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## Extreme Networks

NASDAQ: EXTR

**Buy**

**March 5, 2002**

**S&P Sector – Information Technology**

**Industry – Computer Networking**

### MARKET DATA

Price	52-Wk Range	Price Target	Shares Out.	Market Cap.	Book Value	Beta	Price to Earnings	Price to Sales	5 Year Growth
3/5/02 Close	Low Sept 27 '02	Valuation Result	(Million)	(Million)	Per Share	Bloomberg	Forward	(ttm)	(Annual)
\$8.71	\$5.85 to \$40.00	\$14.58	114.6	\$827.4	\$4.49	2.096	105.2	1.86	29.8%



### COMPANY OVERVIEW – FROM YAHOO! FINANCE

Extreme Networks, Inc. is a provider of network infrastructure equipment for business applications and services. The Company delivers high-performance application and services infrastructure for enterprise, service provider and metropolitan area networks (MANs)-based on technology that combines high performance, intelligence and a low cost of ownership. The Company's family of Summit stackable, BlackDiamond and Alpine chassis switches share the same consistent hardware, software and management architecture, enabling businesses to build a network infrastructure that is simple, easy to manage and scalable to meet the demands of growing businesses.

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### INVESTMENT RECOMMENDATION:

Buy 400 shares of EXTR

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### SUMMARY

- ❑ Extreme reported fiscal second quarter results revenue of \$109 million and EPS of \$0.02 in line with pre-released results. For the FY02, revenue estimate is \$456.8 million down 7% from FY01 revenues of \$491.2 million due to weak market conditions. However, FY03 revenue is expected to increase 32% according to S&P as spending in networking equipment picks up.
- ❑ Based on FY02 free cash flow of \$0.81 per share, a discount rate of 17% and FCF growth of 15% for the next three years, followed by 30% for the following three years, and 2.5% terminal growth – the fair value of Extreme Networks is \$14.58. This represents a 67.4% upside potential.
- ❑ Extreme Networks is well positioned to improve its cash flows as demand for computer networking equipment picks up. Demand for the metropolitan networking market particularly is expected to pick up. Extreme is a leader in this segment with its 10Gb Ethernet and Internet Protocol (IP) technology.

- ❑ Extreme recently got re-elected to the IEEE 10 Gigabit Ethernet Alliance in recognition of its leadership role in the development of Ethernet technology. Extreme clearly has demonstrated its innovative ability.
- ❑ Next major build out by the enterprise and service provider markets will be focused on the metropolitan market. Extreme has a complete suite of product offering capable of migrating legacy systems to the new Ethernet technology.
- ❑ Extreme Networks has roughly 20% market share in the 10Gb Ethernet market. Revenue likely to increase 13-15% over the two to three years and more aggressively at 30% according to consensus estimates. Due to minimal pricing pressures and improving operating margins, Extreme's cash flows should significantly improve.
- ❑ Management expects operating margins to improve dramatically from the current 1 – 2% levels to around 15 – 20%. Extreme Networks is implementing customized ERP and CRM systems companywide to reduce COGS, sales, and marketing expenses.

## INDUSTRY INSIGHT

### News & Trends

The slowdown in the U.S. economy has had a dramatic effect on equity markets in general. With weak service provider and large enterprise capital expenditure projections in technology, the computer networking industry has been hit particularly hard. With the Fed's recent decision to not reduce interest rates further, the outlook seems to be improving. We believe inventory levels are running low and most companies are done with their restructuring programs. The economic recovery will boost capital expenditures aiding networking companies.

S&P expects the computer networking products market to grow at 30% annually in the next three to five years.

The computer networking industry is expected to recover ahead of the telecom equipment sector. This can be attributed to the fact that global enterprise spending should pick up prior to spending in the saturated telecom market. There is an overcapacity in the long haul markets and growth is expected in the local and metropolitan markets. Enterprises are expected to begin a network upgrade cycle to 10Gb Ethernet, a product Extreme continues to lead in innovation.

## INVESTMENT HIGHLIGHTS

### Overall Effect on Wright Fund

Currently, Wright Fund's information technology sector is under-weighted at 7.1% vs. S&P's recommended weighting of 17.8%. Purchasing EXTR will increase the sectors weight to 7.6%. The stock's latest close on March 5, 2002 was \$8.71 compared to its 52 week low of \$5.85 and 52 week high of \$40.00.

Based on our recent analysis of the computer networking sector, we have recommended that the sector be market-weight in relation to the S&P 500 index. We are recommending buying EXTR as it presents a valuable investment opportunity.

**Rationale & Risks** EXTR has significant upside potential. If our assumptions about EXTR's growth and management's effectiveness prove correct, the target price of \$14.58 represents a 67.4% growth potential. The inherent risks are a delay in capex spending in the industry due to a prolonged slow down and management's inability to achieve 10 – 15% operating margins.

<b>FINANCIAL INFORMATION</b>
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**Earnings & Growth Estimates:**

Earnings Estimates	Qtr(3/02)	Qtr(6/02)	FY(6/02)	FY(6/03)
Average Estimate	0.02	0.04	0.08	0.27
Number of Analysts	21	19	24	24
High Estimate	0.04	0.04	0.12	0.40
Low Estimate	-0.01	0.02	-0.02	-0.08
Year Ago EPS	-0.07	-0.01	NA	0.08
Growth Rate	135.37%	457.89%	NA	257.38%

Earnings Growth Rates	Last 5 yrs.	FY 2002	FY 2003	Next 5 yrs.	02 P/E
Company	NA	-30.70%	257.40%	29.80%	105.20
Industry	-8.80%	-8.70%	29.50%	27.40%	-35.20
S&P 500	8.40%	-21.70%	12.40%	7.50%	26.20

Zacks Industry: COMP-NETWORKS

**Recent Annual Financials (from MSN Money)**

<b>Annual Income Statement (Values in Millions)</b>	<b>6/2001</b>	<b>6/2000</b>	<b>6/1999</b>	<b>6/1998</b>
Sales	491.2	262.0	98.0	23.6
Cost of Sales	261.9	119.8	42.6	13.4
Gross Operating Profit	229.3	142.2	55.4	10.2
Selling, General & Admin. Expense	274.4	111.7	51.0	22.7
Other Taxes	0.0	0.0	0.0	0.0
EBITDA	-45.1	30.5	4.4	-12.5
Depreciation & Amortization	56.9	14.2	5.9	1.6
EBIT	-102.0	16.3	-1.5	-14.1
Other Income, Net	10.8	14.6	1.9	0.4
Total Income Avail for Interest Exp.	-91.2	30.9	0.4	-13.7
Interest Expense	0.4	0.5	0.4	0.3
Minority Interest	0.0	0.0	0.0	0.0
Pre-tax Income	-91.6	30.4	0.0	-14.0
Income Taxes	-22.7	10.3	1.7	0.0
Special Income/Charges	0.0	0.0	0.0	0.0
Net Income from Cont. Operations	-68.9	20.0	-1.6	-13.9
Net Income from Discont. Oper.	0.0	0.0	0.0	0.0
Net Income from Total Operations	-68.9	20.0	-1.6	-13.9
Normalized Income	-68.9	20.0	-1.6	-13.9
Extraordinary Income	0.0	0.0	0.0	0.0
Income from Cum. Eff. of Acct. Chg.	0.0	0.0	0.0	0.0
Income from Tax Loss Carryforward	0.0	0.0	0.0	0.0
Other Gains (Losses)	0.0	0.0	0.0	0.0
<b>Total Net Income</b>	<b>-68.9</b>	<b>20.0</b>	<b>-1.6</b>	<b>-13.9</b>
Dividends Paid per Share	0.00	0.00	0.00	0.00
Preferred Dividends	0.00	0.00	0.00	0.00
Basic EPS from Cont. Operations	-0.64	0.20	-0.09	-1.59
Basic EPS from Discont. Operations	0.00	0.00	0.00	0.00
Basic EPS from Total Operations	-0.64	0.20	-0.09	-1.59
Diluted EPS from Cont. Operations	-0.64	0.18	-0.09	-1.59

Diluted EPS from Discont. Operations	0.00	0.00	0.00	0.00
Diluted EPS from Total Operations	-0.64	0.18	-0.09	-1.59

Annual Balance Sheet (Values in Millions)	6/2001	6/2000	6/1999	6/1998
<b>Assets</b>				
<b>Current Assets</b>				
Cash and Equivalents	87.7	116.7	107.1	9.5
Receivables	75.7	61.0	20.8	7.8
Inventories	60.5	23.8	2.6	0.1
Other Current Assets	126.8	100.9	18.4	11.6
Total Current Assets	350.8	302.5	149.0	29.0
<b>Non-Current Assets</b>				
Property, Plant & Equipment, Gross	81.2	36.0	14.0	6.3
Accum. Depreciation & Depletion	23.9	9.2	7.5	1.8
Property, Plant & Equipment, Net	57.3	26.8	6.5	4.5
Intangibles	113.9	49.8	0.0	0.0
Other Non-Current Assets	166.4	136.9	16.3	0.2
Total Non-Current Assets	337.6	213.5	22.8	4.7
<b>Total Assets</b>	<b>688.4</b>	<b>515.9</b>	<b>171.8</b>	<b>33.7</b>
<b>Liabilities &amp; Shareholder's Equity</b>				
<b>Current Liabilities</b>				
Accounts Payable	35.9	39.0	13.4	10.0
Short Term Debt	0.0	0.0	1.6	1.4
Other Current Liabilities	103.5	57.5	14.9	3.9
Total Current Liabilities	139.3	96.6	29.9	15.3
<b>Non-Current liabilities</b>				
Long Term Debt	0.0	0.3	0.0	2.6
Deferred Income Taxes	0.0	0.0	0.0	0.0
Other Non-Current Liabilities	0.3	0.0	0.0	0.0
Minority Interest	0.0	0.0	0.0	0.0
Total Non-Current Liabilities	0.3	0.3	0.0	2.6

<b>Total Liabilities</b>	<b>139.7</b>	<b>96.8</b>	<b>29.9</b>	<b>17.9</b>
<b>Shareholder's Equity</b>				
Preferred Stock Equity	0.0	0.0	0.0	0.0
Common Stock Equity	548.8	419.0	141.9	15.9
<b>Total Equity</b>	<b>548.8</b>	<b>419.0</b>	<b>141.9</b>	<b>15.9</b>
<b>Total Liabilities &amp; Stock Equity</b>	<b>688.5</b>	<b>515.8</b>	<b>171.8</b>	<b>33.8</b>
Total Common Shares Outstanding	113.4 Mil	106.7 Mil	98.7 Mil	23.6 Mil
Preferred Shares	0.0	0.0	29.1 Mil	29.1 Mil
Treasury Shares	0.0	0.0	0.0	0.0

<b>Annual Cash Flow (in Millions)</b>	<b>6/2001</b>	<b>6/2000</b>	<b>6/1999</b>	<b>6/1998</b>
<b>Cash Flow from Operating Activities</b>				
Net Income (Loss)	-68.9	20.0	-1.6	-13.9
Depreciation and Amortization	56.8	14.2	5.9	1.6
Deferred Income Taxes	-64.2	0.0	0.0	0.0
Operating (Gains) Losses	121.9	0.4	0.9	0.0
Extraordinary (Gains) Losses	0.0	0.0	0.0	0.0
<b>Change in Working Capital</b>				
(Increase) Decr. in Receivables	-20.0	-40.2	-13.0	-7.5
(Increase) Decr. in Inventories	-69.5	-21.2	-2.5	-0.1
(Increase) Decr. in Other Curr. Assets	-3.0	-18.8	-1.4	-0.6
(Decrease) Incr. in Payables	-3.3	25.6	3.4	9.2
(Decrease) Incr. in Other Curr. Liabs.	45.4	44.8	10.9	3.1
Other Non-Cash Items	0.0	0.0	0.0	0.0
Net Cash from Cont. Operations	-4.7	24.8	2.8	-8.3
Net Cash from Discont. Operations	0.0	0.0	0.0	0.0
<b>Net Cash from Operating Activities</b>	<b>-4.7</b>	<b>24.8</b>	<b>2.8</b>	<b>-8.3</b>

### Cash Flow from Investing Activities

#### Cash Flow Provided by:

Sale of Property, Plant, Equipment	0.0	0.0	0.0	0.0
Sale of Short Term Investments	8.4	0.0	14.0	0.0

#### Cash Used by:

Purchase of Property, Plant, Equipmt.	-50.0	-27.2	-7.5	-2.5
Purchase of Short Term Investments	0.0	-158.8	-35.7	-11.0
Other Investing Changes Net	-7.8	-9.0	0.0	0.0

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<b>Net Cash from Investing Activities</b>	<b>-49.4</b>	<b>-195.0</b>	<b>-29.1</b>	<b>-13.5</b>
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**Cash Flow from Financing Activities****Cash Flow Provided by:**

Issuance of Debt	0.0	0.0	0.8	1.6
Issuance of Capital Stock	25.1	181.4	126.6	20.4

**Cash Used for:**

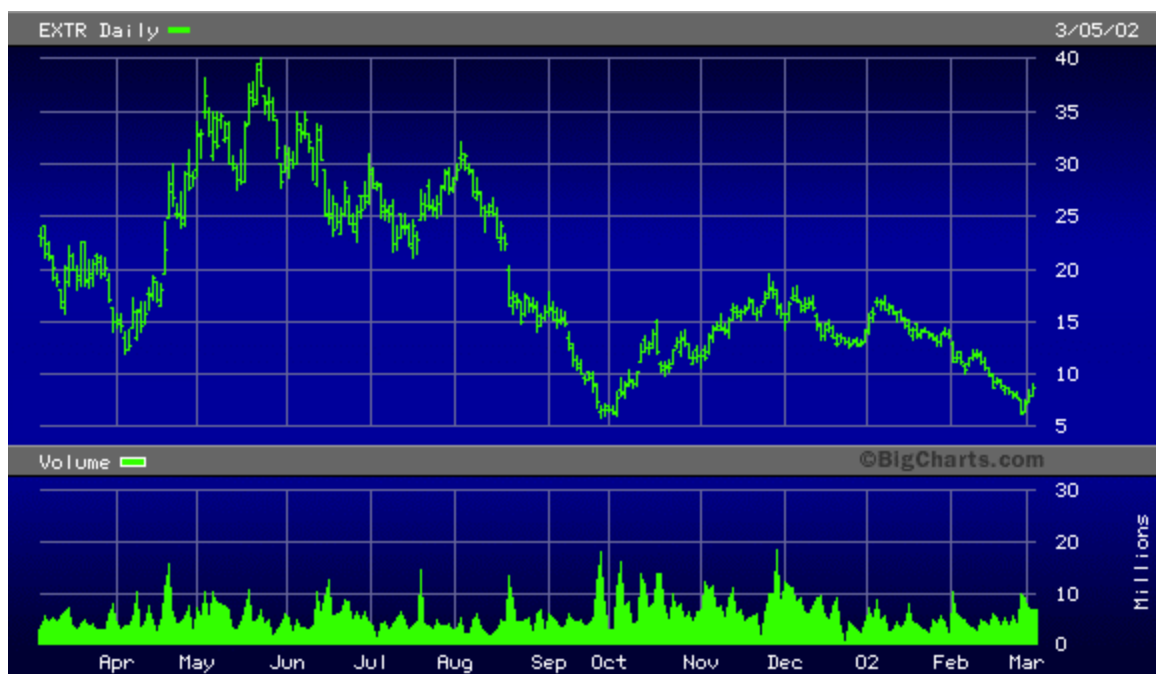
Repayment of Debt	0.0	-1.6	-3.4	-0.8
Repurchase of Capital Stock	0.0	0.0	0.0	0.0
Payment of Cash Dividends	0.0	0.0	0.0	0.0
Other Financing Charges, Net	0.0	0.0	0.0	0.0

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<b>Net Cash from Financing Activities</b>	<b>25.1</b>	<b>179.7</b>	<b>124.0</b>	<b>21.2</b>
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Effect of Exchange Rate Changes	0.0	0.0	0.0	0.0
Net Change in Cash & Cash Equivalents	-29.0	9.6	97.6	-0.5
Cash at Beginning of Period	116.7	107.1	9.5	10.0
Free Cash Flow	-54.7	-2.4	-4.7	-10.8

<b>CHARTS / TECHNICAL</b>
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### COMPUTER NETWORKING CORRELATION MATRIX

	<i>EXTR</i>	<i>CSCO</i>	<i>ETS</i>	<i>JNPR</i>	<i>COMS</i>	<i>RSTN</i>
<i>EXTR</i>	1					
<i>CSCO</i>	0.48	1				
<i>ETS</i>	0.87	0.59	1			
<i>JNPR</i>	0.70	0.43	0.68	1		
<i>COMS</i>	0.35	0.58	0.16	0.50	1	
<i>RSTN</i>	0.63	0.69	0.71	0.30	0.43	1