

Equity Research

TECHNOLOGY  
Employer Services

September 30, 2004  
Basic Report (04-048)

Ticker: JCOM  
Price: \$31.59  
52-week: \$19-\$48

Stock Rating:  
**Outperform**

Company Profile:  
**Aggressive Growth**

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# j2 Global Communications, Inc.

## Initiating Coverage With an Outperform Rating

### Fax to E-mail Is an Attractive Alternative to the Traditional Facsimile Machine.

Low monthly cost, remote access, and confidentiality are all benefits of the fax-to-e-mail service, which requires only a personal computer and an Internet connection to use. Fax remains an important part of business culture despite technological advances in communication.

**Strong Financial Results Derived From a Recurring Revenue Base.** Roughly two-thirds of revenues represent monthly service fees paid by the 469,000 subscribers to the eFax Plus or jConnect Premier versions of the fax-to-e-mail service. We believe the company has only scratched the surface of the market opportunity, with an estimated 1% of the domestic fax market. The company is extremely profitable and generates strong cash flow, boasting operating margins in excess of 40% and free cash flow that has exceeded net income.

**Multiple Growth Opportunities and Attractive Valuation.** J2 is still a relatively small company and has several growth seeds planted for the future. Beyond the opportunity to deepen penetration in existing markets, the company is starting to enter international markets that we believe are at least twice the size of the domestic market, and has expanded its product portfolio to allow cross-selling of enhanced services to existing customers. While near-term revenue growth may slow—as the company has completed its recent pricing increase and there is uncertainty in the conversion of new customers from nascent marketing channels—we believe the stock partially reflects this near-term uncertainty and that longer-term growth prospects remain robust. With a price-to-earnings ratio of just 20 times our fiscal 2005 estimate with a three-year EPS compound annual growth rate of 36%, we believe that the company's current valuation is attractive.

*J2 Global Communications is a leading provider of outsourced messaging and communication services designed for individuals, companies, and government agencies. The company offers a range of product lines including fax/voice mail to e-mail, document management, outsourced e-mail, and phone conferencing.*

### FINANCIAL SUMMARY

Fiscal Year Ends:	December	Book Value Per Share (2004):	\$5.09
Long-term EPS Growth Rate:	36%	Market Value	\$734 million
ROE (2003):	44.9%	Insider Ownership:	17%

FISCAL YEAR	2003A	2004E	2005E
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ESTIMATES			
Earnings Per Share	\$1.05	\$1.19	\$1.58
Revenue (mil.)	\$71.6	\$103.7	\$133.7

VALUATION			
Price/Earnings Ratio	30.1x	26.5x	20.0x

William Blair & Company, L.L.C. has received compensation for investment banking services from the company within the past 12 months, or expects to receive or intends to seek compensation for investment banking services in the next 3 months.

Please consult pages 30 and 31 of this report for all disclosures.

## Company Description

Founded in 1995, j2 provides outsourced messaging and communications services, primarily consisting of enhanced fax-to-e-mail and unified communications. More than 90% of the company's revenue is generated from enhanced services, primarily fax-to-e-mail services. The company provides both a free service as well as feature-rich paid service. J2 currently has 469,000 paying customers and approximately 6.9 million free customers using its services. It boasts 29 consecutive quarters of revenue growth, with pretax operating margins in excess of 40%.

## Investment Thesis

### **Fax to E-mail Provides Benefits Over Traditional Facsimile Machines**

In excess of 90% of the company's revenues are derived from the sale of enhanced service products, including fax to e-mail, voice mail to e-mail, unified communications, and teleconferencing offerings. The most popular product offering is fax to e-mail, a feature that translates an inbound fax into an electronic document and then delivers the document to the user's e-mail inbox. Because the fax message is now an e-mail, it is enabled with all the benefits normally associated with e-mail, such as remote access and the ability to forward the message. Faxes can be received anywhere the user can access the Internet, and documents can be faxed directly from a computer desktop to any number worldwide.

Other advantages of a fax-to-e-mail service versus the traditional paper-based fax machine include confidentiality and enhanced document management and storage capabilities. Users need not worry about faxes "disappearing" from the fax machine or coworkers inadvertently reading a private fax, as all documents are securely delivered to a private e-mail address. Subscribers can eliminate the need to have a fax machine, reducing repair and maintenance expenditures and supply costs (paper and toner cartridges). The service requires only a computer and Internet access; no separate hardware or software is needed. Furthermore, additional phone wiring or a shared fax/telephone line is not required. Traditional fax machines can cost in excess of \$500 and a fax phone line can cost upwards of \$20 per month to maintain, plus usage fees. The fax-to-e-mail service can be purchased for as little as \$12.95 per month, and an introductory, limited feature version is available for free. The fax-to-e-mail functionality is available on eFax Free, eFax Plus, jConnect Free, and jConnect Premier products.

### **The "Free to Pay" Model Successfully Drives Growth, in Our Opinion**

To entice customers to use enhanced services, the company gives an introductory version of the product away free and then tries to "upsell" the customer to a more robust offering. The company has two versions each of eFax and jConnect: eFax Free and jConnect Free provide basic functionalities and, as the names imply, are free, while eFax Plus and jConnect Premier contain enhanced features and require a monthly service fee. We believe that j2's excellent financial results provide evidence that the free-to-pay approach can be successful and profitable in the fax-to-e-mail marketplace. For the quarter ended June 30, 2004, the company reported that it had in excess of 450,000 paying customers generating more than \$23 million of revenue; we believe that a majority of these customers initially were free users.

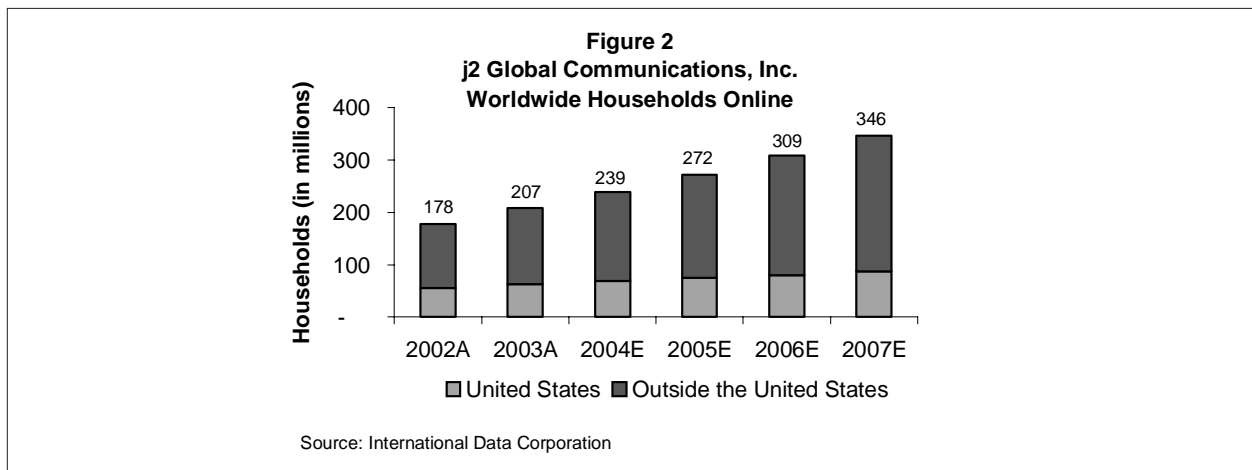
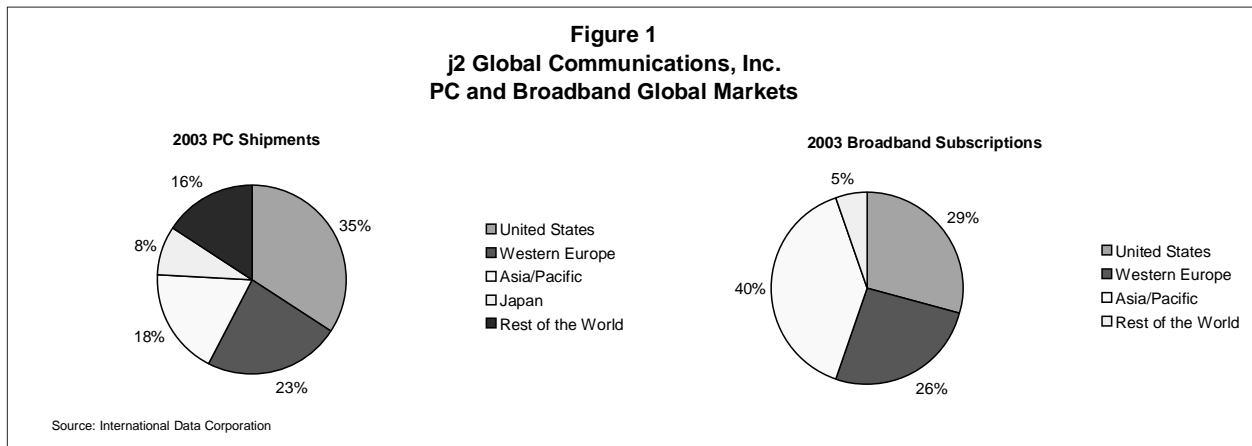
The sales process employed by the company is relatively simple, in our opinion. Using Internet-based advertising, the company solicits consumers to try eFax or jConnect for free. In exchange for the free service, the customer agrees to accept a limited number of advertisements and to allow j2 to monitor the usage of the account. Using a targeted marketing campaign developed by analyzing the customer's usage habits, the company then attempts to convert the free subscriber into a paying customer by educating the user on the benefits of the subscription services, which include the choice of a local fax number

(instead of a number with a North Dakota area code, for instance), outbound fax capabilities, and document management functionality. The company has been successful in converting free customers into paying customers; the number of paying customers has increased almost 35% in the past year. The difference in average revenue per user (ARPU) between the free and paid subscribers is, not surprising, large. The ARPU for a free customer is \$0.04 per month, and is derived primarily from advertising revenue. The ARPU for an eFax Plus and jConnect Premier customer is in excess of \$17 per month.

**Multiple Long-term Growth Opportunities**

We believe that the company is in the enviable position of having access to multiple avenues to achieve future revenue growth. Opportunities include international expansion of the eFax service, cross-selling of additional products into the eFax and jConnect user population, and the underpenetrated fax-to-e-mail markets, including middle-market companies, large corporations, and governmental agencies. In addition, as it has done historically, we believe the company can continue to successfully attract new free customers and convert them into paying customers, as well as expand through strategic acquisitions.

The company recently announced that it launched its first internationally focused product offering, an all-Dutch-language version of eFax targeting consumers in the Netherlands. If successful, the company intends to introduce other language-specific offerings into the European Union, a market in which fax communication remains a popular way of conducting business. Based on global computer shipment rates, number of worldwide households online, and broadband expansion rates, we estimate the international market is at least twice the size of the U.S. market.



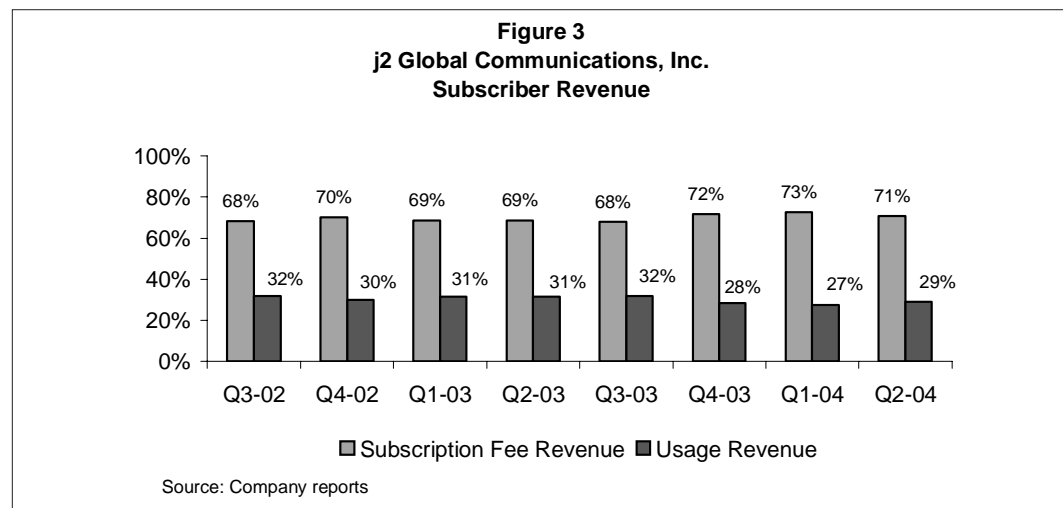
Furthermore, the combination of the free and pay customer base represents fertile ground for the company to cross-sell its sundry product offerings. To date, the company has not placed great emphasis on product cross-selling and, therefore, any future potential success would equate to upside to current revenue growth expectations. J2 has committed resources to expanding its corporate and government agency presence, a relatively underrepresented area, hiring a new director of sales with large-enterprise-client experience, and maintaining an 18-member sales staff. Importantly, on January 27, 2004, the company finalized a General Services Administration (GSA) contract, a virtual hunting license to sign up government agencies to use eFax and jConnect.

Lastly, the company currently has a population of 6.9 million free users who potentially can be converted into paying customers. We estimate that 25% of these free customers have been added within the last two quarters and that these customers are prime candidates for conversion to over the next nine months. We believe that the company should be able to continue to expand its free and paid customer bases, as fax remains an important communication method and relatively underpenetrated; Snapshots International estimates that 8.4 million fax units will be sold in the United States alone in 2004.

Using the estimated number of fax machines sold and assuming a five-year replacement cycle implies an installed fax machine base of about 42 million units. With 469,000 paying users, the company has penetrated roughly 1% of the estimated domestic installed base of fax machines.

**Recurring Revenue Base Business Provides Predictability**

EFax Plus and jConnect Premier customers pay upfront to access the service and are billed on a monthly basis, creating a significant recurring revenue stream, with approximately two-thirds of customers using a credit card (positive float). Because of the low cost and regular billing cycle, we believe this service is viewed by consumers as just another monthly service, similar to Internet access, cable/satellite, and cellular phone. Charges include a standard monthly service fee plus a usage fee, which varies based on the number of fax pages received and sent in excess of the service agreement.



The company's cancellation rate or churn (defined as an individual customer with greater than four months of continuous service and an enterprise customer beginning from the first day of service) has decreased from 3.6% in first quarter 2003 to 2.4% in third quarter 2004, despite a roughly 25% to 30% price increase over the same period. While we do not anticipate additional price hikes for its base service offering, we believe the company's success in implementing the increase with relatively minimal customer churn is evidence of the perceived value of the service. Over the same period, the number of paying subscribers has increased from approximately 300,000 to nearly 470,000, a 56% increase. Monthly service fees currently account for approximately 70% of subscriber revenue and have remained

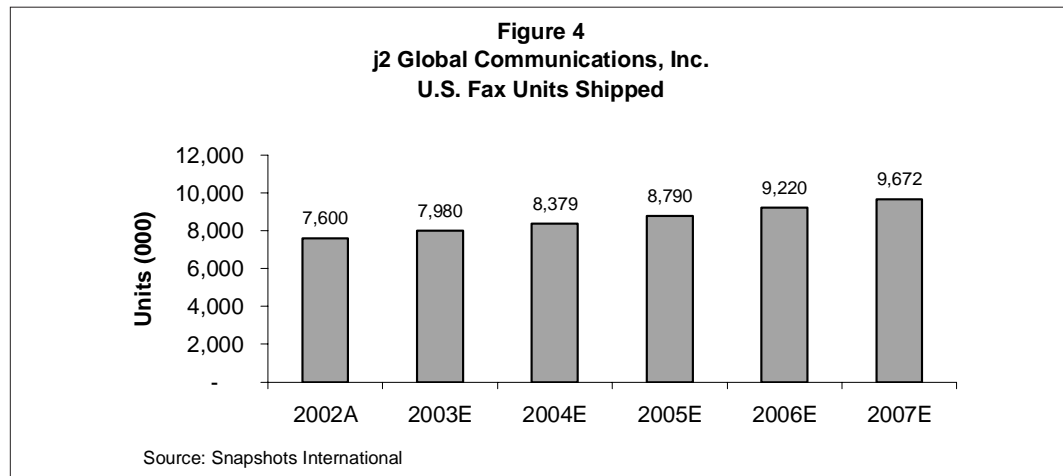
stable within a narrow range of 68% to 73% of subscriber revenue over the past two and half years. The remaining 30% of subscriber revenue represents usage charges (inbound and outbound fax per page fees).

**j2 Global Is Highly Profitable, Generates Strong Cash Flow, and Possesses a Solid Balance Sheet**

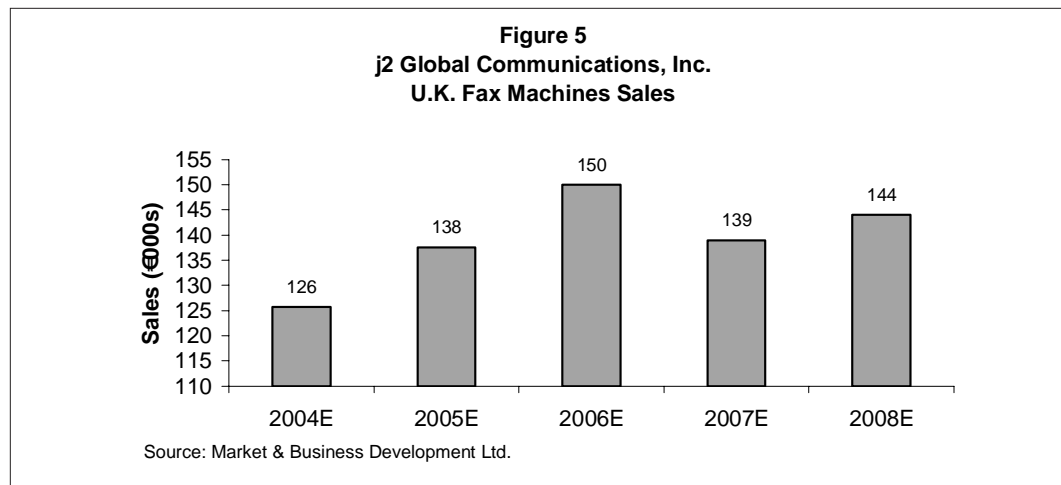
The company boasts gross margins in excess of 80%, operating margins greater than 40%, and a balance sheet flush with cash and virtually no debt. In addition, the company has achieved tremendous revenue growth, with a compounded annual growth rate of 56% since 1999, and has reported 29 consecutive quarters of revenue expansion. Cash flow is strong, capital expenditure requirements are minimal, and the balance sheet has almost \$3 per share cash. For the three-month period ended June 30, 2004, the company generated an impressive annualized return on assets of 23.1% and a return on equity of 25.3%. While there are a number of competitive offerings, we believe the company’s long history has resulted in a more robust offering, and better-known service with strong distribution and relationships with telephone companies.

**Large Addressable Markets**

We believe the fax machine market is large and remains underpenetrated for the company’s solutions. We estimate the installed base of fax machines to be 42 million units, of which j2 has penetrated just 1% of the market. In addition, Snapshots International’s *U.S. Facsimile Equipment 2003* report estimates that 7,980,000 fax machines were sold in the United States in 2003. A review of fax machines listed on Amazon.com revealed that fax machine prices can range from \$20 for a low-end machine to upward of \$900 for a laser printer fax machine. The most common price range was between \$150 and \$300 per machine. Using the midpoint of this price range and Snapshots International’s estimate of machines sold in 2003, we estimate that the annual market for U.S. fax machines sales is roughly \$1.8 billion. By 2007, Snapshots International forecasts the facsimile equipment market to expand to nearly 9.7 million units. Using an average selling price for a fax machine of \$225, this translates into a market size of close to \$2.2 billion in the United States alone. In 2003, j2 reported sales of \$71.6 million, or almost 4% of the addressable market for new fax machines.



Concerning the European fax machine market, MBD estimates that sales of fax machines in the United Kingdom have increased 23% during the period 1999 to 2003 to an estimated •159.1 million. MBD forecasts this market to be uneven over the next five years, trending to nearly •144.0 million in 2008, as pricing pressures offset unit increases. Fax remains particularly attractive to and popular with end-users who require receipt of a signature page, of which the fax protocol is legally binding, such as financial, legal, and real estate professionals, all large markets in our estimation. While certain segments of the fax market may be declining as alternative technologies such as e-mail gain traction, fax communication remains ubiquitous and provides ample opportunities for the company to expand.



### Strong Management and Corporate Governance

We believe j2 has a strong management team, with excellent knowledge of the industry, the core technology, and the complexities surrounding the telecommunications industry. Management has delivered solid financial results historically, and we believe it has positioned the company well for the future. Furthermore, management is very conscious of the sensitivity surrounding stock option plans and other senior management compensation issues. In our opinion, the stock option plan is very reasonable relative to other technology companies, with less than 1% of total outstanding shares issued during fiscal 2003. Of further note, a large portion of the options outstanding remain deep “in the money,” in our view, further evidence of the continued commitment to profitably expand the business. As of December 31, 2003, the weighted average share price of options outstanding is \$4.29, well below the current stock price.

## Investment Concerns

### Relevance of Fax in the Internet Age

With the proliferation of e-mail and the Internet, businesses have become less reliant on faxing as a communication method. The popularity of online order sites, Internet commerce, and e-mailing documents has changed the way business is conducted. Many companies have scaled back the number of fax machines in use, often electing to share one fax machine among several departments. Furthermore, advancements in electronic document production and processing using Adobe PDF files and document management systems provide alternatives to fax as a method of business communication. The movement to a universal standard for a digital signature may further reduce the reliance upon faxed documents, in our opinion. However, we believe that digital signature technology remains underdeveloped and fragmented, reducing the risk to the company in the near term. In addition, the fax machine remains a part of business culture. Despite the technological advances, the receipt of a faxed signature page is still necessary for many businesses to complete a transaction. A fax number is still a must-have item to operate a business. The shipments of fax machines continue to grow; Snapshots International projects a 4.9% compounded annual growth rate in units shipped in the United States for the 2002-2007 period. Furthermore, j2’s fax solution marries the new technology with the older fax technology, we believe positioning the company well during the technological shift.

### **Potential Near-term Dip in Top-line Growth**

Over the next two quarters, the company's revenue growth may slow if the free-to-pay conversion cycle is not consistent with historical experience. This conversion process is an inexact science, and the company may not be able to replicate its past performance. It is possible that the company's decision to expand the number of Internet marketing channels has created a free user base with conversion traits different from previous populations. If so, the current free user base may be more challenging to convert than previous populations, which were obtained from a more select group of Internet sources.

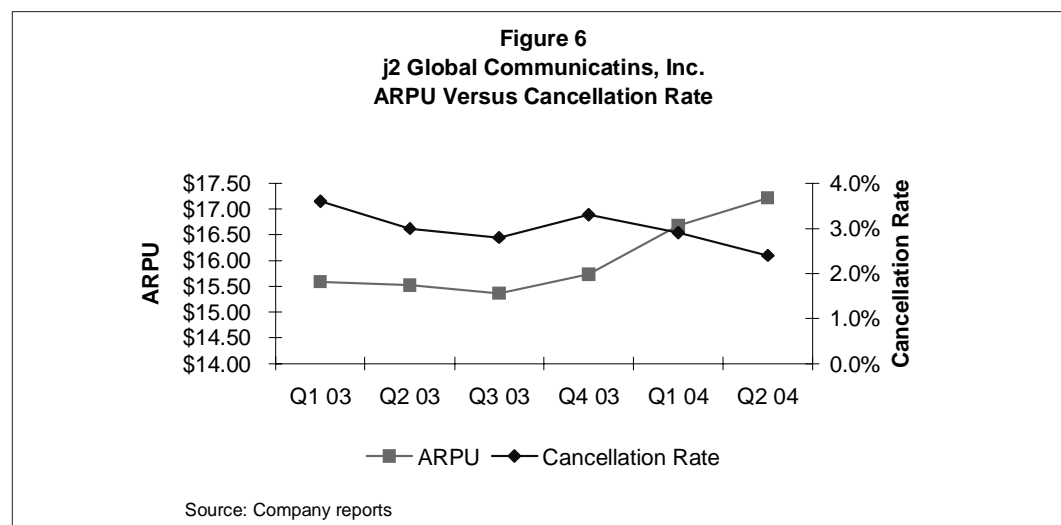
Lastly, the final stage of a price increase for eFax Plus and jConnect Premier was completed in second quarter 2004. While we are impressed with the degree of pricing power the company has exhibited, we suspect that it will be difficult to implement another price increase in the near future, particularly given that j2 is not the low-cost option in the fax-to-e-mail marketplace. Despite aforementioned risks, we are optimistic about the company's intermediate and long-term growth prospects because of the large overall increase in free users. Management has a proven record of successfully growing the pay user base, a historical key driver of revenue growth.

### **Availability and Costs of Direct Inward Dial Numbers**

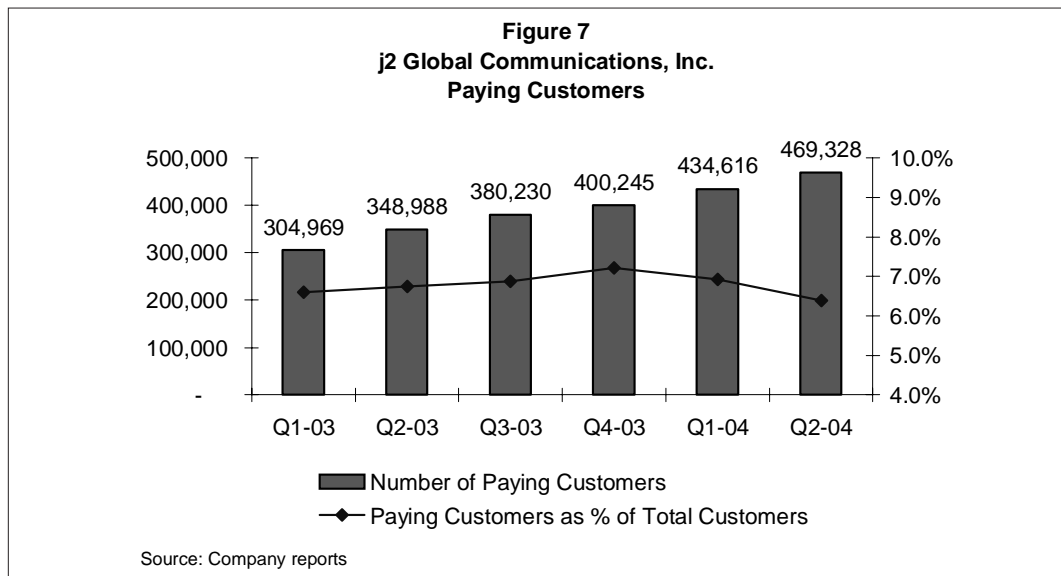
The backbone of the company's product offerings requires the use of a phone number, or DID (direct inward dial phone number). As the name implies, DIDs carry inbound call traffic only. The company obtains most DIDs from either competitive local exchange carriers (CLECs) or incumbent local exchange carriers (ILECs) typically for free or for a nominal fee. As a result of current regulations governing call termination fees and the Universal Service Fund (USF), services such as eFax that stimulate inbound call traffic can generate profitable termination/access revenue for carriers. Termination/access fees are often paid on a per minute basis by the calling party's carrier for use of the terminating party's carrier network. Therefore, carriers with a large supply of unused numbers often willingly grant j2 access to DIDs for free or for a nominal cost. If the current regulatory structure were to change in a way that would reduce inbound call revenue received or increase costs paid by the carriers (USF), we believe the company may not be able to receive low-cost/free DIDs. For instance, if regulators shifted the current USF charge to a per-line charge, this substantially could increase the company's cost of providing service. Such an increase also would likely alter its ability to pursue its free-to-pay strategy, given the relatively low revenue currently received from free customers. However, we view any such changes to either the USF or call terminations regulations unlikely in the near term, as any modifications would require both FCC approval and agreement among the CLECs and ILECs, each with competing interests that have not been able to historically agree on proposed changes.

## Market Position and Corporate Strategy

In our opinion, the company has positioned itself to be a leading provider of outsourced fax-to-e-mail solutions. The company offers a number of superior products, possesses professional and easy-to-use product Web sites, and provides high-quality customer service. The company is able to charge a premium price for eFax Plus, eFax Corporate, and jConnect Premier because of its breadth of product features and functionality, its dedication to providing excellent customer service, and its financial stability and transparency. J2's commitment to provide high-quality customer service allows it to not only charge a premium price, but also to maintain a low customer-cancellation rate. We believe the company's premier position in the fax-to-e-mail market is evidenced by its pricing power. Despite the implementation of a 25%-30% price increase (dependent upon the product—the price increase did not include eFax Corporate services) announced in second quarter 2003 and substantially completed by the end of second quarter 2004, the user cancellation rate decreased over this same period.



Because the company is an Internet-based solution provider, its Web site is a critical component of its business model. Based on our review of company and competitor Web sites, the family of j2 Web sites is easy to navigate, informative, and professional, and is superior to the sites of the competition, in our opinion. Customer service information is readily available, subscription rate information is published to eliminate confusion, and links to additional product lines are plentiful. J2 has been a public company since 1999, and therefore current and historical financial results are readily available. The financial transparency resulting from being a public company allows corporations making critical outsourcing decisions the opportunity to assess the financial stability of their outsourcing partners. Because of j2's outstanding financial position, we believe that being an SEC registrant is a competitive advantage, especially as the company continues expansion into the corporate and governmental marketplace.



**Converting eFax Free and jConnect Free Users to Pay Users**

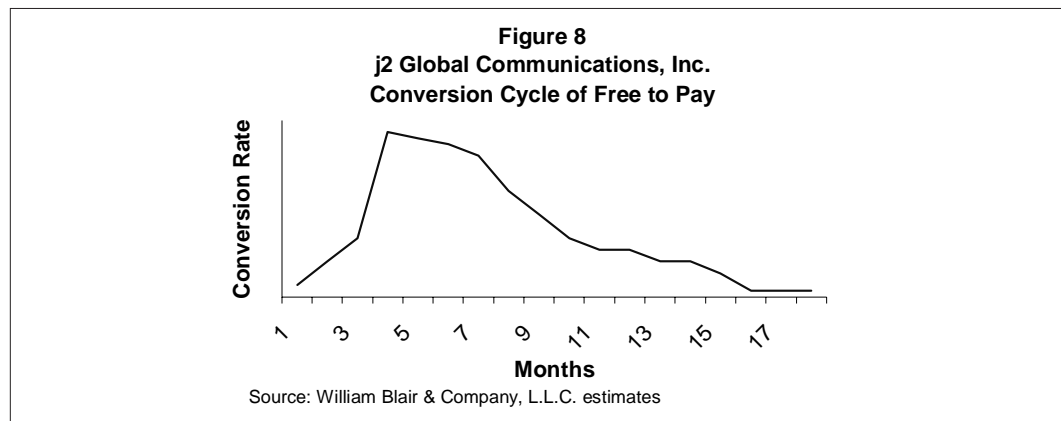
The company’s leading products are eFax and jConnect, constituting more than 90% of revenues. Online advertisements on popular Internet Web sites such as Yahoo! and Google are used to link users to the eFax or jConnect Web sites or to a direct promotion site. At the Web sites, customers can register to use free services without commitment, as long as they adhere to rules of the service. Once registered, users become members of the free community. This free user base is valuable for two major reasons, in our opinion. First, the company earns revenue by distributing third-party advertisements to the base, as free subscribers agree to receive a limited number of advertisements in return for use of the service. Second, the company attempts to induce members of the free population to convert to the more lucrative eFax Plus or jConnect Premier service.

**The Secret Sauce**

Life cycle management is the process by which the company attempts to convert a free user into a paying user. The life cycle management program is a blend of introductory and instructional notes, usage stimulation messages, and direct offers to upgrade to either eFax Plus or jConnect Free sent to each free user. Life cycle management is made possible by j2’s ability to monitor each subscriber’s service usage. Combining the usage analysis with information gathered upon initiation of the service, a user profile is established. Armed with this profile, the company then develops a marketing campaign designed to persuade the free user to upgrade.

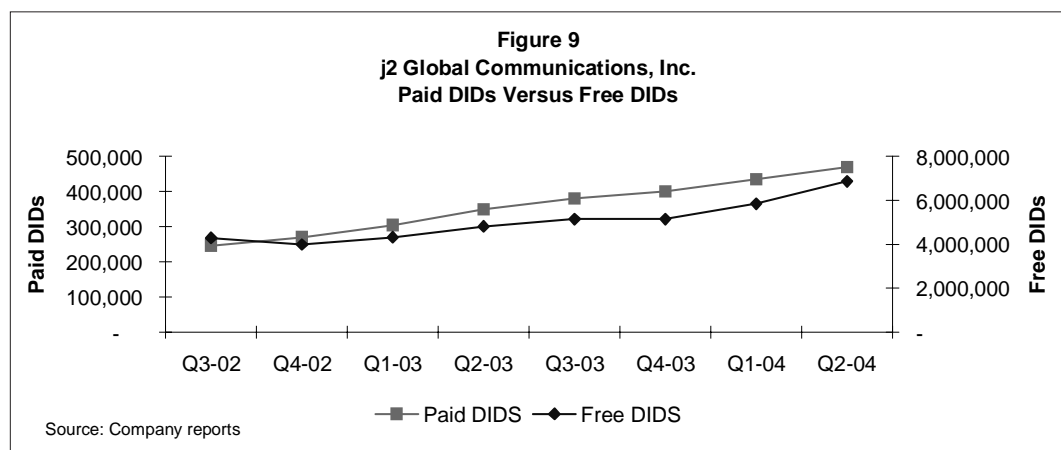
Within the first few weeks after commencing service, free users receive a handful of introductory messages that include simple usage instructions, narratives explaining basic service features, and helpful tips on how to most efficiently use the service. In addition, usage stimulation messages are sent to users who registered for the service but have received only a small number of faxes within the first few months. These messages are designed to be friendly reminders to users that they now have their own private fax number; the message encourages distribution of the number to family, friends, and businesses. After a few months, a usage pattern is established. The company then employs a marketing campaign designed to convince the free user to upgrade to eFax Plus or jConnect Premier. Messages delivered highlight features of the package that could best benefit the user based on usage habits. For instance, an eFax Free user who exceeds the inbound fax page limitation would receive a message that explains that the eFax Plus package allows users to receive upward of 300 inbound pages per month.

The company has stated that the sweet spot for potential conversion of a free subscriber to a paying subscriber occurs in the 4- to 16-month period after service is initiated. After 16 months, the company believes that it is no longer cost effective to try to convert a free subscriber because of a low historical success. However, the company makes no effort to discourage aged free users from continuing to use the service. As long as subscribers adhere to the user agreement, they are allowed to continue using the service, and j2 still will earn advertising revenues on these customers.



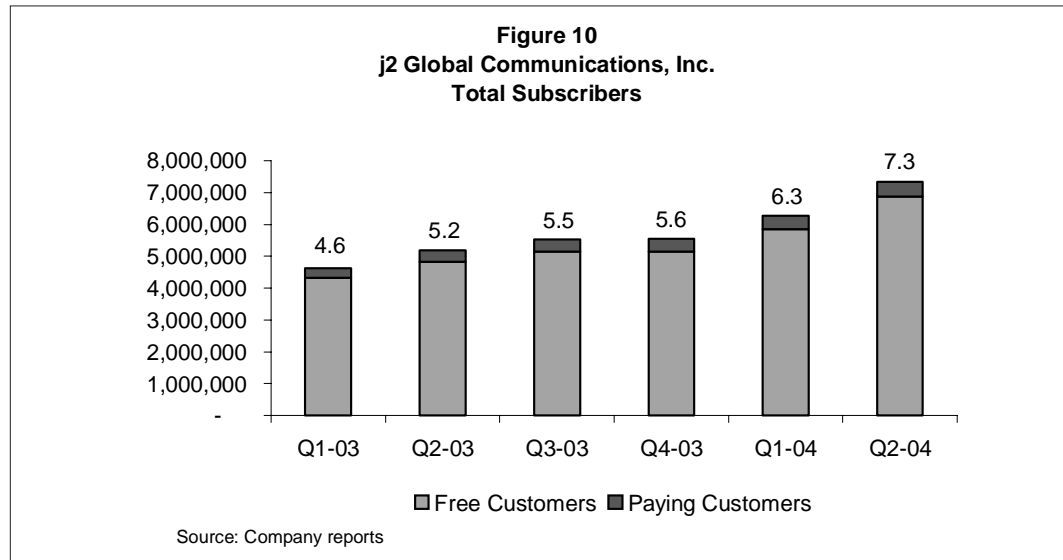
**Free DIDs Make It All Possible**

We believe that the company’s recipe for success includes the combination of its life cycle management program and its ability to obtain free DID. As of June 30, 2004, the company had a total of 7.3 million DIDs under management (469,000 paid DIDs and 6.9 million free DIDs). Access to free DIDs provides the foundation on which the company can grow the free user base, which in turn spawns the growth of the lucrative paid user base. Leveraging an expanded group of relationships, recent growth in the free DID users has been explosive. At the end of fourth quarter 2003, the company base of free DID users was 5.1 million. By March 31, 2004, this base expanded by 800,000 users, and an additional 1 million by the end of second quarter 2004, bring the total free DID population to nearly 6.9 million users. In addition, the company has a backlog or inventory of approximately 2.2 million unused phone numbers allocated between free, paid, and internationally based DIDs.



The company supports an internal department dedicated to procuring DIDs and managing the existing base. This department works closely with both CLECs and ILECs (collectively referred to as carriers) to secure free DIDs. The company receives a large percentage of free DIDs from carriers servicing the less populated areas of the country. For example, the company may receive a block of 10,000 to 100,000 free DIDs with the area code 307, because this area code covers a low population area (in this case Wyoming). In this example,

because there is more supply than demand for 307 numbers, carriers will provide excess numbers to j2. In contrast, the company may not receive any free DIDs with the prefix 212 (New York City), because this area code covers a very densely populated area and is an exhausted area code. The 212 area code numbers are in high demand, and as a result the carrier will not provide DIDs with area codes in high demand for free. If j2 desires a DID with a 212 area code, it will have to pay the carrier for the number. While the company will pay for a DID when it is for an eFax Plus customer, it is not cost effective to do so for an eFax Free customer.



Carriers in less populated areas tend to have a large inventory of unused numbers, and will grant j2 access to these numbers because eFax users generate inbound call volume, providing a source of access or reciprocal compensation revenues for the carrier on otherwise unutilized numbers. Reciprocal compensation agreements were created in response to the passage of the Telecommunications Act of 1996, which required that ILECs provide access to their network to CLECs. Reciprocal compensation agreements ensure that when two separate carrier networks are used to deliver a call, both carriers receive compensation, because both carriers incur costs in handling the call. For instance, if two networks are used to connect a call, only the carrier that services the customer that initiated the call receives revenue (from the customer monthly service bill), even though the call required both networks to incur costs to complete the call. Reciprocal compensation agreements require that the carrier that provides service to the customer that initiated the call provide compensation to the carrier that owns the network on which the call terminated. Therefore, by providing j2 with unused phone numbers, carriers are able to generate reciprocal compensation/termination revenues from inbound fax calls. EFax Free users typically are assigned non-local area codes as their fax number. Because j2 receives a significant portion of its free DIDs with area codes that cover underpopulated or rural areas, a large portion of inbound faxes are serviced by more than one carrier network, and therefore earn the carrier termination compensation revenues.

A change in the structure of reciprocal compensation agreements potentially would change the economic relationships between network carriers and, as a result, affect the ability of j2 to secure free DIDs. In our estimation, if reciprocal compensation agreements were eliminated, carriers would have little economic incentive to provide DIDs at zero cost to j2, and mostly likely would charge j2 a monthly service fee per line. If j2 were required to pay a per-line fee for DIDs, the eFax Free service would become significantly more costly to operate. However, we view any changes to the current structure as highly unlikely, as any modification would require the agreement of all CLECs, ILECs, and the FCC, parties that historically have been unable to agree on changes due to conflicting economic interests.

The availability of free DIDs also is dependent upon the administration of the Universal Service Fund (USF). The USF was created as part of the Telecommunications Act of 1996 (the Act) to ensure high-quality telecommunication services are made available to all consumers. The USF helps to provide telecommunication services to rural regions, low-income communities, and high-cost areas at costs comparable to what is available in more highly populated or affluent areas. In addition, schools, libraries, and health care providers also are provided with assistance under the USF. The act calls for all providers of telecommunication services to contribute to the USF in an "equitable and nondiscriminatory manner." The FCC requires all telecommunication companies to pay a percentage of interstate end-user revenue (access revenue) to the USF. This percentage is commonly known as the contribution factor and is adjusted on a quarterly basis based upon funding needs. For fiscal third quarter 2004, the FCC-proposed contribution factor is 8.9%. We believe that if the USF contribution factor were modified to a per-line charge basis, J2's ability to receive DIDs for free would be negatively affected. Carriers likely would pass the USF per-line fee along to J2. We believe that the per-line charge would be greater than the free user ARPU. However, similar to reciprocal compensation, we believe that change to the funding structure is highly unlikely, as any modification would require the agreement of all CLECs, ILECs, and the FCC.

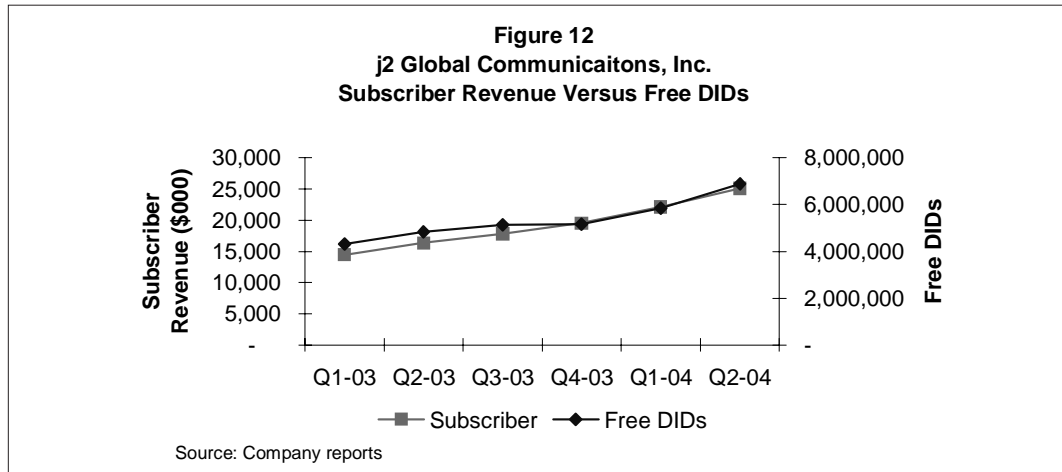
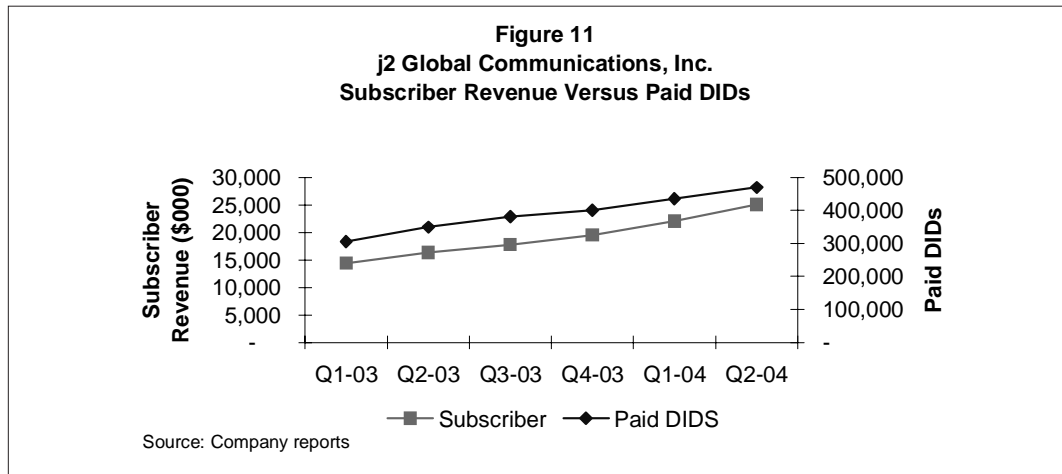
The ability to secure additional free DIDs is critical to the continued growth of the eFax user base—and therefore a key component to future revenue expansion. We believe that the company is adept at managing the DID procurement process, evidenced by the fact that the company has in excess of 2.2 million DIDs available for use as of June 30, 2004—impressive, in our opinion, considering that the company already added more than 1 million free DID users in the quarter then ended. In addition, the company has obtained DIDs in 20 countries and more than 1,350 cities. We believe that the company's ability to secure and obtain large amounts of DIDs is a competitive advantage; we know of no other company providing DID-based value-added services that has as many free DIDs under management.

#### **Multiple Prospects for Revenue Expansion**

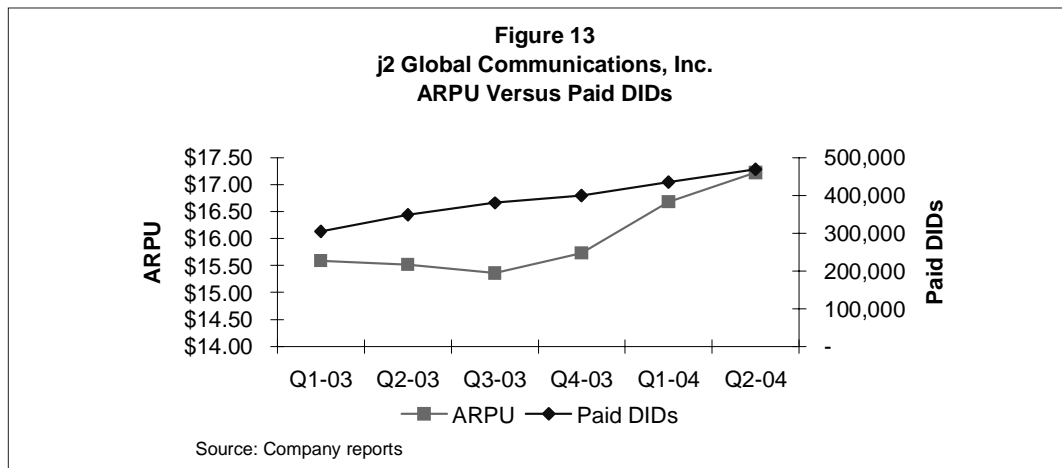
In our estimation, the company has many unique and significant opportunities to achieve revenue growth over both the short and long term. These include 1) capitalizing on the recent increase eFax Free user base, 2) aggressively adding new eFax free users, 3) exploiting cross-selling opportunities, 4) exploiting corporate and government markets, 5) international opportunities and 6) acquisitions.

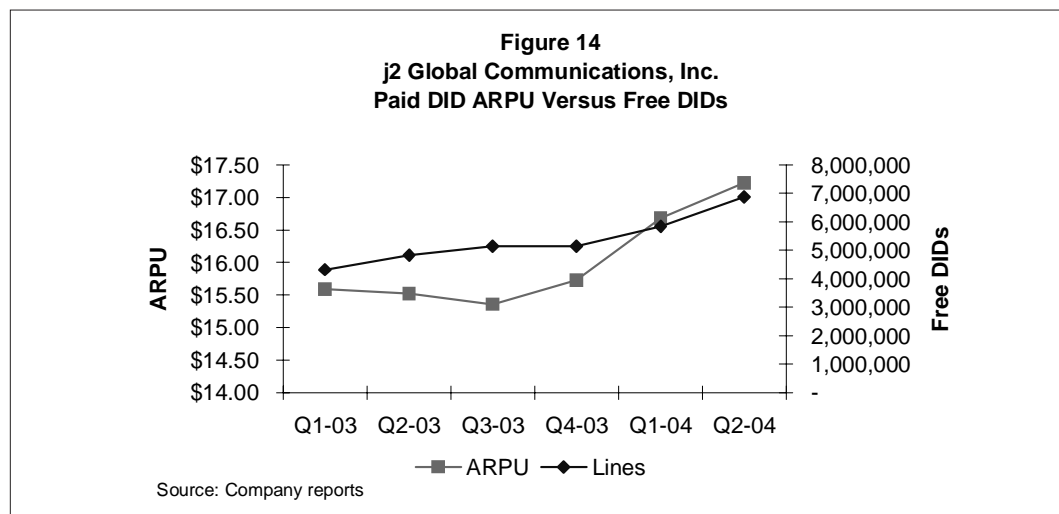
#### **Increase eFax Plus User Base and Continue to Add New Free Subscribers Aggressively**

During the first six months of 2004, the company embarked on an aggressive marketing campaign to add free users. J2 expanded to 17 the number of Internet sites on which it advertised the eFax and JConnect services. As a result, during this six-month period, the free user base increased by about 1.8 million, or 33%. The company historically has been able to convert a portion of free users to paid subscribers, stating that conversion typically occurs between 4 and 16 months of becoming a service initiation. The company has not publicly announced its historical conversion success rate. However, our analysis suggests the company could see its paid user base increase nearly 19% to 557,000 users by the end of fiscal 2004. If the company can continue to successfully execute its life cycle management program, we should witness a continuation in the growth of eFax Plus and JConnect Premier users. In addition, the company is developing new functionality for the fax-to-e-mail service, including the ability to provide additional data storage capabilities. The company anticipates being able to charge additional fees for these enhanced benefits, further expanding revenues.



The free subscriber base serves as a pipeline of revenue opportunity for the company. As this free base of users grows larger, more users are pushed through the company’s life cycle management program. Every new user who goes through the life cycle management program is another potential eFax Plus or jConnect Premier user. We believe that the company can expand its revenue base by seeking new methods of customer acquisitions and further leveraging existing Internet marketing relationships. Historically, the paid user group has grown in line with the growth of the free service population. We believe if the company can continue to expand the population of free users, additional revenue growth can be achieved.





### Cross-sell Products to Free and Paid Users

The company has a large population of service users under management that have agreed to accept advertising messages. Therefore, these customers are eligible to receive messages that market the complete line of j2 offerings including jBlast, eFax Broadcast, Consensus, and PaperMaster. We believe that the free user base is an extremely valuable asset of the company with significant cross-selling potential. To date, the company has not placed much emphasis on cross-selling products. However, j2 has stated its intention to proactively market its product line to the eFax and jConnect user population. We estimate that a cross-marketing campaign could be performed at low cost, and thus would carry high incremental profitability for the company.

### Corporate and Government Agencies Are Attractive Candidates for eFax Service

The company aggressively is attacking large corporate enterprises and government agencies, a large and underserved market for fax-to-e-mail services. To service the market, the company has created the eFax corporate Web site, and assembled a dedicated sales team led by a sales manager with experience with large corporations and government agencies. As a result, the company boasts the Federal Reserve as a client, and it aggressively is targeting other federal agencies. The Federal Reserve is the company's first governmental client, and has provided the company with experience and insight to the usage patterns, habits, and needs of the government users. We expect the company to leverage this knowledge and expand its reach into other governmental agencies as the company has a new GSA contract in place. We believe that the company is a very minor player in the large corporate and governmental fax marketplace. Therefore, if the company successfully can make inroads into this market, the potential lift to eFax revenue is significant. In addition, we believe that the company will be able to cross-sell into corporate enterprises and government agencies as eFax relationships are developed.

### International Expansion of eFax Service

One of the company's most intriguing growth opportunities, in our estimation, is the expansion of eFax into international markets, which combined have an addressable market of at least twice the current domestic opportunity, in our estimation. The European markets are extremely attractive, as many European Union countries are both PC savvy and maintain a tradition of using the fax machine to conduct business. However, international acceptance of the eFax service to date has been limited, primarily due to lack of effort. Although eFax Plus customers have access to fax numbers in more than 20 countries, the service, Web site, and customer service are supported in English only, and payments are accepted only in U.S. dollars. Leveraging a recent acquisition in the Netherlands, the company has completed and launched an all-Dutch eFax Web site, with services customized to needs and traditions of local business, and with local currency payment options. The company is

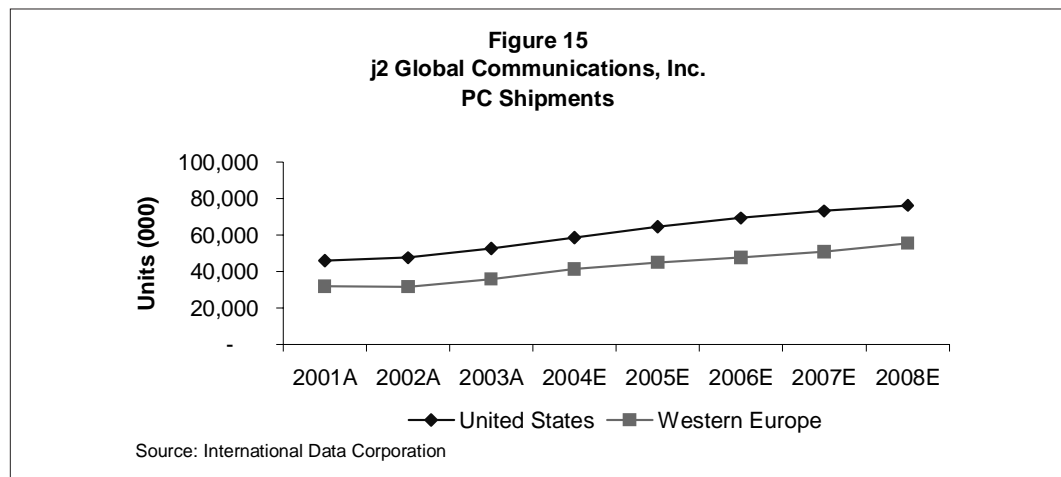
exploring the replication of the country-specific service in other European countries, focusing on those countries that have heavy fax users, a high PC penetration, and high-speed Internet access.

### Targeted Acquisitions

Although we believe that the company's existing fax services offer open-ended growth opportunities over the intermediate term, j2 has been active in reviewing acquisition targets. We believe the company is focused on businesses that possess a product line that enhances its unified communications offerings, or provides access to international markets to aid in the expansion of its faxed-based products. The company recently has completed three acquisitions: The Electric Mail Company, Jump B.V., and Onebox. The Electric Mail Company, a Canadian-based provider of outsourced e-mail and messaging services, strengthens the company's core messaging base of products. With this acquisition now complete, the company can offer complete outsourced e-mail and fax communication service capabilities to corporations and government agencies. The purchases of Jump B.V. and the Onebox unified communication assets provide additional unified communication capabilities, increase the company's paid subscriber base, and provide access to additional DIDs both in the United States and in Western Europe. We believe the company has adequate financial resources on hand to opportunistically perform additional acquisitions. We believe the company will continue to look to both expand its range of product offerings and extend into new marketplaces using targeted acquisitions.

## Industry Outlook and Trends

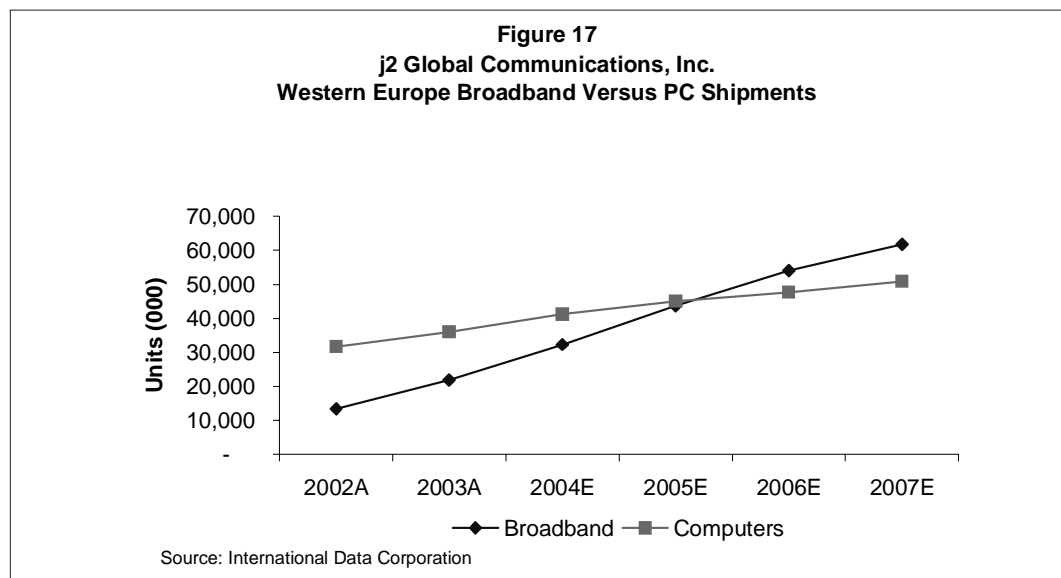
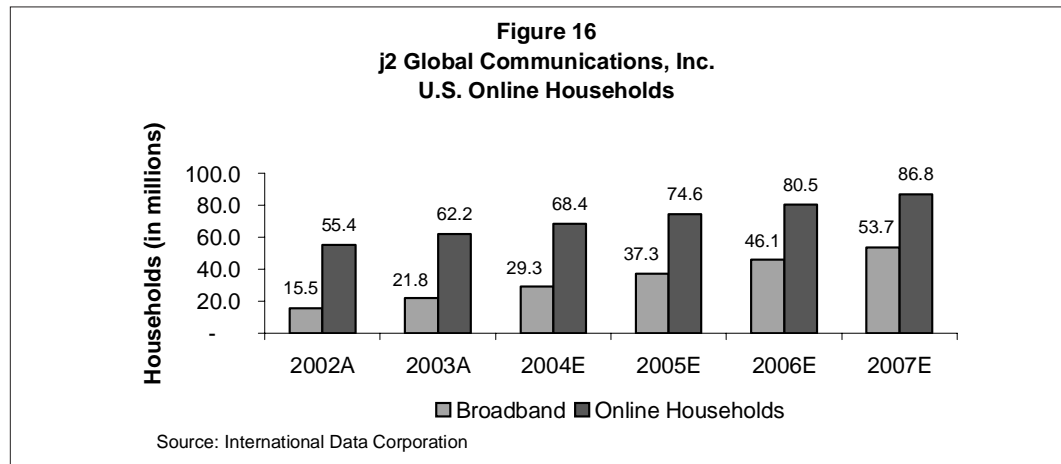
Trends in PC shipments, high-speed Internet access, and facsimile machine sales lead us to conclude that j2's positive momentum will continue. In addition, home offices, real estate firms, and law offices all represent large addressable markets for fax-to-e-mail services.



### PC Sales Continue to Rise

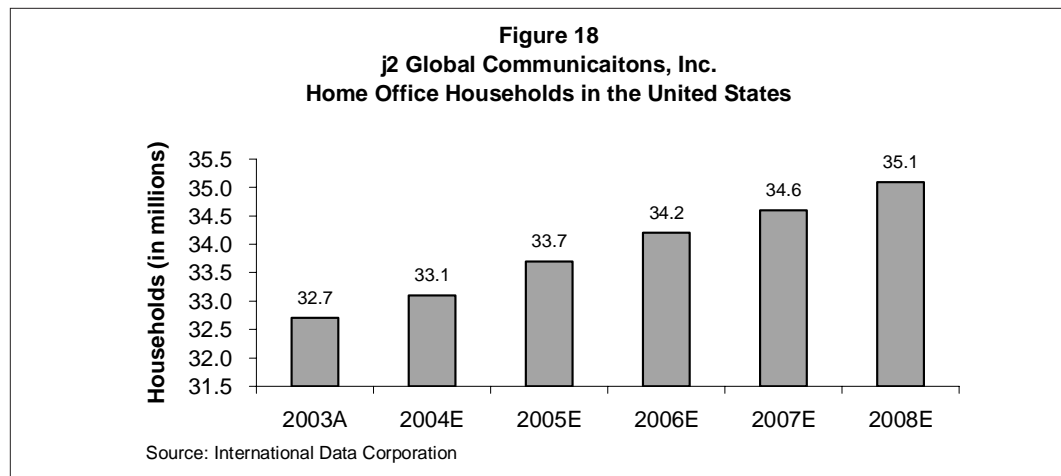
We believe that the positive trends in PC growth support continued growth of the fax-to-e-mail market. Both inside and outside the United States, PC shipments are forecast to increase. As reported in International Data Corporation's computer estimates (June 2004 Update), worldwide 2004 PC shipments are expected to increase 13.5%, to 175.3 million units. Regionally, in the United States, 2004 shipments are projected to rise 11.3%, and in Western Europe 2004 shipments are expected to grow 14.6%. The 2003-2008 worldwide compounded annual growth rate of PC shipments is expected to approximate 9.7%. Household PC penetration rate was 59% at end of 2002 and is expected to reach 72% by the end of 2008. In 2004, PC shipments within the United States are expected to total 58.7 million units, or

33% of worldwide ships, and Western Europe is forecast to account for 24% of global units, or 41.2 million units. Both Western Europe and the United States represent significant growth opportunities for fax-to-e-mail solutions, in our opinion, as continued strong PC shipments increase the potential addressable market for fax-to-e-mail services.



### High-speed Internet Access Proliferates

We are also focused on consumers' ability to obtain high-speed Internet access. We believe that high-speed Internet access enables a PC user greater realization of the benefits of Internet-based services such as fax to e-mail. In addition, the forecast decline in broadband pricing should aid in increasing residential adoption rates, in our opinion, further expanding the potential addressable market. IDC estimates that worldwide broadband adoption increased 70.2%, from 34.2 million subscribers in 2001 to 58.2 million in 2002. Internet usage in Western Europe continues to grow, with digital subscriber line (DSL) the most popular way to access the Internet. In the United States, broadband users are forecast to grow from 17.3 million in 2002 to 59.8 million by 2008. Western Europe users are forecast to grow from 13.4 million in 2002 to 61.8 million by 2008. Asia-Pacific users are forecast to grow from 24.4 million in 2002 to 69.5 million by 2008. At the end of 2002, 55.4 million U.S. households could access the Internet; IDC estimates that by 2007, 86.8 million U.S. households will be able to access the Internet (a 56.6% increase). In addition, IDC estimates by the end of 2007 there will be 347 million worldwide households online.



### Home Offices Offer Potential Target Market

We believe many home office users could benefit from fax-to-e-mail services, and we believe they represent a substantial addressable market. IDC reports that at the end of 2003, there were 32.7 million home offices in the United States. While IDC forecasts a compound annual growth rate in home offices of 1.4%, we believe that the forecast growth in high-speed Internet will help to spawn continued growth in home offices. We believe home offices users represent a tremendous opportunity for j2 on two basic fronts. First, individuals who use a home office as a primary place of business are ideal candidates for fax to e-mail. The low monthly cost of eFax Plus or jConnect Premier and the space efficiency (no additional equipment or phone lines needed) are attractive features to home office users, in our opinion. Second, for individuals using a home office as a second office, the ability to have full fax capabilities both at their primary office and home office using only one fax number promotes great efficiency. The remote access capability eliminates the need to have a separate work and home office fax machine.

### Real Estate and Legal Firms Are Heavy Users

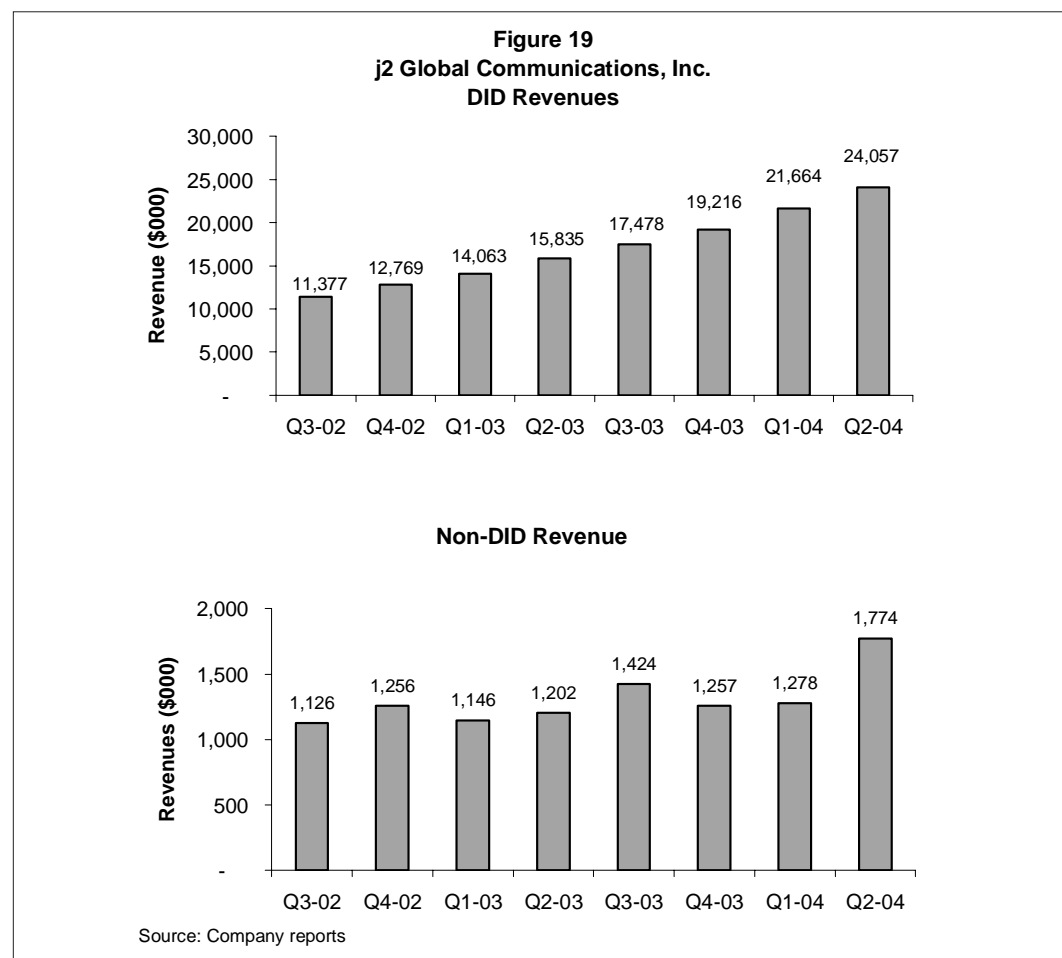
The real estate and legal service professions represent two industries that are considered heavy fax users. In July 2003, *REALTOR* Magazine reported that there were 26 separate real estate realtor franchises in the United States, with more than 24,000 offices and employing in excess of 630,000 sales associates and brokers. The Bureau of Labor Statistics reports that as of 2003, there were 850,000 real estate brokers and sales agents and 119,000 appraisers and assessors of real estate employed in the United States. This implies an estimate population of 1.4 million real estate professionals. The National Association of Realtors states that it has more than 1 million members. Many real estate professionals have both an office fax number and a home office fax number. As for the number of legal professions in the United States, the Bureau of Labor Statistics indicates that in 2003, 1.5 million people were employed in the legal profession. We believe both these industries represent large addressable markets for fax-to-e-mail services. These markets are especially attractive to j2 because of the propensity of these industries to fax a high volume of pages and generate additional usage fees.

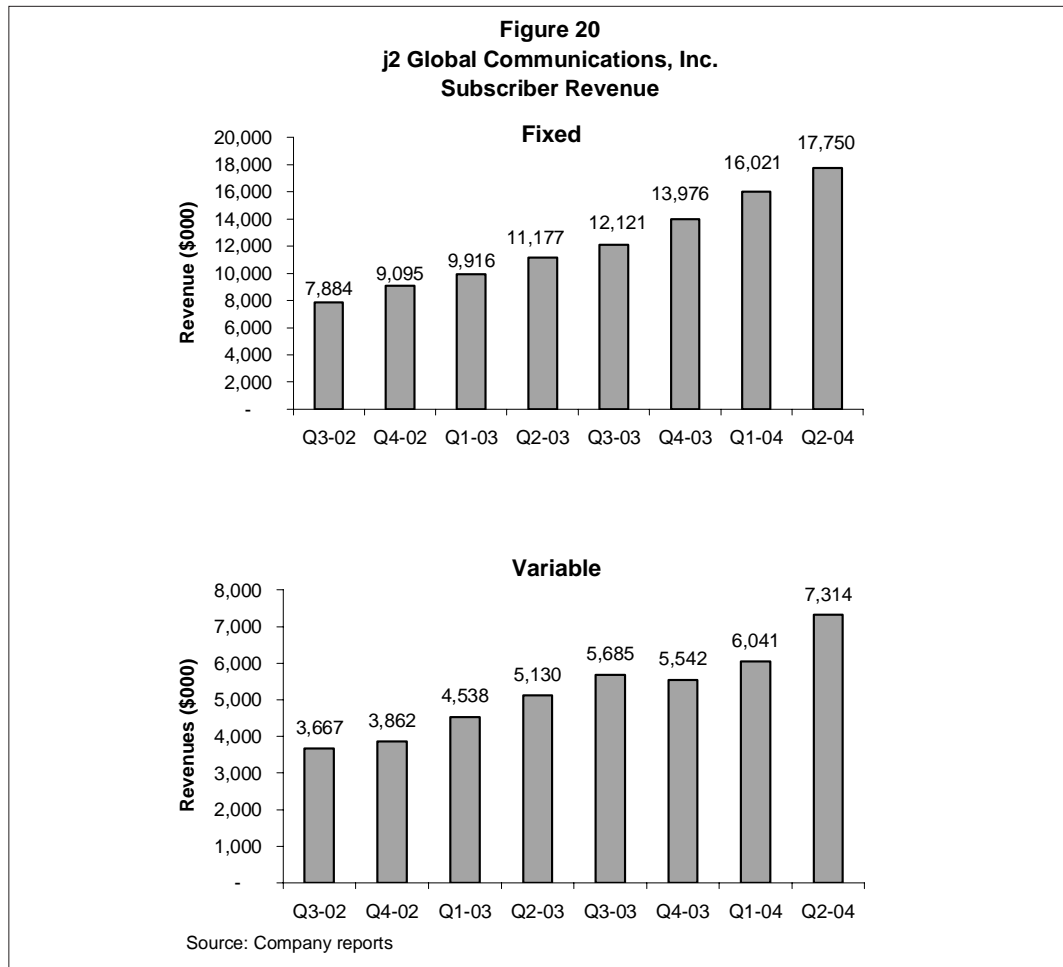
## Company Overview

J2 Global Communications offers a multitude of outsourced communication services to individuals, businesses, and government agencies. Products and services include fax to e-mail, voice mail to e-mail, phone and Web conferencing, e-mail solutions, document management and storage software, and document delivery and marketing campaign solutions. The company derives nearly all revenue from its fax-to-e-mail (eFax) and voice mail-to-e-mail (jConnect) product lines. Revenue is defined as either DID-based, or non-DID-based. DID-based revenue is defined as all revenue associated with a telephone number, whereas non-DID-based revenues are not phone number dependent.

The products that make up DID-based revenues include eFax Plus, eFax Free, eFax Corporate, jConnect Free, and jConnect Premier. The company's August 9, 2004, acquisition of Onebox also will contribute to DID-based revenues. Non-DID-based revenues are derived from jBlast, eFax Broadcast, PaperMaster, Consensus, M4Internet, Electric Mail, and licensing fees on patents. For financial statement purposes, the company demarcates revenue between subscriber, advertising, and licensed services. Subscriber revenue represents one-time setup charges, monthly service fees, and usage fees for the company's offerings.

Subscription revenue, which represents in excess of 90% of total revenue, is further divided between fixed revenue and variable revenue. Fixed revenue represents the setup fees and monthly service fees, and variable revenue accounts for usage fees. Advertising revenue represents amounts earned from advertisements delivered to eFax Free and jConnect Free users. Licensed services revenue primarily consists of software sales of the PaperMaster product.





## Products and Services

### eFax Free and eFax Plus

The eFax service converts an inbound fax into an electronic document that is then sent to the subscriber's e-mail inbox as an attachment. The company offers two version of this service—eFax Free and eFax Plus. The eFax Free service allows the user to receive a limited number of fax pages for free, but does not include outbound faxing capabilities. In addition, the company assigns the customer the fax phone number (oftentimes from a rural market with excess number availability); the customer cannot request a local phone number. To receive the eFax service for free, the subscribers agree to receive a limited amount of advertng e-mailed to their accounts. For \$12.95 a month (or \$139.95 per year), customers can upgrade to the eFax Plus package, which allows subscribers to receive unlimited inbound faxes, plus send outbound faxes for a per page fee of \$0.10. EFax Plus subscribers can send faxes three ways: using e-mail, using the eFax Messenger software, or by logging into the eFax.com Web site. The eFax Plus subscribers can choose a phone number with the area code of their choice and will not receive unsolicited advertisements. Customers can sign up for either the free or Plus package by visiting the company's Web site at [www.efax.com](http://www.efax.com). The eFax service primarily is designed to service individuals, small businesses, and home office users.

### **jConnect Free and jConnect Premier**

Similar in nature to the eFax service, jConnect provides a unique phone number that allows the subscriber customers to receive both inbound fax and voice mails into their e-mail inbox. The voice mail messages are converted into an audio file, and then delivered as an attachment to the user's e-mail. This service enables users to access faxes, voice mails, and e-mails using one unified service. The company offers both a free version (jConnect Free) and fee-based version (jConnect Premier) of the service. JConnect Premier allows subscribers to select a local number, and offers enhancements that allow users to send documents to any fax number worldwide. In addition, jConnect Premier users can initiate and manage Web-based conference calls.

### **eFax Corporate**

The eFax Corporate service is a more robust version of the eFax Plus service, designed to meet the demanding communication needs of businesses and governmental agencies. EFax Corporate enables business users to select a local fax or toll-free number and to send and receive faxes, similar to eFax Plus. However, eFax Corporate includes additional enhancements and benefits that make the service unique and especially attractive to business users, in our opinion. Such benefits and enhancements include 1) online or live customer assistance available 24 hours a day, 7 days a week; 2) specialized monitoring tools that allow a company administrator to review usage statistics to ensure that users are effectively using the service; 3) online tools that allow the company administrator to add or delete numbers; and 4) the ability to integrate document management functionality that includes storage capabilities and tracking mechanisms.

EFax Corporate service is both HIPPA (Health Insurance Portability and Accountability Act) and GLB (Gramm-Leach-Bliley Act) compliant, with versions that include advanced security and encryption technology. In 2004, the company introduced a customized version of eFax specifically designed for legal professional service organizations. The service also is popular with real estate and financial institutions. EFax Corporate is marketed on the Internet and by a dedicated sales staff. The eFax Corporate.com Web page was created to attract and service companies that require 10 to 300 dedicated fax numbers. Large corporations and government agencies are primarily serviced by the company sales team. This team is led by Tom Dolan, who recently joined the j2 team. Mr. Dolan has a full sales staff at his disposal, and he brings vast experience in selling telecommunication products to large enterprise users. The eFax Corporate Web site contains a published rate schedule; pricing includes a one-time activation fee per line and a monthly charge per number (includes 30 pages of inbound faxes per month and an inbound rate per page charge for pages received in excess of 30 per month).

### **jBlast and eFax Broadcast**

This service allows users to send large volume broadcast fax messages, such as newsletters, announcements, and surveys, to a group of fax users. Subscribers can monitor the status of the sent messages, program messages to be delivered at a specific time in the future, and perform database management, including updating do-not-fax requests and removing discontinued fax numbers.

### **PaperMaster**

PaperMaster is a Microsoft Windows-based software application that enables the user to organize archive, store, and retrieve both paper-based documents and digital-based communications such as electronic documents, voice mails, e-mails, music files, and video files. The software interface was designed using a "file cabinet" template to create a simple-to-use interface. The software creates a true paperless office, and allows users to carry with them all stored documents, making the service popular with users who have multiple office locations or frequent business travelers. The software can be integrated with eFax and jConnect, allowing for documents stored in PaperMaster to be easily faxed from the computer desktop. Additional features include the ability to produce documents in PDF format; to organize, edit, and annotate documents; to keep all information secure and centrally

located; and to perform advanced document searches. The software is priced at \$199 for individual users and a licensing program is available for corporations and government agencies. Revenues from this product line have not yet been material to the company.

### **Consensus**

Consensus offers complete conference-calling solutions that can be managed using a Web browser or telephone. There is no need for a reservation or an operator; conference calls can be initiated quickly and easily by the user. Using Consensus, subscribers can conduct either Web- or phone-based conference calls with up to 16 participants. Features include outbound, inbound, or toll-free connection options; call noise reduction; and the privacy and security options. The service can be obtained for a monthly minimum access fee and per-minute fee for the conference call time, and can be purchased using either a credit card or by invoice. Revenues from this product line have not yet been material to the company.

### **M4Internet**

M4Internet was acquired by j2 on October 8, 2003. M4Internet specializes in assisting companies distribute high-volume, permission-based e-mail marketing literature, and analyzing customer response. This is not a product that distributes unwanted or spam e-mails. Revenues from this product line have not yet been material to the company.

### **Electric Mail**

The company purchased The Electric Mail Company in first quarter 2004 for approximately 7.5 million Canadian dollars (about \$5.5 million). The Electric Mail Company specializes in providing companies with e-mail services, enhanced with a number of security protection measures including advanced spam filtering and virus scanning. The company serves businesses of all sizes, and it boasts one *Fortune* 500 client, Thermo Electron. Electric Mail's e-mail services can be hosted either at the customer location or at an off-site location. An established partnership program provides the company with a full array of informational technology offerings for its clients. Partnerships consist of Internet service providers, information technology consultants, wireless service providers, landline telephone service, and cable service providers, and include Microsoft, Lotus, AT&T Global Network, Trend Micro, and Sophos. The company, formed in 1994, reported 2003 revenues of approximately \$2 million. J2 has elected to run Electric Mail as a stand-alone entity, providing support when necessary to continue growth. Both companies pass corporate leads back and forth to provide the most comprehensive messaging solutions to its customers.

## **Competition**

J2 faces a variety of competitors in different product and geographic markets. The company battles directly with a handful of Internet-based fax-to-e-mail service providers for consumers and small businesses. These competitors include Callwave and Venali, Inc. In addition, the company competes with traditional fax machines, in-house fax servers, and business communication integrated solution providers for larger corporations and government entities. Large corporations are generally attractive candidates for enterprise software and hardware solutions that provide desktop faxing and unified communications services, such as provided by Captaris, Inc and PTEK Holdings, Inc. In general, the competition is fragmented and varies by end-market; j2 does not have a true competitive peer that provides a complete range of similar services, in our opinion.

### **Captaris, Inc.**

The Captaris RightFax fax server allows users to send, receive, and manage faxes electronically from their desktops, e-mail, or other business applications. It provides businesses with centralized infrastructure to perform document delivery and receipt needs. According to the company's Web site, its server can cost \$25,000 each, its fax servers are installed at

93 of the *Fortune* 100 companies, and it is the preferred enterprise fax server and e-document delivery partner of FileNet, HP, IBM, Microsoft, Oracle, SAP, Siebel, and Xerox. The company reported revenues for the first six months of 2004 of \$36.4 million, and EPS of \$0.00. Given the upfront capital investment, we believe the company is focused on larger corporate opportunities that can be managed and leveraged on a larger-scale basis and thus is not often direct competition to j2, which is focused on some larger, departmental applications, but often small and midsize businesses.

**PTEK Holdings, Inc.**

PTEK Holdings, Inc. is a provider of business communications services to midsize and large enterprise customers. The company's services include conferencing, Web collaboration, and electronic messaging, and are marketed by two business units, Premiere Conferencing and Xpedite. Premiere Conferencing offers a number of enhanced conferencing and Web-based data sharing services for group events such as training sessions or sales meetings. Premiere Conferencing recently expanded its offerings to include automated and Web-based data conferencing capabilities. Xpedite provides communication service packages including transactional e-mail, wireless, and voice-based messaging products. In April 2004, PTEK acquired Resource Communications, Inc., a conference and Web collaboration solution provider, to service small and midsize businesses. The company reported revenues of \$216.9 million and EPS of \$0.14 for the first six months of 2004. We believe that PTEK has become more of a direct competitor as a result of its acquisitions, although it historically has focused on voice conferencing features.

**Easylink Services Corporation**

EasyLink Services Corporation is a provider of communication-based service packages and transaction delivery services such as electronic data interchange, telex, desktop fax, broadcast, and production messaging services. The company also provides products that protect e-mail systems, including virus detection and elimination, spam filtering, and content monitoring services. The company markets transaction management services, including document capture and management, and provides fax-to-database, fax-to-data, and data conversion processing. The company reported revenues of \$48.4 million and EPS of \$0.05 for the first six months of 2004.

**Venali, Inc.**

Privately held and Miami-based, the company's primary offering is a fax-to-e-mail product similar to j2's eFax service. However, instead of offering a free version of the product, Venali only offers individuals and business users a 30-day free trial offer. The company's Web site provides only a limited amount of rate information, but does state that packages that allow the customer to receive e-mail and select a fax number start at \$9.95 per month, and packages that receive faxes start at \$4.95 per month. In addition, business and governments users can sign up for the service only via the Web site; a customer service number is not provided. On February 20, 2004, j2 filed a patent-infringement lawsuit against Venali. In response, Venali has filed a countersuit against j2 denying the infringement claims and questioning the validity of the two patents in question.

**Packetel Fax Service**

This privately owned company, located in Milpitas, California, offers a fax-to-e-mail service for \$3.95 month with no inbound page limit. However, the company offers phone numbers with limited area code coverage (California, Florida, New Jersey, New York, and others per the Web page). Other limitations of the service include the lack of storage capabilities, and outbound faxing is not available.

### **Data On Call**

Formed in 1996 and based in San Diego, Data On Call offers Web-based business-to-business fax communications products. The company's products consist of business faxing services, including inbound and outbound fax, fax broadcast, fax on demand, Web, and fax integration tools for developers. The company's UniFax Service is a fax-to-e-mail service with plans priced at \$9.95 per month that include free inbound and outbound pages and a toll-free fax number, and they do not require a long-term commitment.

### **Callwave**

The company, privately held and based in Santa Barbara, California, offers software that enables businesses and consumers to receive faxes to e-mail for a \$3.95 per month service fee. Callwave also offers a product that will "bridge" phone calls received between a landline phone, cellular phone, and personal computer. On May 13, 2004, the company announced that it had filed with the Securities and Exchange Commission a registration statement related to a proposed public offering of shares. As of August 29, 2004, the company has not publicly issued shares. For the fiscal year ended March 31, 2004, Callwave reported revenues of \$28.5 million and net income of \$9.1 million. It also noted that it has more than 780,000 users of its various services. On August 25, 2004, j2 filed a patent-infringement lawsuit against Callwave for improper usage of one of j2's 15 U.S. and foreign patents.

## **Management**

The company boasts a talented and experienced management team, in our opinion. The team has managed several recent acquisitions and has achieved solid financial results. We believe management has the company well positioned to achieve further growth.

**Scott Jarus, president.** Mr. Jarus joined j2 in July 2001. He previously served as the president and chief operating officer for New York City-based OnSite Access, an integrated communications provider for buildings. Mr. Jarus also served as an operations executive at both RCN and Metromedia Communications.

**Scott Turicchi, chief financial officer.** Mr. Turicchi has been a member of the company since March 2000, and became the CFO role in May 2003. Before becoming CFO, he was the company's executive vice president of corporate development. Prior joining j2, Mr. Turicchi was a managing director in Donaldson, Lufkin & Jenrette Securities Corporation's investment banking department.

**Hemi Zucker, chief marketing officer.** Mr. Zucker joined j2 in 1996. He served as the CFO between 1996 and 2003. Mr. Zucker became the company's chief marketing officer in 2001, serving in a dual leadership role until Mr. Turicchi's appointment to CFO in 2003. Prior to joining j2, Mr. Zucker worked for 16 years at Motorola performing various finance and operations roles.

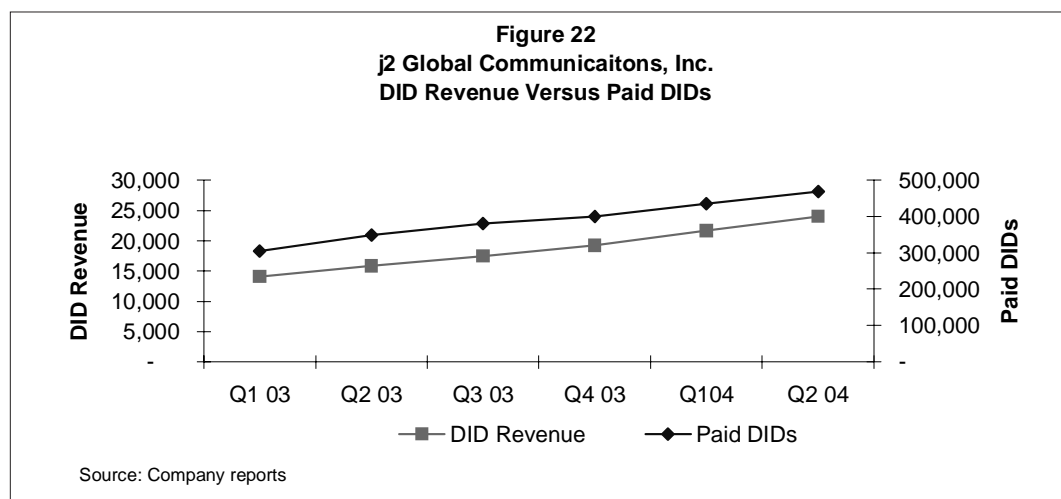
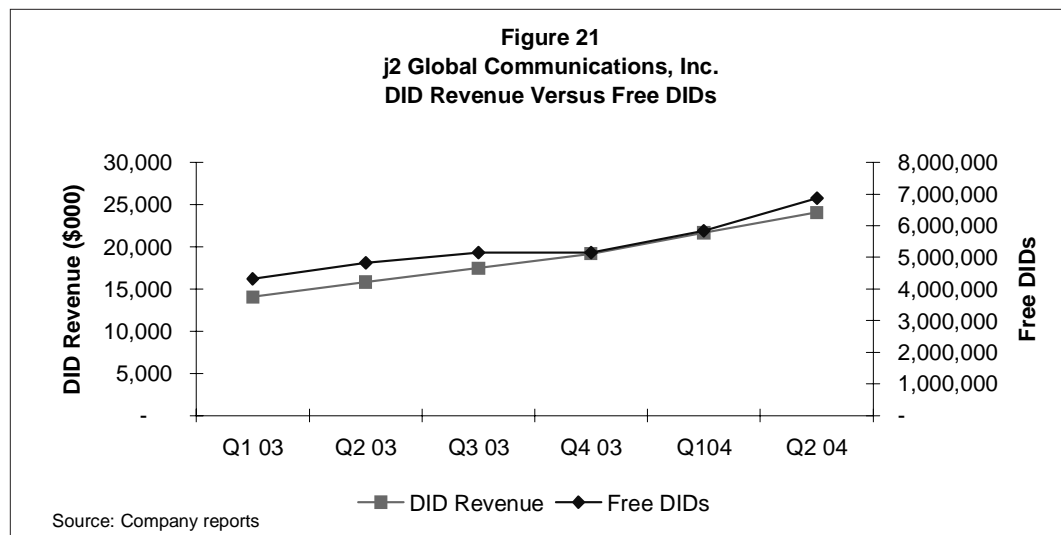
**Zohar Loshitzer, executive vice president of corporate strategy.** Mr. Loshitzer has been the company's executive vice president of corporate strategy since June 2001. Mr. Loshitzer previously was the company's chief information officer. Mr. Loshitzer also serves as a managing director of Orchard Telecom, Inc., a telecommunications consulting company.

**Tom Dolan, vice president of sales.** Mr. Dolan recently joined j2 in 2004 to develop the enterprise-level sales and marketing team. Prior to joining j2, he was a senior vice president of global sales for ETT, a London-based network services integration company. Mr. Dolan also worked for six years at Tele Media International, the international arm of Telecom Italia, as a director of sales and marketing for North America and Asia-Pacific.

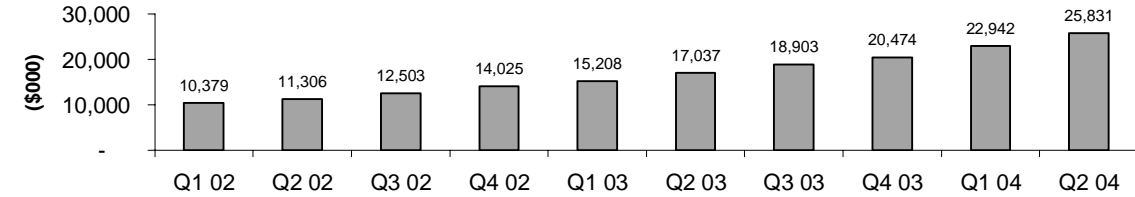
## Financial Review and Highlights

### Revenue Growth

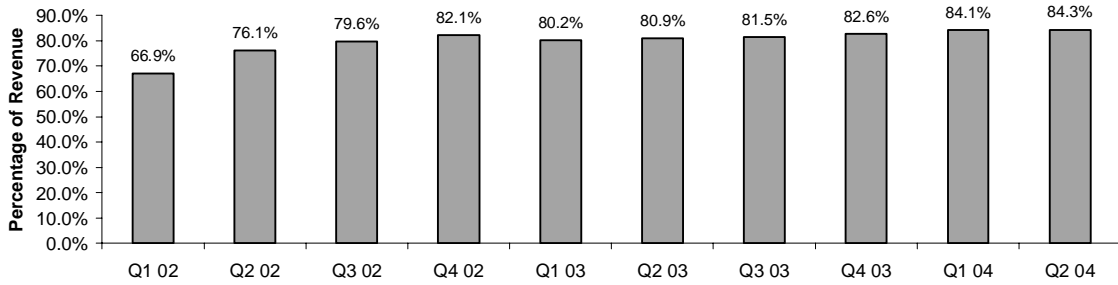
The company has achieved revenue growth for 29 consecutive quarters. Revenue for the first six months of the 2004 grew 51% over the prior year, which was on top of 55% growth in 2003 versus 2002. Sales expansion was been fueled largely by the subscriber revenue, which accounted for in excess of 90% of total revenues. Revenue for the first six months of 2004 totaled \$48.8 million, \$47.1 million of which was subscriber-based. In the first six months of 2003, the company reported \$32.2 million of sales, \$30.8 million of which was subscriber-based. Growth in subscriber revenue has been spurred by the growth in paid DIDs in combination with the implementation of a 25% to 30% pricing increase that was phased in since it was announced in second quarter 2003. Advertising revenue has remained relatively stable on an absolute basis, as the increase in the subscriber base has been mostly offset by pricing pressures in the advertising space. Advertising revenue for the first half of 2004 totaled \$1.4 million, compared with to \$1.2 million in 2003. Although up 15% year-over-year, the \$200,000 increase represents only slightly more than 1% of the overall year-over-year revenue change. Licensing and other revenue, primarily derived from PaperMaster, has been in decline, with year-over-year decreases of 8% in 2004 and 26% in 2003. However, licensing and other revenues are immaterial to j2, representing less than 0.5% of 2004 revenues.



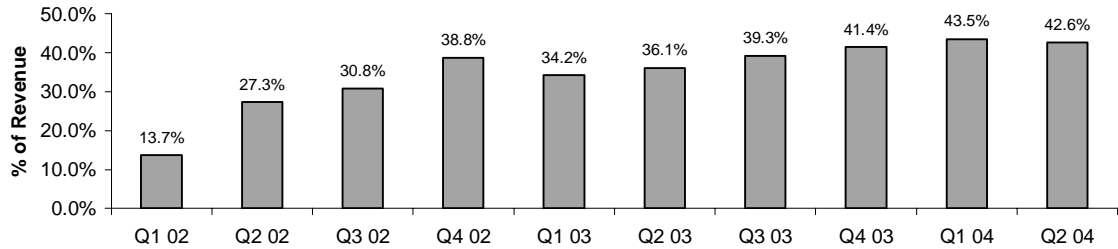
**Figure 23**  
**j2 Global Communications, Inc.**  
**Financial History**  
**Revenue**



**Gross Margin**



**Operating Margin**



Source: Company reports

**History of Outstanding Gross and Operating Margins**

In fiscal fourth quarter 2002, the company's gross margins broke through the 80% threshold and j2 has never looked back. Gross margin has remained above the 80% level since, and reached a record high of 84.3% in second quarter 2004. Cost of sales for the company primarily consists of server and network operating and maintenance costs. Leveraging excess server capacity, the company has been able to achieve gross margin improvement despite a 53% increase in its customer base since first quarter 2003. Operating margins have demonstrated the same trend as gross margin. Reaching nearly 35% in first quarter 2003, operating margins have increased to approximately 43% in second quarter 2004. While general and administrative expenses and engineering expenses as a percentage of sales have trended down during this time frame, sales and marketing spending has increased, as the company expanded its core base of DID customers and commenced marketing its other product offerings. As a result, the company achieved year-over-year growth in net income 26% for the period ended June 30, 2004.

**Ample Cash Flow Has Created a Bounty of Cash on the Books**

For the first six months of 2004, j2 generated operating cash well in excess of net income, reporting cash flow from operating activity of \$23.3 million versus net income of \$13.9 million over the year-ago period. The main driver of this difference is the company's tax situation. The company is not a current taxpayer, with estimated useful federal and state of California net operating loss carryforwards (NOLs) of \$33.8 million and \$39.1 million, respectively, at December 31, 2003. Year-to-date, use of the NOLs has added back slightly more than \$6 million to cash flow from operations. We expect that the company will use the majority of its NOLs in the last two quarters of 2004, resulting in 2005 cash flows more in line with net income.

As of June 30, 2004, the company had approximately \$75 million of cash and investments on balance sheet, or nearly \$3 per share. This is up from nearly \$64 million of cash and investments at December 31, 2003. Capital expenditure requirements are low. For the first six months of 2004, the company has spent \$1.8 million on new property and equipment. This compares with \$3.6 million and \$2.8 million for all of fiscal 2003 and 2002, respectively.

**Forecast**

We project continued strong revenue and EPS growth in fiscal 2004 and 2005, primarily driven by increases in paid DID services. We believe that in the near term, the company will benefit from the addition of 1.8 million free users in the front half of the year; we forecast the number of paid DIDs to increase 19% by the end of the year, and to increase another 24% by the end of fiscal 2005. We note some concern that the free-to-pay conversion cycle could slow due to the large addition of free users from new Internet sources. We suspect that addition of total DIDs (both free and pay) will slow slightly from the torrid pace of the first six months of fiscal 2004, but still remain strong. During the first half of the year, the company added 1.8 million total DIDs, increasing the number of DIDs under management by 32%, to 7.3 million. We are mindful that the company's rapid pace of new free-user additions during the first six months of the year may not be sustainable, and expect some near-term slowing of the addition rate, but believe that the company will continue to add new free users aggressively. We forecast ARPU for both the paid and free DID bases to remain flat at roughly \$17.22 and \$0.04, respectively, as we do not anticipate any significant near-term changes in the pricing and usage environment for paid users. We also believe that advertising revenues generated per each free user will begin to stabilize after decreasing in fiscal second quarter 2004. Longer-term, we expect revenue growth will be aided by international expansion of eFax and jConnect, by eFax Corporate, and from traction gained by new product offerings such as Electric Mail.

We expect gross margins to remain stable at 84% of sales. We are targeting operating margins at roughly 45% to 46% as operating leverage gains are offset by increasing sales and marketing spend to attract new free users and research and development costs to develop new products. Assuming a relatively stable effective tax rate of 34%, we project EPS of \$1.19 in fiscal 2004 and \$1.58 in fiscal 2005. We believe the largest risk in our EPS forecast is a decline in the free-to-pay conversion cycle.

**Valuation and Conclusion**

J2 currently trades at price-to-earnings ratios of 26.5 and 20 times our EPS estimates for fiscal 2004 and 2005. We find the current valuation very attractive given our expectation of three-year compounded annual growth in fully taxed EPS of at least 36% through fiscal 2006—an estimate that may prove conservative given recent growth rates, the low penetration in its existing markets, and the early stage of the company's efforts in tapping multiple growth opportunities. Investors should be aware that recent and near-term reported EPS growth will slow, as the company has transitioned to tax-paying status, but on an apples-to-apples basis should grow more than 33% in fiscal 2005 and 36% over the three-year period ending in 2006. If the stock were to trade at a multiple in line with our projected three-year growth rate, it would suggest a near doubling in the stock from current levels.

The company is highly profitable, generating operating margins in excess of 40% on gross margins of nearly 85% with a low asset intensity that resulted in an impressive 25.3% annualized return on equity in the latest quarter; and without the benefit of leverage, with a net cash position of \$75 million, equating to nearly \$3 per share. With low capital requirements (roughly 5% of sales), an operating model that generates a favorable cash carry based on upfront credit card payments from its customers for monthly service, and recent favorable tax benefits, free cash flow has nicely exceeded net income and in the latest quarter represented 55% of sales, by our estimates.

As shown in table 2, j2 trades in line to at a slight premium to its peers despite its outsized relative profitability and operating model that generates more than 70% of revenue on a recurring monthly basis from its diverse customer base. We believe the enterprise-value-to-EBIT ratio comparisons offer the most valuable insight. On that basis, j2 trades at 17.9 times latest-12-months' (LTM) EBIT versus a peer group median of nearly 13 times and only at a slight premium to one of its peers, Captaris. However, over the LTM period, j2 has reported an EBIT margin of nearly 42%, versus a peer group median of about 12% and roughly 10% for Captaris. While we do not believe that the peer group offers a good valuation comparison in total, it reveals the exceptional profitability that the j2 operating model delivers.

Although we believe that near-term revenue growth may slow due to uncertainty regarding the successful conversion ratio of customers from nascent marketing channels and due to the completion of its phased price increase, we believe the stock largely reflects this uncertainty and believe the multiple growth prospects for the company remain outstanding. Beyond further penetrating a domestic fax market where we estimate it represents perhaps 1%, it has just begun to enter international markets that we believe are at least two times as large as the domestic market. In addition, the company is investing/acquiring other complementary technologies and product offerings that it could cross-sell to its existing customers or use to attract new ones—a process also at a nascent stage.

With a strong management team executing against a recurring, highly profitable, strong cash flow generating business model with multiple growth opportunities, we are initiating coverage of j2 Global Communications with an Outperform rating and an Aggressive Growth company profile.

Additional information is available upon request.

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DJIA:	10080.27
S&P 500:	1114.58
NASDAQ:	1896.84

The prices of the common stock of other public companies mentioned in this report follow:

Adobe Systems Incorporated	\$49.47
Captaris, Inc.	\$4.26
EasyLink Services Corporation	\$1.18
Google Inc.	\$129.60
Ptek Holdings, Inc.	\$8.57
Yahoo! Inc.	\$33.91

**Table 1**  
**J2 Global Communications, Inc.**  
**Earnings Model**  
(\$ in thousands, except per share data)

	FY 2002	1Q03	2Q03	3Q03	4Q03	FY 2003	Mar-04 1Q04	Jun-04 2Q04	Sep-04 3Q04	Dec-04 4Q04	FY 2004	FY 2005E
<b>Fiscal Year Ends December 31</b>												
Total Revenue	48,213	15,208	17,037	18,903	20,474	71,622	22,942	25,831	26,315	28,656	103,744	133,711
% year-over-year change	45.0%	46.5%	50.7%	51.2%	46.0%	48.6%	50.9%	51.6%	39.2%	40.0%	44.8%	28.9%
Cost of Goods Sold	11,202	3,010	3,247	3,494	3,572	13,323	3,640	4,063	4,131	4,469	16,333	20,787
Gross Profit	37,011	12,198	13,790	15,409	16,902	58,300	19,302	21,768	22,184	24,187	87,411	112,924
as a % of total revenue	76.8%	80.2%	80.9%	81.5%	82.6%	81.4%	84.1%	84.3%	84.3%	84.3%	84.3%	84.8%
<b>Operating Expenses</b>												
Research & Development	3,187	1,026	1,023	1,006	1,140	4,195	1,050	1,264	1,300	1,375	4,989	5,902
as a % of total revenue	6.6%	6.7%	6.0%	5.3%	5.6%	5.9%	4.6%	4.9%	4.9%	4.8%	4.8%	4.4%
year-over-year % change	25.7%	30.4%	37.5%	34.7%	25.4%	31.6%	2.3%	23.6%	29.2%	20.7%	18.9%	18.3%
Sales & Marketing	6,415	2,510	2,866	2,897	2,898	11,171	3,779	4,767	4,605	4,700	17,861	23,522
as a % of total revenue	13.3%	16.5%	16.8%	15.3%	14.2%	15.6%	16.5%	18.5%	17.5%	16.4%	17.2%	17.6%
year-over-year % change	39.9%	93.7%	99.9%	46.2%	70.2%	74.1%	50.6%	66.3%	59.0%	62.2%	59.8%	31.8%
General & Administrative	13,604	3,468	3,743	4,085	4,387	15,683	4,482	4,734	4,884	5,134	19,234	23,036
as a % of total revenue	28.2%	22.8%	22.0%	21.6%	21.4%	21.9%	19.5%	18.3%	18.6%	17.9%	18.5%	17.2%
year-over-year % change	-2.3%	1.0%	12.0%	21.1%	26.9%	15.3%	29.2%	26.5%	19.6%	17.0%	22.6%	19.8%
Total Operating Expenses	23,206	7,004	7,632	7,988	8,425	31,049	9,311	10,765	10,789	11,209	42,075	52,460
as a % of total revenue	48.1%	46.1%	44.8%	42.3%	41.1%	43.4%	40.6%	41.7%	41.0%	39.1%	40.6%	39.2%
Operating Income	13,805	5,194	6,158	7,421	8,477	27,250	9,991	11,003	11,395	12,947	45,336	60,464
as a % of total revenue	28.6%	34.2%	36.1%	39.3%	41.4%	38.0%	43.5%	42.6%	43.3%	45.2%	43.7%	45.2%
year-over-year % change	NM	265.0%	99.5%	92.7%	55.7%	97.4%	92.4%	78.7%	53.5%	52.7%	66.4%	33.4%
Net Interest Income (Expense)	439	74	69	126	150	419	186	352	365	414	1,317	1,934
Pretax Income	14,244	5,268	6,227	7,547	8,627	27,669	10,177	11,355	11,759	13,362	46,653	62,398
as a % of total revenue	29.5%	34.6%	36.5%	39.9%	42.1%	38.6%	44.4%	44.0%	44.7%	46.6%	45.0%	46.7%
Provision for income taxes	152	235	280	347	386	1,248	3,778	3,866	3,998	4,543	16,185	21,215
Effective tax rate	1.1%	4.5%	4.5%	4.6%	4.5%	4.5%	37.1%	34.0%	34.0%	34.0%	34.7%	34.0%
Change in Accounting Principle	225	-	-	-	-	-	-	-	-	-	-	-
Net Income	14,317	5,033	5,947	7,200	8,241	26,421	6,399	7,489	7,761	8,819	30,468	41,183
as a % of total revenue	29.7%	33.1%	34.9%	38.1%	40.3%	36.9%	27.9%	29.0%	29.5%	30.8%	29.4%	30.8%
year-over-year % change	NM	189.1%	79.2%	84.0%	54.2%	84.5%	27.1%	25.9%	7.8%	7.0%	15.3%	35.2%
<b>Diluted EPS</b>	<b>0.60</b>	<b>0.20</b>	<b>0.24</b>	<b>0.28</b>	<b>0.32</b>	<b>1.05</b>	<b>0.25</b>	<b>0.29</b>	<b>0.30</b>	<b>0.34</b>	<b>1.19</b>	<b>1.58</b>
year-over-year % change	0.0%	162.3%	68.0%	76.6%	48.2%	74.4%	22.8%	24.1%	6.9%	6.4%	13.1%	33.1%
Diluted Number of Shares	23,793	24,697	25,203	25,493	25,670	25,183	25,564	25,585	25,710	25,810	25,667	26,060
<b>Revenue by Segment</b>												
Subscriber	44,305	14,454	16,307	17,806	19,518	68,085	22,062	25,063	25,337	27,617	100,078	129,131
Advertising	3,029	612	609	681	805	2,707	761	647	854	909	3,171	4,030
Licensing and other	879	142	121	416	151	830	119	121	125	130	495	550
<b>DIDs Under Management (Units)</b>												
Paid	NA	304,696	348,988	380,230	400,245	400,245	434,616	469,328	511,568	557,609	557,609	690,748
Free	NA	4,320,975	4,825,991	5,146,638	5,150,368	5,150,368	5,843,167	6,873,083	7,364,199	7,795,451	7,795,451	8,995,451
<b>DIDs Under Management (% of Total)</b>												
Paid	NA	6.6%	6.7%	6.9%	7.2%	7.2%	6.9%	6.4%	6.5%	6.7%	6.7%	7.1%
Free	NA	93.4%	93.3%	93.1%	92.8%	92.8%	93.1%	93.6%	93.5%	93.3%	93.3%	92.9%
<b>Average Monthly Revenue Per User</b>												
Paid	NA	\$ 15.59	\$ 15.52	\$ 15.36	\$ 15.73	\$ 15.55	\$ 16.68	\$ 17.22	\$ 17.22	\$ 17.22	\$ 17.09	\$ 17.22
Free	NA	\$ 0.05	\$ 0.04	\$ 0.05	\$ 0.05	\$ 0.05	\$ 0.05	\$ 0.04	\$ 0.04	\$ 0.04	\$ 0.04	\$ 0.04
<b>Revenue by DIDs</b>												
DID	43,374	14,063	15,935	17,478	19,216	66,592	21,664	24,057	24,499	26,679	96,889	124,485
Non-DID	4,840	1,146	1,202	1,424	1,257	5,029	1,278	1,774	1,816	1,977	6,845	9,226

\* Fiscal fourth quarter and 2003 figures exclude \$9.4 million of tax benefit related to reversal of federal and state deferred tax asset allowance valuations.

**Table 2**  
**j2 Global Communications, Inc.**  
**Comparable Company Valuation Table**

(In millions except per share data)

Symbol	Company Name	City & State	Price as of: 9/30/2004	YTD Return	5-year Total Return	Shares Out	Equity Value	Total Cash	Total Debt	Enterprise Value (EV)	Debt / Total Capital
JCOM	J2 GLOBAL COMMUN	Los Angeles, CA 90028	\$31.59	27%	218%	23.2	734	74	1	661	1%
PTEK	PTEK HLDGS	Atlanta, GA 30326	\$8.57	-3%	44%	71.2	611	19	36	628	13%
EASY	EASYLINK SERVICES	Piscataway, NJ 08854	\$1.18	-21%	-99%	43.3	51	6	14	59	66%
CAPA	CAPTARIS	Bellevue, WA 98004	\$4.26	-24%	-72%	31.5	134	3	-	131	0%
Average				-5%	23%						20%
Median				-12%	-14%						7%

Symbol	Earnings Per Share			Price to Earnings			EV / LTM			EW / LQ Annualized		
	Calendar Year 2003	Calendar Year 2004E	Forward 4 Qtrs.	Calendar Year 2003	Calendar Year 2004E	Forward 4 Qtrs.	Sales	EBIT	Sales	EBIT	Sales	EBIT
JCOM	\$1.14	\$1.20	\$1.41	27.7x	26.3x	22.4x	7.5x	17.9x	7.5x	17.9x	6.4x	7.6x
PTEK	\$0.49	\$0.59	\$0.65	17.5x	20.4x	14.5x	1.5x	10.1x	1.5x	10.1x	1.4x	2.4x
EASY	\$0.10	\$0.06	-	11.8x	NM	19.7x	NM	0.6x	9.8x	0.6x	1.1x	1.1x
CAPA	\$0.22	\$0.22	\$0.16	19.4x	19.4x	26.6x	1.5x	16.0x	1.5x	16.0x	2.7x	2.7x
Average	\$0.49	\$0.38	\$0.74	19.1x	23.4x	32.9x	2.8x	13.5x	2.8x	13.5x	2.6x	3.4x
Median	\$0.36	\$0.33	\$0.65	18.4x	20.4x	22.4x	1.5x	13.1x	1.5x	13.1x	1.6x	2.5x

Symbol	Report Date	Latest 12 Months (LTM)						LTM / Sales						LTM		
		Sales	GM	EBIT	FCF	GM	EBIT	NI	ROA	ROE	Dividend Yield	Asset Turns	Days Sales Out.	Days Inv. Held	Sales / Employ.	
JCOM	6/30/2004	88	73	37	38	83.1%	41.9%	43.6%	43.9%	37.5%	41.1%	0.0%	0.0%	0.0%	0.0%	
PTEK	6/30/2004	414	239	62	47	57.7%	15.0%	11.4%	5.8%	9.4%	14.6%	0.0%	0.0%	0.0%		
EASY	6/30/2004	98	54	6	5	54.6%	6.1%	5.5%	4.4%	9.7%	96.3%	0.0%	0.0%	0.0%		
CAPA	6/30/2004	86	60	8	7	69.8%	9.5%	8.1%	8.2%	5.4%	6.6%	0.0%	0.0%	0.0%		
Average						66.3%	18.1%	17.2%	15.6%	15.5%	39.7%	0.0%	0.0%	0.0%		
Median						63.8%	12.2%	9.8%	7.0%	9.5%	27.9%	0.0%	0.0%	0.0%		

Symbol	Sales	YOY %	Latest Quarter (LQ)			Latest Quarter						
			GM	EBIT	FCF	Asset Turns	Days Sales Out.	Days Inv. Held	Sales / Employ.			
JCOM	26	52%	22	11	12	84.3%	42.6%	44.9%	1.0x	29	NM	503
PTEK	112	18%	66	18	15	59.6%	15.7%	13.9%	1.3x	52	NM	210
EASY	24	-7%	14	2	1	57.3%	7.0%	2.6%	1.9x	42	NM	203
CAPA	18	-24%	12	-1	1	65.9%	NM	5.6%	0.6x	64	13	273
Average		10%				66.7%	21.8%	16.7%	1.2x	47	13	297
Median		5%				62.7%	15.7%	9.7%	1.2x	47	13	241

Note: Timing differences may exist in latest-12-month and latest-quarter data due to varying fiscal reporting periods and latest-quarter report date.

Source: Baseline, First Call, and William Blair & Company, L.L.C. estimates

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