

MONTHLY TECHNOLOGY COMMENT

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Peter Labé, CFA

ACCUMULATE !!! STOCKS SHOULD STABILIZE HERE

In this issue:

- *Upgrading EMC to STRONG BUY*
- *Stock prices, multiples and valuation*

CURRENT THINKING ON THE ECONOMY

The stock market decline over the past two months I believe can be interpreted as a prediction the economy is going to turn south, at least for a time. It will probably be described as a “slowdown” or in some quarters even a “recession”. Is the stock market right? In our view, probably “yes.”

The myriad of economic numbers coming in are not to us consistent and are not coming in a manner that can easily be interpreted. We have been suspicious of second half economic prospects for some time now, and now that we are almost upon it, we still feel that way!

The consumer, of course, is going to be blamed for all this. The poor, overextended consumer that has carried the economy for so long is now visualized as slowly sagging

Disclosure

I, Peter Labé, 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.

under the weight of gasoline and energy prices, and higher interest rates. Our new Fed chairman gave every indication he was going to miss this call. In fact, late in the month, he raised rates ¼ point **up**, on the inflation worry theme. In our view, he should have been holding the line on rates so as not to put more downward pressure on the economy.

The fact is, this thinking has been in the market now, and close to fairly discounted.

CURRENT THINKING ON STOCKS

We can't say the market action, a downer in May-June, has particularly surprised us. We're not referring to the traditional summer doldrums, widely thought to be May to November. We are thinking about the change in perception on the economy. The NASDAQ Composite reached 2300, high enough for us. It could lose a couple of hundred more from here (2000, roughly) and not be surprising.

Our expectation for a tough market, hard to make money in, also seems to be working out. We had a huge 2 day rally on hints from the Fed that the rate increases would stop or ease up, but there's been no follow through.

Having said this, we believe the current period is one in which we should be **upgrading** many stocks, including the Big Cap Tech that we follow. In this issue we are upgrading the first one of these, **EMC Corporation**, for example. In this kind of market, we feel like "accumulating" positions. We have no such rating, so we are simply attempting to discuss our feelings.

We particularly like Tech in here, for a variety of reasons we turn to next.

THINKING ON TECHNOLOGY STOCKS

This year tech, at least the large caps, did not fully participate in the upswing, but seemed to participate in the downswings. Investors have found other "good economy" stocks as their new favorites. Small cap tech, however, was very strong on the upswing and has participated in the subsequent decline.

The ailments of large Tech seem to us pretty well reflected in the price. Some of these ailments include:

- Some "de-glamorization," that occurs when there is no Next Big Thing
- We have been in an era of reduced weighting, not expansion
- Market leadership has moved slowly to newer and different

Also pretty well reflected in the price, we think, is the imminent economic slowdown.

What will change how investors think about these? They have to get to where the investor looks at tech as “**value**” and alternative securities as “**expensive.**” These are hard things to measure, but we admit to some of that “value” thinking now.

Many of our stocks are “value” stocks now (maybe they weren’t not that long ago!) and they are the topic of this month’s issue.

SOME OF OUR PERSONAL BIASES

Since we are going to talk about valuations today, we may as well be up front as to what we like or don’t like:

- **GAAP vs. NON-GAAP Reporting.** If we had our way, we would adopt GAAP reporting across the board. Unfortunately, there have to be a few exceptions. For example, sale of a large plant for a large sum of money generates a large gain. This gain should be segregated like it is, as a non-recurring event, and excluded from the analyst’s worksheet even though it is GAAP. Non-GAAP in our view segregates a lot more stuff at very little gain – it makes the EPS higher and presumably the world uses the higher number, but we don’t think the stock sells even a penny higher.
- **SHARE BUY-BACK vs. DIVIDENDS.** This is another of our favorites. Companies with excess cash – their businesses apparently are not good enough for further investment of cash generated – invariably go to share buy-back, and those buying back more than 5% of the outstanding get high marks. While Buy-Backs increase earnings, and the apparent growth rate, nobody is fooled. Buy-backs most commonly fund employee option and other plans.
- **IPO’s.** We are normally skeptical to indifferent, that is we use customary analysis. Right now, we look upon these as potential moneymakers. There has been a real scarcity of tech IPO’s (a few came and did not do well) while on the other hand there has been a mountain of venture capital investment. This mismatch led me to conclude that the only ones who can go public right now are probably going to be bulletproof or good ones.

WHERE IS TECH GOING

We have seen a great valuation re-set in the first half year. We’re not arguing it will reverse, necessarily, but that at today’s valuations we have a good comfort level with reasonable potential.

The scale of values right now, compared with the market, are as follows.

	Price 6/30/06	2006E EPS	2007E EPS	P/E	
				2006E	2007E
S&P 500	1270	\$82.75	\$87.33	15x	15x
EMC	\$11.18	\$0.57	\$0.67	20x	17x
Network Appliance	35.34	1.02	1.29	35x	27x
Hewlett Packard	31.94	2.32	2.39	14x	13x
Dell	24.62	1.45	1.63	17x	15x
Gateway	1.69	0.12	0.19	14x	9x
nVidia	21.49	1.25	1.55	17x	14x
Lexmark	55.02	3.75	4.25	15x	13x
Unisys	6.28	0.16	0.47	39x	13x

Source: Reuters, Nutmeg Securities

Where have the 20 and 30 multiples gone? None of that around here. We are talking market multiples or less.

We also calculated what the P/E was on January 1, based on 12-month forward earnings (2006E) and what the P/E is now on 2007E. Multiples have dropped 28%!!

PEG rates have also gone down, as would be expected. A rough idea of current values is shown below:

	Our estimate CAGR – 5 yr	P/E 2007E	PEG Rate
EMC	13	17	1.28
Network Appliance	28	27	0.98
Hewlett	10	13	1.34
IBM	7	12	1.72
Dell	10	15	1.51
nVidia	14	14	1.00
Lexmark	11	13	1.18

(Gateway and Unisys not considered subject to this analysis)

Source: Previous table, Nutmeg Securities estimates

Finally, we throw in a summary of cash positions in the industry.

	Shares	Cash L.T. Debt	Cash/shr. Net of	Stock price 6/30	adj. for cash	Adj. P/E 2007
EMC	2,300	\$7,431	\$3.10	11.18	8.08	12.2
Network Appliance	393	1,323	2.61	35.34	32.73	25.4
Hewlett-Packard	2,887	14,024	4.03	31.94	27.91	11.7
IBM	1,587	12,300	6.18	76.63	70.45	10.8
Dell	2,318	8,456	3.43	24.62	21.19	13.0
nVidia	390	955	2.45	21.49	19.04	12.3
Lexmark	110	766	6.97	55.02	48.05	11.3
Unisys	342	980	-0.20	6.28	6.48	13.8
Gateway	410	590	0.71	1.69	0.98	5.2

Source: Nutmeg Securities estimates

These three exercises we have presented are an attempt to show statistical cheapness of this stock group. We have never found any single approach wins, and remember it is the **“second sentence that matters.”** Analyst presenting to PM : **“Sir, this stock is cheap.”** PM probably already knew that, but having a reminder was good. **If there is no second sentence, the stock will be unlikely to be a big winner. If there is a second sentence, the reason why, and it’s good enough, it has a chance.**

We like this group at this juncture in the market. Our specific comments follow.

DATA STORAGE

EMC Corporation (Strong Buy – \$11.18)

- We are overcome by the statistical cheapness of this stock
- The software acquisitions are weaving in nicely to present a total package of solid double digit growth
- The storage business is a solid base
- We look upon the Restricted Stock program, geared to senior executives if they meet certain EPS targets, as excessive (cost – 7 cents a share this year). The regular stock option program costs 9 cents a share this year. This is not big enough as a negative.
- Finances are strong, stock coming down nicely and we have upgraded it to **Strong Buy**

Network Appliance (Hold – \$35.34)

- We have no new insights on this great company here
- Stock looks cheap on a PEG basis, rarely available at that price. Assuming 28% growth, need 40 petabyte/year storage industry growth to support it. That growth should be there.

SERVERS

Hewlett-Packard (Strong Buy – \$31.94)

- No change in our 40+ target price

IBM (Buy – \$76.63)

- We have reduced IBM from Strong Buy to Buy, since the stocks all around it are now very cheap
- The Services business is a tough business, we think. We are expecting a strong second half in Services to finally get some pep in the stock, with low risk

PC AND RELATED

Gateway (Hold – \$1.69)

- Still awaiting the CEO appointment, believed to be at interviewing stage
- Still watch

Dell (Buy – \$24.62)

- At these levels, very comfortable with the stock, rated Buy.
- Fits in with my view that anything associated with Vista is going to make money
- Well positioned for this market, with its industry emphasis
- Would like to see a soft quarter, make it a table-pounder

nVidia (Hold – \$21.49)

- Market understands Vista is a growth driver, but maybe not that HD DVD and Blue Ray are growth drivers as well. The resolution is complex, maybe 6 times that of a DVD, and the pixel itself is 3 or 4 times the quality of a DVD. These requirements spell a need for graphics processors
- Stock coming down nicely and needs to be watched

Lexmark (Buy – \$55.02)

- Talk about stocks statistically cheap – how about this one? This \$6 billion business with nearly \$800 million in cash is perched on just 110 million shares !
- The company seems to be quietly and slowly addressing its problems
- **Continue to Buy**

SERVICES

Unisys (Strong Buy – \$6.28)

- No news this month, patience
- We are getting closer to 2008, continue to **Buy**

SUMMARY

We are maintaining a conservative posture as we have all year. We are going out with Hewlett, EMC and Dell as Buys, and IBM, too. We have Buys on Lexmark and Unisys, both regarded as special situations.

We will return to our regular format with the next issue.

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 6 stocks (38%) 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	52-week	E.P.S.			P/E			Rating
		6/30/2006	Range	2004A	2005A	2006E	2007E	2006E	2007E	
S&P 500*	SPX	1270	1318 1139	\$67.10	\$76.28	\$82.75	\$87.33	15	15	
NASDAQ Composite	COMP	2172	2376 1890							
Storage										
EMC Corp. (Dec)	EMC	11.18	15 - 12	\$0.37	\$0.53	\$0.57	\$0.67	20	17	STRONG BUY
Network Appl. (Apr)	NTAP	35.34	39 - 23	\$0.62	\$0.81	\$1.02	\$1.29	35	27	HOLD
Servers										
Hewlett-Packard (Oct)*	HPQ	31.94	35 - 20	\$1.36	\$1.72	\$2.32	\$2.39	14	13	STRONG BUY
IBM Corp. (Dec)*	IBM	76.63	90 - 73	\$4.50	R \$5.32	\$5.86	\$6.37	13	12	BUY
Sun Micro. (Jun)*	SUNW	4.14	5 - 4	(\$0.12)	(\$0.13)	(\$0.11)	\$0.13	NMF	32	HOLD
Personal Computers										
ATI Technologies (Aug.)*	ATYT	13.65	18 - 10	\$0.90	(\$0.03)	\$0.72	\$0.96	19	14	HOLD
Dell (Jan fol.)	DELL	24.62	42 - 26	\$1.28	\$1.56	\$1.45	\$1.63	17	15	BUY
Gateway (Dec)	GTW	1.69	4 - 2	(\$0.40)	\$0.12	\$0.12	\$0.19	14	9	HOLD
Lexmark (Dec)	LXK	55.02	70 - 39	\$4.13	\$3.35	\$3.75	\$4.25	15	13	BUY
nVidia (Jan fol.) ⁴	NVDA	21.49	31 - 10	\$0.57	\$1.07	\$1.25	\$1.55	17	14	HOLD
Wireless										
Palm, Inc. (May)* ²	PALM	18.66	25 - 10	\$0.65	\$0.73	\$0.97	\$1.07	19	17	HOLD
Res. in Motion (Feb)* ¹	RIMM	65.99	91 - 51	\$1.67	\$2.59	\$2.80	\$3.48	24	19	HOLD
Services										
Accenture (Aug)*	ACN	27.05	33 - 21	\$1.28	\$1.50	\$1.69	\$1.82	16	15	HOLD
Affiliated Computer (June)*	ACS	50.51	64 - 47	\$2.83	\$3.23	\$3.12	\$3.73	16	14	HOLD
First Data (Dec)*	FDC	43.99	49 - 37	\$2.16	\$2.25	\$2.38	\$2.73	18	16	HOLD
Unisys (Dec) ³	UIS	6.28	7 - 4	\$0.31	(\$0.46)	\$0.16	\$0.47	39	13	STRONG BUY

Notes: ¹Research in Motion split 2-for-1 on June 4, 2004.

²Palm stock split 2-for-1 effective March 15, 2006.

³Unisys estimates GAAP and include pension accounting.

⁴nVidia 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	3/31/2006	Prices			% chg June	2006 year to date
				4/28/2006	5/31/2006	6/30/2006		
S&P 500	1212	1248	1295	1311	1270	1270	0.0%	1.8%
NASDAQ Composite	2175	2205	2340	2323	2179	2172	-0.3%	-1.5%
Storage								
EMC Corp. (Dec)	14.87	13.62	13.63	13.51	12.80	11.18	-12.7%	-17.9%
Network Appl. (Apr)	33.22	27.00	36.03	37.07	32.00	35.34	10.4%	30.9%
Servers								
Hewlett-Packard (Oct) (1)	20.97	28.63	32.90	32.47	32.38	31.94	-1.4%	11.6%
IBM Corp. (Dec) (1)	98.58	82.20	82.47	82.34	79.90	76.63	-4.1%	-6.8%
Sun Micro. (Jun)	5.39	4.19	5.13	5.00	4.63	4.14	-10.6%	-1.2%
Personal Computers								
ATI Technologies (Aug)	19.39	16.99	17.18	15.52	16.51	13.65	-17.3%	-19.7%
Dell (Jan)	42.14	29.95	29.76	26.20	25.38	24.62	-3.0%	-17.8%
Gateway (Dec)	6.01	2.51	2.19	2.20	1.72	1.69	-1.7%	-32.7%
Lexmark (Dec)	85.00	44.83	45.38	48.70	57.25	55.02	-3.9%	22.7%
nVidia (Jan)	11.78	18.28	28.63	29.22	22.98	21.49	-6.5%	17.6%
Wireless								
Palm, Inc. (May)	15.78	15.90	23.16	22.60	16.48	18.66	13.2%	17.4%
Res. in Motion (Feb)	82.42	66.01	84.88	76.63	64.89	65.99	1.7%	0.0%
Services								
Accenture (Aug)	27.00	28.87	30.07	29.07	28.15	27.05	-3.9%	-6.3%
Affiliated Computer (June)	60.19	59.18	59.66	55.76	49.92	50.51	1.2%	-14.7%
First Data (Dec)	42.54	43.01	46.82	47.69	46.11	43.99	-4.6%	2.3%
Unisys (Dec)	10.18	5.83	6.89	6.24	6.58	6.28	-4.6%	7.7%

Research in Motion split 2-for-1 on June 4, 2004.

Palm stock split 2-for-1 on March 15, 2006.

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

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

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 \$48.60
Hold 1/31/02 at \$74.80
Sell 5/31/02 at \$31.80
Hold 8/30/02 at \$15.20

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

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 \$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
Hold 2/1/06 at \$44.96

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 7/1/05 at \$3.73
Hold 1/3/06 at \$4.19

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

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

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