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MONTHLY TECHNOLOGY COMMENT

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Peter Labé, CFA

STILL POSITIVE ON TECH STOCKS, NO COURSE CHANGE NOW

In this issue:

- *Hewlett emerges as next Big Story*
- *Sun Buys Storage Tech – What could they be thinking?*
- *Debate on Lexmark continues*
- *Downgrading Sun, Dell, revising Hewlett to Long Term Buy*

IS MR. GREENSPAN HOLDING UP THE WORKS?

The answer to this is, probably "yes". One would think that with the Federal Funds Rate at 3%, another couple of bumps, say to 3 ½%, ought to be enough. The economy is just not that exuberant and there just isn't any appreciable inflation.

Yet the Fed talk is for continued rate increases beyond the 3 ½% that we favor. This kind of highlights one of the market's latent fears: the breakage of the residential real estate "bubble." How high do interest rates have to go before new mortgage interest rates are high enough to pull down the market? Have heard a lot of opinions, but really don't know – but it surely isn't anytime *soon*! Mortgage rates remain low, and new "programs" have been built around them. We believe the stock market can absorb some amount of cutting into the housing market, just not major surgery. Our guess is we fall short of that.

THE ECONOMY: LOOKS OK

Oil continues to be a problem, but actually the economy looks ok and is sturdier than its detractors or mixed signals would suggest. On this point Mr. Greenspan noted "the economy is on a reasonably firm footing." This is right from what we see.

On July 1, the Institute for Supply Management released its manufacturing index, at 53.8, up from 51.4. We suspect this was a mild surprise in one of our favorite indexes. We just cite it as more support for the view.

If we are right about the economy, it throws the ball back in the interest rate court. We'll have to watch this carefully like everybody else.

INDUSTRY SECOND QUARTER

Everything we see points to the tech business as pretty good for the second quarter. We don't expect a lot of negative surprises. We believe we will hear that business is as expected and the guidance will be moderately improved. The industry executives we talked to this quarter have not left us with any sense of alarm.

OUR BUY LIST

Our Buy list, including changes made this month, is shown below:

Stock	**Rating**	**Reason**
EMC	Strong Buy	Growth
Net App	Strong Buy	Growth
IBM	Strong Buy	Value
Hewlett	Long Term Buy	Value/Some Growth
nVidia	Strong Buy	Growth
Lexmark	Strong Buy	Value/Growth
Unisys	Buy	Value/Recovery
Sun	Sell	Value
Dell	Sell	Growth

From here, we move to our sector reviews.

DATA STORAGE

EMC Corporation ($13.71 – Strong Buy)

Nothing new at EMC, but company presentations continue to feature the $51 billion in market opportunity. The company should approach $10 billion in revenues this year. The market opportunity is calculated by taking hardware at $19-20 billion and growing it 5% a year, software at $9 billion and 8% a year, and services, at $20 billion growing 6-7% a year. EMC adds in a few peripheral markets because its breadth is a little bigger than the storage market. EMC comes up with a 7-8% growth rate for the market, which actually seems fair, and has public projections that by the end of the year EMC company growth will be 2x the market – also we think eminently fair.

Even with all this it doesn't give us much room to maneuver. Under $14, Strong Buy, over $14, Buy, Hold at $20 or maybe even $17. This is based on a $0.52 per share estimate for 2005, and $0.65 per share opening line for 2006. How do we think we can make money?

- Margins have not peaked, there is room for expansion.
- The company is a good economic play. Back in the good graces of the customers, EMC should benefit from any improvement in the economic wind.
- There is a scarcity of quality growth vehicles in the relatively mature IT spending space, i.e. some premium would appear warranted.
- We probably ought to back out $3.13 cash from the price, to improve the multiple to 21x for 2005 and 17x for 2006.

The company will report, at the high end of the guidance range we think, on **July 21**.

Network Appliance ($28.27 – Strong Buy)

No particular news this month. Maintaining Strong Buy rating. Growth stocks are cheaper than the last cycle (at least measured by PEG rates) and could benefit from any improvement in this valuation or the economy could put some upside in earnings. Quality company.

SERVERS

Sun Microsystems ($3.73 – Sell)

Sun is such a cheap stock ($13.4 billion market cap) we didn't think we'd ever be moving the stock into the "source of funds" category, but that's what we've done.

The catalyst for our change of view is the proposed acquisition of **Storage Technology ($37.00 – Not Rated)** in a $4 billion cash transaction. Storage Tech is the dominant factor in the tape market, which industry experts forecast as a 1% growth market. We don't see how growth can be that high. We believe a declining market is more accurate. Low cost ATA disk is generating an ever-wider swath through the tape market in major application sets like backup.

A defense is offered by the company, in that Storage Tech has 1,000 blue suits in the market, meaning storage sales personnel. While there is little doubt that Sun is sadly missing qualified storage sales people, the fact is there is no real product line to sell. Sun has basically four different disk products designed to fit with their servers, which are not interoperable and do not offer a complete solution. Sun has had a storage problem for 10, 20 years that we can remember.

Sun has a revenue growth problem to begin with, and Storage Tech doesn't solve it. What could these people be thinking?

Our disenchantment is such that we feel constrained to revise the rating on the stock to **Sell.** This is a risk with the stock so cheap, but we see nothing but further languishing around.

Hewlett-Packard ($23.51) – Long Term Buy)

We've had an active past month at H-P, which we'll comment on in a minute, and a 20% gain in the stock price. The steep stock rise short term takes away some of the appeal, which leads to our revised opinion Long Term Buy. *We still think this is going to be a Big Stock.* What has been going on?

- Wall Street rumors that Thomas Hurd, the new CEO, will lay-off 15,000 people. This should be pretty accurate. While the savings would approximate $1 billion or over $3 per share pretax, most of this will simply go to the customer to keep H-P competitive. There should be enough left over though to create handsome returns, as we'll discuss in a minute.
- Five months old decision to meld the PC and Imaging & Printing groups was reversed – PC is now once again separate and with a new hire, an executive from the outside, brought in to run it. Todd Bradley, known well and most recently at Gateway and later as CEO at PalmOne, has a good reputation in the business and has been particularly cited for his expertise in reducing costs.
- Vyomesh Joshi, long time Hewlett executive in Imaging & Printing, returns to his position as head of that group. He has granted several interviews lately and his visibility and that of the group have increased.
- Wall Street pipedreams that Imaging & Printing were going to be spun off appear to be just that – pipedreams.

- Business unit by business unit plans, and cost reductions may not be available for some time, but we expect a lot of the macro thinking and cost reductions to be available relatively quickly, like in a month or so.

What is the potential in Hewlett in a few years? If we take the business units and add them up, a conservative view is about 6% revenue growth per year. On this kind of base, could Hewlett earn $2.60 per share? Probably not, we think. It would require the big marginal businesses to earn some money – like 5% operating margins in PC, 10% operating margins in enterprise systems and storage, 10% in software, 10% in services, and 10% in financial services. Historically one could justify 14% in imaging and printing. This kind of plan is too ambitious. But 11% in imaging and printing, 5% in enterprise systems and storage, 5% in PC, 7% in services and 5% in software, at least looks achievable. This would generate $2.20 per share. With this kind of potential, the stock could sell in the low 30s a year or two out.

We have omitted other possibilities, like stock buyback, as too conjectural right now. But, we like Mr. Hurd, and we suspect his program will be well received (at least initially). The stock is a **Long Term Buy.**

IBM ($74.20 – Strong Buy)

No news to single out this issue. We'll have more to say next month. The stock is one of the cheapest of the major stocks at 16x even using earnings deducting option expense. It is early but we like the valuation on this laggard. No change in rating.

PC AND RELATED

Dell Computer ($39.46 – Sell)

As far as we know, everything is going wonderfully at Dell. This is certainly a well known story. It's going to be hard to beat the market from here, we think. The multiples are 25x this year's estimate, 22x next. For what is at best a 15% grower, this should be enough. Another way of looking at it is a $99 billion market cap for what essentially is a marketing company is a lot. For the time being, we are revising our rating to **Sell.**

nVidia Corp. ($26.72 – Strong Buy)

There are four developments at nVidia last month that we want to comment on:

- Early in the month, at the Electronic Expo in Los Angeles, nVidia demonstrated the Sony Playstation 3. Although this chipset has been under development for some time, this is the first time it has been demonstrated. This tends to show us that this important program is on time!

- On June 21, the company launched *GeForce 7800 GTX*, a brand new high performance chip that in essence replaces the *GeForce 6800 Ultra.* There is considerable new design in the new chip, particularly in the pipelines, which go from 16 on previous chips to 24 here. This chip provides 30% to double increased performance over the predecessor, and unusual for the industry, is available *immediately.*
- The back-to-school season for PC's, late August through September, comes a couple of months earlier for the suppliers. Our appraisal is that nVidia had a good BTS, and once again is going to beat Wall Street estimates. Reporting date is **August 11.**
- nVidia has been working with the motherboard people to lower the cost of SLI technology – very significant.
- Three more design wins in laptops; the one of the Acer Travelmate is the most important since it is the first with this key industry player.

We again are strongly recommending the stock. The company has enjoyed 30x multiples in the past. All of the developments cited here are very bullish. Our estimates of $1.35 this year, $1.85 next, are likely to be raised next month.

Lexmark International ($64.83 – Strong Buy)

Lexmark stock continues to be a poor performer, as Wall Street debates the pros and cons of the stock. Until the debate is resolved, not much action can be expected. To us, this means a Buy opportunity. The stock represents *compelling* value here. The stock is selling for 13x a reasonable estimate for next year, and there is $11 per share cash at least in theory we might back out.

Investors seem to be worried about a number of things:

- The industry's largest factor, Hewlett-Packard, may be rejuvenated under new management and therefore tougher, or price, competitive. We expect this to be true, at least in part, but not overwhelmingly so.
- Refillers have gotten a lot of publicity this year, but in fact we believe they have made small inroads in the lucrative replacement cartridge (supplies) market. This would be an industry negative but the companies have plenty of defenses if this issue becomes more prominent.
- Dell, a major OEM customer roughly 10% of revenues, is often rumored to be taking on new suppliers, or upsetting prices. In fact, we believe Dell would be imprudent not to diversify its supply base, but we see no material change in the present relationship. Lexmark should continue as a leading supplier to Dell. There are three other Dell partners that have been publicly identified so far. While Dell is in a buildup phase, which we believe takes years, we expect no irrational pricing.
- The industry will continue to experience declining average selling prices (ASP). This may very well be true, and would tend to produce negative hardware revenue growth. While such a development is not necessarily bearish (it is the supplies

revenue that provides all the industry's profit) it would not be the case if the supplier is a market share gainer. We believe with some contribution from Dell, and from internal marketing plans, Lexmark will continue to be a market share gainer.

- Nobody likes to buy into a punk quarter. The company's guidance for the June quarter is not very exciting, in fact one might say soft. Some want to see the report, and the guidance for the next quarter.

We think all of these fears will be laid to rest or reduced over the next several quarters. The catalyst for Lexmark stock is going to be old-fashioned "sales and earnings." Buy now and be patient, is our advice.

Gateway ($3.30 – Hold)

The only news item this past month was the resignation of the well-liked and well-respected CFO, Rod Sherwood. He will stay on until a successor is named, which tends to guarantee we will have a capable replacement. While this news won't help the stock, at this price it probably doesn't matter much. What the new company will look like under CEO Innouye and Chairman Snyder is yet to be defined. For now, rate the stock **Hold.**

DATA SERVICES

Unisys ($6.33 – Buy)

No news this past month. We note, though, that the stock was a very poor performer. It is our hope that after the second quarter report is out, investors will conclude the worst has been seen, with improvement in the second half and substantial improvement next year. We'll have more to say next issue. For now, maintain **Buy** rating.

PERFORMANCE AND RATING CHANGES

This month, we reduced Sun Micro from Hold to Sell, Dell Computer from Hold to Sell, and raised Hewlett from Hold to Long Term Buy. We made no important estimate changes for the month. Readers are reminded that our quarterly and annual estimates are carried on First Call.

Performance of the universe for the month of June was generally speaking small percentage changes and mostly lower. The market, as measured by the S&P 500 was absolutely flat (0.0%) while the NASDAQ Composite was down 0.6%.

In storage, EMC was down 2.5% and Network Appliance down 1.7%. In servers, IBM was down 1.8% and Sun 2.1%; only Hewlett was strong, up 4.4%, reflecting the management change. In PC and related, Dell was down 1.2% and nVidia 1.4%. Gateway was down 4.6% and Lexmark 5.3%. In services, Unisys dropped 12.6%.

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. 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 7 stocks (37%) but no sell ratings. 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

		Price	52-week	E.P.S.					P/E		
Company (FY)	Symbol	6/30/2005	Range	2003A	2004A		2005E	2006P	2005E	2006E	Rating
S&P 500*	SPX	1191	1229 1061	$55.44	$67.10		$72.57	$76.19	16	16	
NASDAQ Composite	COMP	2057	2192 1751								
Storage											
EMC Corp. (Dec)	EMC	13.71	15 - 9	$0.19	$0.37		$0.52	$0.65	26	21	STRONG BUY
Network Appl. (Apr)	NTAP	28.27	35 - 16	$0.40	$0.62		$0.78	$1.03	36	27	STRONG BUY
Servers											
Hewlett-Packard (Oct)*	HPQ	23.51	25 - 16	$1.16	$1.34		$1.48	$1.68	16	14	L.T. BUY
IBM Corp. (Dec)*	IBM	74.20	99 - 72	$4.34	$4.50	R	$4.83	$5.37	15	14	STRONG BUY
Sun Micro. (Jun)*	SUNW	3.73	6 - 3	($0.24)	$0.00	E	$0.05	$0.07	75	53	SELL
Personal Computers											
ATI Technologies (Aug.)*	ATYT	11.85	21 - 11	$0.27	$0.78		$0.66	$0.70	18	17	HOLD
Dell (Jan fol.)	DELL	39.46	43 - 33	$1.01	$1.28		$1.57	$1.81	25	22	SELL
Gateway (Dec)	GTW	3.30	7 - 3	($0.96)	($0.40)		$0.15	u/r	22	NMF	HOLD
Lexmark (Dec)	LXK	64.83	95 - 64	$3.34	$4.13		$4.44	$4.85	15	13	STRONG BUY
nVidia (Jan fol.)	NVDA	26.72	30 - 9	$0.50	$0.57		$1.35	$1.85	20	14	STRONG BUY
Wireless											
palmOne (May)*[3]	PLMO	29.77	47 - 21	($0.11)	$1.54		$1.65	$1.64	18	18	HOLD
PalmSource (May)*[3]	PSRC	8.50	27 - 8	$0.10	$0.29		$0.13	$0.26	65	33	HOLD
Res. in Motion (Feb)*[2]	RIMM	73.79	104 - 52	$0.48	$2.10		$2.51	$3.34	29	22	HOLD
Services											
Accenture (Aug)*	ACN	22.67	28 - 21	$1.05	$1.23		$1.42	$1.58	16	14	HOLD
Affiliated Computer (June)*	ACS	51.10	61 - 46	$2.62	$3.12	E	$3.41	$3.91	15	13	HOLD
First Data (Dec)*	FDC	40.14	45 - 37	$1.96	$2.16		$2.33	$2.65	17	15	HOLD
Unisys (Dec)[4]	UIS	6.33	14 - 6	$0.78	$0.31		$0.48	$0.74	13	9	BUY

Notes: [1]Globix now trading post-bankruptcy. New Symbol GBXX. [2]Research in Motion split 2-for-1 on June 4, 2004.
[3]Palm became palmOne and PalmSource started trading October 29, 2003.
[4]Unisys estimates non-GAAP and exclude pension accounting.
* First Call consensus estimates.
u/r = under review
Source: Nutmeg Securities estimates, except as noted.

Table II - Price History

Company (FY)	12/31/2003	12/31/2004	3/31/2005	Prices 4/29/2005	5/31/2005	6/30/2005	% chg June	2005 year to date
S&P 500	1112	1212	1181	1157	1192	1191	0.0%	-1.7%
NASDAQ Composite	2003	2175	1999	1922	2069	2057	-0.6%	-5.4%
Storage								
EMC Corp. (Dec)	12.92	14.87	12.32	13.12	14.06	13.71	-2.5%	-7.8%
Network Appl. (Apr)	20.44	33.22	27.66	26.67	28.76	28.27	-1.7%	-14.9%
Servers								
Hewlett-Packard (Oct) (1)	22.97	20.97	21.94	20.47	22.51	23.51	4.4%	12.1%
IBM Corp. (Dec)	92.68	98.58	91.38	76.38	75.55	74.20	-1.8%	-24.7%
Sun Micro. (Jun)	4.47	5.39	4.04	3.62	3.81	3.73	-2.1%	-30.8%
Personal Computers								
ATI Technologies (Aug)	15.12	19.39	17.29	14.80	15.07	11.85	-21.4%	-38.9%
Dell (Jan)	33.98	42.14	38.42	34.83	39.93	39.46	-1.2%	-6.4%
Gateway (Dec)	4.60	6.01	4.03	3.41	3.46	3.30	-4.6%	-45.1%
Lexmark (Dec)	78.64	85.00	79.97	69.45	68.44	64.83	-5.3%	-23.7%
nVidia (Jan)	23.20	23.56	23.76	21.93	27.10	26.72	-1.4%	13.4%
Wireless								
palmOne (May)	11.75	31.55	25.38	21.43	28.42	29.77	4.8%	-5.6%
PalmSource (May)	21.77	12.74	9.04	8.89	10.03	8.50	-15.3%	-33.3%
Res. in Motion (Feb)	33.42	82.42	76.42	64.41	82.82	73.79	-10.9%	-10.5%
Services								
Accenture (Aug)	26.32	27.00	24.15	21.70	23.28	22.67	-2.6%	-16.0%
Affiliated Computer (June)	54.46	60.19	53.24	47.67	51.73	51.10	-1.2%	-15.1%
First Data (Dec)	41.09	42.54	39.31	38.03	37.83	40.14	6.1%	-5.6%
Unisys (Dec)	14.85	10.18	7.06	6.49	7.24	6.33	-12.6%	-37.8%

Palm Had a 20-1 reverse split in October 2002. *Globix stock quoted is post-bankruptcy stock.*
Research in Motion split 2-for-1 on June 4, 2004.
Palm became palmOne and PalmSource started trading October 29, 2003.
Notes: (1) The author has a position in the common stock. (2) The author has a position in the debentures.
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

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

EMC
Buy 10/31/01 at $12.32
Strong Buy 3/28/02 at $11.92

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

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

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

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

IBM
Hold 10/31/01 at $108.77
Buy 1/5/05 at $98.58
Strong Buy 5/2/05 at $76.38

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

Lexmark International
Hold 1/5/04 at $78.64
Strong Buy 3/31/04 at $92.00

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

nVidia
LT Buy 10/31/01 at $42.75
Buy 1/31/02 at $65.74
Strong Buy 2/28/03 at $52.01
u/r 6/28/02 at $17.18
Buy 7/25/02 at $15.07
Strong Buy 8/9/02 at $9.42
Buy 5/30/03 at $ 26.17
Strong Buy 6/30/03 at $22.91
Buy 8/29/03 at $18.17
Hold 9/30/03 at $15.91
Strong Buy 1/5/04 at $23.20
Hold 8/2/04 at $15.42
Buy 8/9/04 at $9.43
Hold 10/29/04 at $14.47
Buy 3/1/05 at $28.99
Strong Buy 4/1/05 at $23.76

palmOne
Sell 10/31/01 at $48.60
Hold 1/31/02 at $74.80
Sell 5/31/02 at $31.80
Hold 8/30/02 at $15.20

PalmSource
u/r 10/31/03 at $38.17

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

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 on 7/1/05 at $3.73

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

Accenture
Hold 5/2/05 at $21.70

Affiliated Computer
Hold 5/2/05 at $47.67

First Data
Hold 5/2/05 at $38.03