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September 04, 2003

Are AVID insiders really screaming that their stock is overvalued?

A Barron's ONLINE story recently asked "Are AVID Shares Due for a Cut?" The story quotes Jonathan Moreland of InsiderInsights.com as saying that Avid Technology, Inc.'s ("AVID") (NASDAQ Symbol: AVID) insider selling "screams that AVID is overvalued". We wondered if he could be right, having observed AVID's spectacular rise despite a seemingly well-researched and reasonable short thesis, which by the way was not well presented in the story.

AVID has a very strong product line and many competitive advantages. It is the pioneer and undisputed leader in digital video editing. Film editors worldwide are trained and experienced AVID users. It spends far more on marketing and R&D than its competitors, and enjoys an excellent reputation in its industry.

AVID is facing risks. Apple has created video editing software that is used to create competing products. AVID operates in a small-ish niche market. It is introducing new products into its existing markets partly as a reaction to severe price competition and is introducing new products into new markets. These new markets are only now developing and their actual size is unknown.

Some of AVID's markets are directly affected by advertising revenues, which have been depressed and whose recovery is dependent on macro-economic factors. AVID's earnings growth depends on new products and new markets. AVID has suffered declining revenues and losses in its recent history. All of these factors combined with a 5-fold increase in its stock price have made AVID a favorite among short sellers.

On April 15th the short position in AVID's stock peaked at 5.9 million shares. After reporting strong quarterly earnings on April 16th and July 17th the short position in AVID's stock declined to 4.7 million shares on August 15th. With the stock trading at over 30 times next year's earnings, and with earnings projected to reach $54 million next year up from $3 million last year, and with short sellers in disarray we decided to conduct a brief investigation of AVID's product market.

We found no reasonable basis to believe with any great amount of certainty that its early success in digital newsrooms will not continue and expand. The digital newsroom market is new to AVID and is estimated to be $2.5 billion. It may be half of this amount or a third but the market is large and profitable. AVID's product has been extremely successful having outsold Sony, the next largest supplier of digital newsrooms, by over 5 to 1. We also found no reasonable basis to believe that its new post-production editing and workflow products have not been accepted or are having implementation problems, or that they will create a sharp drop in revenues and profits. AVID remains the leader and is the only company providing a single source of responsibility for all of the components and functions of video editing (capturing, storage, display, sharing work among groups and editing).

What are the likely outcomes? There could reasonably be some sort of earnings miss in AVID's future. Or there may be a series of blockbuster years that greatly exceed expectations. Both are possible. But what seems certain to us is that contrary to the Barron's story, management is not selling out and calling it quits but is addressing its problems in a strong and proper—and successful--manner. What's our bet? We have none. We limit our operations to stocks where there are very wide margins between our internally calculated value and the market's value. What do we believe will happen? AVID may stumble but it will not fall too far. We believe that AVID has everything it takes to be a great success and advise caution to our fellow short sellers.