William Blair & Company®

Equity Research

TECHNOLOGY: SOFTWARE & SERVICES
Employer Services

October 6, 2004
Research Note

Ticker:	JCOM
Price:	$32.15
52-week:	($19-$48)

Stock Rating:
Outperform

Company Profile:
Aggressive Growth

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j2 Global Communications, Inc.

Visit Reinforces Near- and Long-term Prospects

FINANCIAL SUMMARY

Fiscal Year Ends:	December	Dividend/Yield:	$0.00/0.0%
Long-term EPS Growth Rate:	35%	Market Value (mil.):	$747

FISCAL YEAR	2003A	2004E	2005E
ESTIMATES			
Earnings Per Share	$1.05	$1.19	$1.58
VALUATION			
Price/Earnings Ratio	30.6x	27.0x	20.3x

Following our recent coverage initiation, we had an opportunity to meet with Scott Turicchi, j2's CFO in Chicago. We continue to feel quite good about the company's near-term and long-term prospects given:

1) **Multiple open-ended growth opportunities.** Many of these are quite nascent in nature. We estimate the company represents maybe 1% of the domestic fax market. It has essentially none of the international market, which we believe is more than two times larger, and it has begun to enter those markets. The company currently derives little revenue from other products like outsourced e-mail, voice mail services, document management, and conferencing services, which may be sold to emerging customer bases or cross-sold into the existing base.
2) **A strong recurring revenue model.** More than 70% of the company's revenue is derived by fixed monthly fees. About 60% of the company's customers are individuals that often pay an upfront monthly fee by credit card, suggesting no significant customer concentration and limited industry concentration and offering nice financial predictability and strong cash flow characteristics.
3) **A strong financial model.** The company boasts near 85% gross margins and operating margins in excess of 40%. Asset intensity is low, with capital spending representing less than 5% of revenue, and given the use of prior NOLs, free cash flow has nicely exceeded net income.
4) **Historically strong execution.** The company is focused on its core business, primarily fax–to–e-mail. It is maniacal about the details of maximizing its financial returns, boosting customer growth through multiple channels, including its historical free-to-paid conversions. The strong numbers speak for themselves.

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On the investor concerns front, we have heard frequent concerns regarding competition (given the high profitability), uncertainty about future customer growth rates in historically strong channels, and the potential for product obsolescence with the introduction of new technology, like digital signatures. These are not new concerns. We have known the company for several years and voiced these same concerns (and of course, included them in our investment risks/concerns), but the company has continued to execute and profitably grow the business over the years. And beyond continuing to penetrate the North American market, the company is now beginning to venture into larger international markets. While we believe Mr. Turicchi expressed great confidence in the business outlook during our discussions, we believe his personal stock sales tell also express confidence; Mr. Turicchi has more than 280,000 options that are deep in-the-money (average strike price likely below $4). He has not exercised and sold, but instead has held; we believe the outlook continues to remain strong.

The company will report its earnings on October 18. As noted, it recently reiterated its quarterly and annual outlook calling for quarterly revenue of between $27.4 million-$27.8 million and EPS of $0.31 on a flat expected sequential marketing spend; the full-year guidance calls for revenue between $100 million-$106 million and EPS of $1.00-$1.18. We believe our quarterly revenue and EPS estimate--about $1 million below the low end of revenue guidance and a penny light on EPS--is too conservative and believe the company will at least meet its guidance. Similarly, we are comfortable with our full-year estimate of $104 million in revenue and EPS of $1.19. On the conference call, we expect the company to reveal its early studies on the conversion experience of free customers received from new marketing channels; we are not certain it will exhibit the same historical trends but believe the company is building the business on multiple axes, allowing any potential shortfall to historical conversion ratios to be offset by better traction in its alternative channels, including small business, direct enterprise sales, and its largest channel, subscribers coming directly from the company's Web sites.

The stock is trading at a price-to-earnings multiple of about 20 times for a company that we believe can grow EPS in excess of 35% over the next several years, we believe reflecting the uncertainty around conversion rates of recently added free customers; we believe our estimates are conservative and reiterate our Outperform rating.

William Blair & Company, L.L.C. is a market maker in the security of this company and may have a long or short position.

Additional information is available upon request.

Current Rating Distribution (as of 09/30/04)

Coverage Universe	**Percent**	**Inv. Banking Relationships***	**Percent**
Outperform (Buy)	61	Outperform (Buy)	4
Market Perform (Hold)	33	Market Perform (Hold)	3
Underperform (Sell)	6	Underperform (Sell)	1

*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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Company Profile: The William Blair research philosophy is focused on quality growth companies. Growth companies by their nature tend to be more volatile than the overall stock market. Company profile is a fundamental assessment, over a longer-term horizon, of the business risk of the company relative to the broader William Blair universe. Factors assessed include: 1) durability and strength of franchise (management strength and track record, market leadership, distinctive capabilities); 2) financial profile (earnings growth rate/consistency, cash flow generation, return on investment, balance sheet, accounting); 3) other factors such as sector or industry conditions, economic environment, confidence in long-term growth prospects, etc. Established Growth (E) – Fundamental risk is lower relative to the broader William Blair universe; Core Growth (C) – Fundamental risk is approximately in line with the broader William Blair universe; Aggressive Growth (A) – Fundamental risk is higher relative to the broader William Blair universe.

The ratings and company profile assessments reflect the opinion of the individual analyst and are subject to change at any time.

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