

Small Stocks

## Small Tech, Big Gains

Jim Oberweis, 02.08.10, 12:00 AM ET

In 2008 fear was king. Virtually everybody, including big companies, pulled back the reins. It's no surprise that investments in large-scale technology infrastructure sank amid the uncertainty. Still tech innovation marched on. Smart phones like the iPhone and BlackBerry are everywhere, with such minicomputers requiring more bandwidth for data and video. While the appetite for bandwidth increases, the network investment to provide it is not keeping pace. Similarly, semiconductor chip sizes continue to shrink, but investment in the new equipment to make smaller chips has fallen. According to Gartner Group, global semiconductor industry capital spending declined 32% in 2008 to \$31 billion and further declined an estimated 43% in 2009. But technology capital investments can't be put off forever.

Confidence is returning to our economy. I expect 2010 to be a very good year for tech stocks, despite the run-up we saw in 2009. In particular, I'm betting on companies building the latest-generation semiconductors or facilitating greater network bandwidth. Gartner Group predicts capital spending in the chip business will increase 45% in 2009. Here are three tech stocks I think will benefit from the rebound:

Ottawa's DragonWave (DRWI, 13) sells wireless technology to expand so-called backhaul capacity. Explosive demand for data and video on smart phones is creating a bottleneck for backhaul, which refers to the connection between cellular towers and a fiber network. In the U.S., towers are usually connected to core networks via copper wires. In Europe and Asia, wireless microwave technology dominates. The problem is that copper wires don't have enough capacity. A wireless backhaul can fill the void.

abi Research predicts that demand for backhaul will grow at a compound annual rate of 30% through 2014, with microwave wireless taking the lion's share of new business. Clearwire, a new carrier backed by Sprint, Comcast and Time Warner, is building out the first nationwide superfast 4G WiMax network that uses wireless backhaul and primarily relies on DragonWave. The relationship is a coup for DragonWave, as Clearwire is armed with cash and is spending it to expand its network from 29 cities to 80 with 120 million potential customers.

An investment in DragonWave has a big risk. Clearwire accounts for 80% of DragonWave's revenues. I expect this concentration to decline as new customers sign on, driving revenue growth of at least 40% a year. I am estimating earnings per share of \$1.05 for the year ending February 2011. Shares trade for 11 times that forward estimate.

Another beneficiary of rising bandwidth demand is NetLogic Microsystems (NETL, 45). This Silicon Valley firm makes semiconductors that manage traffic across next-generation Internet networks, particularly within multimedia networks that carry voice, data and video. NetLogic chips allow network providers to prioritize network traffic, slowing down low-priority traffic like

e-mails and accelerating delivery of high-priority traffic like streaming video. This convergence of voice and data networks, paired with the growth in bandwidth, increases the need for packet prioritization. As with DragonWave, investors in NetLogic need to be aware of concentrated customer risk: Cisco accounted for 40% of revenues in the third quarter. My expectation is for revenue, helped by two acquisitions late in 2009, to grow 80% in 2010 and for the company to earn \$1.90 a share; shares go for 24 times that number.

Here's one more bet on a rebound for semiconductors. Nanometrics (NANO, 12) in Milpitas, Calif. supplies measuring systems for manufacturing advanced semiconductors. The company has an installed base of 6,000 systems at 150 factories for customers like Samsung, Intel and Toshiba. As chip lines shrink below 32 nanometers, metrology systems that monitor the physical, optical and material characteristics become more important. Like most semiconductor capital equipment providers, Nanometrics suffered during the downturn but should rebound in 2010. I estimate revenues will increase 76% in 2010, and earnings per share will swing from a loss of 68 cents to a profit of 56 cents. The stock sells for 20 times the latter number.

Like other columnists, I am obliged to report how I did in 2009. I'm happy to report that a \$10,000 investment in each of my 24 picks would have gained 50.6% by Dec. 31, versus 27% for someone putting the same money on the same dates into the S&P 500. (My picks, but not the benchmark, were docked 1% for transaction costs.) I am going to hold on to ten of these picks for the next derby (for details see [forbes.com/oberweis](http://forbes.com/oberweis)). Small caps are still the place to be in 2010.

Investment	Issue Date <sup>1</sup>	Issue Price	Publishing Date	Publishing Price <sup>2</sup>	12/31/09 Price <sup>3</sup>
Home Inns & Hotels ManagementH	2/2/09	\$10.00	1/14/09	\$7.81	\$35.35
VisionChina MediaH	2/2/2009	7.00	1/14/09	6.30	10.92
Neutral TandemH	2/2/2009	16.00	1/14/09	16.95	22.75
GenoptixH	2/2/09	32.00	1/14/09	34.82	35.53
HMS HoldingsH	2/2/2009	30.00	1/14/09	29.45	48.69
American SuperconductorH	7/13/09	25.00	6/24/09	24.93	40.90
ArcSightH	7/13/09	17.00	6/24/09	16.96	25.58
AsiaInfoH	10/5/09	18.00	9/16/09	18.99	30.45
ImaxH	10/5/09	9.00	9/16/09	9.85	13.31
STECH	10/5/09	39.00	9/16/09	37.90	16.34
H: Holdover from 2009 portfolio					
1: Issue prices rounded to nearest dollar.					
2: Stock prices are tracked as of the publishing date - 19 days prior to the issue date.					
3: Portfolio holdovers are tracked from the beginning of the calendar year, and does not include a 1% transaction cost.					
All prices in USD					

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