Special Situation Investing Newsletter

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Insightful Analysis and Commentary
for U.S. and Global Equity Investors

August 2, 2007

Company Spotlight:	**Getty Images Inc. (GYI-NYSE)**

gettyimages®

"Getty Images Falls Victim To Mass Collaboration, Cuts Jobs… Sooner Than We Expected"

Current Stock Price:	**$38.00; Option $5.40**
Trade Update:	**Cover Short, or Sell the JAN2009 $40 PUTS to close the position out and lock in option gains with $5.40 sale price.**

ORIGINAL POSITION ON MAY 8. 2007

Stock Price on MAY 8, 2007:	**$50.43**
24/7 Wall St. Price Target:	**$36.00 to $38.00; 18-month outlook**
Options Strategy:	**De-leveraged JAN09 $40 PUTS at $1.95; This is not a naked short call, we are taking the put options instead.**

<u>Today we are recommending that our Special Situation Investing Newsletter clients either exit the Put Option trade or cover their short sale we looked at in Getty Images Inc. (NYSE:GYI) from our May 8, 2007 newsletter. This will lock in considerable gains of either over 30% in the short sale or more than 150% on the options</u>. Please read the conclusion down at the end of this report, and we also included some excerpts from the May 8 newsletter. Here is what happened to Getty, and here is why we believe the position can be exited at a substantial profit:

Last night, Getty Images Inc. (NYSE:GYI) saw earnings and revenues increase after the close of trading yesterday, but the lowered guidance (which we expected) is taking a toll. Revenues rose 6% to $218 million and earnings came in at $0.56 on a diluted basis. First Call estimates were $218.8 million revenues and $0.58 EPS.

The company has announced a restructuring and related reduction in workforce of about 100 employees that will result in a charge of approximately $4.0 million in the third quarter of 2007 and is expected to result in annualized savings of approximately $20 million in staff and staff related costs. The company continues to focus on managing costs effectively while investing in the areas of the business that provide the best opportunities for growth.

Guidance is weak, and sooner than we would have expected. For the third quarter of 2007, the company expects revenue of approximately $210 million and diluted earnings per share of $0.47 outside of charges. Unfortunately, First Call was looking for estimates of $0.61 EPS and $221 million in revenues. For full year 2007, the company expects revenue of approximately $855 million and earnings per share of approximately $2.22 before items. First Call estimates are $880 million and $2.48 EPS. The pressure is mounting faster.

Cash balances were $288.6 million at June 30, 2007, with cash flow from operations adding $48.8 million in the quarter. During the quarter, the company spent a total of $248 million for acquired businesses, of which $120 million was financed through the company's senior credit facility and the remaining $128 million paid from existing cash balances. Unfortunately the company is posting higher SG&A costs at the same time it is trying to trim jobs.

This is all as we expected per our previous newsletter recommendation against Getty Images based upon the special situations we have been seeing throughout the private companies in digital imaging over the last year. We would not have expected this to pan out as fast as it is happening, and we didn't expect the margin compression to start until the end of 2007 or even or early 2008. Some of this ramping up of the calendar may stem from the News Corp & Dow Jones tie-up and the Thomson & Reuters tie-up. Fewer and fewer news agencies usually means a consolidation of clients and the propensity for companies to have "good hits and bad misses." If you don't believe that, look at how only a few major cell phone carriers can affect companies selling to them (but that's another story).

The monetary value of digital, audio, and video images is unfortunately not what it was once before. Not in a model where your business has the easiest model to mass collaborate or wiki at any rate. Getty Images is becoming and will be the true victim of the wiki-model and mass collaboration, and even though it has made some good acquisitions it cannot acquire everyone and cannot stop the coming onslaught of lower-priced or nearly-free competitors that are mounting an assault.

We aren't entirely negative on Getty Images because we think the company will survive and do well in niche markets. The truth is that the company will have a strong place in a few lines of copyright protected material, such as live entertainment and sporting events. But vast portions of the company's business will fall prey to mass collaboration. I had previously noted that anyone with about $20,000 can build a similar wiki-model stock photo and copyright video and audio business, but according to a contact in the industry my estimated cost structure is far too high:

According to Augustine Fou, CEO of PictureSandbox.com, *"Anyone with $1,000 can build a web 2.0 service -- something as simple as a meta search engine for photos which searches across every available microstock collection. Helping the potential buyer more quickly and easily find and license a photo means that purchase will occur outside walls of traditional stock houses like Getty."*

Once these online digital photo hubs begin to take a C2C or C2B (yeah, remember those terms? urgh) approach a step further, then there is even more trouble. With a 20 forward P/E ratio the company isn't expensive at all, but they are going to have to fight harder and harder to maintain that through time and the company is now just going to be too easy to compete against. To top it off, Getty is a battleship that can't make fast turns overnight. Augustine Fou, CEO of PictureSandbox.com also noted, *"Getty is so far behind, not just because of technology, but also because of the speed of their business processes. Not only has the playing field changed, the game has changed too. And launching their own "collaborative site" like Corbis' SnapVillage is not going to help -- since the terms of use are still carried over from their traditional business."*

It looks like the market has started to adopt the same opinion. This stock never did get any strength to speak of when the market was climbing day in and day out. It looks like it has also sold off more than the broader market in the recent malaise. If those percentages are accurate then technicians are going to harp on this too. This morning there was a key downgrade on Getty Images: Deutsche Bank cut the stock down to a Sell rating from a Hold rating.

These are some of the summary notes from the MAY 8, 2007 newsletter, if you want to go back and see the excerpts:

Key Statistics (May 8): Market Capitalization $3.0 Billion; Forward EPS estimates: 2007 $2.35; Current P/E Ratio: 23.0; Forward P/E Ratio: 19.1; Dividend $0.00; 52-Week Trading Range $41.21 to $68.10; Average Daily Volume 560,000 Shares; Institutional & Insider Ownership 82%.

So we are looking at the safest de-leveraged bet against the company as the JAN09 $40 PUTS. The options are still too pricey to buy at the money calls out to JAN-08 and are far too pricey for JAN-09. The premium for the JAN-09 $40 PUT premium is $1.95. The same $40 Strike in JAN-08 only costs $1.00, but it doesn't really give enough time for a longer-term call like this. We also expect that the company will do fairly well compared to estimates in the next two quarters and that the newer-model business pressures will not come to pass until late 2007 or early 2008.

The JAN09 (January, 2009) $40 PUT options offer the safest position as a "bet against the company," but we are addressing this only on a de-leveraged basis. Buying options is a 100% risk to capital, so we are treating this only with the return based capital expectations. On a de-leveraged basis, you would look only at one contract per 100 shares you would buy/sell in the underlying stock.

Why not just short the stock and hedge with call options? For starters it is just too expensive for our taste. We look for at least a 2-1 perceived upside to downside matrix and shorting the stock with a hedged "Call" just adds too much premium. The option pricing indicates a higher propensity for this one to rise (which we disagree with), because if you model for a gain you'll see that the JAN09 $60 CALL options cost $5.00. So you'd be taking 20% risk to the rise in the stock price, plus the 10% for the premium if the option expired worthless, plus roughly 6% for the cost of borrowing the stock. We like to look for special situations where we feel we can limit downside on any single trade to roughly 10%. So taking on 30% or more downside is something we feel is foolish.

So in short, if you were considering shorting 1,000 shares of the stock then you would only want to purchase 10 contracts of the JAN09 $40 PUTS. Any change to this strategy is one we would not endorse whatsoever. If a buyer stepped in or if the cautious opinion proves to be too much then this limits your downside to what would be limited to a rough equivalent of 4% based on the $1.95 premium.

If we are wrong and the stock rises 10% or 20% we still think that roughly 1/3 of the premium would be left as time value for the stock options and the 4% downside risk would actually be able to be closed out at a slightly lower loss than that. If this stock begins to feel more pressure than we think the event risk is and longer-term time value could take these put options to a value of closer to $6.00 or a tad higher based on current option pricing. $5.40 is close enough to that $6.00 estimate, and even with the seemingly long time out to 2008 you would see a $0.05 drop in time value each week if the price remains static.

CONCLUSION OF POSITION, AUGUST 2, 2007:

We did have some traders look at the options and some that shorted the stock, despite the belief that an un-hedged short sale was too expensive to hedge. We are about preservation of capital and maximizing returns with the ability to hedge risk. The stock may continue to weaken from here, but the forward valuations and the target being achieved in this short of a period merits locking in some or all of the profits. The Getty clan can always end up tapping vast sums of capital, even in a liquidity crunch environment like this, and we do not feel that leaving all the money on the table is worth it.

A short sale in the position would have yielded a more than a 30% gain, and the option trade represents roughly a 150% gain. Keep in mind we are not counting this as a 150% gain per se because we were looking at this as a de-leveraged trade that would allow a smaller commitment. Some did note that they felt a short sell was an easier move and noted that was the easiest strategy. We cannot demand that any set-up has to be followed to the tee. We also don't believe that there is only one way to make the same outcome. But we do weigh the entire spectrum in a diversified and hedged strategy. That being said, this short sale position can be closed or selling out of those purchased JAN2009 $40 Put Options can now be done.

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