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EQUITY RESEARCH

COMPANY REPORT | **INITIATING COVERAGE**

TECHNOLOGY
Telecom Services and Equipment

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Company Headquarters: Los Angeles, CA
Company Website: http://www.j2global.com

Rating	BUY
Current Price	$36.59
Price Target	$44.00
52 Wk Price Range	$42.16 - $22.25
3 Month Avg Daily Vol	488,527
Market Capitalization	$929 M
Shares Outstanding	25.4 M
Cash	$98.2 M
Cash/Share	$3.87
Debt/Capital	1.0%
Book Value	$151.7 M
Book Value/Share	$5.97
Dividend Yield	NA
3 Yr EPS Growth	NM
FY End	December

Earnings Per Share

	2004A	2005E	2006E
Q1	$0.25	$0.40A	$0.51
Q2	$0.29	$0.42	$0.54
Q3	$0.32	$0.45	$0.56
Q4	$0.37	$0.49	$0.59
Year	$1.23	$1.75	$2.20
P/E	29.7x	20.9x	16.6x

Note: Numbers may not add because of rounding. NA: Not Available.

Revenue ($mil)

	2004A	2005E	2006E
Q1	$22.9	$32.2A	$42.8
Q2	$25.8	$34.8	$45.5
Q3	$27.8	$37.6	$48.2
Q4	$29.8	$40.2	$50.7
Year	$106.3	$144.8	$187.2
RM	8.7x	6.4x	5.0x

Price History

Source: BigCharts.com

j2 Global Communications Inc.

BUY

JCOM - $36.59 July 21, 2005

Initiating Coverage with a Buy Rating

- *We initiated coverage on July 20 with a Buy rating and a $44 price target.* j2 Global offers an attractive investment opportunity for growth investors looking to participate in the trend toward outsourced services, in our opinion. The value proposition offered by j2 Global includes paper reduction, security, privacy, regulatory, efficiency, cost savings, and infrastructure replacement.

- *Profitable and effective distribution model.* Customers include individuals, small to medium-sized businesses, large enterprises, and government organizations. Its vertical markets tend to be document/signature intensive and include financial institutions, real estate firms, law firms, medical organizations, government agencies, hospitality companies, remote workers, and road warriors. Penetration of large enterprises continues to gain traction, generated by the concern about the security and privacy of their internal fax infrastructures; by concerns about, or interest in regulatory compliance issues; and by general interest in providing a higher level of fax services within the enterprise at a lower cost.

- *International sales should help grow subscribers.* The company currently serves customers in 23 countries. j2 Global sizes the international opportunity at 728 million people, representing 231 million Internet users. To date, the company has penetrated only a very small percentage of these users, or about 600,000 as of March 31, 2005.

- *Strong subscriber metrics* j2 Global has shown the ability to grow its subscriber base, with 1Q paid subscribers of 598,000 (up 37.7% year over year). Moreover, net adds and gross adds continue to grow strongly, the cancellation rate has remained less than 3% per month since 1Q:04, and ARPU has remained at about $17.00 for the last five quarters.

- *Strong financial position.* j2 Global has experienced 32 consecutive quarters of revenue growth and 13 consecutive quarters of operating earnings growth. Gross margins have consistently been in the neighborhood of 80%, and operating margins have ranged from 41.4% to 44.0% over the last five quarters. j2 Global has been cash flow positive since 1Q:03.

- *Valuation remains compelling, in our view, and gives no credit to the company's ability to continue to grow its business.* Using share prices net of cash and fully taxed earnings, j2 Global shares are currently valued at 16.6x estimated 2006 EPS versus a comparable group average of 29.4x. We value j2 Global at a P/E/G of roughly 1.0x on the 2005-06 EPS growth rate of 23.5%, or at about 44.00 per share. We believe the shares will appreciate if the company is able to execute on its enterprise and international strategies.

Specific required disclosures with regard to the companies mentioned in this publication can be found beginning on page 18. Reg A/C certification can be found on page 18.

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INVESTMENT OVERVIEW

Investment Thesis

We initiated coverage of j2 Global Communications on July 20 with a Buy rating and a $44 price target. j2 Global Communications provides outsourced, value-added messaging and communications services to individuals and businesses. The company offers fax and voice-mail solutions; document management solutions; hosted e-mail, virus protection, spam detection, and e-mail marketing services; call management and conference calling; and a bundled suite of these services. j2 markets its services under the brand names eFax, j2, jConnect, eFax Corporate, Onebox, Electric Mail, eFax Broadcast, eVoice, M4 Internet, and jBlast. During the past three years, the company has derived substantially all of its revenues from the sale of its eFax Plus and jConnect Premier paid services.

The company sells its services to a broad spectrum of prospective customers, including individuals, small to medium-sized businesses, large enterprises, and government organizations. Its vertical markets tend to be document/signature intensive and include financial institutions, real estate firms, law firms, medical organizations, government agencies, hospitality companies, remote workers, and road warriors. The value proposition offered by j2 includes paper reduction, security, privacy, regulatory, efficiency, cost savings, and infrastructure replacement.

Over the past few quarters, the company has seen a significant increase in interest by large enterprises for outsourced fax-to-e-mail service. j2 has increased its direct sales focus over the past 12 months to focus on large enterprise accounts.

The company has experienced very solid growth, the business model has produced strong margins, and j2's current financial position is strong. The company has shown the ability to grow its subscriber base, with first-quarter paid subscribers of 598,000, up 37.7% from the year-ago period. Furthermore, net adds and gross adds continue to grow strongly, up 29.6% and 31.5%, respectively, in 1Q:05. The company has generated free cash flow of greater than $11 million back to the second quarter of 2004, and it has generated cash dating back to the first quarter of 2003. As of March 31, 2005, the company had roughly $98.2 million of cash on its balance sheet and only a nominal amount of debt.

Using share prices net of cash and fully taxed earnings, j2 Global shares are currently valued at 16.6x estimated 2005 EPS versus a comparable group average of 29.5x. We value j2 Global at a P/E/G of roughly 1.0x on the 2005-06 EPS growth rate of 23.5%, or at about $44.00 per share. We believe the shares will appreciate if the company is able to execute on its enterprise and international strategies.

Risks

Sustainability of growth. Despite a large base of untapped potential customers, there is a perception that j2's core application (i.e., fax) is not a growth market. If the demand for j2's fax application were to dry up, there would be an impact on the company's financial results.

Competition. The company faces competition from fax-to-e-mail providers, broadcast fax companies, traditional fax machine or multifunction printer companies, unified messaging/communications providers, telephone companies, voice-mail providers, Internet service providers, and e-mail providers. In the world of fax, the company competes primarily against traditional fax machine manufacturers, which are generally large and well-established companies; providers of fax servers and related software, such as Captaris; and publicly traded and privately held application service providers, such as Premiere Global Services, CallWave, and Easylink Services Corporation.

Regulatory. Depending upon which alternative(s) is chosen, the government's plan to restructure the Universal Service Fund (USF) could affect the company's cost structure in a significant way.

Intellectual property. j2 has a portfolio of 23 issued U.S. patents, numerous pending U.S. patent applications, issued foreign patents, and pending foreign applications. Because its intellectual property is critical to the company's ability to provide a differentiated set of services, the company aggressively protects its intellectual property rights by relying on a combination of patent, trademark, copyright, trade dress, and trade secret laws, and by using the domain name dispute resolution system. There are two lawsuits in progress at this time.

Valuation

Using share prices net of cash and fully taxed earnings, j2 Global shares are currently valued at 16.6x estimated 2005 EPS versus a comparable group average of 29.4x. We value j2 Global at a P/E/G of roughly 1.0x on the 2005-06 EPS growth rate of 23.5%, or at about 44.00 per share. We believe the shares will appreciate if the company is able to execute on its enterprise and international strategies.

EXHIBIT 1: Relative Valuation
Source: Compant reports, First Albany Capital

	Symbol	Price	Market	Enterprise	Revenue[1]		Taxed EPS		EV/Revenue			P/E (Taxed,Net Cash)		
(Millions, except per share data)		7/19/05	Cap.	Value	2005E	2006E	2005E	2006E	2004	2005E	2006E	2004	2005E	2006E
j2 Global Communications	JCOM	$35.91	$852	$755	$145	$187	$1.75	$2.20	7.1x	5.2x	4.0x	29.2x	20.5x	16.4x
CallWave	CALL	4.50	100	43	46	47	0.33	0.32	1.0x	0.9x	0.9x	10.6x	13.8x	14.0x
Monster Worldwide, Inc.	MNST	29.33	3,549	3,385	994	1,143	0.86	1.16	4.0x	3.4x	3.0x	48.9x	34.1x	25.3x
InfoSpace, Inc.	INSP	35.80	1,164	880	346	442	1.78	2.34	3.6x	2.5x	2.0x	27.8x	20.1x	15.3x
Macromedia, Inc.	MACR	39.71	2,967	2,622	462	501	0.95	1.09	6.2x	5.7x	5.2x	46.7x	41.8x	36.4x
WebEx Communications, Inc.	WEBX	28.67	1,310	1,145	305	338	1.08	1.22	4.6x	3.8x	3.4x	30.5x	26.5x	23.5x
Websense, Inc.	WBSN	53.74	1,273	1,030	140	169	1.32	1.57	9.3x	7.3x	6.1x	50.7x	40.7x	34.2x
Comverse Technology, Inc.	CMVT	24.50	4,889	3,215	1,079	1,206	0.47	0.67	3.4x	3.0x	2.7x	84.5x	52.1x	36.6x
Openwave Systems, Inc.	OPWV	18.95	1,306	1,173	377	366	0.42	0.30	3.7x	3.1x	3.2x	NM	45.1x	63.2x
Average									4.8x	3.9x	3.4x	41.1x	32.8x	29.4x
Median									4.0x	3.4x	3.2x	38.6x	34.1x	25.3x

Notes:

(1) All revenue and EPS figures are for the calendar year.

N.M. - Not Meaningful N.R. - Not Rated

Consensus FirstCall estimates used for Not Rated companies.

Stocks priced as of July 19, 2005.

COMPANY OVERVIEW

Company Description and Background

j2 Global Communications provides outsourced, value-added messaging and communications services to individuals and businesses. The company offers fax and voice-mail solutions; document management solutions; hosted e-mail, virus protection, and spam detection, and e-mail marketing services; call management and conference calling; and a bundled suite of these services. J2 markets its services under the brand names eFax, j2, jConnect, eFax Corporate, Onebox, Electric Mail, eFax Broadcast, eVoice, M4 Internet, and jBlast.

The company's core services include fax, voice mail, e-mail, call management, and conference calling, and a bundled suite of these services. j2 Global generates substantially all of its revenue from subscribers that pay activation, subscription, and usage fees, with a little revenue from advertising and revenue share on premium rate telephone numbers (which the company calls Direct Inward Dial numbers, or DIDs) issued to non-paid subscribers (which the company refers to as Free subscribers). Of the more than 9.0 million telephone numbers deployed as of March 31, 2005, approximately 598,000 were serving paying subscribers, with the balance deployed to Free subscribers.

During the past three years, the company has derived substantially all of its revenues from the sale of its eFax Plus and jConnect Premier paid services. The company's stated objective is to increase the number of paying DIDs through a variety of distribution channels, marketing arrangements, and enhanced brand awareness, as well as to increase the average revenue per DID. The company sells its services to a broad spectrum of prospective customers, including individuals, small to medium-sized businesses, large enterprises, and government organizations. The company currently has five primary methods by which it acquires paying subscribers: 1) selling direct through its Web sites, such as www.efax.com and www.j2.com; 2) converting a portion of its Free base of customers to a paid solution; 3) attracting direct paying individual subscribers from various portals, ISPs, search engines, and affiliate programs; 4) promoting its solutions to small to mid-sized businesses through its efaxcorporate.com Web site, assisted by in-house sales representatives; and 5) selling its solutions to large enterprises and governmental organizations through its direct sales force.

The company has made a number of small acquisitions over the last couple of years. During 2004, j2 acquired the following: 1) The Electric Mail Company, a provider of outsourced e-mail and value-added messaging services; 2) the Onebox unified communications assets from Call Sciences, a New Jersey and U.K.-based provider of unified communications solutions; and 3) Jump B.V., a Netherlands-based provider of fax-to-e-mail and unified messaging services.

Investment Considerations

Profitable and effective distribution model. j2 Global sells its services to a broad spectrum of prospective customers, including individuals, small to medium-sized businesses, large enterprises, and government organizations. Its vertical markets tend to be document/signature intensive and include financial institutions, real estate firms, law firms, medical organizations, government agencies, hospitality companies, remote workers, and road warriors. The value proposition offered by j2 includes paper reduction, security, privacy, regulatory, efficiency, cost savings, and infrastructure replacement.

The company has experienced solid growth, the business model has produced strong margins, and j2's current financial position is strong. The company has shown the ability to grow its subscriber base, with first-quarter paid subscribers of 598,000, up 37.7% from the year-ago period. In addition, net adds and gross adds continue to grow strongly, up 29.6% and 31.5%, respectively, in 1Q:05. The company's cancellation rate has remained less than 3% per month since the first quarter of 2004. Revenue per subscriber (ARPU) has remained at about $17.00 for the last five quarters. j2 has experienced 32 consecutive quarters of revenue growth and 13 consecutive quarters of operating earnings growth. Gross margins have consistently been in the neighborhood of 80%, and operating margins have ranged from 41.4% to 44.0% over the last five quarters. The company has generated free cash flow (cash flow from operations less capex) of greater than $11 million back to the second quarter of 2004, and it has generated cash dating back to the first quarter of 2003. As of March 31, 2005, the company had roughly $98.2 million of cash on its balance sheet and only a nominal amount of debt. Return on equity (ROE) was 25.6% and 22.6% in the last two fiscal years, respectively. ROE (annualized) in 1Q:05 was 26.9%.

Penetration of large enterprises continues to gain traction. Over the past few quarters, the company has seen a significant increase in interest by large enterprises for outsourced fax-to-e-mail service. This interest appears to be generated by the concern about the security and privacy of their internal fax infrastructure, by concerns or interest in regulatory compliance issues, and by general interest in providing a higher level of fax services within the enterprise at a lower cost. j2 has increased its direct sales focus over the past 12 months to focus on large enterprise accounts. The company currently has 13 enterprise accounts with more than 1,000 telephone numbers each, all of them under annual or multiyear contracts. According to the company, there are currently five Fortune 100 companies under contract, with another 17 in the sales pipeline. The company also claims to be seeing significant traction on the international side in attracting large enterprises.

Outbound usage from enterprise customers has more than doubled in the past six months. It is important to recognize that the revenues and usage profile of enterprise customers is different from that of the typical individual subscriber. Individual subscribers' revenue profile is heavily weighted toward the fixed, or subscription fee, component of their average revenue per user, or ARPU, with a smaller contribution by their actual usage. Conversely, enterprise customers typically have a smaller revenue contribution from the fixed component of their ARPU.

Enterprise sales typically have a longer sales cycle than sales to other customers. Sales to larger enterprises typically take anywhere from five to seven months; those to medium-sized organizations take anywhere from four to six months.

International sales should help grow subscribers, in our view. The company currently serves customers in 23 countries, after having launched service in Malaysia in the first quarter of 2005. j2's biggest market at the present time is Western Europe. On its last conference call, company management mentioned that London, Germany, and The Netherlands have been very good markets, with some good growth occurring in Ireland and France. The company sizes the international opportunity by showing that the population of j2-served countries is 728 million people, representing 231 million Internet users. To date, the company has penetrated only a very small percentage of these users, or about 600,000 as of March 31, 2005.

Valuation remains compelling, in our view, and gives no credit to the company's ability to continue to grow its business. Using share prices net of cash and fully taxed earnings, j2 Global shares are currently valued at 16.6x estimated 2005 EPS versus a comparable group average of 29.4x. We value j2 Global at a P/E/G of roughly 1.0x on the 2005-06 EPS growth rate of 23.5%, or at about $44.00 per share. We believe the shares will appreciate if the company is able to execute on its enterprise and international strategies.

Product and Services

eFax Plus offers the subscriber a unique local telephone number, or toll-free U.S. telephone number, which enables that subscriber to receive inbound fax messages in his or her e-mail inbox and to send documents to any fax number in the world directly from the subscriber's desktop. This service is also localized in many international currencies and languages, including Spanish, German, French, and Dutch. This service is priced at $12.95 per month with each sent page costing $0.10 per page.

jConnect Premier offers the subscriber a unique local telephone number, or toll-free U.S. telephone number, which enables the subscriber to receive inbound fax and voice-mail messages in his or her e-mail inbox and to send documents to any fax number in the world directly from the subscriber's desktop. Subscribers also have the ability to access all messages, including e-mail, from the Web or any touch-tone telephone. Web-initiated, 16-party conference calling is also available. jConnect Premier service is priced at $15.00 per month, with each sent page costing $0.10.

eFax Corporate offers capabilities similar to those offered by eFax Plus and jConnect Premier, but with added features and tools geared toward enterprises and their users. For example, the company provides its corporate customers with a Web browser-based account administration interface, which enables them to provision telephone numbers to employees, as needed, without the need to contact a j2 account representatives. eFax Corporate also offers the option of enhanced security features, which are attractive to firms in the financial, healthcare, and legal industries.

eFax Broadcast and jBlast offer a solution for high-volume faxing. These services enable users to send documents simultaneously to hundreds or thousands of recipients anywhere in the world. Customers do not need special computer equipment, expensive fax boards, or multiple phone lines. These services also enable customers to accurately monitor the status of their faxes and update their database of "do not fax" names and undeliverable fax numbers.

eFax Free and jConnect Free are j2 Global's limited use, advertising-supported "introductory offerings." Each subscriber is given a unique, randomly assigned telephone number, which enables the user to receive a limited number of faxes (20 pages per month) into his or her personal e-mail inbox. With these services, the subscriber does not have the capability of sending faxes from his or her desktop (as do paid subscribers) or access to other j2 Global services (e.g., conference calling). In addition, the customer agrees to receive and open e-mail advertising (four to six advertisements per month), which the company distributes on a consistent basis.

Onebox is a full-featured suite of unified communications services, including e-mail, voice mail, fax, and "find me/follow me." Service plans are available for 100 minutes, 400 minutes, and 2,000 minutes per month at $16.95, $19.95, and $29.95, respectively

Electric Mail is an outsourced hosted e-mail service offered to businesses. Through its Electric WebMail, E-mmunity virus scanning, and SpamSMART SPAM filtering to professional consulting and needs analysis, Electric Mail develops and delivers customized e-mail and perimeter protection solutions that can be hosted offsite or installed at a customer site, with seamless integration into a customer's existing e-mail systems.

M4 Internet offers a permission-based, opt-in, outsourced e-mail marketing solution. This service enables users to create and execute e-mail campaigns from their desktop. In addition, the service enables the user to deliver, track, report, and analyze customer reactions to build customer relationships.

EXHIBIT 2: Products and Services
Source: Company reports,

Intellectual Property

j2 has a portfolio of 23 issued U.S. patents, numerous pending U.S. patent applications, issued foreign patents, and pending foreign applications. Because its intellectual property is critical to the company's ability to provide a differentiated set of services, the company aggressively protects its intellectual property rights by relying on a combination of patent, trademark, copyright, trade dress, and trade secret laws, and by using the domain name dispute resolution system.

In February 2004, j2 filed a patent infringement suit against Venali, Inc., a Florida-based provider of Internet fax solutions to businesses, alleging that Venali violates two of its patents, and amended its complaint in October 2004 to add allegations that Venali violates two additional patents. In August 2004, the company filed suit against CallWave, Inc., a provider of communications application services based in Santa Barbara, California, alleging that CallWave infringed and continues to infringe one of j2 Global's patents. In December 2004, j2 amended its complaint to add allegations that CallWave also infringed and continues to infringe an additional two patents. In both cases, j2 is seeking a reasonable royalty for the infringement, treble damages for the willful infringement of certain of these patents, attorney's fees, interest, and costs.

Universal Service Fund (USF) Issue

The Universal Service Fund was established by the Federal Communications Commission (FCC) in the 1930s to ensure that all Americans, particularly those living in rural areas or with low incomes, would have access to affordable telephone service. Since then, there have been various Universal Service Fund, or USF, funding methods used, ranging from a surcharge on long distance calls to a flat surcharge for telephone, cellular, or DSL lines. In 1996, the sources and uses of USF funds and the definition of the services covered under USF were significantly broadened. As a result, there has been a long-running discussion regarding a possible shortfall in the funding of USF.

In March, a congressional budget office (CBO) report regarding new funding methodologies for the USF was distributed. In this report, four proposals were outlined. These proposals are: 1) maintaining the current funding methodology; 2) expanding the current revenue base system to include revenues that are currently excluded (such as high-speed Internet service delivered through cable modems); 3) imposing a monthly $1.00 per telephone number tax on all U.S. telephone numbers; or 4) using some combination of these three funding proposals.

On March 29, 2005, j2 Global responded to the news of the CBO report by sending an e-mail to the research analysts who cover the company. The company's stance on this issue is that the USF funding issue has been under discussion around Washington, D.C., for more than three years. The referenced CBO report was a research report outlining possible solutions. According to the company's sources and the lobbyists that it has retained, this matter is highly unlikely to be formally debated this year. Even when the issue has formal Congressional attention, it will probably be quite some time—at least more than a year and likely longer—before any action, whatever that might be, would take effect.

If such a proposal were to be enacted, and j2 Global were to make USF payments to its underlying service providers, the company would likely either: a) discontinue its Free service in the United States, which would result in a monetization of its Free customers, who would be encouraged to become paying subscribers; or b) create a "pass-through subscription" to the Free subscribers. In either case, j2 Global would establish direct billing relationships with its Free customers, which is one of the primary barriers to converting Free customers to paid subscribers. For its existing paid subscribers, it is likely that the company would pass through any tax to these customers, just as telephone companies currently do with the various other taxes and surcharges assessed on telecommunications services.

Competition

The company faces competition from fax-to-e-mail providers, broadcast fax companies, traditional fax machine or multifunction printer companies, unified messaging/communications providers, telephone companies, voice-mail providers, Internet service providers, and e-mail providers. j2 believes that the primary competitive factors determining success in the market for value-added messaging and communications services include pricing, reputation for reliability and security of service, effective customer support, easy-to-use software, product scalability, customer messaging and branding, geographic coverage, and scope of services.

In the world of fax, the company competes primarily against traditional fax machine manufacturers, which are generally large and well-established companies; providers of fax servers and related software, such as Captaris; and publicly traded and privately held application service providers, such as Premiere Global Services and Easylink Services Corporation.

Management

Scott Jarus has been president of j2 Global since July 2001. Prior to joining j2 Global, Mr. Jarus was the president and chief operating officer of OnSite Access, Inc., a premier building-centric integrated communications provider, from 1998 to 2001. From 1994 to 1998, Mr. Jarus held various senior management positions in the telecommunications industry, including serving as senior vice president of Operations at RCN Telecom, and was co-founder and vice president of Multimedia Medical Systems, Inc. For nine years prior to 1994, Mr. Jarus served in various senior management positions, including vice president of operations of Metromedia Communications.

R. Scott Turicchi has been j2 Global's chief financial officer since May 2003, and from March 2000 through May 2003 he served as the company's executive vice president, corporate development. Mr. Turicchi served as a director of j2 Global from 1998 through 2000. From 1990 to 2000, he was a managing director in Donaldson, Lufkin & Jenrette Securities Corporation's investment banking department. In addition, Mr. Turicchi is a member of the board of directors of Greenhills Software, Inc., a privately held company that develops real-time operating systems. He also serves as a member of the board of governors of the Reed Institute of Decision Sciences.

Nehemia Zucker has been chief marketing officer since December 2000. He served both as the company's chief marketing officer and its chief financial officer from December 2000 through May 2003. From 1996 through December 2000, he served exclusively as j2 Global's chief financial officer. Prior to joining j2 Global in 1996, Mr. Zucker was chief operations manager of Motorola's EMBARC division, which packages CNBC and ESPN for distribution to paging and wireless networks. From 1980 to 1996, he held various positions in finance, operations, and marketing at Motorola in the United States and abroad.

FINANCIAL OVERVIEW

Historical Results

Summary. For the first quarter of 2005, j2 posted total revenues of $32.2 million, which was up 40.5% from the prior-year period and 8.1% from the prior quarter. The gross margin was 79.8% versus 79.1% in the prior year quarter and 81.3% in the prior quarter. The sequential decline was due to additional depreciation and amortization charges booked in cost of sales. The operating margin in the first quarter was 41.5%, which was lower than the 43.5% posted in the year-ago period and 44.0% posted in the December quarter. First-quarter 2005 EPS was $0.40, up from $0.25 in the year-ago period and $0.37 in the prior quarter.

Subscriber Revenues. The company refers to activation and subscription fees as “fixed” revenues, while usage fees are referred to as “variable” revenues. The company also generates a small percentage (about 3%) of its revenue from advertising and international “calling party pays” arrangements to Free subscribers. These Free advertising-supported subscribers also serve as a source for attracting new paid subscribers. Over the past nine quarters, the fixed portion of subscriber revenues has consistently contributed approximately 70% of subscriber revenues. Subscriber revenues for 1Q:05 were $31.3 million, up 41.6% from the $22.1 million in March 2004. The increase in subscriber revenues was due to an increase in the company’s base of paying subscribers. For the first quarter of 2005, the company reported 598,490 paying subscribers, up from 553,949 in 4Q:04 and 434,616 reported in 1Q:04 (a year-over-year increase of 37.7%). First-quarter revenue per subscriber, or ARPU, was $16.85, up slightly from the $16.68 reported in the year-ago period.

Other revenues were $949,000 in the first quarter of 2005, which was up from $880,000 in the first quarter of 2004 and $749,000 in the prior quarter. Other revenues consist primarily of advertising revenues generated by delivering e-mail messages and banners on behalf of advertisers to Free customers and the sale of PaperMaster Pro document management software. The year-over-year increase in other revenues was due primarily to an increase in PaperMaster software sales, offset slightly by a decrease in advertising revenues, due to a continued decline in e-mail advertising prices.

For the past three years, 90% or more of total revenues has been produced by DID-based services. DID-based revenues increased to $30.2 million in the first quarter of 2005 from $21.7 million in the prior-year quarter on the back of an increase in the number of paid DIDs over the period.

Cost of Revenues. Cost of revenues are primarily comprised of costs associated with data and voice transmission, telephone numbers, customer service, online processing fees, and equipment depreciation. Cost of revenues were $6.5 million, or 20% of total revenues, and $4.8 million, or 21% of total revenues, for the three months ended March 31, 2005 and March 31, 2004, respectively. The increase in cost of revenues was due primarily to costs incurred in building and expanding network infrastructure, enhancing and growing customer support services, and incurring increased variable transmission costs associated with a larger subscriber base and increased usage.

Sales and Marketing. Sales and marketing costs consist primarily of payments to sales and marketing personnel, advertising expenses, and other business-development-related expenses. Sales and marketing expenses were $5.5 million, or 17% of total revenues, and $3.8 million, or 16% of total revenues, for the three months ended March 31, 2005 and March 31, 2004, respectively. The year-over-year increase in sales and marketing expenses was due primarily to increased Internet-based advertising, partner marketing spend, and additional marketing personnel. Internet-based advertising relationships consist primarily of fixed costs and performance-based (cost per impression, cost per click, and cost per acquisition) advertising relationships with an array of online service providers. Throughout 2004 and the first quarter of 2005, the company experienced upward pricing pressure for certain Internet-based advertising.

R&D. Research, development, and engineering costs consist primarily of personnel-related expenses. R&D costs were $1.8 million, or 5% of total revenues, and $1.0 million, or 5% of total revenues, for the three months ended March 31, 2005 and March 31, 2004, respectively. The increase in R&D costs was primarily due to an increase in personnel costs to maintain existing services, accommodate service enhancements, develop and implement additional service features and functionality, and continue to bolster infrastructure security. Research, development, and engineering costs as a percentage of revenues remained fairly consistent year over year. For the rest of 2005, the company expects R&D to rise as a percentage of revenues, as it intends to increase spending to further develop and implement additional service features and functionality.

General and Administrative. General and administrative costs consist primarily of personnel-related expenses, depreciation and amortization, bad debt expense, and insurance costs. General and administrative costs were $5.1 million, or 16% of total revenues, and $3.3 million, or 14% of total revenues, for the three months ended March 31, 2005 and March 31, 2004, respectively. The increase in general and administrative expenses was primarily attributable to a combination of increased depreciation and amortization, due to additional property and equipment and intangible assets; increased bad debt expense, due to a growing customer base; additional personnel, due to internal growth and acquisitions; and increased professional and consulting fees, primarily related to compliance with the Sarbanes-Oxley Act of 2002. Amortization expense, included in general and administrative expense, during the three-month periods ended March 31, 2005 and March 31, 2004 approximated $409,000 and $78,000, respectively.

Interest and Other Income, net. Interest and other income is generated primarily from interest income earned on cash, cash equivalents, and short- and long-term investments, offset primarily by interest expense on long-term debt. Interest and other income, net, amounted to $597,000 and $186,000 for the three months ended March 31, 2005 and March 31, 2004, respectively. The increase in interest and other income, net, was primarily due to higher cash and investment balances and higher interest rates period over period.

Income Taxes. The company's effective tax rate is based on pretax income, statutory tax rates, tax regulations, and different tax rates in the various jurisdictions in which it operates. Income tax expense amounted to approximately $3.8 million for both the March 31, 2005 and March 31, 2004 quarterly periods. Income tax expense for the three months ended March 31, 2005 was based on a worldwide estimated effective annual tax rate for 2005 of approximately 27%.

Balance Sheet and Cash Flow

At March 31, 2005, the company had cash and cash equivalents of $16.5 million, short-term investments of $54.1 million, and $27.9 million of long-term investments.

Net cash provided by operating activities was $13.8 million and $10.3 million for the three months ended March 31, 2005 and March 31, 2004, respectively.

Net cash used in investing activities was approximately $15.9 million and $10.1 million for the three months ended March 31, 2005 and March 31, 2004, respectively. For the first quarter of 2005, net cash used in investing activities was primarily attributable to net purchases of investments, acquisition of a business, purchases of intangible assets, and purchases of property and equipment. For the first quarter of 2004, net cash used in investing activities was primarily comprised of acquisition of businesses and purchases of investments.

Free cash flow was $11.0 million in the first quarter of 2005, up from the $9.9 million reported in the first quarter of 2004. The company defines free cash flow as cash from operations less capital expenditures.

Second-Quarter and Full-Year 2005 Outlook

For 2Q:05, the company is estimating revenues of between $34.5 million and $34.8 million and EPS of $0.42 to $0.43. This assumes a tax rate of between 25% and 28% of pretax earnings and approximately 25.4 million fully diluted shares. For 2005, the company has guided to $145 million to $148 million of revenues and $1.70 to $1.75 in EPS.

Our estimates are for revenues of $34.8 million and $144.8 million for 2Q:05 and 2005, respectively. Our EPS estimates of $0.42 and $1.75 for 2Q:05 and 2005, respectively, are in line with the company’s expectations. In modeling our annual estimates, we assume a slightly higher ARPU in the second half of the year and slightly higher net adds, which we believe will come from more enterprise sales and additional traction internationally. We also assume that gross margins will remain around 80% and that SG&A will remain flat as a percentage of revenue, with R&D approximately one percentage point higher than the first quarter’s 5.5%.

EXHIBIT 3: Quarterly Income Statement
Source: Company reports, First Albany Capital

QUARTERLY INCOME STATEMENT ($000's)								
	FY Ending December 2004				FY Ending December 2005			
	Mar-04	**Jun-04**	**Sep-04**	**Dec-04**	**Mar-05A**	**Jun-05E**	**Sep-05E**	**Dec-05E**
Revenue								
Subscriber	*22,062*	*25,063*	*26,985*	*29,050*	*31,275*	*33,809*	*36,536*	*39,134*
Other	*880*	*768*	*786*	*749*	*949*	*979*	*1,043*	*1,112*
Total Revenue	**$ 22,942**	**$ 25,831**	**$ 27,771**	**$ 29,799**	**$ 32,224**	**$34,789**	**$37,579**	**$40,246**
Cost of Sales	*4,805*	*5,133*	*5,455*	*5,576*	*6,497*	*6,958*	*7,516*	*8,049*
Gross Profit	**$ 18,137**	**$ 20,698**	**$ 22,316**	**$ 24,223**	**$ 25,727**	**$ 27,831**	**$ 30,063**	**$ 32,196**
Operating Expenses								
Sales & Marketing	*3,779*	*4,767*	*4,729*	*5,226*	*5,462*	*6,088*	*6,576*	*6,842*
Research & Development	*1,050*	*1,264*	*1,418*	*1,517*	*1,761*	*1,913*	*2,424*	*2,596*
General & Administrative	*3,317*	*3,664*	*4,229*	*4,378*	*5,145*	*5,392*	*5,637*	*5,836*
Total Operating Expenses	**$ 8,146**	**$ 9,695**	**$ 10,376**	**$ 11,121**	**$ 12,368**	**$ 13,394**	**$ 14,637**	**$ 15,273**
Operating Income	**$ 9,991**	**$ 11,003**	**$ 11,940**	**$ 13,102**	**$ 13,359**	**$ 14,437**	**$ 15,426**	**$ 16,923**
Other Income/(Expense), net	*186*	*352*	*505*	*140*	*597*	*244*	*263*	*285*
Pre-Tax Income/(Loss)	**$ 10,177**	**$ 11,355**	**$ 12,445**	**$ 13,242**	**$ 13,956**	**$ 14,682**	**$ 15,690**	**$ 17,208**
Income Taxes/(Benefit)	*3,778*	*3,866*	*4,316*	*3,652*	*3,768*	*4,111*	*4,393*	*4,818*
Net Income/(Loss), GAAP	**$ 6,399**	**$ 7,489**	**$ 8,129**	**$ 9,590**	**$ 10,188**	**$ 10,571**	**$ 11,296**	**$ 12,390**
Shares, Fully Diluted	25,564	25,585	25,572	25,809	25,382	25,382	25,382	25,382
GAAP EPS, Fully Diluted	**$ 0.25**	**$ 0.29**	**$ 0.32**	**$ 0.37**	**$ 0.40**	**$ 0.42**	**$ 0.45**	**$ 0.49**
% of Total Revenue								
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of Sales	20.9%	19.9%	19.6%	18.7%	20.2%	20.0%	20.0%	20.0%
Operating Expenses								
Sales & Marketing	16.5%	18.5%	17.0%	17.5%	17.0%	17.5%	17.5%	17.0%
Research & Development	4.6%	4.9%	5.1%	5.1%	5.5%	5.5%	6.5%	6.5%
General & Administrative	14.5%	14.2%	15.2%	14.7%	16.0%	15.5%	15.0%	14.5%
Total Operating Expenses	35.5%	37.5%	37.4%	37.3%	38.4%	38.5%	39.0%	38.0%
Margin Analysis								
Gross Margin	79.1%	80.1%	80.4%	81.3%	79.8%	80.0%	80.0%	80.0%
Operating Margin	43.5%	42.6%	43.0%	44.0%	41.5%	41.5%	41.1%	42.1%
Net Margin	27.9%	29.0%	29.3%	32.2%	31.6%	30.4%	30.1%	30.8%
Year-Over-Year % Change								
Revenue	50.9%	51.6%	46.9%	45.5%	40.5%	34.7%	35.3%	35.1%
Cost of Sales	59.6%	58.1%	56.1%	56.1%	35.2%	35.5%	37.8%	44.4%
Operating Expenses								
Sales & Marketing	50.6%	66.3%	63.2%	80.3%	44.5%	27.7%	39.1%	30.9%
Research & Development	2.3%	23.6%	41.0%	33.1%	67.7%	51.4%	70.9%	71.1%
General & Administrative	-4.4%	-2.1%	3.5%	-0.2%	55.1%	47.2%	33.3%	33.3%
Total Operating Expenses	16.3%	27.0%	29.9%	32.0%	51.8%	38.1%	41.1%	37.3%
Profitability								
Gross Profit	48.7%	50.1%	44.8%	43.3%	41.8%	34.5%	34.7%	32.9%
Operating Income	92.4%	78.7%	60.9%	54.6%	33.7%	31.2%	29.2%	29.2%
Net Income	27.1%	25.9%	12.9%	18.2%	59.2%	41.2%	39.0%	29.2%
Sequential % Increase								
Revenue	12.1%	12.6%	7.5%	7.3%	8.1%	8.0%	8.0%	7.1%
Cost of Sales	34.5%	6.8%	6.3%	2.2%	16.5%	7.1%	8.0%	7.1%
Operating Expenses								
Sales & Marketing	30.4%	26.1%	-0.8%	10.5%	4.5%	11.5%	8.0%	4.0%
Research & Development	-7.9%	20.4%	12.2%	7.0%	16.1%	8.7%	26.7%	7.1%
General & Administrative	-24.4%	10.5%	15.4%	3.5%	17.5%	4.8%	4.5%	3.5%
Total Operating Expenses	-3.3%	19.0%	7.0%	7.2%	11.2%	8.3%	9.3%	4.3%
Profitability								
Gross Profit	7.3%	14.1%	7.8%	8.5%	6.2%	8.2%	8.0%	7.1%
Operating Income	17.9%	10.1%	8.5%	9.7%	2.0%	8.1%	6.9%	9.7%
Net Income	-21.1%	17.0%	8.5%	18.0%	6.2%	3.8%	6.9%	9.7%

EXHIBIT 4: Annual Income Statement
Source: Company reports, First Albany Capital

ANNUAL INCOME STATEMENT ($000's)	FY2004	FY2005E	FY2006E
Revenue			
Subscriber	*103,160*	*140,754*	*181,937*
Other	*3,183*	*4,084*	*5,241*
Total Revenue	**$ 106,343**	**$ 144,837**	**$ 187,177**
Cost of Sales	*20,969*	*29,020*	*39,307*
Gross Profit	**$ 85,374**	**$ 115,818**	**$ 147,870**
Operating Expenses			
Sales & Marketing	*18,501*	*24,968*	*33,370*
Research & Development	*5,249*	*8,694*	*10,868*
General & Administrative	*15,588*	*22,010*	*27,512*
Total Operating Expenses	**$ 39,338**	**$ 55,672**	**$ 71,750**
Operating Income	**$ 46,036**	**$ 60,146**	**$ 76,120**
Other Income/(Expense), net	*1,183*	*1,389*	*1,288*
Pre-Tax Income/(Loss)	**$ 47,219**	**$ 61,535**	**$ 77,409**
Provision for income taxes	*15,612*	*17,090*	*21,674*
Net Income/(Loss), GAAP	**$ 31,607**	**$ 44,445**	**$ 55,734**
Shares, Fully Diluted	25,633	25,382	25,382
GAAP EPS, Fully Diluted	**$ 1.23**	**$ 1.75**	**$ 2.20**
% of Total Revenue			
Revenue	100.0%	100.0%	100.0%
Cost of Sales	19.7%	20.0%	21.0%
Operating Expenses			
Sales & Marketing	17.4%	17.2%	17.8%
Research & Development	4.9%	6.0%	5.8%
General & Administrative	14.7%	15.2%	14.7%
Total Operating Expenses	37.0%	38.4%	38.3%
Margin Analysis			
Gross Margin	80.3%	80.0%	79.0%
Operating Margin	43.3%	41.5%	40.7%
Net Margin	29.7%	30.7%	29.8%
Year-Over-Year % Change			
Revenue	48.5%	36.2%	29.2%
Cost of Sales	57.4%	38.4%	35.5%
Operating Expenses			
Sales & Marketing	65.6%	35.0%	33.7%
Research & Development	25.1%	65.6%	25.0%
General & Administrative	-0.6%	41.2%	25.0%
Total Operating Expenses	26.7%	41.5%	28.9%
Margin Analysis			
Gross Profit	46.4%	35.7%	27.7%
Operating Income	68.9%	30.6%	26.6%
Net Income	20.2%	40.6%	25.4%

EXHIBIT 5: Analysis of Cash Flow
Source: Company reports, First Albany Capital

Annual Statistics ('$000's)

	FY2003	FY2004	FY2005E	FY2006E
Analysis of Cash Flow				
Operating income	$27,250	$46,036	$60,146	$76,120
Depreciation and amortization	3,910	4,549	4,549	4,549
Interest income (expense), net	419	1,183	1,389	1,288
Taxes	(1,375)	(15,612)	(17,090)	(21,674)
Capital expenditures	(3,566)	(6,981)	(7,000)	(7,000)
Working capital	1,401	363	1,000	1,000
Other non-cash expenses	1,024	14,802	1,273	-
Cash Generated/(Used) from Operat	**$29,063**	**$44,340**	**$44,267**	**$53,548**
Marketable securities - sell(buy)	(30,947)	(43,946)	(7,007)	-
Acquisitions	(757)	(8,607)	(3,587)	-
Other proceeds (investments)	413	(5,877)	(2,869)	-
Net Cash Generation/(Use)	**($2,228)**	**($14,090)**	**$30,804**	**$53,548**
Cash and cash equivalents, BOP	$32,777	$32,882	$18,814	$49,485
Cash Generated/(Used) from Operatio	(2,228)	(14,090)	30,804	53,548
Cash Raised, net	2,333	(72)	(66)	-
Exchange rate impact	-	94	(67)	-
Cash and cash equivalents, EOP	**$32,882**	**$18,814**	**$49,485**	**$103,032**
Marketable Securities - Short Term	22,011	47,225	54,125	54,125
Marketable Securities - Long Term	8,936	27,753	27,861	27,861
Total Cash and Investments	**$63,829**	**$93,792**	**$131,471**	**$185,018**

EXHIBIT 6: Balance Sheet
Source: Company reports, First Albany Capital

BALANCE SHEET (thousands)

	Dec-03	Dec-04	Mar-05
ASSETS			
Current Assets:			
Cash and cash equivalents	$32,882	$18,814	$16,507
Short-term investments	22,011	47,225	54,125
Accounts receivable, net	5,877	8,227	9,940
Prepaid expenses and other	2,571	2,873	2,578
Deferred income taxes	10,004	2,520	2,520
Total Current Assets	**$73,345**	**$79,659**	**$85,670**
Long term investments	8,936	27,753	27,861
Property and equipment, net	6,594	12,386	13,609
Goodwill and other intangibles, net	17,936	31,429	20,344
Other assets	329	170	175
Deferred income taxes, net	5,716	1,520	1,520
Total Assets	**$112,856**	**$152,917**	**$149,179**
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilites:			
Accounts payable and accrued expenses	4,010	5,324	6,364
Income taxes payable		192	1,838
Deferred revenue	4,698	5,378	5,428
Current portion of long-term debt	1,022	1,196	965
Total Current Liabilites	**$9,730**	**$12,090**	**$14,595**
Long-term debt	$221	$866	$593
Total Liabilities	**$9,951**	**$12,956**	**$15,188**
Stockholders' Equity	**$102,905**	**$139,961**	**$151,698**
Total Liabilites and Stockholders' Equity	**$112,856**	**$152,917**	**$166,886**

PUBLIC COMPANIES MENTIONED IN THIS REPORT:

CallWave Inc (CALL - $4.60 - Neutral)
Captaris Inc (CAPA - $3.83 - Not Rated)
Comverse Technology Inc (CMVT - $24.82 - Not Rated)
EasyLink Services Corporation (EASY - $0.93 - Not Rated)
InfoSpace Inc (INSP- $36.65 - Neutral)
Macromedia Inc (MACR - $39.62 - Not Rated)
Monster Worldwide Inc (MNST - $28.91 - Not Rated)
Openwave Systems Inc (OPWV - $19.01 - Not Rated)
Webex Communications Inc (WEBX - $28.89 - Not Rated)
Websense Inc (WBSN - $54.22 - Buy)

Stocks priced as of July 20, 2005.

Regulation AC Disclosure:

Each analyst and associate who has participated in the preparation of this report certifies that the views expressed in this publication accurately reflect the personal views of the analyst about the subject company(s) and its (their) securities. The analyst and associate further certify that they have not received and will not be receiving direct or indirect compensation in exchange for expressing the recommendation contained in this publication.

Required Disclosures:

First Albany Capital makes a market in the securities of CallWave, InfoSpace, j2 Global, and Websense.

First Albany Capital managed or co-managed a public offering of securities for CallWave within the last 12 months.

First Albany Capital received compensation for banking-related services from CallWave within the last 12 months.

CallWave Inc. is currently a client of First Albany Capital which provides banking services for this company.

Within the last 12 months First Albany Capital provided banking services for CallWave.

First Albany Capital's Rating System

Strong Buy—*Potential return of 20% or more.*
Buy—*Potential return of 10%-20%.*
Neutral—*Fairly valued.*
Underperform—*Negative potential return of 10%-20%.*
Sell—*Negative potential return of 20% or more.*
Restricted— *Applicable laws and regulations preclude certain types of communications during the course of First Albany Capital's engagement in investment banking transaction and in certain other circumstances*

For our latest pricing chart for any of the companies mentioned in this report for which First Albany has maintained a rating for more than one year, depicting price target and rating revisions, please refer to http://www.firstalbany.com/itemDetail.asp?categoryID=180&itemID=16369.

Quarterly Report for 7/21/2005

Entire Universe - Total: 270

	Buys: 155(57.4%)	Sells: 11(4.1%)	Holds: 104(38.5%)

Banking Client Universe - Total: 26

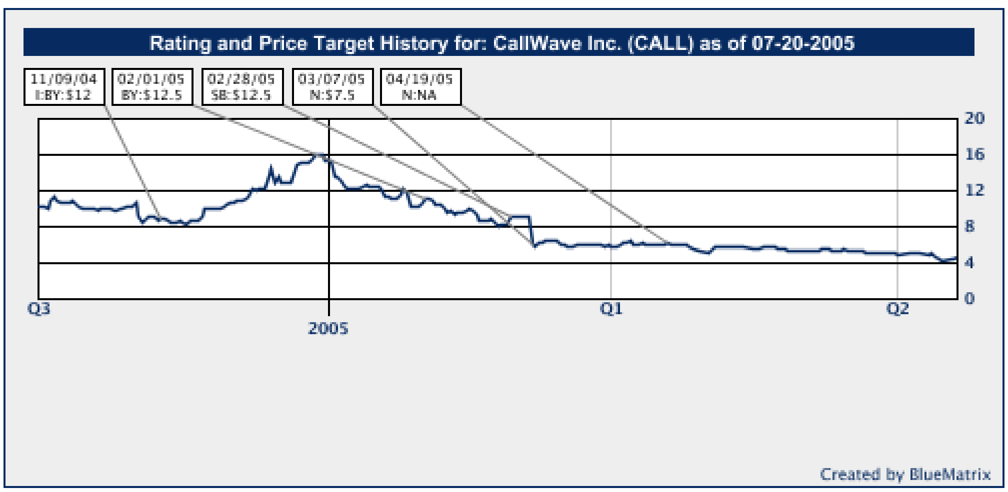
	Buys: 18(69.1%)	Sells: 0(0%)	Holds: 8(30.7%)

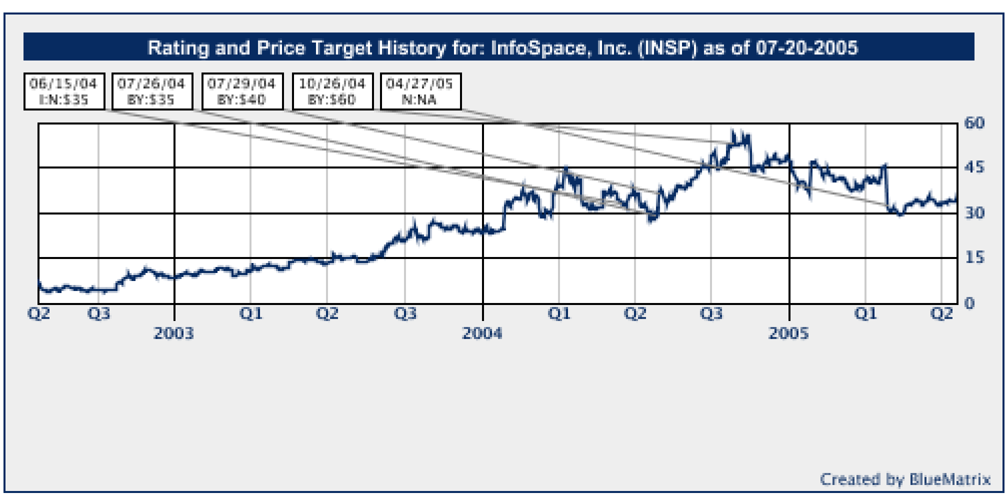
Entire Universe By Vertical - Total: 270

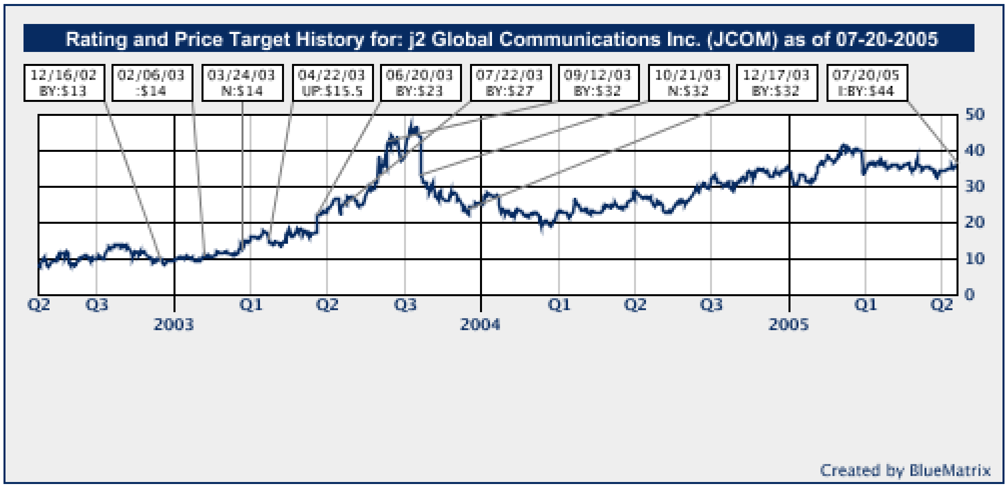
Consumer	Buys: 0(0.0%)	Sells: 0(0.0%)	Holds: 0(0.0%)	Total: 0
Economics	Buys: 0(0.0%)	Sells: 0(0.0%)	Holds: 0(0.0%)	Total: 0
Energy	Buys: 33(12.2%)	Sells: 1(0.4%)	Holds: 17(6.3%)	Total: 51
Equity Research	Buys: 0(0.0%)	Sells: 0(0.0%)	Holds: 0(0.0%)	Total: 0
Fixed Income	Buys: 0(0.0%)	Sells: 0(0.0%)	Holds: 0(0.0%)	Total: 0
Healthcare	Buys: 57(21.1%)	Sells: 2(0.7%)	Holds: 39(14.4%)	Total: 98
Special Situations	Buys: 17(6.3%)	Sells: 1(0.4%)	Holds: 1(0.4%)	Total: 19
Technology	Buys: 48(17.8%)	Sells: 7(2.6%)	Holds: 47(17.4%)	Total: 102

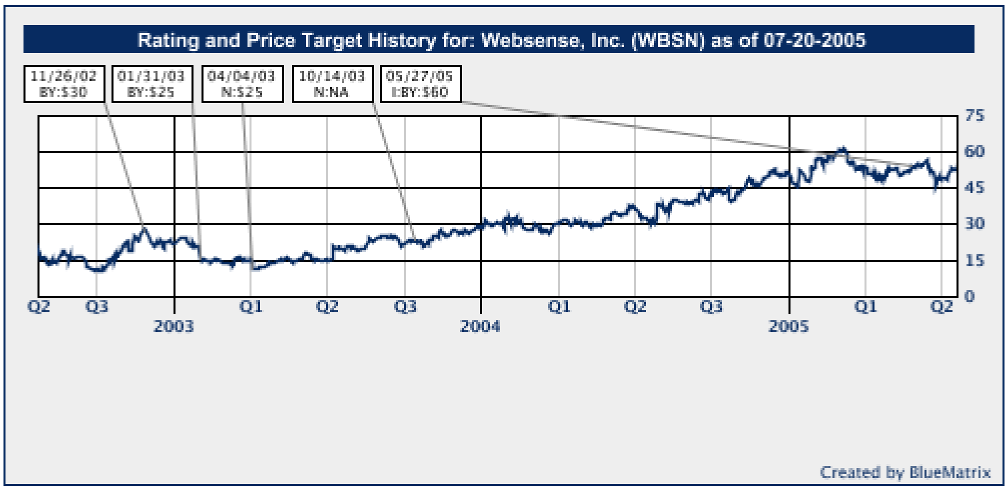
Banking Client Universe By Vertical - Total: 26

Consumer	Buys: 0(0.0%)	Sells: 0(0.0%)	Holds: 0(0.0%)	Total: 0
Economics	Buys: 0(0.0%)	Sells: 0(0.0%)	Holds: 0(0.0%)	Total: 0
Energy	Buys: 5(19.2%)	Sells: 0(0.0%)	Holds: 1(3.8%)	Total: 6
Equity Research	Buys: 0(0.0%)	Sells: 0(0.0%)	Holds: 0(0.0%)	Total: 0
Fixed Income	Buys: 0(0.0%)	Sells: 0(0.0%)	Holds: 0(0.0%)	Total: 0
Healthcare	Buys: 11(42.3%)	Sells: 0(0.0%)	Holds: 4(15.4%)	Total: 15
Special Situations	Buys: 1(3.8%)	Sells: 0(0.0%)	Holds: 1(3.8%)	Total: 2
Technology	Buys: 1(3.8%)	Sells: 0(0.0%)	Holds: 2(7.7%)	Total: 3









Other Disclosures and Disclaimers:

Although not compensated directly for any banking deals, an analyst may receive income from a bonus pool that may include monies derived from banking revenues.

Blue Sky exception in VI for CallWave, InfoSpace, j2 Global, and Websense.

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FIRST ALBANY CAPITAL

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Boston, Massachusetts 02110
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Chicago
First Albany Capital
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Chicago, Illinois 60606
877 751-2820

Minneapolis
First Albany Capital
294 East Grove Lane
Wayzata, Minnesota 55391
877 925-3220

New York
First Albany Capital
One Penn Plaza
New York, New York 10119
800 228-1146

San Francisco
First Albany Capital
One Montgomery Street, 24th Floor
San Francisco, California 94104
888 929-9292

More information is available on request.