Team David's Review

David Gardner and The Stock Advisor Team | December 18, 2009 | Core , Best Buys Now

CURRENT PRICE: NVDA $ 383.36 ↑ $ 2.29 (0.6%) ĆẉǜĜ Ýṙ Ḃ≈ÃŐĜ`ÃẤ`ÃẬÃ ǜṈ ǜ

Our review goes in depth on our rerecommendation, Best Buys Now, Core companies, and stocks on hold. Click on a company name below to jump to its entry, and read our commentary on all of David's stocks in our Report Card.

- **Re-Recommendation:** Nvidia
- **Best Buys Now:** Apple, DreamWorks Animation, Hasbro, Medco Health, Netflix
- **Core Stocks:** Activision Blizzard, Amazon.com
- **On Hold:** Embraer, GameStop, Marvel, Mobile Mini

NVIDIA

What It Does:

Nvidia designs processors that power video games, mobile devices, and more.

Why Buy:

- Personal and business applications demand high-end graphics.
- Intel just scrapped a rival technology, which adds to Nvidia's leadership and competitive moat.
- As the technology cycle turns, today's price will look like a steal.

Key Facts:

- **Recent Price:** $15.65
- **Risk Level:** High
- **Industry Position:** Innovator
- **Market Cap:** $8,680
- **Cash/Debt:** $1,634 / $25

NVIDIA CORPORATION IN 1 MINUTE

What It Does

Nvidia deals in programmable graphics-processor technologies. Its major business segments are graphics processing units, media and communications processors, and handheld and consumer electronics.

Company Guide

- **Industry:** Semiconductors and Semiconductor Equipment
- **Asset Class:** Large
- **Region:** US
- **Price on June 21, 2020:** $ 381.07

Key Data

- **Headquarters:** Santa Clara, CA, US
- **Sector:** Technology
- **Market Cap:** $9B

Add NVDA to Your Favorites

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- **Revenue (TTM/'08/'07):** $2,825 / $3,425 / $4,098
- **Earnings (TTM/'08/'07):** ($347) / ($30) / $798
- **Insider Ownership:** 4%
- **Biggest Threat:** Intel Inside, AMD Outside
- **The Team Says: Image Is Everything**
- Own Nvidia? Add it to My Scorecard
- Want to know more? Join the Nvidia discussion

Data as of 12/15/09. Dollar amounts in millions except recent price.

Re-Recommendation: Nvidia

Nvidia (NASDAQ: NVDA) makes a business of crystal-clear graphics, but its bright future lies in blurring the line between graphics and computing. When I first recommended this chip maker in 2005, graphics processing units were just an add-on for game enthusiasts. Today, they're essential to how we all use computers, opening up all kinds of new growth opportunities for this market leader. The stock is already a winner — up more than 120% since that initial selection — and our opportunity is timely once again, which makes Nvidia my top pick today.

Intel, which knows a thing or two about microprocessors, just scrapped its plans to sell a discrete graphics processor, putting the much-anticipated Larrabee chip on hold indefinitely. That's a strong statement about Nvidia's technological leadership and competitive moat, and the unexpected withdrawal of a heavyweight contender leaves the market where it has long been: shared between Nvidia and the ATI Technologies division of AMD. But now, it's about to get a lot bigger.

What's really interesting are the emerging growth opportunities Intel is conceding to its rivals. Nvidia's products are more vital than ever, because even nongamers perform graphically demanding tasks such as streaming high-definition video and editing photos and home movies. Both Microsoft's Windows 7 and Apple's OS X hand off these tasks and more — the visual portion of programs, even the operating system itself — to graphics processors. That makes Nvidia's products seamlessly integral to your computer's performance. Increasingly, computing means *visual* computing. Graphics aren't just an output but an important part of how we interact with a computer — just think of the touch screen on an iPhone.

It's easy to see how Nvidia is making the jump from technical concepts to real-world rewards. First, with the release of Windows 7 and an upgrade cycle slowed by the recession and the unpopularity of Vista, we're long overdue for more individuals and businesses to buy new PCs. That will directly benefit Nvidia, which has relationships with most major manufacturers. We also expect touch screens to become more common on notebooks and PC monitors, which will boost the demand for high-performance graphics even further. Windows 7 supports multitouch screens — again, think of the iPhone — and this is where Microsoft sees the industry heading.

A second catalyst is Nvidia's Tegra chip for mobile devices. Imagine a phone with a touch screen interface that makes today's iPhone look downright clunky — that can play 1080p video and stream it to your TV. All of a sudden, your phone becomes a portable HD video drive. It's in the new Zune HD, and we expect the first Tegra-based smart phone to launch in the next few months. Considering Nvidia's cozy relationship with Apple, Tegra could show up in a future iPhone, as well.

Indeed, Nvidia's pipeline is bursting with new products. Its next-generation Ion chip for netbooks should launch in January, and the new Fermi architecture, which will eventually encompass all its high-end processors and secure Nvidia's position as the performance leader in graphics chips, is due later in the first quarter of 2010.

The timing is right, and so is the price. Nvidia just returned to profitability after three quarters in the red, and it has maintained a sterling balance sheet and strong cash flow. Analysts think Nvidia is on track to earn about $0.74 a share in fiscal 2011, which starts at the end of January. We think they're probably shooting too low. But even at that level, a forward P/E of 22 isn't too much to pay for a company with these stellar long-term prospects, particularly one that consistently produces better cash flow than earnings. Whether you're a Mac or a PC, you need Nvidia, and something that looks this sharp belongs in your portfolio.

Best Buy Now: Apple

As the first decade of the 21st century draws to a close, it's hard to resist admiring **Apple**'s (NASDAQ: AAPL) tremendous impact. After the iPod, iPhone, and Intel-based computers, what will the next decade bring? We're still in the early days of the smart phone revolution, and Apple, despite a legion of imitators, is likely to maintain a long lead.

It's no exaggeration to say that the iPod reinvented the music industry, and the iPhone is still radically transforming mobile applications. And as for that fabled tablet computer that may launch as soon as March, or maybe late in 2010, or maybe doesn't exist at all? We don't know more about it than any other pundits, but we do think Apple is primed to reinvent how we browse and read. Download Apple into your portfolio, and don't miss what this innovator does next.

Best Buy Now: DreamWorks Animation

CEO Jeffrey Katzenberg expects 2010 to be the biggest year in the history of **DreamWorks Animation** (NASDAQ: DWA). While we'd like to hear every exec say that every year, it's a big-time goal here, especially because 2009 turned out to be such an incredible year for the animated filmmaker. The 2008 blockbusters *Kung Fu Panda* and *Madagascar: Escape 2 Africa* continue to pay dividends through DVD and on-demand sales, while *Monsters vs. Aliens* grossed nearly $400 million in theaters worldwide. Those all helped DreamWorks earn $1.81 per share over the past 12 months, a 16% pickup from 2008.

Yet we see plenty of reasons to believe, as Katzenberg does, that 2010 will be even bigger. Three films are set to hit the screen, headlined by the fourth installment in the *Shrek* series, DreamWorks' biggest franchise. Another fantasy comedy, *How to Train Your Dragon*, comes out this spring, and *Oobermind*, a superhero spoof, debuts next fall. What's more, DreamWorks recently signed a licensing deal with THQ to develop a line of new video games based on its movies and characters. It's been a great year for DreamWorks, but 2010 has blockbuster written all over it. Buy some shares, grab the popcorn, and pull up a seat to watch.

Best Buy Now and Core Stock: Hasbro

Our newest Core company is picking up the mantle Marvel has set aside as it becomes a part of Disney. We're excited about **Hasbro**'s (NASDAQ: HAS) multimedia growth strategy, but we're even more pleased that management is focused on the core business: Hasbro just won a 10-year contract to sell *Sesame Street* products. It beat out larger rival Mattel for what Mattel's CFO recently called one of the toy industry's top 10 licensing deals. Hasbro won, reportedly, because it had a better strategy to make *Sesame Street* products a year-round rather than just a fourth-quarter brand, as Hasbro's chief marketing officer put it.

Hasbro has tracked a few points ahead of the S&P 500 since our re-recommendation in October, and you can still buy at a bargain valuation.

Best Buy Now: Medco Health

Medco Health (NYSE: MHS) is riding out the recession by saving consumers cash. The nation's largest pharmacy benefit manager runs prescription programs for insurance companies and government programs such as Medicare, and the more it encourages consumers to switch from name-brand drugs to generics, the higher margins it earns.

The company has grown like gangbusters in 2009 and expects to nearly double its operating cash flow and increase its return on invested capital from 20% to 25% by the end of the year. We're impressed with management's decision to spend $1.2 billion over the past 12 months to buy back nearly 29 million shares at an average price 35% below today's $65. Just as impressive, Medco is adding clients, taking New Jersey's Horizon Blue Cross and Blue Shield contract away from Caremark Rx, which is under FTC investigation. We expect more big wins in 2010. Medco's recent success is no flash in the pan, so you should take the chance to buy into this fast-growing company that benefits as consumers keep an eye on costs.

Best Buy Now and Core Stock: Netflix

The recession has made a lot of people eat their words about "recession-proof" businesses, as even seemingly safe industries like pharmaceuticals and utilities have taken it on the chin. But **Netflix** (NASDAQ: NFLX) sure looks like the real deal.

CEO Reed Hastings is one of our heroes here in Fooldom, for both his visionary leadership and his ability to continually prove the naysayers wrong. There aren't many companies with more than $1 billion in annual sales that increased earnings per share at a compound rate of 38% over these past two difficult years, but that's exactly what Netflix did. In fact, the company is on track to increase its revenue even faster this year than in 2007. And we expect a few more reels. A few years ago, Amazon and Wal-Mart were going to kill Netflix. Now it's Hulu and Google. Our prediction? Five years from now, Netflix will look stronger than ever.

Core Stock: Activision Blizzard

If you're looking for the industry poised to capture the winning share of the world's entertainment dollars in the decades to come, look to video games. And if you're looking for the world's top game, look no further than *Call of Duty: Modern Warfare 2*. The first-person shooter raked in more than $550 million in sales in its first five days, making it not only the best-selling new video game but the biggest *entertainment* release ever. Is it any wonder why we think **Activision Blizzard** (NASDAQ: ATVI) is your best bet to profit from this enormous trend?

Activision has a deep portfolio of proven franchises with potential blockbusters in the pipeline, including updates to its massively popular *Starcraft* and *World of Warcraft*. It benefits from the skillful stewardship of CEO Bobby Kotick and a war chest of almost $3 billion ready to develop the next blockbuster games. Yet the market continues to price the stock for low-single-digit growth over the next 10 years. We think Activision is going to do a lot better than that.

Core Stock: Amazon.com

Amazon.com's (NASDAQ: AMZN) success continues to impress: In the latest quarter, Amazon's sales climbed 28% over last year, while its profit soared 69%. Meanwhile, its online retail platform and hugely scalable virtual marketplace mean that expansion into new product lines and markets is efficient and cost-effective.

But even if Amazon's retail business slows, the Kindle, cloud computing initiatives, and new digital content platforms are turning the company into much more than just the most dominant online retailer. Founder and CEO Jeff Bezos — equal parts businessman and entrepreneur — is bent on turning his company into one of the world's premier providers of online services. Amazon's stock has plenty more room to run — and a place in any long-term investor's portfolio.

On Hold: Embraer

It hasn't been smooth flying for Brazilian jet maker **Embraer** (NYSE: ERJ) the past few years. High fuel prices and the global economic slowdown have severely dampened the demand for commercial airliners, just as the tough credit market makes it difficult for customers to place new orders. Embraer's order backlog has plummeted, and its balance sheet has shifted from a positive net cash position to having almost $450 million in net debt.

Yet we still see signs of hope, which is why we're not ready to give up on this story. Embraer's new $2.2 billion deal with a leasing unit of China Development Bank, to fund the sale of jets in Asia, has alleviated some concerns. And while business has been tough, Embraer's margins have held steady as management cut costs during the downturn.

We're still looking for evidence of a sustainable pickup in commercial aircraft demand, which would be the catalyst to get this stock off the ground again. **Don't start a new investment position, and if you own shares of Embraer, hold for now,** until the turbulence on the economic and credit fronts subsides.

On Hold: GameStop

GameStop (NYSE: GME) is fighting battles on several fronts. Video games sales have been sluggish this year. Best Buy and Wal-Mart have invested heavily in their game departments and encroached on GameStop's hallowed used-games business. And over the longer term, digital download services from Amazon.com and the game developers themselves threaten GameStop's middleman, bricks-and-mortar approach. So what will become of GameStop in an era devoid of video game DVDs and cartridges?

GameStop's stores remain popular among game enthusiasts, and by all measures, the stock looks cheap at $22. But we'd like to see the company more aggressively develop a competitive digital download service and pursue growth strategies more creative than simply opening new stores or acquiring other retail chains. **We're putting GameStop on hold** while we see if the business can adapt to the changing market.

On Hold: Marvel Entertainment

We're just a few weeks away from saying our final goodbyes to **Marvel** (NYSE: DIS). After nearly eight years in our service, *Stock Advisor*'s best performer — a 15-bagger and counting — is going to Disneyland. Shareholders are set to vote on the **Walt Disney** (NYSE: DIS) acquisition Dec. 31, and the buyout will almost certainly win approval, meaning the transaction will take place shortly afterward. Marvel owners should therefore expect to include the taxable cash portion of the deal on their 2010 tax returns.

We advise Marvel owners to hold onto their shares through the transaction and welcome Disney into your portfolios. Disney has an excellent future and, with good stewardship of our precious Marvel, is almost certain to be a long-term market beater.

On Hold: Mobile Mini

Last year's acquisition of competitor MSG hasn't turned out the way **Mobile Mini** (NASDAQ: MINI) hoped. The portable storage container company is now underperforming and overburdened with too much debt. Mobile Mini doubled the total capital invested in the business by adding $550 million in debt, but revenue and profit growth has been minuscule.

Without a residential or commercial real estate bubble in the cards, the company will have to rely on increased government infrastructure spending to fuel growth. The market seems optimistic in that stimulus catalyst, and the stock has rebounded. With a favorable valuation and no major debt repayments due until 2013, investors have time to be patient and see if the optimism is warranted. **We are storing Mobile Mini on hold** — don't buy shares for now — while we watch for business to improve.

David owns shares of Activision, Amazon.com, Apple, Best Buy, GameStop, Intel, Marvel, Microsoft, Netflix, and Walt Disney; Karl owns shares of Apple and Hasbro. The Motley Fool owns shares of Best Buy and Hasbro.

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