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By Lauren Keyson

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Exclusive TTB Interview with Scott Kessler
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Internet Software & Service & Internet Retail Analyst
Standard & Poor's U.S. Equity Research

Standard & Poor's raised its fundamental outlook on the Internet Software & Services sub-industry to Positive from Neutral, following its January 2006 upgrade of **Yahoo! (YHOO)** based on valuation.

Lauren Keyson (The Tech Briefing): At the time you had said that Yahoo! was by far the most significant component of the S&P sub-industry index. Do you want to talk about that?

Scott Kessler (Standard & Poor's): There actually has been a number of changes to the S&P 500 Internet Software & Services sub-industry in the last couple of months. I wanted to note that Standard & Poor's Index Services operates completely independently and separately from Standard & Poor's Equity Research. But that being said, changes that they make impact the way that we think about sectors

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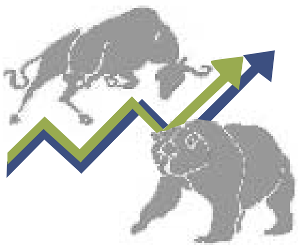
Tech Points

S&P Composite 1500 GICS IT Scorecard (3/24/06)

		Price Changes (%)		
	% of S&P 1500	1 Wk.	13 Wks.	YTD 2005
Information Technology	**15.41**	**(0.1)**	**2.0**	**4.3**
Application Software	0.59	(0.7)	(1.9)	0.0
Communications Equip.	2.87	(0.3)	15.2	18.1
Computer Hardware	2.80	(1.0)	0.3	2.3
Computer Storage & Peripherals	0.56	(0.6)	2.9	4.9
Data Processing & Outsourced Services	1.14	(0.7)	5.4	6.9
Elec. Equip. Manufacturers	0.34	(0.9)	8.7	11.6
Elec. Manufacturing Services	0.20	3.9	15.4	16.6
Home Ent. Software	0.17	(0.1)	(0.4)	0.5
Internet Software & Services	0.70	1.2	(22.1)	(19.2)
IT Consulting & Other Services	0.16	0.6	11.3	13.3
Office Electronics	0.13	(1.1)	1.7	3.2
Semiconductor Equip.	0.51	2.1 5	.4 8.0	2.9
Semiconductors	2.54	1.6	(6.4)	(3.3)
Systems Software	2.55	(1.0)	1.8	3.5
Technology Distributors	0.15	(0.0)	0.9	2.4

Source: Standard & Poor's



Keeping Up

By John Filar Atwood

Latest News Keeps Pressure on Tech Stocks

Bellwether **Oracle (ORCL)** pulled tech stocks down recently with weaker-than-expected database software sales. The report joined **Microsoft's (MSFT)** Vista shipment delay and disappointing February video game sales among the news items that put pressure on tech stocks in the past few weeks. Even a possible merger of key communications equipment vendors **Lucent (LU)** and **Alcatel (ALA)** left investors and analysts unmoved. Here's a look at analysts' take on that proposed deal, ORCL's report, and other news from around the industry.

Systems Software
Oracle (ORCL) reported an in-line quarter, but database software sales grew only 4% versus Street expectations of 9%. The news caused a brief sell-off of ORCL shares that had a ripple effect on other tech stocks. Kevin Buttigieg of A.G. Edwards found the quarterly numbers uninspiring, and he reiterated his Hold rating on the stock. He remains concerned that database revenues will stay in a slow growth pattern, and that the company's applications segment will continue its erratic performance.

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Looking Ahead

By Charlie Grainger

Looking for Stocks in the Right Places

During Christmas week in 1992, I appeared as a guest on CNBC television. While television appearances can be fun, and I did continue live interviews from the floor of the Montreal Stock Exchange for many years, most of my clients and friends asked me not to do them since it usually entailed making stock recommendations.

Most of the recommendations that we see on television are not always timely, and too many are designed for trading, to which the public is not and never will be suited. An example would be "breakouts" as a stock hits a new high. Too often it is a signal to short a stock, and the public, for the most part, is incapable of trading the stock market.

The complaints have a lot of merit. Most brokerage house research is, and always has been, severely lacking, and experienced investors are quite aware of it. In 2001 and 2002, there was a media frenzy covering the dismal performance of brokerage industry analysts. The best ideas come from private investment services, independent investors, some newsletters and, yes, one's own analysis.

Among the ashes of the badly beaten down stocks can come superb returns. Mutual funds, for the most part, tend to recommend and thus support their own holdings. They never seem to recommend stocks that they are just starting to accumulate at or near a stock's bottom. It is important to understand that of the more than 10,000 stocks that are traded in the U.S., only about 2,000 stocks (at best) get comprehensive research coverage. Among those

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Tech Spotlight

By Dennis Askew

Willie Loman Meets I Robot

Automation is the key to **Salesforce.com (CRM)**. CRM products systematically record, store, and act upon business data. They help businesses manage customer accounts, track sales leads, evaluate marketing campaigns, and provide post-sales services via sales force automation, marketing automation, and customer service and support automation.

As of January 31, 2006, CRM had a client base of 20,500 (with 399,000 paying subscriptions worldwide) and 1,304 full-time employees. The San Francisco-based company trades in the $36 range, with a market cap of about $4.11 billion.

CRM's "AppExchange" is recognized in the telecom industry and Internet sector as one of the leading Web-based platforms that enables salespeople to be productive by automating manual and repetitive tasks. The product provides organized data about current and prospective customers and helps companies establish a system and a process for recording, tracking, and sharing information about sales opportunities, sales forecasts, closed business, and other tasks that include marketing and client support.

Salesforce.com recently joined companies like Writely, Zimbra, and Bloglines, as well as established players such as **Yahoo! (YHOO)**, **Google (GOOG)**, Skype, and **Microsoft (MSFT)** in being honored by Business 2.0. Yes, CRM has taken the often-anecdotal title of customer relationship manager and not only used its abbreviation as its trading symbol, but taken the concept to an entirely different level. The CRM balance sheets make a clear statement about growth, and good recommendations from analysts outweigh the pessimists.

On February 1, CRM started its 2007 fiscal year, coming off of some impressive 2006 gains that continued with year-over-year fundamentals trending up. Total revenues (in thousands) in 2006 were $309,857, up from $176,375 in 2005. Total revenues in 2004 were $96,023. Gross profits continue the uptrend, with $240,731 in 2006, up from $142,921 in 2005. Gross profits in 2004 were $78,750.

Even the trend lines in revenues by geography were solidly up for CRM. Take a look (all figures in thousands):

	2006	2005	2004
Americas	**$247,009**	**$140,871**	**$78,958**
Europe	**$43,577**	**$25,201**	**$11,754**
Asia Pacific	**$19,271**	**$10,303**	**$5,311**

Even CRM's cash, cash equivalents, and marketable securities were up year after year.

As I mentioned, most analysts like this stock. But I think the believers see more than just the numbers. In a more strategic view, they see that CRM is dedicated to expanding the infrastructure needed to take full advantage of the business Web.

Thomson/First Call's consensus of 14 brokers place the trading price at a high target of $50 and a low target of $26, with a median target of $38. CRM was flat in two of its fiscal 2006 quarters, with estimated earnings versus actual earnings, but it beat estimates twice in the other two fiscal 2006 quarters. On February 23, Piper Jaffray initiated coverage with a Market Perform. On Valentine's Day, First Albany upgraded its recommendation to Buy from Neutral. On January 6, Credit Suisse upgraded CRM to Outperform from Neutral. ◆

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Keeping Up

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Communications Equipment
Lucent (LU) and **Alcatel (ALA)** are exploring a potential merger, and LU's shares have risen on the news. Ken Leon of Standard & Poor's does not believe the merger will change LU's exposure to customer consolidation. The company derives most of its revenues from a few wireless and fixed-line telecom firms, he said, and deals like the pending **AT&T (T)/BellSouth (BLS)** merger will hurt it. He rates LU a Sell and maintains a Neutral position on the entire industry. His top picks in the group are **Motorola (MOT)** and **Cisco (CSCO)**.

Internet Software and Services
Standard & Poor's is adding **Google (GOOG)** to the S&P 500 Index. The company's shares are off more than 15% this year, but Scott Devitt of Stifel Nicolaus still likes its prospects. He upgraded the stock to Buy from Hold, noting that company fundamentals support a 20% upside to the current share price. GOOG continues to gain market share and handles nearly 60% of all searches worldwide, he said. Along with the upgrade, he cut his 2006 EPS estimate to $8.57, because the company is building its infrastructure this year.

Home Entertainment Software
Video game sales declined 13% in February, which is the sixth consecutive month sales have fallen, according to NPD Funworld. The rate of decline in sales of current-generation software accelerated from 26% in January to 29% in February. Wedbush Morgan's Michael Pachter believes a more dramatic and persistent slowdown in software sales is coming. He thinks investors should stay on the sidelines for the next few months but add to positions in **Activision (ATVI)**, **Electronic Arts (ERTS)** and **THQ (THQI)** on price declines.

Computer Hardware
Microsoft (MSFT) reported that shipment of the consumer version of its Vista operating system will be delayed. The announcement did not change the 2006 PC sales estimate of 9% provided by Martha Graham-Hackett of Standard & Poor's. She expected muted sales this year, because users are choosing not to upgrade low-end systems. She believes sales growth will be modest in the face of intense pricing competition and maintains a Neutral outlook for the hardware group. She reiterated her Hold ratings on **Dell (DELL)** and **Hewlett-Packard (HPQ)**.

Electronic Manufacturing Services
Jabil Circuit (JBL) reported a solid second-quarter performance and provided Q3 revenue guidance of $2.5 billion. It also raised its fiscal 2006 EPS estimate to $1.70 from $1.65. Needham's Richard Kugele upgraded the stock to Buy from Hold on the report. He said that JBL's consistent performance continues to demonstrate why the company is among the elite EMS companies. He likes JBL's customer mix, strong returns on investment and solid outlook into fiscal 2007. His 12-month target for JBL's shares is $46.

Technology Distributors
Valuations for companies in this industry have peaked and begun a cyclical downward trend, according to Dylan Cathers of Standard & Poor's. He lowered the price-to-earnings multiple of both **Arrow Electronics (ARW)** and **Avnet (AVT)**, and cut his 12-month price target for both. Although he thinks the two companies are fundamentally sound, he downgraded both to Sell from Hold, based on his expectation of lower valuations.

Data Processing and Outsourced Services
The U.S. Navy recently extended a key contract with **Electronic Data Systems (EDS)** through 2010 that will increase significantly the company's first-quarter total contract value. The renewal adds visibility for EDS on improving profitability and free cash flow, said William Loomis of Stifel Nicolaus. He reiterated his Buy rating and $34 price target on EDS. In addition to the Navy contract, he believes EDS has won an unannounced mega-deal that also will boost its total contract value.

Computer Storage and Peripherals
Xyratex's (XRTX) storage and network systems business grew 6% in the February quarter, with a larger proportion of sales going to **Network Appliance (NTAP)**. The company guided for 6% to 13% growth in the coming quarter. The report is positive for NTAP, says Shebly Seyrafi of Kaufman Bros. He estimates NTAP's sequential revenue growth to be 9% in the April quarter, but he believes it could reach 12%. He maintained his estimates and Hold rating on NTAP but now feels his projections for the company are conservative.

Semiconductors
Microsemi (MSCC) appears to be gaining market share in cold-cathode fluorescent lamp inverter chips, according to channel checks done by Wedbush Morgan's Craig Berger. He thinks solid demand and tight supply mean that MSCC will be able to raise its prices later this year. He upgraded the stock to Buy from Hold, based on the promising near-term outlook and the recent drop in share price. He believes his premium EPS multiple is warranted, based on MSCC's growth prospects and potential for margin expansion.

Semiconductor Equipment
Applied Materials (AMAT) increased its dividend by $0.02 per share and announced a new $5 billion stock repurchase program. The moves should increase shareholder value, according to Colin McArdle of Standard & Poor's, but they also demonstrate management's confidence in AMAT's near- and long-term prospects. He continues to rate the stock a Buy with a $26 12-month price target. His analysis places AMAT at a multiple of 29 times his fiscal 2006 EPS estimate of $0.90.

Electronic Equipment Manufacturers
Tektronix (TEK) reported a strong fiscal Q3, with revenues up 3% sequentially and 2% year over year. The best news was the pick up in its core instruments business, where orders were up 8%. Needham's John Harmon was encouraged by the report and believes TEK will continue to introduce new products in the coming year. However, he believes the stock is fairly valued at its current price and maintains his Hold rating on TEK.

Application Software
Acquisition rumors have been swirling around **Mercury Interactive (MERQ)** for a year now, but no deal is in sight. The company will be hard to sell in its current condition, says Jefferies & Co.'s Katherine Egbert. However, once regulatory obligations have been met, she believes some software and systems companies would find MERQ attractive. For now, she sees Q1 shaping up as a difficult quarter for MERQ, and she reiterates her Hold rating and $35 target.

IT Consulting and Other Services
Unisys (UIS) intends to freeze its pension plan and redesign its stock-based matching contribution plan. The company's pension expense was $181 million in 2005, which was 3.1% of its revenue. Cindy Shaw of Moors & Cabot believes the move will not eliminate the drag on earnings until 2008. She reiterated her Hold rating on the stock and believes that UIS needs to execute on revenue growth plans before its shares can sustain a meaningful rise. ◆

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Looking Ahead
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stocks that are overlooked and uncovered are some of the best values available.

The CNBC host that December day was Ted David, whom I have always liked since I have felt that he views a lot of research with a critical eye. He asked me what stocks Santa Claus had in his sack.

One of my own rules was that if I recommended a stock publicly, I could not sell for quite a while. So I never liked doing it, but I gave Ted three stocks that I thought were undervalued. I knew the managements of each company, and I believed that at their very undervalued prices, viewers would benefit.

My three stock recommendations were Iatco (later changed to Airboss) at $1, Freewest at $2, and Petromet at $0.75. All were listed on the Toronto Stock Exchange, were undervalued, and, above all, were not being recommended. They were all new, overlooked small-cap companies not yet meriting attention, except perhaps from value buyers. I left the studio satisfied that my recommendations would do well.

So how did they perform? Petromet was up 482% in six months, and, within three years, it was trading at more than $9. It was later bought by NYSE-listed **Talisman (TLM)** for $13.40 Canadian. Freewest moved up 50% within 18 months and was taken over by Hemlo, which was taken over by Battle Mountain, which was taken over by **Newmont Mining (NEM)**. Thus, the old Freewest shareholders now own Newmont Mining through takeovers, and they still own the new Freewest from the spin-off. Iatco, later renamed Airboss, popped up 30% and went down as well. But it was up 600% from my original recommendation price by the end of the decade.

Petromet was up over 1,000% when it was taken over by Talisman. Not bad. I had several others that were overlooked and forsaken that I had recommended on other appearances that did as well and even better. Very few did not perform superbly.

Tech Ups and Downs

The following companies received ratings changes between March 20 and March 31:

Upgrades

Company	Consensus Rating	Consensus Target Price
Microsemi (MSCC)	Outperform	$33.00
Google (GOOG)	Outperform	$471.22
Jabil Circuit (JBL)	Outperform	$45.03

Downgrades

Company	Consensus Rating	Consensus Target Price
Check Point Software (CHKP)	Hold	$24.57
Adobe (ADBE)	Outperform	$41.85
Arrow Electronics (ARW)	Outperform	$37.29

Source: Reuters Estimates

The Aftermath

After I returned to my office from CNBC that December day, I received several phone calls from viewers. I also received a phone call from the CNBC booker who informed me that I was not going to be allowed to recommend any more of the low-priced Canadian stocks. I called the producer, and she told me that she did not want it.

Ted had asked me what stocks I thought would do well, not what large-cap, NYSE-listed company would do well. And viewers who paid attention did well. I did my analysis, and the results were excellent.

My friend and brilliant economist, the late David Bostian, had warned me to use only my own recommendations — not those of the firm at which we were both working. I might add that I cannot recommend any stocks on television. However, there are many — yes, many — investment professionals that should be on television giving stock recommendations that would greatly benefit viewers and possibly boost ratings. You think that viewers don't pay attention to television stock picks? You should see my emails!

What is my point? Well, as Peter Lynch said in his best selling book, *One Up On Wall Street*, the number one rule is to stop listening to professionals! Twenty years in this business convinces me that any normal person using the customary 3% of the brain can pick stocks just as well, if not better, than the average Wall Street expert.

Peter was, and remains, absolutely correct. There is so much valuable information available to investors that can allow for significant investment success, but you should do your own homework.

I love business television in Canada and the U.S. But if they really want to give their ratings a boost, the stations should be looking for professionals who can give viewers undervalued stocks, not their own brokerage house's stock picks. There are plenty of them around, not the same old "usual suspects." ◆

Written as of April 3, 2006.

Charlie Grainger of Montreal's CanAmInvestor is a fundamental and technical analyst.

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Movers & Shakers

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and sub-industries. So, for example, at the time that we raised our outlook for the Internet Software & Services sub-industry, Yahoo! was the only large component of that particular index. That change prompted our upgrade of Yahoo! to Buy from Hold on January 24, which was driven by what we saw, and still see, as solid fundamentals and an attractive valuation. The growth should be driven by the continuing migration of advertisers online.

Yahoo! is really uniquely positioned, because it is the number one provider of display advertising, often characterized as banners, or sponsorships, or things like that. Yahoo! is really the market leader in that category, notwithstanding buzz and interest around other companies, like **Google (GOOG)**. Yahoo! is number two when it comes to search advertising as well. They a have unique diversification, not only in terms of Internet advertising. They also offer a number of different products and services that we think have appeal.

One of the things we really like about Yahoo! is that they have effectively partnered with a number of broadband service providers like **AT&T (T)**, **British Telecom (BT)** and **Rogers Communications (RG)** of Canada, to offer customized content to consumer end-users. More recently, Yahoo! also launched a similar service with **Verizon (VZ)** and announced a new offering with **BellSouth (BLS)** that is scheduled to launch by the end of this year. My sense is that the timetable for the BellSouth service could somewhat be accelerated by the fact that AT&T, with which Yahoo already partners, has agreed to the proposed acquisition of BellSouth.

Yahoo! shares haven't done so well year to date, but I'd note that we upgraded the stock after it fell substantially from when we downgraded it around Thanksgiving. It was around $42 to $43, and we upgraded the shares at under $35 a share. We feel pretty good about Yahoo! right now. It is one of our top Internet stock ideas.

LK: What other significant changes have happened with the S&P 500 Internet Software & Services sub-industry index?

SK: I was hoping we could circle back to changes to the S&P 500 Internet Software & Services sub-industry. **eBay (EBAY)** was moved from Internet Retail to Internet Software & Services at the end of January. This makes sense because even though eBay is inextricably linked to the concept of retail, the reality of what eBay does in its business model is definitely more technology-oriented. Google was also added to the S&P 500 in late March.

In addition, Internet Software & Services sub-industry company **VeriSign (VRSN)** was added to the S&P 500 in late January. VeriSign is a stock that we actually liked relatively recently, but we downgraded the shares to Hold from Buy in late February, because we thought the valuation was getting a little bit too rich. The stock was around $24 to $25 per share. Our 12-month target is $27, and the stock didn't have that much-implied appreciation potential.

VeriSign is a multi-faceted company. It is the exclusive registry of .com and .net domain names. The company also provides infrastructure services to telecommunication service providers, including wireless service providers, around the world. During the last couple of years, VeriSign has been building this business through acquisitions.

Another area on which they are increasingly focused is this notion of Internet security — providing digital certificates and safeguarding communication and content on the Internet. VeriSign also provides what I'll refer to as managed services, which essentially enables the company to provide security offerings to large enterprises.

So I guess the bottom line with VeriSign is that we think they have a number of attractive and interesting businesses, but we think the shares are fairly valued right now. ◆

Scott Kessler is an equity analyst in and director of the Information Technology group of Standard & Poor's U.S. Equity Research Services. Since March 2000, he has personally covered the Internet Software & Services and Internet Retail sub-industries, which include bellwethers eBay, Google, **IAC/InterActiveCorp (IACI)** *and Yahoo!. He also authors the bi-annual industry survey entitled, "Computers: Consumer Services & the Internet." Mr. Kessler also oversees Standard & Poor's equity research regarding the Information Technology sector, which consists of more than 250 stocks.*

Tech In The News

By Ira Gamm

Apples Aren't Just Apples, as London's Apple Corps Sorts It Out with U.S.'s Apple in Court

Whose Apple Is It? Beatles Sue Apple

A lawyer for the Beatles' record company has asked a British court to order **Apple Computer (AAPL)** to stop using the Apple logo to promote its iTunes music store, the *Wall Street Journal* is reporting. The record company claims that Apple Computer had engaged in a "flagrant violation" of an agreement the two sides had previously reached over use of the Apple name and logo. The case could settle a long-running feud between the companies. In 1991, the companies agreed to share use of the Apple name. Apple Computer was allowed to use the brand for computers, as well as for equipment and software to distribute music. London's Apple Corps had the right to use it to produce and sell music. The Beatles' company argued in court that iTunes violated the agreement by placing the Apple logo on the iPod program and in advertisements for it.

Google Hopes to Raise $2 Billion with Stock Offering

Google (GOOG) plans to sell an additional 5.3 million shares of its stock, hoping to raise more than $2 billion to finance its ambitious plan to expand beyond its Internet-leading search engine, the *Wall Street Journal* is reporting. In an SEC filing, the company said it expects to sell the 5.3 million shares primarily to index funds that must own a stake in the company, because Google is now in the S&P 500. Google's market value has climbed by more than 15% since S&P said it will include the stock in the blue-chip bellwether. News of the offering raised a red flag for some investors that the increase in shares outstanding will make it difficult for the company to reach the lofty EPS target set by analysts.

Nokia Plays Catch-up in Race over Music-Player Cell Phones

Nokia (NOK) is playing catch-up in the cell phone industry's rush to add music players to cell phones, according to a story in the *New York Times*. The company has been hit with technical glitches that have delayed the introduction of its latest cell phones into stores until this summer. Nokia will have to compete with a range of models from Sony Ericsson, LG, **Motorola (MOT)** and Samsung. Many analysts predict that the market for mobile phones with built-in music players will take sales from dedicated devices like the iPod and eventually overtake the market. Gaining ground in this new market will be especially tough for Nokia, which is known for inexpensive, entry-level handsets, according to the article. Analysts say that Nokia needs to unveil more models in the high-end range or risk being further stuck behind the competition. ◆

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