Equity Research
North America

Investment Review

New York Morning Meeting Summary

March 14, 2001

Highlights

Some of these items are summaries of longer notes available to clients through Research Link on www.msdw.com, First Call, and other electronic systems.

Strategy and Economics

Topic	Analyst/Ext
Strategy	**Leah Modigliani/(212) 761-6319**

Market Commentary/Strategy

Changes to Our US Model Portfolio

- **Leah announced changes to our US Model Portfolio**
  We removed our 1% position in Mellon Financial (MEL, $42.35, rated Strong Buy by David Hilder, target $61) and added a 1% position in W.R. Berkley (BKLY, $47.18, rated Outperform by Alice Schroeder, target $54).

For further details, please contact your Morgan Stanley Dean Witter sales representative.

Topic	Analyst/Ext
Strategy	**Steve Galbraith/(212) 761-7880**

US Equity Strategy

Links Between Nasdaq and the Consumer Signal Cuts in Outlays

- **The real economy is more linked to the stock market than ever, in our view**
  The significant increase in individual investors' involvement in the market has helped drive strong correlations between retail sales and the Nasdaq since 1996, versus almost no correlation historically. From 1972 to 1996, the correlation between the Nasdaq and retail sales was less than 3%, compared with more than 70% since 1996. This suggests that as the Nasdaq goes, so may go the consumer.

- **We see more cutbacks in consumer spending, as the Nasdaq's 1999 gains have evaporated and joblessness may rise**
  The response of individual investors in consumption is one of the most important factors in the market today; consumers have seen their net worth decline sharply, and a negative wealth effect could lead to a more protracted and steeper earnings decline than the consensus expectation.

- **Unwinding of big gains may not be done, as 85% of all Americans with incomes topping $50,000 are in the market**
  While retail investor activity, leverage, and expectations are all down from last year's peaks, they remain extended by historical standards. We believe the next several months will be critical in determining whether the consumer leads us out of the current downturn or heads for the exits.

- **Regarding implications for portfolio managers, we would be cautious on financial stocks and selective on retail issues**
  We believe opportunities lie in the energy and healthcare sectors.

Industry Analysis

Topic	Analyst/Ext
Tech: Enterprise Software - Distributed & High-Availability Technologies	**Joseph Farley/(212) 761-7409**

Industry Overview

Initiating Coverage of the Sector

- **We initiated coverage of the enterprise software–distributed and high-availability technologies sector**
  Our new coverage, with our ratings and price targets, includes Business Objects (BOBJ, $34.69, Neutral) of France, and Cognos (COGN, US$17.56, Neutral) of Canada, and the US-based companies Embarcadero Technologies (EMBT, $20.31, Neutral), Mercury Interactive (MERQ, $41.94, Outperform, target $77), and Quest Software (QSFT, $19.55, Neutral). We also assumed coverage of Hyperion Solutions (HYSL, $18, Neutral), and assumed co-coverage of Veritas Software (VRTS, $59.13, Neutral) with Charles Phillips.

- **The sector consists of the business intelligence and high-availability software groups**
  We have a neutral stance on the business intelligence group, as demand for these companies' solutions may shrink along with information-technology budgets. In this group, we believe that Business Objects has the best momentum. Cognos has missed expectations in the past couple of quarters, but remains a contender, in our view. We regard Hyperion as a company in transition.

- **The high-availability technologies companies have widely different functions**
  The growth of this industry typically has trailed that of systems investments, such as in building business-to-business exchanges and implementing enterprise resource planning systems; all of these have generated large amounts of data and required incremental investments to keep these systems reliable and available. That is where these high-availability technologies come into play.

- **Mercury Interactive dominates the load-testing market and is an early leader in Web performance management**
Our thesis on Mercury is that it trades at a significant discount to our estimate of its intrinsic value. Regarding Veritas Software, it sets the standard for storage-management solutions; Veritas expects to meet expectations for the current quarter, but the stock has declined amid questions about the company's prospects for the rest of the year. Quest Software has an expanded product line, and it is selling into the systems investment cycle; its main products are low-cost tools that could be the last of any items cut in an IT budget and the first approved once these budgets expand. Embarcadero Technologies' database development tools are platform-neutral, that is, easily usable among a wide variety of systems; it also has low-cost tools.

Topic	Analyst/Ext
Autos, Auto Parts & Tires	**Stephen Girsky/(212) 761-6317**

Industry Overview

We Remain Concerned About the Outlook for Profits

- **Several factors could make it difficult for any of the auto stocks to outperform**
While inventory days' supply has declined to more normal levels, unit inventories remain high, particularly at General Motors (GM, $56.44, Neutral). If sales soften further, the inventory situation could get worse very quickly.

- **The Japanese yen has depreciated against the US dollar**
This gives Japanese original equipment manufacturers (OEMs) pricing leverage, which could amount to as much as $1,000–2,000 per vehicle.

- **The Big Three US automakers have lost a total of 7.6 percentage points of light-truck market share since 1996**
That year, the share peaked at 86.4%. With the onslaught of fresh products from foreign OEMs, especially in Japan, the Big Three have been losing share in key profit segments such as minivans, pickups, and SUVs.

- **We reiterate our Outperform rating on Ford Motor (F, $29.84, target $35)**
The key to significant stock performance by Ford, in our view, is the company's North American operations. If Ford can return North American operating margins to more normal levels, significant cash flow and stock performance are likely.

Topic	Analyst/Ext
Healthcare: Biotechnology	**David Zimbalist/(212) 761-8055**

Industry Overview

Prospects for a Robust Mass Spectrometry Market

- **The mass spectrometry market has attracted attention from some investors recently**
Mass spectrometry is a widely used analytical technique for measuring molecular mass, and is an enabling tool in proteomics. Enthusiasm about the technology in 2H00 has given way to concerns regarding growth and competition. We believe that this market in 2001 should be as robust as it was last year.

- **Demand remains strong**
Proteomics is the driving force, as protein research labs scale up their efforts and new proteomics enterprises are built.

- **We have models that provide a basis for discussion, given the lack of financial data and recent concerns**
Several biotech tools companies have exposure to mass spectrometry. (See related item below on Millipore.)

Company Analysis

Company (Ticker, Price, Target)	Rating	Country	Industry	Analyst/Ext
American International Group (AIG, $78.79, $110)	**Strong Buy**	**US**	**Insurance: Property-Casualty**	**Alice Schroeder/(212) 761-4626**

Change in Rating

Attractively Valued; Upgrading to Strong Buy

- **We raised our rating on American International Group to Strong Buy from Outperform**
  Our upgrade is based on the stock's recent price performance. AIG has dropped 24% from its 52-week high. Our price target remains $110, which is based on a multiple of 34 applied to our 2002E EPS and represents 495% of 2002E book value, roughly in line with the current valuation.

- **We see several catalysts for the stock**
  In addition to a more attractive valuation, we cite AIG's expected first-quarter earnings performance relative to large-cap peers, and the possibility of more clarity on the company's management succession process, as CEO Maurice "Hank" Greenberg is 75 years old.

- **We have conviction that AIG has the earning power to outperform the market for the foreseeable future**
  We regard the company as a true growth story in the global financial services industry. Moreover, it has been the most consistently profitable major insurer ever. And the company has expressed its desire to make acquisitions in the life insurance and asset management industries.

Company (Ticker, Price, Target)	Rating	Country	Industry	Analyst/Ext
Hispanic Broadcasting (HSP, $18, $25)	**Outperform**	**US**	**Broadcasting**	**Frank Bodenchak/(212) 761-4251**

Change in Rating

Better Risk-Reward Scenario; Upgrading to Outperform

- **We raised our rating on Hispanic Broadcasting to Outperform from Neutral and set a price target of $25**
  HSP shares may outperform from current price levels. HSP has fallen from $35, or 28 times 2002E EBITDA, to $18, or a multiple of 13. This is below the bottom of its historical trading range of 20–40.

- **Though the radio industry's momentum should start to improve in 2H01, we cut our estimates of HSP's performance**
  This reflects what we believe will be weakness in the radio business this year. We reduced our estimates of Hispanic Broadcasting's after-tax cash flow per share for 2001 to $0.81 from $0.85, for 2002 to $0.95 from $1.01, and for 2003 to $1.10 from $1.17. We also lowered our pro forma broadcast cash flow estimates for 2001 to $113 million from $120 million, for 2002 to $133 million from $144 million, and for 2003 to $155 million from $166 million. The company's January revenue fell 3%, with important HSP markets such as New York and Los Angeles showing weakness.

- **The recent US census showed Hispanic population growth of 58% from 1990–2000**
  The Hispanic population totals 35.3 million, or 8% more than estimates in early 2001. The number of Hispanics is equal to African-Americans, or one out of eight persons.

- **Our fragmentation concerns are fully reflected in HSP's valuation**
  Though HSP faces increased competition in Los Angeles, the overall market opportunity remains substantial, with Spanish formats garnering only 51% of their advertising market share. Moreover, the company's growth is outpacing that of the industry in other markets, especially San Antonio, Texas.

Company (Ticker, Price, Target)	Rating	Country	Industry	Analyst/Ext
Magna International (MGA, $46.19, $65)	**Outperform**	**US**	**Autos, Auto Parts & Tires**	**Stephen Girsky/(212) 761-6317**

Change in Rating

An Inexpensive Stock; Upgrading to Outperform

- **We raised our rating on Magna International to Outperform from Neutral and set a price target of $65**
  We like Magna's improving return on invested capital (ROIC) and increased focus.
- **Separating MGA into three businesses is likely to create even more focus, we believe**
  This should reduce some investors' perception that MGA is a company with size but no scale.
- **The company's ROIC has begun to improve over the past year**
  Since 4Q99, it has increased to 18.3% from 15.7%.
- **We reckon that MGA stock is inexpensive**
  MGA trades at about 3.9 times EV/2001E EBITDA, below the peer group average of 5.2. Our $65 target implies a multiple of 5.5.

Company (Ticker, Price, Target)	Rating	Country	Industry	Analyst/Ext
Johnson Controls (JCI, $68.29, NA)	**Neutral**	**US**	**Autos, Auto Parts & Tires**	**Stephen Girsky/(212) 761-6317**

Change in Rating

Downgrading to Neutral Based on Valuation

- **We lowered our rating on Johnson Controls to Neutral from Outperform based on valuation**
  JCI now trades at a premium to the group on the basis of EV/EBITDA and P/E.
- **JCI stock has outperformed the market**
  Since March 2000, JCI has risen 23%, compared with a 21% decline by the S&P 500.
- **We view JCI as one of the best companies that we cover**
  As a supplier of interiors, the company stands to benefit from increased mobile multimedia content.

Company (Ticker, Price, Target)	Rating	Country	Industry	Analyst/Ext
Applied Biosystems (ABI, $50.25, $70)	**Outperform**	**US**	**Healthcare: Biotechnology**	**David Zimbalist/(212) 761-8055**

Change in Price Target

Cutting Price Target, but Maintaining Our Estimates

- **We cut our price target on Applied Biosystems' shares to $65–70 from $95**
  But we remain comfortable with our estimates and our Outperform rating on ABI. We consider ABI a defensive haven in the current economic environment.
- **Life-sciences stocks have been weak, but we believe concerns about Applied Biosystems' earnings are unwarranted**
  We believe that most of the volatility has stemmed from a rotation out of healthcare, but some company-specific concerns also come into play.
- **Demand for ABI's genetic analysis tools was better than expected at a Tri-Genome conference**
  And a hearing related to sequencing reagents may hold ABI back in the near term. (See related industry item above.)

Company (Ticker, Price, Target)	Rating	Country	Industry	Analyst/Ext
Riverstone Networks (RSTN, $7.69, $17)	**Outperform**	**US**	**Technology: Data Networking/ Internet Infrastructure**	**Christopher Stix/(617) 856-8741**

Initiating Coverage

A Metro Service Provider Opportunity; Outperform

- **We initiated coverage of Riverstone Networks with an Outperform rating and a price target of $17**
  Our EPS estimates are $(0.01) for F2002 (February) and $0.32 for F2003. Our residual income model indicates Riverstone is undervalued at current levels. We view Riverstone as a leader in the market for metropolitan area networking. We believe Riverstone could be one of the fastest-growing companies in our coverage universe over the next several years.

- **The company has a singular focus on the emerging metro market**
  We like Riverstone's purpose-built best-of-breed products, combined with a sales and marketing organization.

- **Despite capital-spending concerns, we view the metro market as a growth area**
  Profitable Internet protocol data services are deployed in metro areas. We believe service providers need to focus on metro networks to monetize investments in core and last-mile buildouts.

Company (Ticker, Price, Target)	Rating	Country	Industry	Analyst/Ext
Automatic Data Processing (ADP, $56.21, NA)	**Neutral**	**US**	**Technology: Computer Services**	**David Togut/(212) 761-6388**

Company Update

Earnings Growth Could Slow in the Second Half

- **We believe Automatic Data Processing is approaching an inflection point for earnings growth**
  Given softening of several economic drivers, we believe ADP's recent above-trend earnings growth of 16–18% will slow in 2H01. We believe this prospect will be highlighted in discussions at the company's semiannual analysts' meeting and by cuts expected in short-term interest rates by the Federal Reserve.

- **We see economic drivers turning more negative**
  We believe continued, substantial cuts in the federal funds rate this year will pressure income on ADP's tax filing float of more than $8 billion. We also see pressure from slowing employment, which could affect the company's payroll processing business. ADP's brokerage services revenue could slow, owing to softening growth in trade volumes and reduced activity in the company's proxy services business.

- **Automatic Data's relative valuation is near its record high**
  ADP trades at 154% of the 2001E S&P Industrials' P/E ratio, near the top of the stock's nine-year range of 84–163%.

Company (Ticker, Price, Target)	Rating	Country	Industry	Analyst/Ext
Millipore (MIL, $53.42, $70)	**Outperform**	**US**	**Chemicals: Specialty**	**Robert Ottenstein/(212) 761-3018**

Company Update

Credibility in Life Sciences Builds

- **Millipore is advancing in ultrahigh throughput DNA purification and cleanup**
  Our discussions with major competitors of Millipore confirm that it is taking a leadership position in DNA sample preparation via low-cost technology. This preparation is required in numerous genomic technologies.

- **ZipTip is becoming a proteomics industry standard**
  It is viewed as the default standard for protein cleanup and desalting prior to matrix-assisted laser desorption ionization, a technique in mass spectrometry for analyzing proteins. ZipTip's success reflects Millipore's leadership position in protein chemistry; the company has the broadest product line and a leading market share.

- **Millipore's Montage kits for low- and medium-throughput sample prep are gaining traction**
  These life-sciences kits are at least 50% faster than and more than 20% less expensive than those of its competition.

- **We maintain our Outperform rating on MIL shares**
  Our grassroots research suggests Millipore is gaining significant ground in life sciences segments. (See related industry item above.)

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