (Speculative)	NA	6.00
Infowave Software (C\$)	IW	2.74	34.00	2.40	64	4-Hold	6.00	4.00
Intrinsyc Software (C\$)	ICS	1.55	3.45	1.12	50	2-Buy	7.00	4.50

This report is based on information available to the public. Information presented, while obtained from sources we believe to be reliable, is not guaranteed either as to accuracy or completeness. Estimates and projections contained herein are Yorkton's own or obtained from our consultants. This report is not an offer to buy or sell or a solicitation of an offer to buy or sell the securities mentioned herein. This research material is approved by Yorkton Securities Inc., which is regulated by SFA for the conduct of investment business in the U.K. Approval is only to the extent defined in Section 57 of the Financial Services Act 1986. The investments or investment services, which are the subject of this research material, are not available for private customers as defined by the SFA. Yorkton Capital Inc. accepts responsibility for the contents of this report and U.S. persons receiving this report and wishing to effect a transaction in any security described herein should do so with Yorkton Capital Inc. Yorkton Securities Inc., Yorkton Capital Inc. and their respective officers and directors has, or may have, a position or holding in, or may effect transactions in the investments concerned, or related investments, and is providing, or has provided within the last three years, significant advice or investment services in relation to the investments concerned or related investments. Yorkton Securities Inc. has or may perform financial advisory, investment banking, or other services for the companies mentioned herein. Copyright Yorkton Securities Inc. under the Berne Convention. All rights reserved. No part of the publication may be reproduced without the written permission of the publishers. Printed in Canada.

**COMPANY NOTES:****724 Solutions Inc., SVNX US\$10.66; US\$603 million market cap; 2-BUY; US\$25 Target**

**Management:** We believe 724 possesses a strong management team which was bolstered through the acquisition of TANTAU Software. This is exemplified through management's recently executed series of well-placed business acquisitions including ezlogin.com, Spyonit and Webhelp technologies which have been well integrated and fit the firm's overall strategy.

**Technology:** 724's key technological differences include its rich application suite consisting of alerts, aggregation technology and customer service, its security capabilities and the scalability of its transactional infrastructure. As a vertically focussed package we believe this represents a powerful combination of services.

**Distribution Channels:** While a plethora of wireless middleware providers have arisen in the last year, we have not observed one which can rival the powerful global distribution channels and reference clients that 724 has built including Citicorp (C, NYSE), Wells Fargo (WFC, NYSE) and Bank of America (BAC, NYSE).

**Business Model Outlook:** The company's business model is attractive in sharing in the upside as wireless penetration grows. With the acquisition of TANTAU and its traditional licensing model, forecast revenues are subject to higher variability and a greater degree of risk. We expect 724 to continue adding financial institution clients as well as enterprises, portals and carriers in the coming year.

**Valuation:** We are lowering our target on 724 Solutions from US\$40 to US\$25. Our target had been based upon a 60 times multiple of forward F2003 EPS discounted back two years. We are lowering this multiple to 40 times to arrive at a US\$25 target.

**Certicom Corp. CERT US\$8.40; US\$256 million market cap; 2-BUY; US\$21 Target**

**Management:** Certicom management has delivered on the timely launch of two new products in recent months and launched a European office. We hope to see further additions to management in Europe and Asia in the near to mid-term.

**Technology:** We believe Certicom possesses a leading defensible core technology and an expanding portfolio of wireless security products. This continues to be validated as the number of firms using and licensing its elliptic curve cryptography grows monthly.

**Distribution Channels:** The company's direct sales force has garnered wireless leaders to adopt its technology including 724 Solutions, Aether Systems, RIM and PALM. As Certicom rolls out its latest suite of products, we expect many of its existing OEM licensees to become adopters and distributors of its latest products.

**Business Model Outlook:** The company has grown 20% sequentially the last eight quarters and we are forecasting continued strong growth. Revenue typically consists of base license fees and ongoing maintenance as well as recurrent revenue related to core technology licensing. Certicom has just begun offering full wireless public key infrastructure and services in addition to virtual private network software. The software model is based on license and maintenance fees while its Certificate Authority service represents a recurrent per user revenue model.

**Valuation:** We are lowering our target on Certicom from US\$31 to US\$21. We have valued Certicom on a revenue multiple basis utilizing a fifteen times F2002 revenue multiple; we are lowering our multiple to ten times revenue. This is consistent with the valuations of our wireless and security software peer group.

**Diversinet Corp., DVNT US\$1.83; US\$48 million market cap; 2-SPECULATIVE BUY; US\$6 Target**

**Management:** Relatively recent management additions include Richard Palmer, CFO, and Ed Karthaus, Head of North American sales. Both add experience and credibility to Diversinet.

**Technology:** In September 2000, the Yankee Group consulting firm rated Diversinet's PKI solution as the global leader in terms of availability and functionality. The firm is on version four of its software, which offers broad compatibility with devices and networks.

**Distribution Channels:** The company has built up a broad and diverse set of channels including wireless application service providers, certificate authorities, systems integrators, infrastructure vendors and carriers.

**Business Model Outlook:** Diversinet's clients agree to upfront software licensing and ongoing certificate royalties which given even modest predictions of PKI acceptance result in solid revenue growth and profitability. The challenge remains that Diversinet's recurrent revenue model remains unproven, given the infancy of Wireless PKI.



**Valuation:** We recently lowered our target on Diversinet to US\$6 to reflect the added risk in its business model, thus we are maintaining our existing target. One aspect to our valuation of Diversinet is a belief in this firm's technology value. We maintain our Speculative Buy recommendation.

**Infowave Software, IW C\$2.74; C\$64 million Market Cap; 4-HOLD; C\$4 Target**

**Management:** With the recent addition of Thomas Koll as CEO the company has strengthened its management ranks. Mr. Kroll joins Infowave after several years at Microsoft Corporation (MSFT, NASDAQ) where his last position was vice president of Microsoft's Network Solutions Group. In that role he was responsible for Microsoft's worldwide business with telecommunication companies in the wire-line and wireless markets, network equipment providers and Internet service providers.

**Technology:** We believe that Infowave possesses a leading connectivity technology, which is validated by early enterprise adopters such as AT&T Wireless (AWE, NYSE), Telus (T, TSE) and Compaq's (CPQ, NYSE) global reseller relationships with Infowave. We note that the market is crowded and we have concerns that technology leadership is not an overriding factor in this arena.

**Distribution Channels:** Compaq is a significant global reseller; however the relationship is not exclusive. We have ascribed nominal value to the firm's relationship with Intel (INTC, NASDAQ) as visibility into the potential of that relationship is limited. The company did recently announce its first UK reseller, Getronics, and we would expect further expansion in Europe.

**Business Model Outlook:** Infowave's revenue stream is back-end loaded with the bulk of revenues forecast in the second half of F2001. The company operates on a traditional software-licensing model.

**Valuation:** We are lowering our Infowave target from \$6 to \$4, which equates to seven times calendar 2001 revenue. We maintain our Hold recommendation.

**Intrinsyc Software, ICS C\$1.55; C\$50 million Market Cap; 2-BUY; C\$4.50 target**

**Management:** We believe that Derek Spratt, CEO, remains one of the keys to this firm's future success. We expect Intrinsyc to continue adding to its depth of management as it continues along its growth curve.

**Technology:** Technically not a wireless name, Intrinsyc is a systems integrator in the pervasive computing arena. The company does provide leading technologies, many of which have wireless applications. Intrinsyc possesses a core platform technology and must continually provide creative solutions to an increasingly demanding potential client base. We believe the company is well positioned to continue providing leading technology.

**Distribution Channels:** The company has several relationships with larger firms, including the recently announced Pioneer Electronics relationship. We expect Intrinsyc to continue increasing its direct sales force, its reseller relationships, and other channels to become a leading embedded software company.

**Business Model Outlook:** Intrinsyc has helped to redefine its industry as it shares in the upside of the products it assists in designing for its clients. This revenue model is compelling given the anticipated growth in embedded systems and communications software.

**Valuation:** We are lowering our target on Intrinsyc from C\$7 to C\$4.50 as we lower our multiple associated with our F2003 discounted EPS model from 60x to 40x and raise the discount rate in our DCF valuation from 15% to 18%. We are maintaining our forecasts and our 2-Buy recommendation.

**CONCLUSION:** There are two ways to treat the above stocks. The first is strictly as momentum investments whereupon an investor should wait for strength in the technology sector and then leverage these names. Our valuations represent a one-year time horizon and presume a rebound in the technology sector during that period. Given the high beta nature of the wireless sector, should the NASDAQ rise by a given percentage next year we expect that our BUY recommendations would rise materially more than the index. In this case we believe the shares actually represent a form of call option on the NASDAQ. Alternatively investors may choose to begin building core long-term positions in anticipation of strength in the technology sector and more importantly companies executing on their business plans. In this latter case investors will also share in gains made as companies achieve their corporate objectives, should the NASDAQ not perform well over the next 12 months.