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## Morningstar Equity and Credit Research

- ▶ One of the largest independent equity and credit research groups in the world.
- ▶ Broad coverage: 90 equity and credit analysts & strategists covering 1,800 companies across the globe.
- ▶ Consistent, disciplined research approach focused on intrinsic values and economic moats.

# One Analyst Staff, Three Audiences

90 Analysts, 1,800 Companies, 90 Industry Groups

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Company Fundamentals  
Valuation  
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**MORNINGSTAR®**

# Equity Coverage by Region

North America



Europe



Asia



Australia /  
New Zealand



Latin America

45

Index	Mkt. Cap. Covered
S&P 500	99%
ASX 50	100%
TSX 60	98%
Stoxx 50	99%
CAC 40	96%
FTSE 100	80%
DAX 30	95%
Euro 350	79%
AEX 25	91%

Eurasia /  
Middle East /  
Africa

15

Data as of 7 Sep 2011

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# Equity Coverage by Sector and Market Capitalization

## Cyclical

	Basic Materials	<b>186</b>
	Consumer Cyclical	<b>167</b>
	Financial Services	<b>244</b>
	Real Estate	<b>50</b>

## Sensitive

	Communication Services	<b>84</b>
	Energy	<b>164</b>
	Industrials	<b>242</b>
	Technology	<b>171</b>

## Defensive

	Consumer Defensive	<b>117</b>
	Health Care	<b>175</b>
	Utilities	<b>80</b>

 Large-cap stocks

**730**

 Mid-cap stocks

**573**

 Small-cap stocks

**398**

Data as of 7 Sep 2011

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# Morningstar Approach to Equity Research



## Morningstar Competitive Advantage: Performance

	YTD	Trailing 3-Year*	Trailing 5-Year*	Trailing 10-Year
<b>Morningstar Wide Moat Focus Index</b>	0.55	6.36	6.67	—
<b>Morningstar Tortoise</b>	-4.85	0.51	0.79	6.69
<b>Morningstar Hare</b>	-10.19	5.90	3.80	6.79
<b>Morningstar Dividend Builder</b>	-2.31	-2.27	0.42	—
<b>Morningstar Dividend Harvest</b>	4.31	13.23	N/A	—
<b>Buy at 5-star / Sell at 3-star</b>	-17.03	12.12	4.67	—
<b>S&amp;P 500 Index (cap-weighted)</b>	-8.68	1.22	-1.18	2.81
<b>Morningstar Large Cap Blend Mutual Fund Cat</b>	-11.30	0.36	-1.83	2.19

- Our Wide-Moat, 5-star stocks have generated an annualized return of over 16% since 2002.
- Morningstar was one of only three firms (out of 196 sell-side and independent firms surveyed) with three

**#1 ranked analysts in *The Wall Street Journal's* 2011 'Best on the Street' survey.**  
Time-weighted returns through 9/30/2011

\* Annualized percentage returns

Source: Morningstar

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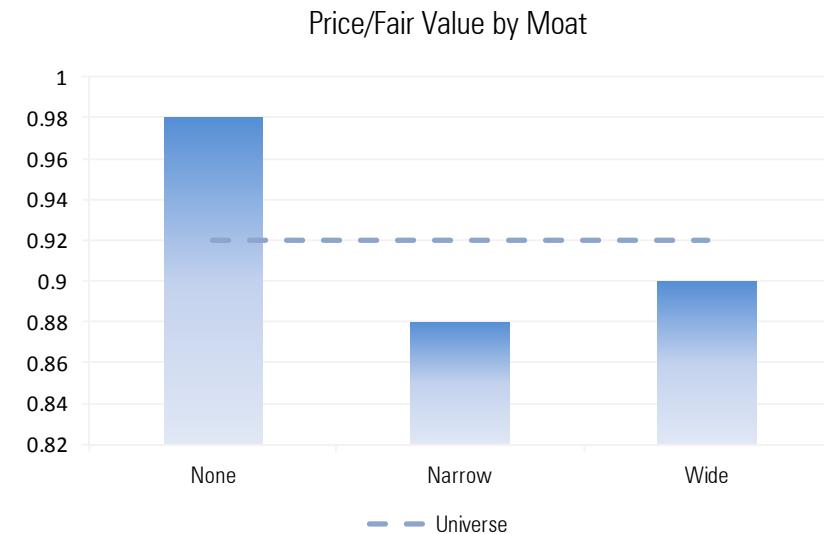
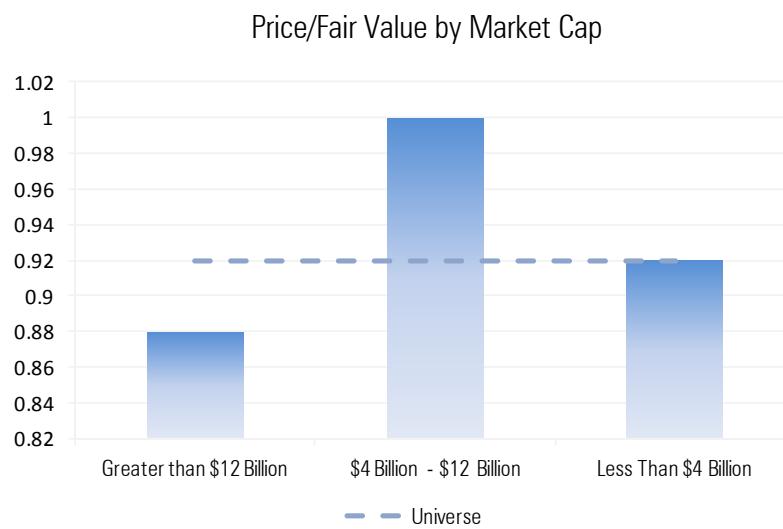
# Tech Strategy — Clouds and Hardware

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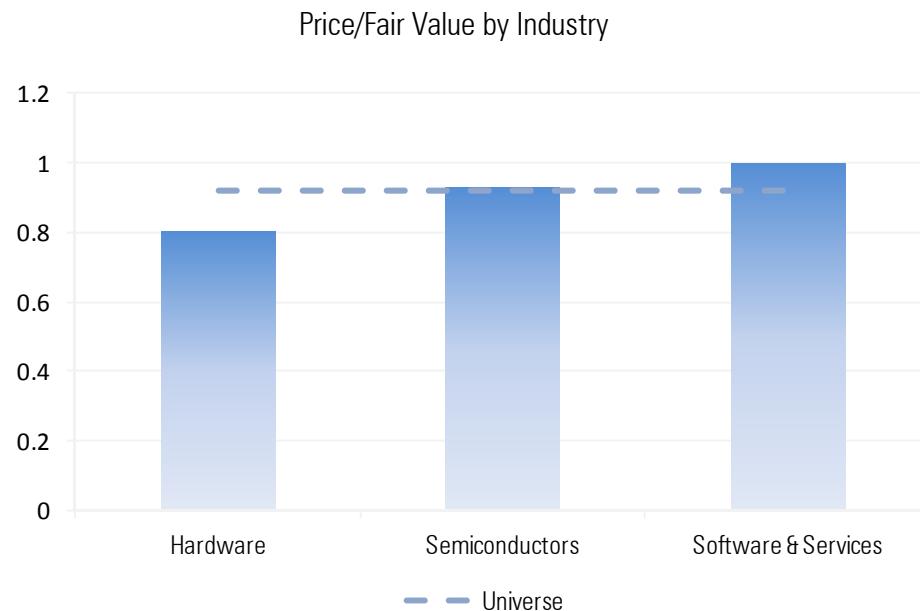
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## Figures 1-2: Quality Large Cap Still Moderately Undervalued After Recent Rally



- Economic, Market Uncertainty Provided Third Quarter Lift to Higher Quality Large Cap → Margin of Safety Matters
- Avoid No Moat, Deep Cyclical and Consumer Tech → Weak Macro + No Customer Switching Costs + Disruption = Disaster
- Higher Quality Large Cap Tech Still Most Attractively Valued → Recent Nasdaq Rally has Shrunk Opportunity Set
- Best Ideas List More Moaty Than Ever → ORCL, GOOG, CSCO (wide) -- AAPL, ATMI (narrow)

**Figure 5: Hardware industry remains undervalued, as long-term and near-term uncertainty increases**



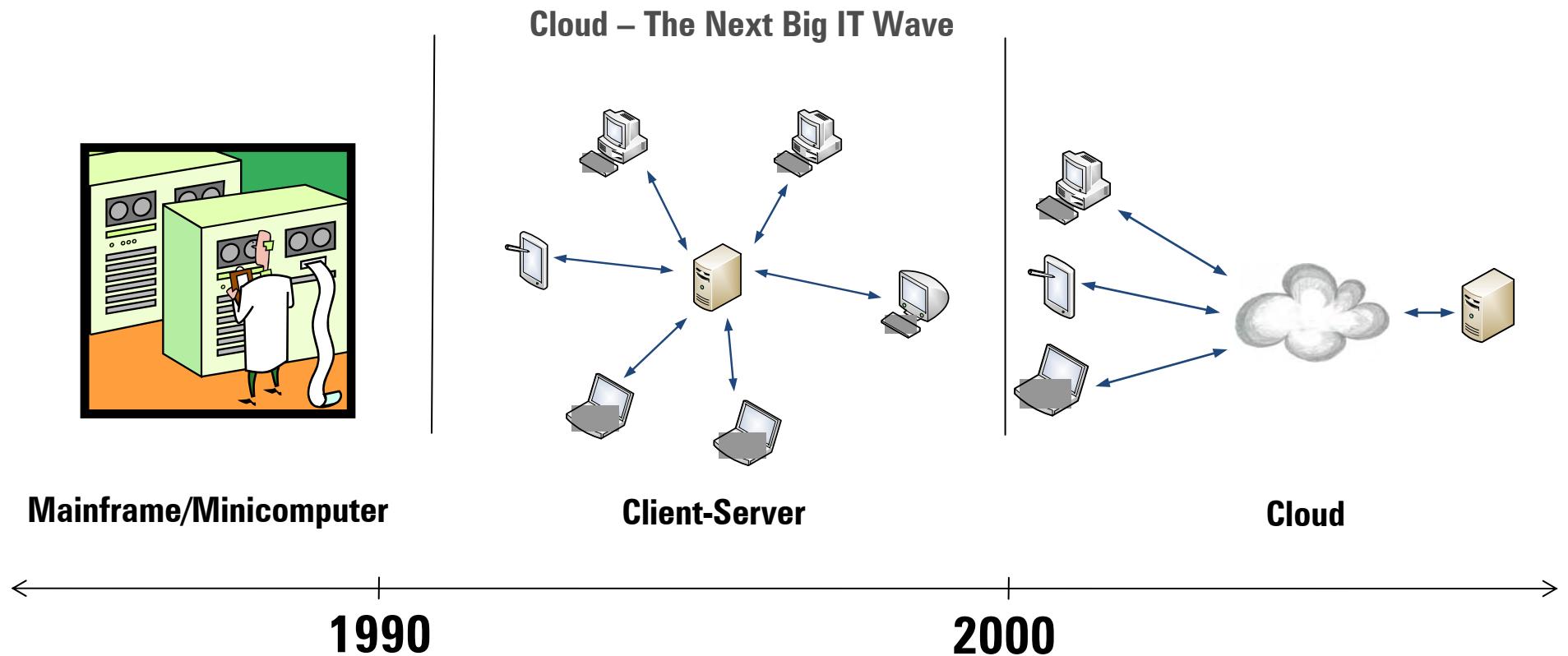
Although individual opportunities exist in other industries, hardware industry is significantly undervalued. Why?

- Canary in coalmine? HP, Dell and Cisco sluggish outlook was expected. But F5, NetApp, Riverbed slowing?
- Chipmakers Cautious in 2Q and 3Q. Typical cyclical pattern → chips, hardware, software services.
- Cyclical aside, hardware vendors face significant **secular** headwinds.

## Cloud Computing Long-run Threat to Hardware Vendors

*"In Silicon Valley you cannot go to a VC and get money to buy hardware, and they in fact aren't going to give you the money. They are going to say go get it from cloud. Because you have an unknown business model, they don't want to take the risk in that and you only want to pay for what you use."*

9/14/2011 - Lew Tucker, VP and CTO, Cloud Computing, Cisco

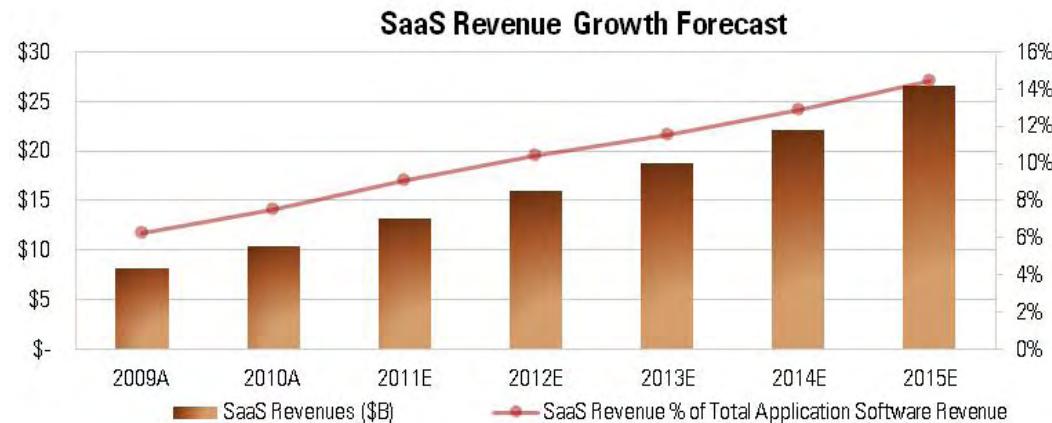


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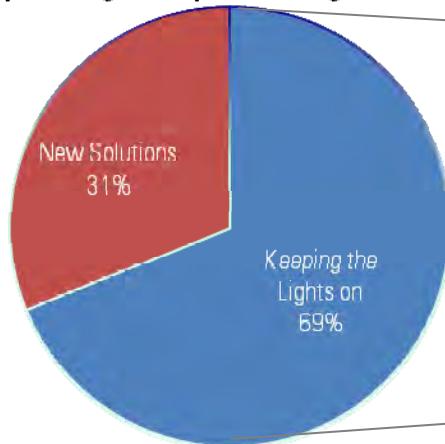
## Cloud...

- ▶ Concentrates Customer Base
- ▶ Reduces Customer Switching Costs
- ▶ Emphasizes Best of Breed
- ▶ Rewards Innovation
- ▶ Commoditizes Standards-based Solutions
- ▶ Consolidates Under-Utilized Hardware

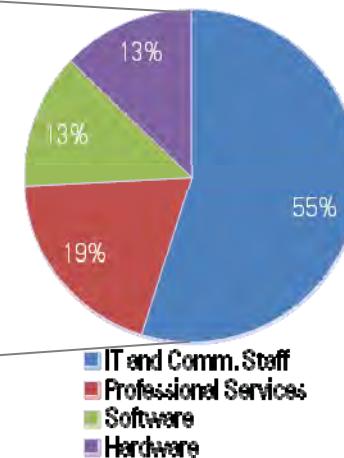
Figures 6, 7: SaaS vendors should grow quickly as corporations look to reduce IT spend



Typical Large Enterprise IT Budget Allocation



"Keeping the Lights on"



Source: IDC, Forrester, Gartner, Morningstar estimates

Figure 9: Competitive lines continue to blur among large vendors

	Private Cloud Portfolios						Recent Acquisitions	Acquisition Candidates
	Oracle	IBM	HP	Dell	Microsoft	VCE		
<b>Business Intelligence</b>	●	●	○	○	●	●		SAS Institute, TIBX, MSTR
<b>Data Warehouse</b>	●	●	●	○	●	●		
<b>Application Software</b>	●	○	○	○	●	○	LWSN, AU	SAP, JDAS, LWSN, TDC, EPIC, PEGA, OTEX, AU
<b>Middleware</b>	●	●	○	○	●	○		RHT, TIBX
<b>Database Software</b>	●	●	○	○	●	○		PostgreSQL, Ingres
<b>Operating System</b>	●	●	○	○	●	○		RHT, NOVL
<b>Virtualization (x86)</b>	●	○	○	○	●	●		CTXS, RHT
<b>Systems Management</b>	●	●	●	○	●	●	newScale	BMC, CA, SWI, QSFT, CPWR
<b>Application Delivery</b>	○	○	○	○	○	●	Zeus	FFIV, CTXS, RDWR
<b>Storage Solutions</b>	●	●	●	●	○	●	PAR, CML, ISLN, Pillar	ISLN, CVLT, CML, NTAP
<b>Server Hardware</b>	●	●	●	●	○	●		BNT, COMS, Force10
<b>Networking</b>	○	○	●	●	○	●		BRCD, JNPR
<b>Security</b>	○	●	●	●	○	●	ArcSight	CHKP, FIRE, FTNT, WBSN

● Has a comprehensive solution  
 □ Has a partial solution  
 ○ Lacks a substantial solution

### Software Vendors Have Upper Hand

- Higher customer switching costs
- More control over development roadmaps
- Moore's Law

*"I don't care if our commodity x86 business goes to zero. We don't make any money selling those things. We have no interest in selling other people's IP. Commodity x86 includes Intel IP, Microsoft IP... we have interest in selling systems that include our IP."*

Larry Ellison, Oracle, 9/20/2011

## Cloud Losers - Hardware

- Lack of Customer Switching Costs
- Component Suppliers to OEMs
- Feature of the Cloud
- Wrong Side of Disruptive Forces
- Limited Profitable Reinvestment Opportunities
- Classic Value Traps

### Significant Pressure Over Long-run **STX, BRCD, GRMN, RIMM**

COMPARABLES												
Company	Ticker	Stock Price	FVE	P/FV	Market Cap	Economic Moat	Moat Trend	Enterprise Value	1-yr fwd EV/EBITDA	2-yr fwd EV/EBITDA	5-yr EBITDA CAGR	
Brocade	BRCD	\$4.42	\$4	1.11	\$ 2,214	None	Stable	2,452	5.2x	5.1x	3.8%	
Garmin	GRMN	\$35.29	\$26	1.36	\$ 6,846	None	Negative	2,962	5.4x	5.1x	-8.5%	
RIM	RIMM	\$18.74	\$26	0.72	\$ 9,417	None	Stable	10,849	2.8x	3.4x	-20.4%	
Seagate	STX	\$16.74	\$12	1.40	\$ 7,031	None	Stable	5,819	3.9x	4.1x	-3.8%	
<b>Average</b>				<b>1.2</b>	<b>\$ 6,939</b>			<b>4,391</b>	<b>4.6x</b>	<b>4.6x</b>	<b>-6%</b>	

Sources: Morningstar Estimates

## Cloud Winners – Hardware

- Cloud Friendly
- Platforms
- Increasing Customer Switching Costs
- Innovative Solutions

### Six Solid Long-term Cloud Plays **AAPL, RVBD, EMC, NTAP, ARUN, FFIV**

- Consider Buy – AAPL, EMC
- Wait for Discount – RVBD, NTAP, ARUN, FFIV

COMPARABLES												
Company	Ticker	Stock Price	FVE	P/FV	Market Cap	Economic Moat	Moat Trend	Enterprise Value	1-yr fwd EV/EBITDA	2-yr fwd EV/EBITDA	5-yr EBITDA CAGR	
Apple	AAPL	\$397.39	\$530	0.75	\$ 370,367	Narrow	Positive	396,724	11.6x	9.1x	23.6%	
Riverbed	RVBD	\$25.72	\$30	0.86	\$ 4,218	None	Positive	3,861	32.4x	21.x	51.6%	
EMC	EMC	\$24.34	\$30	0.81	\$ 49,678	Narrow	Negative	57,867	13.3x	11.6x	12.4%	
NetApp	NTAP	\$40.54	\$46	0.88	\$ 15,284	Narrow	Negative	14,518	13.x	11.3x	12.5%	
<b>Average</b>				<b>0.8</b>	<b>\$ 32,481</b>			<b>36,193</b>	<b>13.2x</b>	<b>11.5x</b>	<b>18.1%</b>	

Sources: Morningstar Estimates

## Attractive Opportunities Exist in the Middle

- Conflicting Exposures
- Innovator's Dilemma
- Valuations Depressed
- Look for Customer Switching Costs
- Strategy to Navigate Disruption
- Shareholder Friendly Behaviors

### Inflections Create Discounts CSCO, JNPR, HPQ

COMPARABLES												
Company	Ticker	Stock Price	FVE	P/FV	Market Cap	Economic Moat	Moat Trend	Enterprise Value	1-yr fwd EV/EBITDA	2-yr fwd EV/EBITDA	5-yr EBITDA CAGR	
Cisco	CSCO	\$17.59	\$26	0.68	\$ 95,866	Wide	Negative	122,667	12.4x	11.1x	4.5%	
Juniper	JNPR	\$23.28	\$30	0.78	\$ 12,269	None	Positive	13,053	13.3x	12.6x	10.1%	
HP	HPQ	\$25.64	\$45	0.57	\$ 51,998	Narrow	Negative	117,241	7.1x	6.9x	2.3%	
<b>Average</b>				<b>0.7</b>	<b>\$ 51,998</b>			<b>117,241</b>	<b>12.4x</b>	<b>11.1x</b>	<b>4.5%</b>	

Sources: Morningstar Estimates