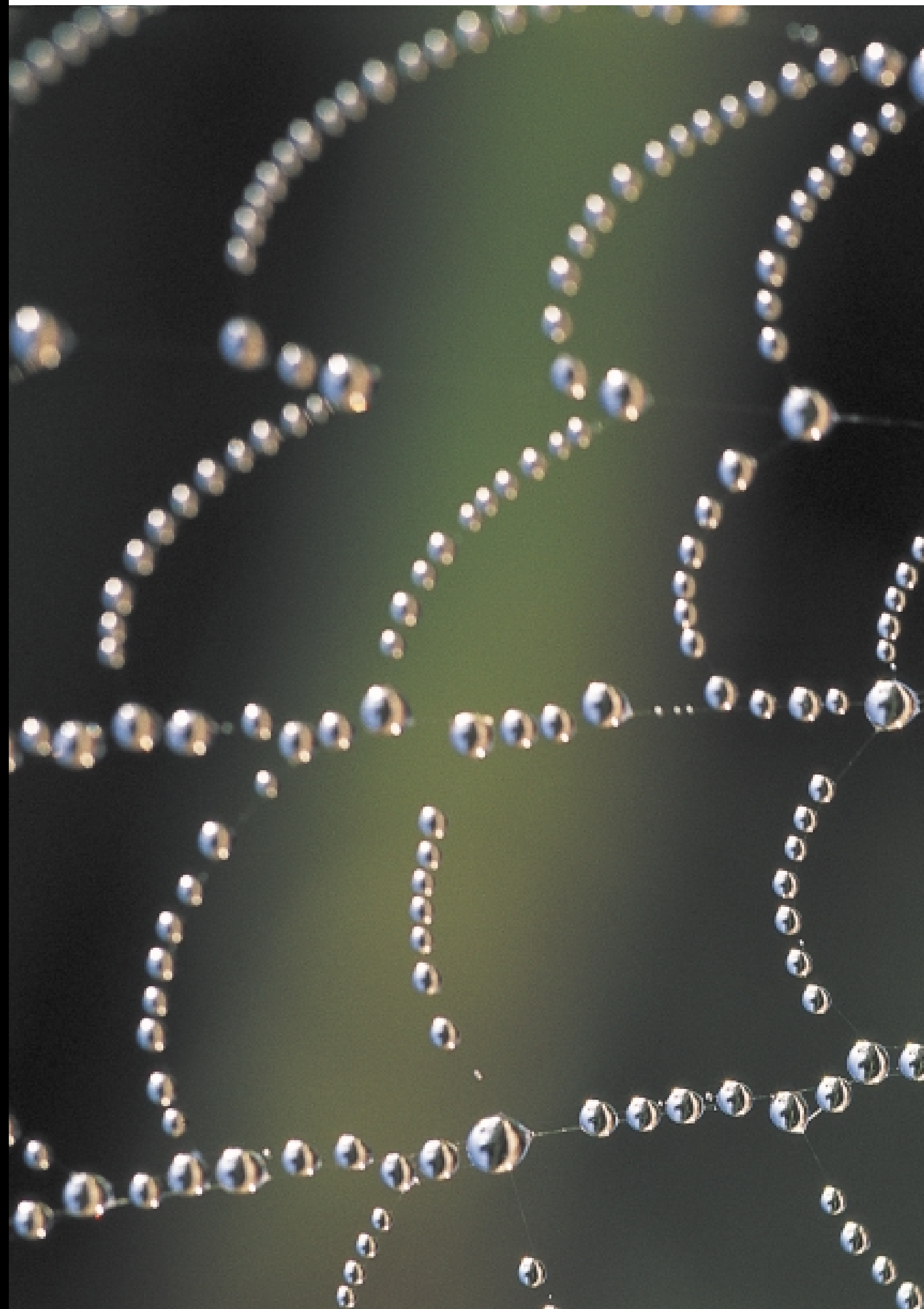
Your worlds Our people

Internet 150 Report
01/2001

PRICEWATERHOUSECOOPERS

An analysis of company performance in Europe's internet sector



Internet 150 Report 01/2001
Our Services

PricewaterhouseCoopers is the world's leading professional services organisation, drawing on the knowledge and skills of 160,000 people in 150 countries, we help clients solve complex business problems.

Dot.com management teams now have the difficult challenge of re-defining the future of their companies against a background of adverse sentiment in the investor community whilst continuing to manage their businesses. Management of traditional companies with dot.com subsidiaries are facing the same issues but with an added layer of complexity.

In these conditions you need advisors that:

- understand the potential of e-business
- will ensure swift and decisive action
- understand your business, but are prepared to challenge you
- have successfully helped similar companies

PwC's Corporate Finance and Recovery team understands the issues and can help in a number of ways:

- Development of contingency plans to cover the risk of an unsuccessful funding round, including packaging the company for a trade sale
- Short term financial management and cost management advice
- Independent wrongful trading review, protection from legal action
- Advisory services on the sale of a business
- Interim management
- Fund raising advice
- Strategy advice and action planning

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Fletcher Advisory Ltd.(www.fletcheradvisory.com) is a specialist consultancy helping senior management build and implement strategies for the internet and new media. It is an affiliate of Forrester Research Inc the internet information business.

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Internet 150 Report 01/2001
Introduction

We are delighted to present the results of our 2nd European Internet Index. We initiated this report as a result of some burn rate research we conducted on a population of UK Internet companies last year. The research was so popular we decided to broaden the population to cover 150 Internet Companies in Europe.

Our objective is to provide an independent report, on a quarterly basis, which considers changes in the internet sector, trends in burn rates, share price performance and profitability.

The data in this report covers financial reports up to 30 September 2000 (end of Q3 2000) and follows our last report which covered financial reports to 30 June 2000 (end of Q2 2000). References to share prices and market capitalisation in this report cover market activity throughout 2000 up to December 31st (which will include Q4 market reaction to Q3 financial reports).

If you have any questions about this survey or other matters relating to internet businesses please do not hesitate to contact either Kevin Ellis on 020 7804 4102, e-mail kevin.ellis@uk.pwcglobal.com or Hugh Brown on 020 7804 502, email hugh.m.brown@uk.pwcglobal.com

Internet 150 Report 01/2001
Executive Summary

— We have identified the top 150, publicly listed, European internet companies with a combined market capitalisation at the end of 2000 of EUROs 100bn (£62bn). The research and analysis was done in conjunction with e-business strategy consultants, Fletcher Advisory.

— The research is undertaken on a quarterly basis to identify European cross border trends and sector trends in respect of:

- share price
- burn rates
- cash raised
- cash usage

— German dominance has reduced in the 3rd quarter. Germany now represents 45 of the 150 companies and 35% of the total market capitalisation compared to 56 companies and 45% in the 2nd quarter.

— Burn rates have worsened slightly in the period. 28% are not burning cash compared to 41% in the 2nd quarter. For those burning cash the average burn rate is 18.5 months compared to 20 months in the last quarter. B2B companies continue to look relatively more secure than their B2C counterparts.

- some companies in the Internet 150 have moved from the non-burning group to the burning group, increasing the overall population of burning companies

- these companies, new to the burning group, have relatively good burn rates thus preventing the average burn rate from worsening dramatically from Q2 to Q3

— Spending and sales have increased in the quarter. Average cash holdings have declined and IPOs have fallen from 60 in quarter 2 to 45 in quarter 3.

— The Internet 150 has closed the year down 64%. B2B companies have outperformed B2C companies over the year but this masks the relatively worse performance of B2B's since September 2000.

— The overall slump masks increasing polarisation between the best and worst performing internet companies in Europe. Worst performers have shed over 75% of their value with the best performers nearly tripling their value.

— Successful companies are much better able to convert Sales General & Administrative Expenses (SGA) / marketing spend into revenue than those with poor share price performance.

Internet 150 Report 01/2001
Changes to the Index Population

The companies in the index are listed on one of the following exchanges: - LSE, PAR, FRA, Italy, Switzerland, Spain, Sweden, Austria, AEX, HEX, EASDAQ, EURO NM.

Companies included must be headquartered in Europe, have had an IPO before 1st October 2000 and have at least 50% of their revenue dependent on the existence of the internet or internet technologies and are not investment companies.

From a wider population we have then selected the 150 largest companies by market capitalisation — these represent the overwhelming majority (circa 95%) of all European internet market capitalisation.

IPOs and organic changes in share price have been responsible for the changes in the constituents to date. Looking forward we expect merger activity to be more significant.

27 new companies have entered the index:

- 20 due to IPOs between 1 July and 30 September 2000
- 6 due to growth in market capitalisation
- 1 due to reclassification due to increased internet activity

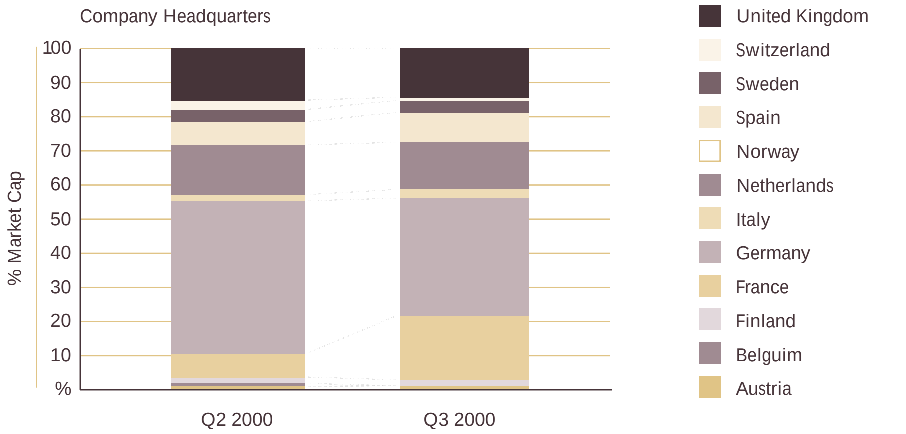
27 old companies out:

- 26 due to shrinking market capitalisation
- 1 due to reclassification
- there were no departures due to takeover or de-listing in the period

There are also a number of announced mergers which are expected to affect the Internet 150 soon.

The top 150 now have a combined market capitalisation of EURO 116bn (as at 29 November 2000) compared to EURO 200bn (as at 6 September 2000) a drop of 46%.

Source: Bloomberg, Fletcher Advisory



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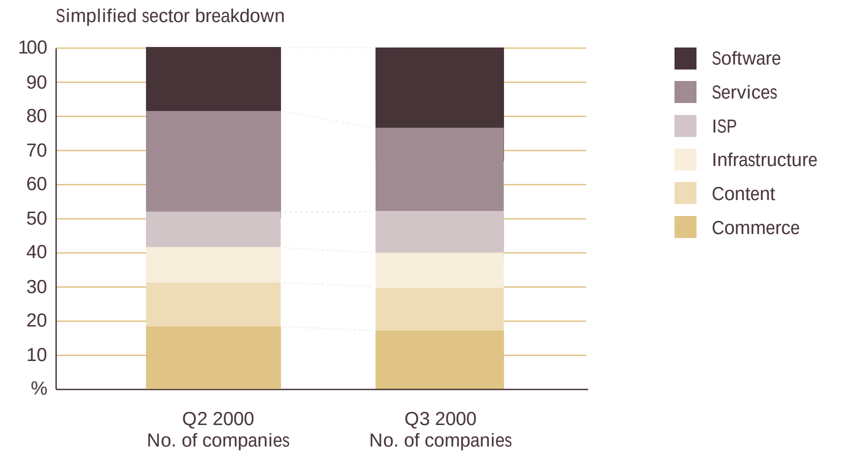
Changes to the Index Population

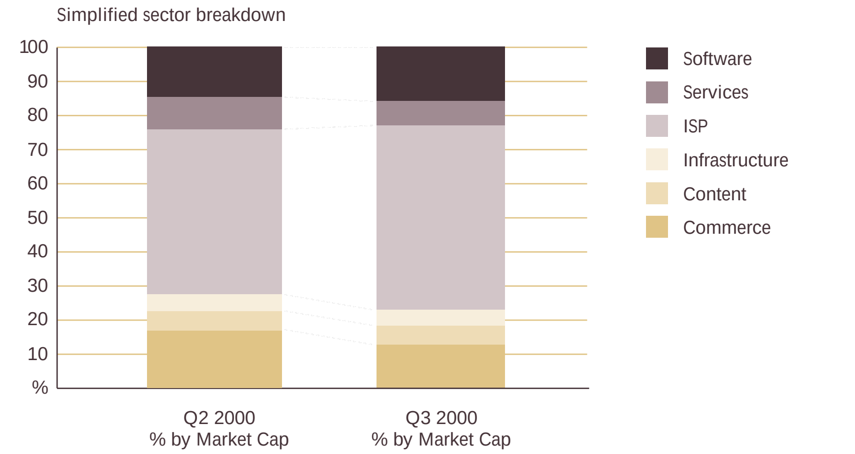
Germany represented 56 of the 150 companies in the last quarter's index but only 45 companies this quarter. German companies represent 35% by market capitalisation this quarter and 45% last time.

The sector composition of the index is largely unchanged between quarter 2 and quarter 3. ISPs continue to represent the largest companies within the index.

Source: Bloomberg, Fletcher Advisory



Source: Bloomberg, Fletcher Advisory



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Burn Rate Trends

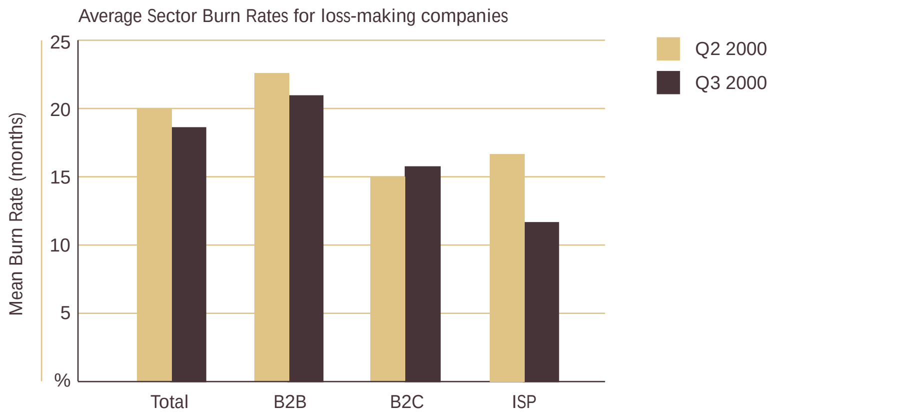
— Burn rates have worsened slightly in the period, driven by reduced cash holdings and increased SGA spend.

— Of the 108 companies for which we have data, 28% are not burning cash compared to 41% that were not burning cash in the last quarter's results.

— For those companies which are burning cash, the average burn rate is 18.5 months vs 20 months for the last quarter.

- B2B firms have an average burn rate of 21 months compared to 23 months in the last report
- B2C firms have an average burn rate this quarter of 16 months compared to 15 months last quarter
- B2B companies continue to look relatively more secure than their B2C counterparts

Source: Bloomberg, Fletcher Advisory



— The proportion of companies burning cash has increased from quarter 2 to quarter 3. This increase is also apparent within each sub-sector where the % of companies burning cash has increased in B2B, B2C and ISPs.

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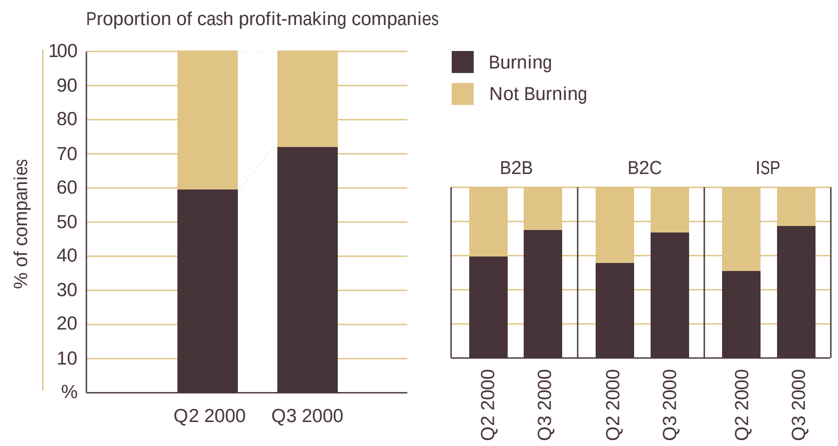
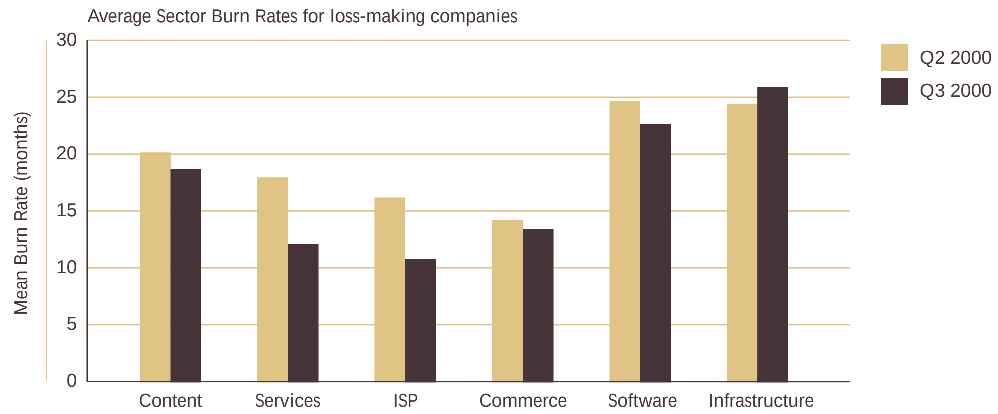
Burn Rate Trends

Source: Bloomberg, Fletcher Advisory



— The sharpest worsening of burn rates is seen in the Services and ISP companies. Infrastructure alone has improved its burn rate since the end of quarter 2.

Source: Bloomberg, Fletcher Advisory



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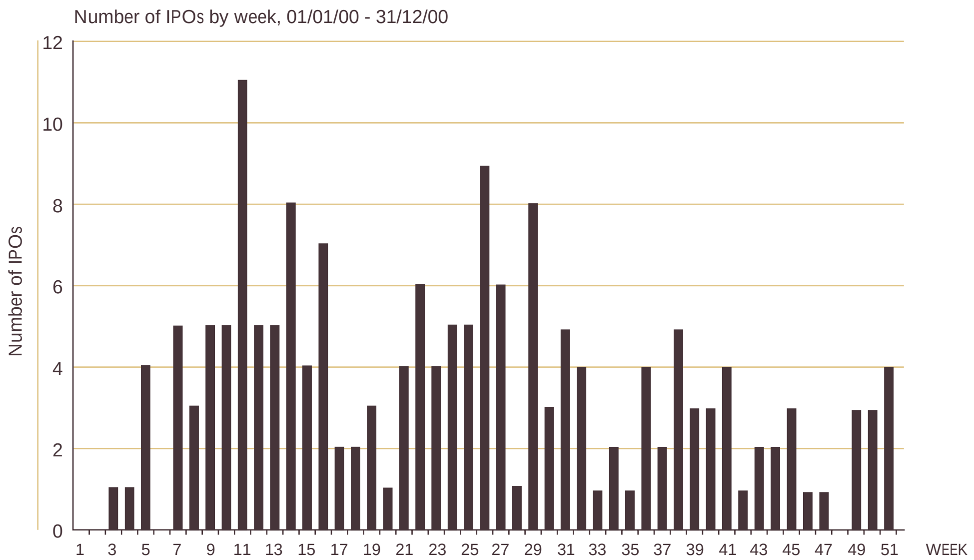
Factors Affecting Burn Rates

Cautious equity markets have contributed to shorter burn rates

- Average cash holdings per company have declined from quarter 2 to quarter 3 – the median change is –10% for like for like companies
- Internet IPOs have fallen from 60 in quarter 2 to 45 in quarter 3

Source: Bloomberg, Fletcher Advisory



Companies have also continued to spend

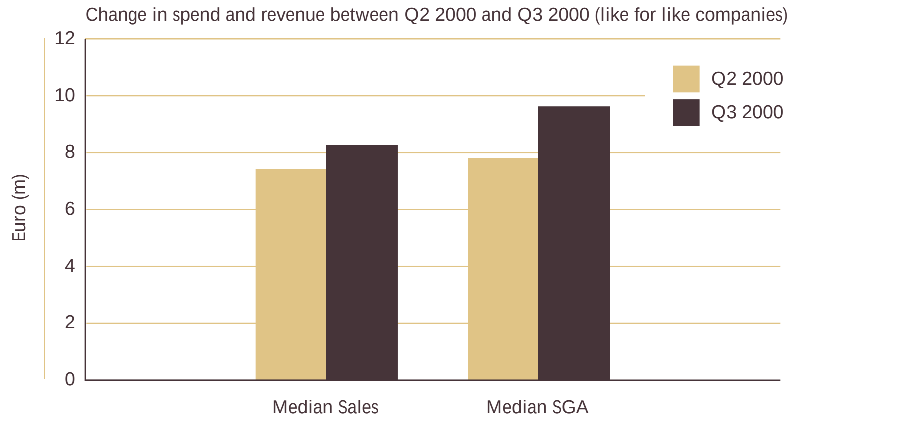
- Median spend on SGA has risen to EUROS 9.7m/quarter per company from EUROS 8m/quarter
- Median sales have also risen to EUROS 8.4m/quarter per company from EUROS 7.6m/quarter
- Median gross margins have remain unchanged

It is important to note that increases in SGA have been proportionately more than increases in sales.

We have seen an 11% median SGA increase for like for like companies compared to a 5% increase in sales. Consequently net spending rates are up and burn rates have worsened.

Internet 150 Report 01/2001
Factors Affecting Burn Rates

Source: Bloomberg, Fletcher Advisory



Overall it has been business as usual for European dot-coms – with increased SGA, increased sales and reduced available funds as fund raising declines.

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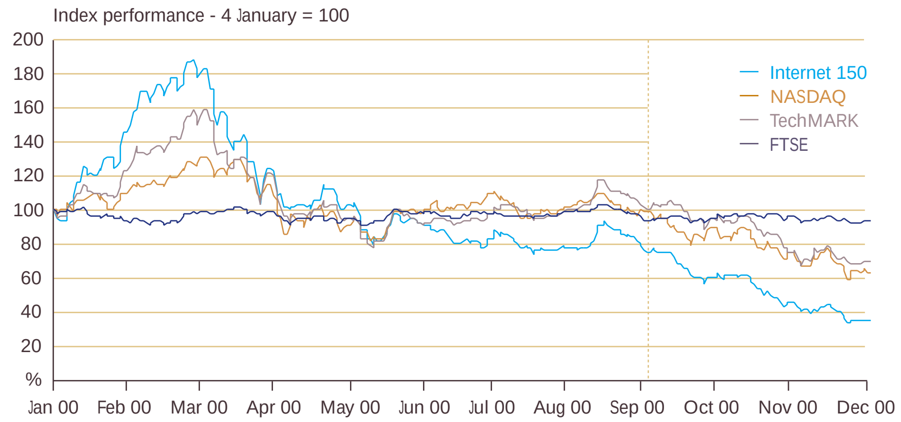
Stock Market Activity

Since January 2000 the European Internet Index performed less well that the NASDAQ, TechMARK or the FTSE100 and has demonstrated greater extremes of price movement. The Internet 150 closed the year at 36.6 having started at 100 down 64% compared to a reduction in the year for the NASDAQ and TechMARK of circa 35%.

Source: Bloomberg, Fletcher Advisory

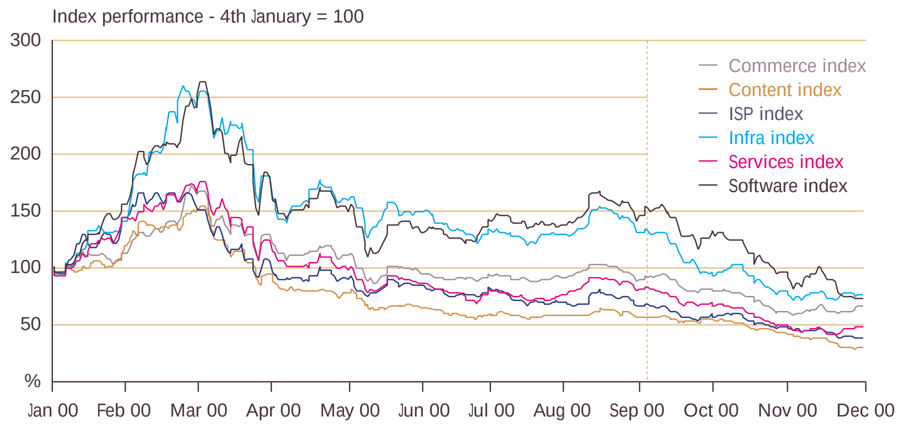


B2B companies have outperformed B2C companies over the year. Individual sub-sectors still show a degree of price variation. Software and Infrastructure companies have performed better than Content, ISPs and Services over the year.

Source: Bloomberg, Fletcher Advisory

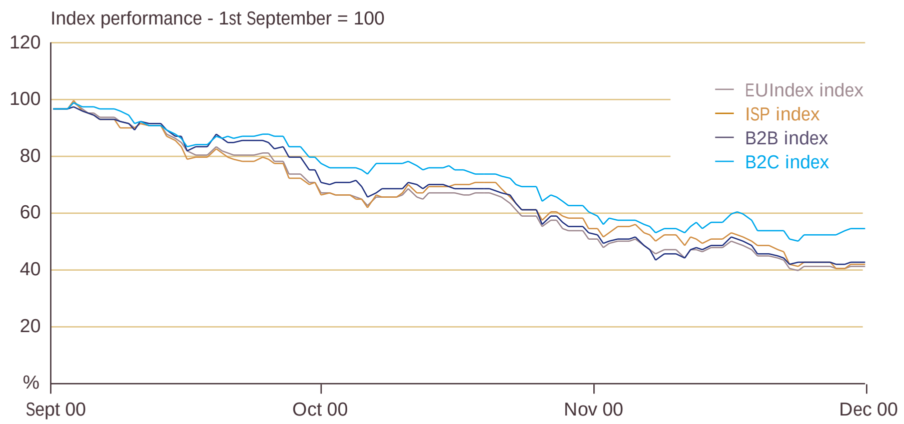
Internet 150 Report 01/2001
Stock Market Activity

Source: Bloomberg, Fletcher Advisory



However, with regard to investing timing remains critical. Although B2B companies outperformed B2C since the start of 2000, this masks a relatively worse performance since September 2000. An investor choosing his portfolio in September would be worse off today if he had chosen a B2B portfolio rather than a B2C portfolio.

Source: Bloomberg, Fletcher Advisory



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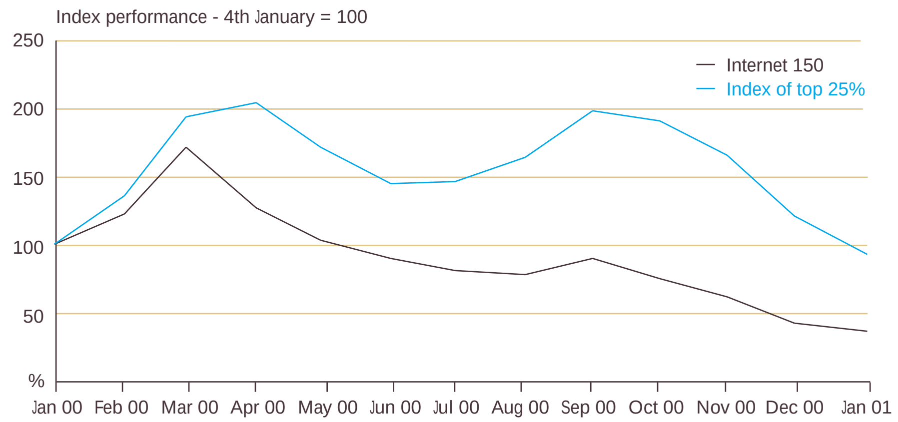
Rewarding Sound Management

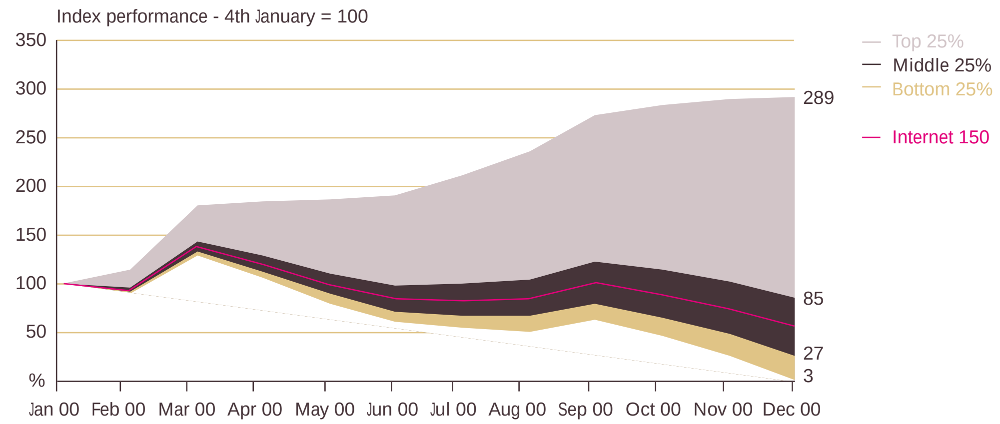
Profitable companies (those not burning cash) have outperformed the remainder of the index both since January 2000 and since the 1st September 2000 sell off. Whilst the worst performers have shed over 75% of their value since January 2000 the individual best performing companies have nearly tripled their value.

Source: Bloomberg, Fletcher Advisory



We have defined quartiles of share price performance over the year, relative to the Internet 150. Differing share price performance is largely independent of sector, although software is over represented in the top quartile of performance and under represented in the bottom quartile).

Source: Bloomberg, Fletcher Advisory



Internet 150 Report 01/2001
Rewarding Sound Management

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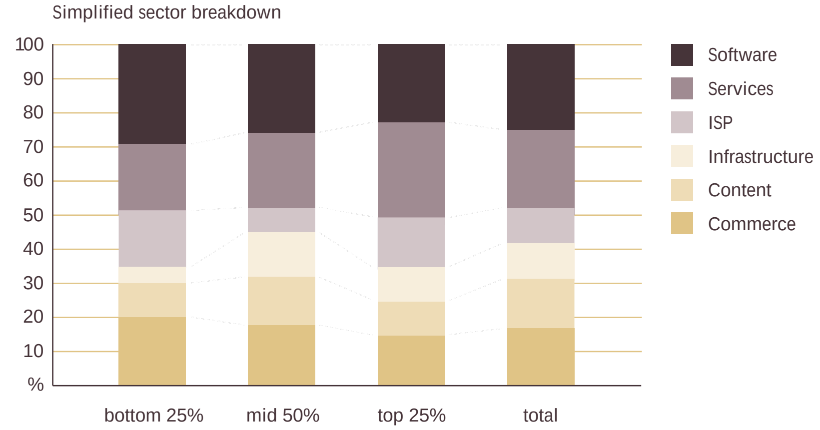
Source: Bloomberg, Fletcher Advisory



What our analysis shows is that it is more important to look at the managerial performance of the companies in question than their sector.

In particular, companies in the top 25% of share price performance during 2000 show the following characteristics:

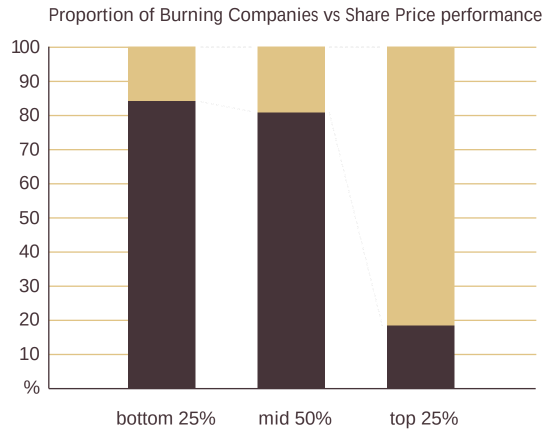
- Lower proportion of burning companies than companies in the mid 50%
- Lower ratio of SGA / Sales than companies in the mid 50%

Companies in the bottom 25% of share price performance during 2000 show the reverse characteristics:

- Higher proportion of burning companies than companies in the mid 50%
- Higher ratios of SGA / Sales than companies in the mid 50%

Therefore the market is rewarding financial prudence and profit which reflects a sentiment change to more short termism than the position at the start of the year when future value was the watchword.

Source: Bloomberg, Fletcher Advisory

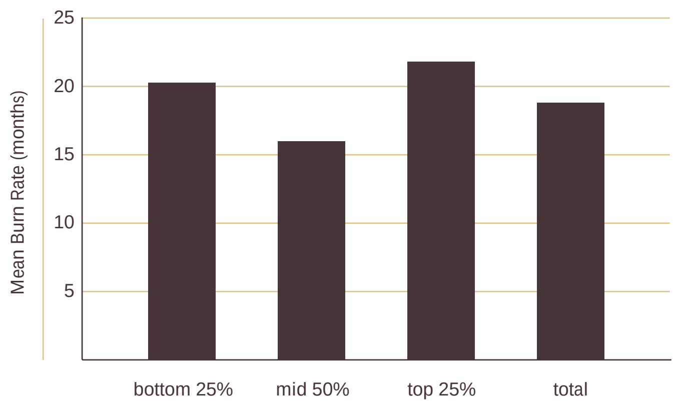


Internet 150 Report 01/2001
Rewarding Sound Management

Interestingly, though, worse performing companies actually have longer than average burn rates. Showing companies that have longer term business models have funded themselves accordingly in most cases.

Source: Bloomberg, Fletcher Advisory

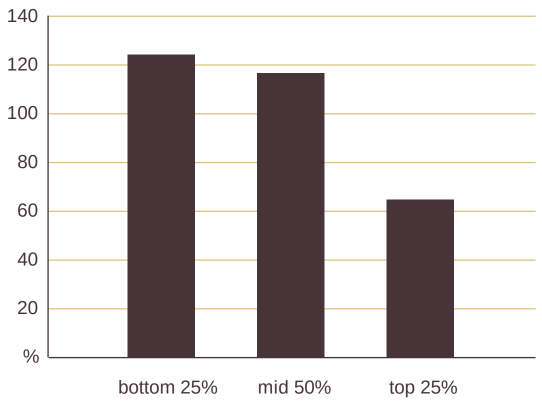
Average Burn Rates vs Share Price performance quartile



Successful companies are much better able to convert SGA / marketing spend into revenue than those with poor share price performance. Companies within the top quartile of the index are spending 64p for every £1 of revenue they make compared to £1.25 for every £1 of revenue that the bottom quartile companies are spending.

Source: Bloomberg, Fletcher Advisory

Median SGA / Sales vs Share Price performance quartile



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Companies most at Risk

A significant proportion of companies are still in the ‘danger zone’. 23 of the companies in our population have burn rates of less than 12 months compared to 20 companies for the last quarter. In total these companies account for a combined market capitalisation of EUROS 12.5bn.

In summary there are principally 3 potential solutions for these companies:

- Raising more money on the equity / debt markets
- Selling marketable securities to release cash
- Turning the business around to become more profitable

Companies unable to achieve one of the 3 solutions to a short burn rate potentially face financial distress.

Expected future trends

We expect to see profitable dot.coms continuing to exercise greater discrimination over what they spend their marketing budget on — moving away from expensive advertising and towards more targeted marketing.

We also expect to see increased polarisation between the best and worse performers leading to further consolidation in the sector. It is likely that there will also be a flow of new e-business ideas and propositions from the bricks and mortar companies due to the negative market sentiment and lack of funding for dot.com start ups.

Who will the survivors be?

The Survivors	**The Strugglers**
Low overhead & marketing cost:sales ratio, meaning they expend less to achieve sales (typical Survivor spending 64p for every £1.00 of revenue they make)	Higher overhead cost:sales ratio. (typical Struggler spends £1.25 for every £1.00 of revenue they make)
Higher Gross Margins (typical Survivor had an 82% gross margin in Q3)	Lower Gross Margins (typical Struggler had 65% gross margin in Q3)
Less likely to be burning their cash giving them a higher chance of long-term survival (80% are not burning cash)	More likely to be burning their cash meaning a business turn around is essential to avoid bankruptcy (85% are burning cash)
Long track records, often being companies in operation long before the net arrived, implying managerial experience	Shorter track records, more likely to be opportunistic children of the net
Operate in areas with high barriers to entry, often where R&D costs are high and industry expertise is essential	Operate in areas with lower barriers to entry, where players need less experience to begin competing