

Communications Equipment

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December 14, 2009

Communications Equipment (PLCM, RVSN)

Videoconferencing Technology from Vidyo Inc. Could Emerge as a Disruptive Force Over the Next 12-24 Months

- **Vidyo is positioning itself as a disruptive force to traditional players in the enterprise videoconferencing market.** We think Vidyo's use of the H.264 SVC protocol to introduce a cheaper, higher quality, videoconferencing solution aimed at the desktop has the potential to create significant disruption in the traditional conferencing market over the next 12-24 months. Radvision, which is facing challenges as it attempts to replace lost Cisco revenue has begun to adopt H.264 SVC, but faces the greatest near-term challenge as the industry consolidates. The company has fewer players to sell its technology to and we believe it has to pivot to potentially acquire or leverage the Vidyo technology to remain viable. Polycom is working to shore up its current business with the Cisco competitive threat looming. Polycom appears primarily focused on traditional conferencing technology. However, instead of simply offering an identical solution to Cisco's, we think the company should develop a longer-term focus on cutting-edge technology which would help them gain a missing competitive edge. Vidyo offers a compelling solution, which in the hands of an acquiring or partnering company could provide a significant advantage.
- **Vidyo's conferencing platform is beginning to resonate with customers as partner network expands.** Since the company began selling its product in mid-2008, the company has installed over 200 enterprise systems and has seen sustained revenue growth of over 35% in recent quarters despite the difficult spending environment. In addition, the company is gaining traction with large customers including Google, Hitachi, ShoreTel, Teliris as well as several OEM customers while offering integration capabilities with Microsoft's Office Communication Server. In addition, we think the company is working with several service providers to offer a managed services solution (e.g. video as a service). Note that at Polycom's most recent analyst day, Polycom also articulated a strategy whereby it would also start to target carriers. While we think the managed services opportunity could be large, we think it will be competitive and will take time to develop. The challenge for Polycom will be to develop an offering which approaches the economics of the solution offered by Vidyo.
- **We believe Vidyo's approach to videoconferencing could significantly alter the economics of the industry.** Relative to traditional videoconferencing players, Vidyo's solution offers lower up front cost for its HD solution than the competition with price points of \$1000 per port per year vs. \$5000-8000 per port in upfront costs and an additional 5-10% per year for service with legacy vendors. Furthermore, we think the Vidyo has lower total cost of ownership as the technology does not require dedicated networks and bandwidth, thus allowing customers to build videoconferencing capabilities on top of their existing infrastructure. Eliminating the MCU results in further benefits, including lower latency and a higher usability threshold should packet loss occur. In our view, a solution which offers a cheaper conferencing experience, with higher quality, represents a threat to traditional vendors and could alter the economics of the industry.
- **We think Vidyo's disruptive technology could represent both a threat and an opportunity to existing players such as Polycom and Radvision.** Management indicated that contrary to some public criticism, its videoconferencing solutions are interoperable with those of larger vendors by means of its Vidyo Gateway product. In addition, they noted that a large percentage of its installed base possessed a competing legacy solution and its customers would not have purchased the Vidyo solution if it was not interoperable with prior investments. The capacity of the system is higher than a traditional solution, allowing 50 people in a single conference. Given attractive economics and the high value that customers derive by their ability to deploy an enterprise-wide videoconferencing capability without the need of dedicated networks, we think that the Vidyo solution will emerge as a significant force in the industry over the next 12-24 months. Thus, we think the company represents a near to intermediate term threat to traditional conferencing vendors. In fact, we believe that Google could also emerge as an acquirer of the technology given its burgeoning desktop and mobile strategy. A potential deal with Google would pose a significant competitive threat to traditional videoconferencing vendors, in our view. The opportunity, in our view, is for a traditional vendor to acquire Vidyo. We think that should the technology be acquired by Radvision, Polycom, Logitech (LifeSize), or Cisco (Tandberg), the acquiring company will obtain a significant competitive advantage over their rivals. Note that Vidyo has indicated that its goal is to become a public company in the next 24 months.

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PRICE TARGETS and RISKS

- **We maintain our NEUTRAL rating and our \$25 target on shares of Polycom.** Our target represents a ~16x multiple on our CY10 cash-adjusted EPS estimate of \$1.26 plus \$4.73 in cash.
- **We maintain our UNDERPERFORM and our \$6 target on shares of Radvision based on our DCF analysis.**
- Risks to attainment of our Polycom share price target include increased competition, reduced IT spending by enterprise customers, slower than expected adoption of video communications, and channel execution.
- Risks to attainment of our Radvision share price target include faster than expected rollout of 3G, faster than expected adoption of video communications, failure of Cisco acquisition of Tandberg to win shareholder approval, decreased revenue concentration, and stronger than expected enterprise spending.

Covered public companies mentioned in this report (intraday 12/14/09)

COMPANY	TICKER	RATING	PRICE	PRICE TARGET
Radvision	RVSN	UNDERPERFORM	\$6.09	\$6.00
Cisco Systems	CSCO	OUTPERFORM	\$24.13	\$28.00
Polycom	PLCM	NEUTRAL	\$22.86	\$25.00

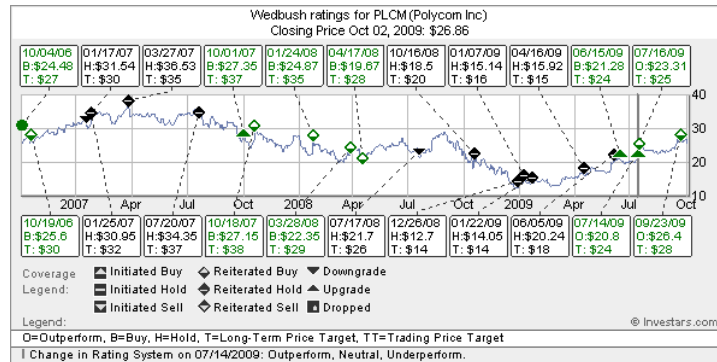
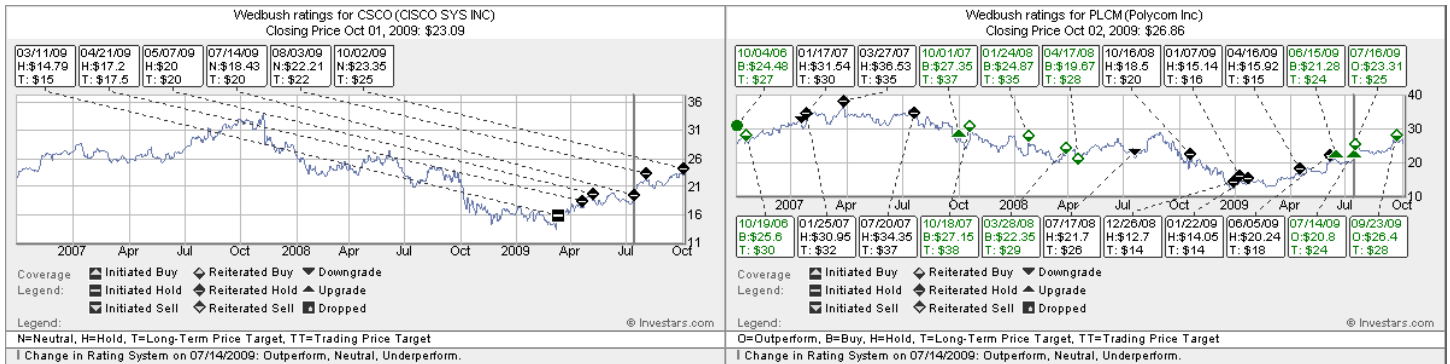
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* WS changed its rating system from (Strong Buy/Buy/Hold/Sell) to (Outperform/ Neutral/Underperform) on July 14, 2009.

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