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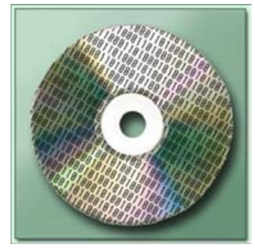

Embedded Systems Bulletin – September 2005

August News Wrap-Up

MontaVista Gets Real (Time)
WIND Gets Beaten (Up)

There were two pieces of news last month that got quite different reactions. The first, MontaVista's announcement of a real-time Linux breakthrough, received much less attention than was warranted, while Wind River's Q2 earnings announcement elicited a more violent reaction from the market than it deserved. VDC will address both issues in this bulletin.

MontaVista Software

MontaVista came out with a breakthrough in Linux real-time performance at the start of August that received only a slight interest from the market and media. MontaVista's long-term strategy has been to work only on native improvements for real-time Linux rather than on hybrid or dual OS strategies. Reportedly, the interrupt response improvements that MontaVista (and the community of developers contributing to the work) has seen are approaching the level previously only seen in a traditional RTOS.

VDC's View

Real-time performance is one of the key factors keeping Linux from being considered for many applications. Every time an improvement is made in Linux's real-time capabilities, it gains access to an even larger total available market. Based on VDC's data of developers' real-time requirements, MontaVista estimates next-generation commercial Linux offerings might have access to as much as half the embedded market. This does not mean that suddenly developers in those applications will jump to Linux, but it does mean there will now be another option when selecting an OS – an option that has proven compelling to many developers already.

There will always be a need for traditional RTOSs, but how much of the market will be the exclusive domain of very fast, small footprint and ultra reliable technology? While some traditional RTOS vendors have adopted a multi OS (Linux/RTOS) strategy or otherwise addressed Linux, these vendors see Linux as complementary, given its lack of real-time capabilities. However, as those capabilities improve, Linux will be more competitive to their traditional RTOS offerings.

Of course much of this work is confined to the lab and not quite ready for commercial use. VDC expects that if these improvements are as robust at MontaVista says they are, then look for them to be part of future kernel releases.

Wind River Systems (Nasdaq: WIND)

Wind River announced earnings on August 23 reporting revenue up 12% and net income up 73%. With such strong news, the market naturally hammered the stock. WIND had traded as high as $17 in early August and was trading at $15.73 before earnings. On August 31 it opened at $12.68. What made the market so jumpy? Some say a drop in short-term differed revenue (a key measure of the company's subscription licensing model and near-term growth), but others looked to Q3 outlook (WIND is forecasting 6-7 cents per share and the analysts are looking for 9 based on earlier guidance.)

VDC has no inside information regarding WIND reaching its numbers for the year, but this management team does have a track record of delivering. What caught our attention was the consistency between FY05 and FY06 trends, which would lead us to believe that the differed revenue decline and a flat Q2 to Q3 outlook is consistent with WIND's fiscal year cycle. In FY05, Q2 and Q3 revenues were $59.4million and $60 million respectively, essentially flat. In addition, FY05 deferred revenue dropped by 2.2% between Q1 and Q2. Again, this drop is consistent with this year's 3.9% decline during the same period.

VDC's View

It can be argued that the FY06 results and forecasts are a little more exaggerated in their cycles, however these movements need to be factored in when considering Wind River. As WIND transitions to a subscription business model and continues execute on its strategy, investors, analysts and market watchers will need to continually adjust their methods of evaluating this company. Of course, it will be essential for the company to educate the community on its evolving business model and direction.

VDC expects WIND will surprise over the estimate of $66-67 million, perhaps $68-69 million. That means WIND will need to have a big Q4 in the $72-73 million range. This is completely possible given its strong Q4 showings the last two fiscal years. WIND typically has strong Q2s and Q4s and this year is shaping up to be consistent with years past. However, several factors may impact VDC estimates including:

1. Hurricane Katrina's effect on the US economy in the short term
2. Weak manufacturing outlook
3. Raising oil prices

ABOUT VDC

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