

MONTHLY TECHNOLOGY COMMENT

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GETTING READY FOR VISTA

In this issue:

- *Hewlett rating changed from Strong Buy to Buy*
- *Network Appliance reports strong earnings*
- *Lexmark continues to refocus*
- *Gateway re-evaluating strategy*

VIEWS ON THE ECONOMY

The economy grew at a moderate pace in the third quarter of 2006; the housing market is in a slump, but some inventory building and investment in equipment, software and commercial construction kept growth going. With a so-so outlook for consumer spending this holiday season, this looks to us to be a fine balancing act. Certainly businesses do not want to build too much inventory or capacity (or overhead) in the face of a slowing economy. On the other hand, if the economy is able to slowdown without a recession, investments made now will reap benefits in future. The bet that business appears to be making so far is that we will have only slowdown.

This seems to be the same bet that the Fed is making. Reportedly, the Fed is more concerned about inflation than a recession and is not expected to cut interest rates at its

Disclosure

I, Jean W. Orr, certify that (1) the views expressed in this report reflect my personal views on all of the subject companies and securities, and (2) my opinions are not affected by my compensation which is derived solely from brokerage trade commission(s) which may or may not be of securities discussed in this report.

December meeting. We believe that the technology companies can continue to show growth revenue and earnings in this environment.

The market appears to be content with the “gridlock” outlook for the government over the next couple of years after the gains in both houses of Congress by the Democrats. A benign legislative environment is not expected to have a big impact on business one way or another and market valuations would be expected to reflect growth and profit forecasts.

TECHNOLOGY STOCK OUTLOOK

We expect a number of the technology companies to benefit from increased consumer demand after the shipments of Microsoft’s Vista operating system and Office 2007 begin in early 2007. These companies include Hewlett-Packard, Lexmark, Dell, Gateway, nVidia and Microsoft, all except Gateway and nVidia are currently rated Buy. Gateway is working through some major operational challenges which have led us to recommend holding the stock, while in the case of nVidia shares, also rated Hold, it’s a question of valuation.

We continue to rate EMC Buy. This stock appears to us to be undervalued based on the outlook for storage and EMC’s strong position in this market. Our other Buy-rated stocks are IBM and Unisys, both of which we expect to benefit from improvements in their services divisions.

DATA STORAGE

Network Appliance (\$39.33 - Hold)

The company announced another strong quarter for the period ended October 27, 2006. Business was good across the board with revenues up 35% compared with revenues in the second quarter of fiscal 2006. Non-GAAP net income increased 38% from \$79.1 million, or \$0.21 per diluted share, in the second quarter of fiscal 2006 to \$108.9 million, or \$0.28 per diluted share, in the most recent quarter. According to IDC, Network Appliance was the market leader in terms of petabytes shipped for the first time in the second calendar quarter 2006. The company’s newer products recorded strong shipment increases in the second fiscal quarter while sales of some of the older products declined.

During September the company completed the sale of NetCache assets, recording a net gain on sale of assets of \$25 million. This operation contributed approximately 3% of revenues which will decline significantly now that the assets are sold. The company will continue to fulfill its customer commitments and record revenues from deferred revenue. The sale of the NetCache assets is not expected to have a material impact on future results.

Network Appliance has announced an agreement to acquire Topio, a privately-held company that supplies software for heterogeneous data replication and recovery in any server or storage environment across any distance. This transaction has not closed, but since Topio is in the early phase of revenue development, it is expected to cost about \$0.01 per share in each of the first two quarters after the acquisition is completed.

Based on the strength in the business so far in fiscal 2007 and the outlook for the next several quarters, we are increasing our non-GAAP diluted earnings per share estimates for fiscal 2007 and 2008 to \$1.12 and \$1.41, respectively. Our rating on the stock remains **Hold**.

SERVERS

Hewlett-Packard (\$39.86 - Buy)

Hewlett ended its fiscal year with a strong quarter and a continuation of the improving profit trends seen throughout the year. The company's non-GAAP operating profit margin increased from 6.4% in fiscal 2005 to 8.0% in fiscal 2006 and all of the business segments had operating profits in the fourth quarter and for the full year. In fiscal 2005, the software segment had an operating loss for the year.

Earnings in the fourth quarter were modestly above expectations and estimates for fiscal 2007 have been increased. In fiscal 2007 the company will have the full benefit of the cost reduction program instituted in fiscal 2006 and is expected to participate in the increased consumer demand for personal computers and printers created by the new Microsoft software.

Hewlett's stock has reflected the increase in earnings and profitability over the past year and is now selling for 15.6x the non-GAAP earnings estimate of \$2.55. While we believe margins and earnings continue to improve in fiscal 2007, we expect the pace to be slower than in fiscal 2006. We are changing our rating on the stock from **Strong Buy** to **Buy** based on this outlook.

PC AND RELATED

Gateway, Inc. (\$1.90 – Hold)

Gateway reported revenues of \$963 million and net income of \$18.2 million, or \$0.05 per diluted share, including a net tax benefit of \$8.2 million for the third quarter of 2006. This compared with revenues of \$1,018 million and net income of \$15.1 million, or \$0.04 per diluted share, in the third quarter of 2005. Revenues from the retail and professional segments of the business increased sequentially while direct revenues showed a modest

decline. Gateway has been refocusing the direct business on higher value systems – an approach that is yet to be proven to benefit the company – resulting in lower volume.

Ed Coleman, who became CEO in September, briefly discussed his priorities for the company on the quarterly conference call. Recognizing that the company's cost structure is too high, the company has already initiated a cost reduction program to eliminate \$30 to \$35 million of annual G&A expenses. The company has also made changes to improve execution of various functions including opening a new configuration center in Nashville and an office in Shanghai for managing supply chain relationships. Gateway has instituted a program to increase customer satisfaction by supporting all but international customers with North American-based telephone service. Longer term, management will be evaluating the company's strategy and making changes as necessary.

Windows Vista, the new operating system from Microsoft, will be available for consumers in the first quarter of calendar 2007. This is widely known and may slow sales of personal computers to consumers in the fourth quarter. Most PC companies, including Gateway, are participating in an upgrade program with Microsoft for computers sold between October 24 and January 30 (the date Vista will be available). However, this is not expected to completely offset a slowdown in consumer sales. Once Vista is available, the anticipated promotion and "buzz" related to the introduction will likely stimulate the market. We have based our estimates for Gateway on this scenario.

For the fourth quarter we estimate revenues will be \$1,040 million with earnings per share of \$0.04. There has been little guidance from the company and forecasting the fourth quarter with the changes at the company and the industry dynamics is more difficult than usual. For the year this would result in earnings per share of \$0.04. We expect a stronger market environment combined with improved operations at the company to result in revenues up about 16% with earnings per share of \$0.17 in 2007. We would like to see some clarification of the company's longer-term strategy and continue to rate the stock **Hold**.

Lexmark International (\$71.50 - Buy)

At the company's annual analyst meeting, Lexmark management re-iterated its strategic plan and gave an update on its progress. Simply put, the company's goal is to increase the base of printers in use to increase the ongoing sales of supplies. In order to do this, Lexmark is focusing on introducing new products in the segments of the market that are the fastest growing including:

- low end mono lasers
- color lasers
- laser all-in-one and multi-function
- 3-in-1 inkjet
- 4-in-1 inkjet

In addition, the company is emphasizing branded products rather than private-label printers. Results in recent quarters have reflected this product transition. As part of the realignment of the business, Lexmark has instituted a restructuring program which will be substantially completed in the fourth quarter of 2006. The restructuring resulted in charges of \$130 million; in 2006 cost savings will be \$50 million and in future years \$80 million.

A year ago results were negatively impacted by a decrease in inventories in the channel; management believes that the channel inventories are now at satisfactory levels. While the company is making progress on its plan, the market remains very competitive. Early in 2007 Microsoft will ship a new version of the Windows operating system, Windows Vista, to consumers. This is expected to stimulate demand for personal computers and, we believe, will have a ripple effect on the printer market including Lexmark. Our estimates for 2007 are based on this outlook and we are making no changes at this time. We continue to rate Lexmark stock **Buy**.

SOFTWARE

Microsoft (\$28.85 – Buy)

Windows Vista and Office 2007 have been released for volume licensing customers; the products will be available to consumers and organizations without volume license agreements on January 30, 2007. Businesses usually take their time to evaluate and implement major upgrades of operating systems and widely-used applications so we do not expect these releases to have a significant impact near term. Consumers are much more likely to implement new products as soon as they are available. As we discussed in the November issue of the monthly, the fact that the new products will not be released for consumers until early in calendar 2007 could have a negative impact on the personal computer and related markets in the fourth quarter of 2006 with a subsequent stimulus after the products begin shipping. We have factored this outlook into our estimates for Microsoft and the personal computer and related companies and are making no changes now based on these introductions.

Progress Software (\$26.91 – Buy)

In the November issue of the monthly, we incorrectly noted that Progress expected to file revised financial reports with the SEC by November 15, 2006. In fact, the company expected to file by November 30. However, the outside auditors were unable to complete the reports by that date and the company now expects to file by December 15, 2006. We understand NASDAQ will likely not delist the stock before that date. The company plans to release results for the fourth quarter and fiscal year on December 19, 2006. We are making no changes on our estimates or **Buy** rating on the stock at this time.

PERFORMANCE AND RATING CHANGES

The markets hit new highs in November. The NASDAQ Composite index was up almost 3% in the month while the S&P 500 increased 1.6%. Most of the technology stocks on our list outperformed the market during the month. The best performers were Gateway, up 13%, and Dell and Cognos, both up 12%. Unisys stock increased 10% during the month, Lexmark was up 9% and EMC and Network Appliance were up 7% and 7.6%, respectively. Laggards this month were Progress Software, down 6%, Citrix, down 3% and IBM down less than 1%.

We made one rating change this month: Hewlett was taken from Strong Buy to Buy based on the performance of the stock in 2006 and outlook for fiscal 2007. We increased our estimates for Network Appliance for FY 2007 from \$1.02 to \$1.12 and for fiscal 2008 from \$1.29 to \$1.41 and the estimates for Hewlett were increased for FY 2007 from \$2.48 to \$2.55 and for fiscal 2008 from \$2.80 to \$2.88.

REGULATORY COMPLIANCE

Nutmeg Securities, Ltd. has implemented rules that conform to published SEC rules to address analyst conflicts. Accordingly, we note for the record that we have not acted as manager or co-manager for any equity offering, nor received investment banking fees from, any of the companies mentioned in this review. Nutmeg Securities, within the past two years, has acquired common stock for the company under Progress Software's stock buyback program. Further, we have footnoted in Table II where the analyst has a position in any of these securities. Next, we have some kind of Buy rating on 8 stocks (53%) and no sell ratings (0%). We consider this somewhat unusual, but not in a case of an attractive investment sector. Finally, we note our investment performance can be gauged by comparing our recommendations which appear in Table I along with the prices at the time, with the NASDAQ Composite Index, which also appears in Table I.

Table I - Price, P/E and Rating

Company (FY)	Symbol	Price 11/30/2006	52-week Range	2005A	E.P.S.			P/E		Rating
					2006E	2007E	2008E	2006E	2007E	
S&P 500*	SPX	1401	1408 1219	\$76.28	\$85.20	\$90.41	\$101.75	16	15	
NASDAQ Composite	COMP	2432	2468 2013							
Storage										
EMC Corp. (Dec)	EMC	13.11	15 - 9	\$0.53	\$0.51	\$0.62	\$0.74	26	21	BUY
Network Appl. (Apr)	NTAP	39.28	41 - 26	\$0.81	\$1.12	\$1.41	u/r	35	28	HOLD
Servers										
Hewlett-Packard (Oct)*	HPQ	39.46	41 - 28	\$1.72	\$2.22 A	\$2.55	\$2.88	18	15	BUY
IBM Corp. (Dec)*	IBM	91.92	94 - 73	\$5.32	\$5.98	\$6.54	\$7.26	15	14	BUY
Personal Computers										
Dell (Jan fol.)	DELL	27.24	33 - 19	\$1.56	\$1.16	\$1.45	\$1.60	23	19	BUY
Gateway (Dec)	GTW	1.90	3 - 1	\$0.12	\$0.04	\$0.17	u/r	48	11	HOLD
Lexmark (Dec)	LXK	68.98	69 - 44	\$3.35	\$4.02	\$3.85	\$4.80	17	18	BUY
nVidia (Jan fol.) ²	NVDA	36.99	37 - 17	\$1.07	\$1.25	\$1.55	\$2.00	30	24	HOLD
Software										
Citrix (Dec)	CTXS	28.74	46 - 26	\$1.17	\$1.33	\$1.50	\$1.70	22	19	HOLD
Cognos (Feb fol.)	COGS	40.91	44 - 25	\$1.35	\$1.60	\$1.95	u/r	26	21	HOLD
Microsoft (June)	MSFT	29.36	30 - 21	\$1.28	\$1.45	\$1.70	\$1.85	20	17	BUY
Oracle (May)	ORCL	19.05	20 - 12	\$0.75	\$0.86	\$1.00	\$1.08	22	19	HOLD
Progress (Nov)	PRGS	27.11	32 - 20	\$1.34	\$1.44	\$1.73	\$1.90	19	16	BUY
Services										
Akamai (Dec)	AKAM	48.87	53 - 19	\$0.52	\$0.87	\$1.18	\$1.60	56	41	HOLD
Unisys (Dec) ¹	UIS	7.21	7 - 5	(\$0.46)	(\$0.90)	\$0.30	\$0.90	NMF	24	BUY

Notes: ¹Unisys estimates GAAP and include pension accounting.

²nVidia split 2-for-1 effective April 6, 2006.

* First Call consensus estimates.

u/r = under review

Source: Nutmeg Securities estimates, except as noted.

Table II - Price History

Company (FY)	12/31/2004	12/30/2005	8/31/2006	Prices			% chg November	2006 year to date
				9/29/2006	10/31/2006	11/30/2006		
S&P 500	1212	1248	1304	1336	1378	1401	1.6%	12.2%
NASDAQ Composite	2175	2205	2184	2258	2367	2432	2.7%	10.3%
Storage								
EMC Corp. (Dec)	14.87	13.62	11.65	11.98	12.25	13.11	7.0%	-3.7%
Network Appl. (Apr)	33.22	27.00	34.24	37.01	36.50	39.28	7.6%	45.5%
Servers								
Hewlett-Packard (Oct) (1)	20.97	28.63	36.56	36.69	38.74	39.46	1.9%	37.8%
IBM Corp. (Dec)	98.58	82.20	80.97	81.94	92.33	91.92	-0.4%	11.8%
Personal Computers								
Dell (Jan)	42.14	29.95	22.55	22.84	24.33	27.24	12.0%	-9.0%
Gateway (Dec)	6.01	2.51	2.00	1.89	1.68	1.90	13.1%	-24.3%
Lexmark (Dec)	85.00	44.83	56.07	57.66	63.59	68.98	8.5%	53.9%
nVidia (Jan)	11.78	18.28	29.11	29.59	34.87	36.99	6.1%	102.4%
Software								
Citrix (Dec)	24.46	28.73	30.71	36.21	29.53	28.74	-2.7%	0.0%
Cognos (Feb)	44.06	34.71	32.52	36.50	36.48	40.91	12.1%	17.9%
Microsoft (June)	26.72	26.15	25.70	27.35	28.71	29.36	2.3%	12.3%
Oracle (May)	13.72	12.21	15.66	17.74	18.47	19.05	3.1%	56.0%
Progress (Nov)	23.35	28.38	25.32	26.00	28.79	27.11	-5.8%	-4.5%
Services								
Akamai (Dec) (1)	13.03	19.93	39.20	49.99	46.86	48.87	4.3%	145.2%
Unisys (Dec)	10.18	5.83	5.35	5.66	6.54	7.21	10.2%	23.7%

Notes: (1) The author has a position in the common stock.
Source: Reuters.

DEFINITION OF OUR RATING SYSTEM

In general, we have three basic ratings of followed securities: Buy, Sell and Hold (Not Rated is a term we use where a security is not followed, or if followed, where not enough information is currently available to base an opinion).

BUY – is our rating for a stock that we consider currently attractive for purchase for most technology investors. It is a stock that we believe will outperform the market, as measured by the NASDAQ Composite, in a six to eighteen month timeframe. The recommendation could be based on industry or company fundamentals, on equity prices, or any one of a host of other factors, as assessed by the analyst.

We have also formed additional sub-categories of “BUY” rated stocks to make more clear our position. The most common of these are listed below:

- **STRONG BUY** – where the analyst feels a stock is especially attractive, in some cases due to recent price declines, in some where conventional wisdom on prospects is viewed as wrong, in some where there is a visible catalyst that will call attention to the security.
- **LONG-TERM BUY** – where the analyst considers the stock as fundamentally attractive but where fruition appears extended over a longer than normal period of time, or where the stock price currently is higher than levels where the analyst would rate the stock “BUY”.
- **SPECULATIVE BUY** – where the analyst considers the stock as very attractive on the price and the fundamentals but where well above average risk must be assumed by the investor.

HOLD – is our rating for a stock where prospects appear more or less in line with the market, or where we feel a compelling case cannot be made either for Buy or for SELL.

SELL – is our rating for a stock that in our opinion is likely to underperform the market as measured by the NASDAQ Composite in a six to eighteen month time frame.

Additional information on subjects in this report is available upon request.

Our recommendation changes on the securities mentioned in this report are as follow:

ATI Technologies

Hold 4/30/04 at \$14.57
Acquired 11/25/06 at \$21.36

Celestica

Hold 8/30/02 at \$22.97
Ended coverage 5/2/05 at \$11.50

Flextronics

Hold 8/30/02 at \$9.47
Ended coverage 5/2/05 at \$11.15

Hewlett-Packard

Sell 10/31/01 at \$16.83
LT Sell 12/31/02 at \$17.36
Hold 1/8/03 at \$19.65
Buy 5/5/03 at \$16.65
Strong Buy 5/30/03 at \$19.50
Buy 8/2/04 at \$20.15
Hold 9/1/04 at \$17.89
LT Buy 7/1/05 at \$23.51
Strong Buy 8/1/05 at \$24.62
Buy 12/81/06 at \$39.86

Lexmark International

Hold 1/5/04 at \$78.64
Strong Buy 3/31/04 at \$92.00
Hold 11/1/05 at \$41.52
Strong Buy 12/1/05 at \$47.62
Buy 2/1/06 at \$48.57

Palm, Inc.

Sell 10/31/01 at \$24.30
Hold 1/31/02 at \$37.40
Sell 5/31/02 at \$15.90
Hold 8/30/02 at \$7.60
Ended coverage 11/1/06 at \$15.35

Dell

Hold 10/31/01 at \$23.89
LT Buy 3/28/02 at \$26.11
Buy 8/9/02 at \$25.59
Hold 11/29/02 at \$28.60
Sell on 7/1/05 at \$39.46
Hold on 9/1/05 at \$35.60
Buy 5/1/06 at \$26.20

Gateway

Value Buy 10/31/01 at \$5.65
Strong Buy 1/31/02 at \$5.21
Buy 2/28/02 at \$5.60
Strong Buy 3/25/02 at \$6.45
Buy 12/31/02 at \$3.14
Strong Buy 7/31/03 at \$5.11
Buy 4/30/04 at \$4.82
Speculative Buy 9/1/04 at \$4.39
Hold 6/1/05 at \$3.46

IBM

Hold 10/31/01 at \$108.77
Buy 1/5/05 at \$98.58
Strong Buy 5/2/05 at \$76.38
Buy 7/3/06 at \$76.63

Network Appliance

Strong Buy 10/31/01 at \$13.30
Buy 9/1/04 at \$20.07
Strong Buy 6/1/05 at \$28.76
Hold 1/3/06 at \$27.00

PalmSource

u/r 10/31/03 at \$38.17
Acquired 11/14/05 at \$18.50

EMC

Buy 10/31/01 at \$12.32
Strong Buy 3/28/02 at \$11.92
Buy 8/1/05 at \$13.69
Hold 1/3/06 at \$13.62
Strong Buy 7/3/06 at \$11.18
Buy 8/1/06 at \$10.15

Globix

Spec. Buy 10/31/01 at \$0.56
Hold 1/31/02 at \$0.06
Ended coverage 5/2/05 at \$3.55

Jabil

Hold 8/30/02 at \$18.71
Ended coverage 5/2/05 at \$27.60

nVidia

LT Buy 10/31/01 at \$21.38
Buy 1/31/02 at \$32.87
Strong Buy 2/28/03 at \$26.00
u/r 6/28/02 at \$8.59
Buy 7/25/02 at \$7.53
Strong Buy 8/9/02 at \$4.71
Buy 5/30/03 at \$ 13.09
Strong Buy 6/30/03 at \$11.45
Buy 8/29/03 at \$9.09
Hold 9/30/03 at \$7.95
Strong Buy 1/5/04 at \$11.60
Hold 8/2/04 at \$7.71
Buy 8/9/04 at \$4.71
Hold 10/29/04 at \$7.24
Buy 3/1/05 at \$14.50
Strong Buy 4/1/05 at \$11.88
Hold 2/1/06 at \$22.48

Res. In Motion

Buy 10/31/01 at \$16.01
Strong Buy 2/28/02 at \$23.89
LT Buy 4/15/02 at \$20.39
Hold 2/28/03 at \$12.70
Ended coverage 11/1/06 at \$117.48

Sun Microsystems

Hold/LT Sell 10/31/01 at \$10.17
LT Buy 11/29/02 at \$4.29
Buy 1/8/03 at \$3.75
Hold 9/30/03 at \$3.31
LT Buy 1/5/04 at \$4.47
Hold 4/30/04 at \$3.90
Sell 7/1/05 at \$3.73
Hold 1/3/06 at \$4.19
Ended coverage 11/1/06 at \$5.43

Taiwan Semi Mfg.

Hold 8/30/02 at \$8.17
Ended coverage 5/2/05 at \$8.61

Unisys

Value Buy 10/31/01 at \$8.93
Buy 1/31/02 at \$12.50
Strong Buy 8/9/02 at \$7.82
Buy 7/31/03 at \$12.26
Strong Buy 8/29/03 at \$12.98
Buy 10/29/04 at \$10.62
Long Term Buy 1/5/05 at \$10.18
Buy 6/1/05 at \$7.24
Long Term Buy 8/1/05 at \$6.47
Strong Buy 11/1/05 at \$5.11
Buy 2/1/06 at \$6.69
Strong Buy 4/3/06 at \$6.89
Buy 8/1/06 at \$5.12

Accenture

Hold 5/2/05 at \$21.70
Ended coverage 11/1/06 at \$32.19

Affiliated Computer

Hold 5/2/05 at \$47.67
Ended coverage 11/1/06 at \$53.48

First Data

Hold 5/2/05 at \$38.03
Ended coverage 11/1/06 at \$24.25

Citrix

Hold 11/1/06 at \$29.53

Cognos

Hold 11/1/06 at \$36.48

Microsoft

Buy 3/5/02 at \$31.54

Oracle

Hold 3/5/02 at \$13.85

Progress

Buy 3/5/02 at \$17.76

Akamai

Strong Buy 6/25/04 at \$16.02
Hold 3/10/06 at \$25.29

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