

> Subject: FW: Yusuf, you turned Bruce
> Smith around...

>
>
>

-----Original Message-----

> From: Tony Dirksen
> Sent: Tuesday, February 03, 1998 8:23 AM
> To: Lora Shiner
> Subject: FW: Yusuf, you turned Bruce

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>
> Since Yusuf is out, I'll pass
> this to you, too...

>
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> From: Tony Dirksen
> Sent: Tuesday, February 03, 1998 8:22 AM
> To: Yusuf Mehdi; Brad Chase; Tod Nielsen
> Cc: Vaughan Briggs; Carla Lewis; Tim

> Halladay; Erika Shaffer

> Subject: Yusuf, you turned Bruce Smith

> around...

>
> Latest report from Bruce; note
> paragraph highlighted in red...after our conversation with him, he's
> rethought his "army of developers" boast...

>
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> Global Securities Research ML++ML++ML Merrill Lynch
> ML++ML++ML
> NETSCAPE COMMUNICATIONS

> CORP. (NSCP/OTC)

> Juncture

> 449-0923

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> NEUTRAL

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> Term

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> NEUTRAL

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> Report

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> \$16 1/16

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> 1997A 1998E 1999E

>

> \$0.05 -0.20 \$0.14

>

> 321.3x NM 114.7x

>

> (YoY):

> EPS:

>

> 26-Jan-98)

>

> \$0.09 -0.14

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> NA NA NA

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321.3x NM 114.7x

(YoY):

EPS:

26-Jan-98)

\$0.09 -0.14

NA NA NA

Estimates (Dec)

EPS:

P/E:

EPS Change

NM NM

Consensus

\$0.01 NA

(First Call:

Q1 EPS (Mar):

Cash Flow/Share:

Price/Cash Flow:

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> NM	NM	NM	Dividend Rate
> Nil	Nil	Nil	Dividend Yield:
> Nil	Nil	Nil	Opinion & Financial
> Data			Investment Opinion:
> D-3-3-9			Mkt. Value / Shares Outstanding (mn):
> \$1,548.4 / 96.4			Book Value/Share (Dec-97):
> \$4.45			Price/Book Ratio:
> 3.6x			LT Liability % of Capital:
> 0.0%			Est. 5 Year EPS Growth:
> 35.0%			
>			
>			
>			Stock
> Data			52-Week Range:
> \$49 1/2-\$14 7/8			Symbol / Exchange:
> NSCP / OTC			Options:
> Chicago			Institutional Ownership-Spectrum:
> 31.6%			Brokers Covering (First Call):
> 13			
>			
>			
>			ML Industry Weightings &
> Ratings**			Strategy; Weighting Rel. to
> Mkt.:			Income:
> Underweight (07-Mar-95)			Growth:
> Overweight (07-Mar-95)			Income & Growth:
> Overweight (07-Mar-95)			Capital Appreciation:
> Overweight (28-May-93)			
>			
>			
>			Market Analysis; Technical Rating:
> Average (29-Dec-97)			
>			
>			
>			**The views expressed are those of the macro
> department and do not necessarily			coincide with those of the Fundamental
> analyst.			For full investment opinion definitions, see
> footnotes.			
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>			Investment
> Highlights:			o We remain very cautious on
> Netscape.			o The next 3 quarter will be
> critical.			

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> Fundamental
> Highlights:
> o Q4 slightly worse than
> pre-release
> o New estimate for 1998 is now \$513 million
> and a loss of (\$0.20).
> o Netscape success has broad implications for
> industry
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> Critical
> Juncture
> Netscape reported fourth quarter results that
> were slightly worse than the
> company indicated in their release of
> preliminary Q4 results on January 5th.
> Revenues came in at \$125 million vs. the
> reported range of \$125-\$130 million
> with a loss per share of (\$0.22) vs. a range of
> (\$0.15 - \$0.19). The company
> stated that the major reason for the slight
> shortfall was the need to adjust
> contracts due to the decision to give away their
> client software. The company
> also stated that the \$35 million restructuring
> charge, originally expected in
> Q4, would now be split with \$12 million now
> falling in Q1. This is due to the
> delay in headcount reduction which did not take
> place until the first quarter.
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> After Further
> Review...
> We have had extensive conversations with the
> development and corporate
> community since Netscape's decision to license
> its source code free of charge.
> Our initial reaction was that this was a major
> positive strategic move. We
> felt that Netscape would gain access to an army
> of unpaid developers, and with
> the success of the Apache Web Server, we felt
> that this could mitigate
> Microsoft's enormous resource advantage. After
> our recent discussions though,
> we are not as confident as we were originally.
> The major issue is this, will
> Netscape be able to maintain a quality product
> with so many uncontrolled
> developers. There is skepticism about
> Netscape's ability to successfully
> police this development and prevent the entire
> market from fragmenting. If the
> market does fragment it would be very good for
> Microsoft because the Internet
> Explorer platform would be a very stable
> alternative.
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> Rebranding
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> We remain very excited about the ability of OEMs
> and customers to rebrand the
> browser. This could become a significant

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> strategic advantage for Netscape
> because Microsoft only allows the rebranding of
> the IE embedded control. This
> control is embedded inside another application,
> such as Lotus Notes, and for
> all intents and purposes, it appears to be part
> of the overall product. But
> Microsoft does not allow the total IE product to
> be rebranded. Netscape could
> use this as a wedge to gain access to OEMs.
> Microsoft intends to fully
> integrate IE into Windows98 to such an extent
> that Windows and IE become
> indistinguishable. If this is the case, we
> don't know how they will allow
> rebranding if Netscape is
> successful.

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> Free Could
> Help
> Netscape's decisions to give away its client
> software could stem its decline in
> market share. We believe that Netscape's market
> share is hovering in the mid
> 50s with Microsoft in the low 40s, with
> Microsoft having the momentum. We
> believe Netscape's success hinges on their
> ability to hold market share.
> Netscape is making a significant push into the
> eCommerce space with the recent
> purchases of Actra and Kiva. We believe that
> this push will be beneficial if
> Netscape is successful in the browser
> space.

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> We still do not believe that Netscape will be
> anything more than a small niche
> player in the messaging and groupware space.
> This market has quickly
> consolidated around two vendors, Lotus/IBM and
> Microsoft. In fact, Netscape's
> free client will do nothing in this space
> because they continue to charge
> Client Access Licenses or CALs that in some
> cases could make them more
> expensive than Microsoft and
> Lotus.

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> Implications for the
> industry
> We have maintained for a while that Netscape's
> success or lack thereof, has
> broad implications for the entire industry.
> Netscape has acted as a strong
> counterweight to Microsoft in the computer
> industry. Netscape's success has
> brought Microsoft to the open standards arena
> and the success of Navigator has
> forced Microsoft to support technologies such as
> Java. If Microsoft is
> successful in gaining dominant market share in
> browsers, we feel that it will
> have a significant impact on how Microsoft acts
> in the future. Microsoft is
> already leading the charge in the evolution of
> many Web standards such as XML

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> and we believe that the degree of openness could
> change if Microsoft prevails.
> We even believe that Sun's Java initiative could
> falter under this scenario,
> although Steve Milunovich, our Sun Microsystems
> analyst, has maintained for
> quite some time that Sun's Java opportunity lies
> in the embedded system market
> and is not dependent on the
> desktop.

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New

> Estimate

> We have established new estimates for Netscape.

> For 1998 we are at \$513

> million in revenue with a loss of (\$0.20). Our

> 1999 estimates are \$690 million

> and \$0.14. We believe we are low on the street

> with these estimates.

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