Hazards on the high tech road ahead
Kevin Allison

Technology hardware companies are adopting a stance taken by other sectors by suggesting that growth in emerging markets will offset the effects of a slowdown.

But the positive noise is reminiscent of the language that came before the recession of 2000, which was catastrophic for the sector.
Seven years ago John Chambers, chief executive of Cisco Systems, addressed an investor conference to reassure Wall Street about the networking group’s prospects in the downturn that followed the dotcom bubble.

“This is a US phenomenon,” Mr Chambers said of the downturn that would eventually wipe out almost 90 per cent of the company’s market capitalisation.

Today, with another recession touted, hardware companies such as Cisco, Hewlett-Packard and IBM are striking a similar tone.

“Our estimate is that this is a relatively short-term challenge,” Mr Chambers said this month as Cisco warned that sales growth would slow in the current quarter. That trend could continue for months as a turbulent stock market and lagging economic indicators cause executives to hedge bets on new IT purchases.

Hewlett-Packard, the biggest computer maker, on Tuesday became the latest Silicon Valley heavyweight to play down concerns about a possible recession as it raised sales and profits forecasts for the full year.

Growth in emerging markets has outpaced the US in recent years. On Tuesday Mark Hurd, HP’s chief executive, said he considered the company’s strong overseas presence (69 per cent of its $104bn in annual sales) an asset given the economic uncertainty gripping the US.

But some analysts are sceptical that fast-growing overseas markets will stay immune to any downturn.

“The belief that somehow we are less interconnected than during the dotcom days – I don’t see evidence that it’s true,” said Roger Kay, an analyst at Endpoint Technologies Associates, a market research group. “We are more interconnected now.”

The US is the world’s biggest export market, and a fall-off in consumption by American consumers could hit Asian exports.

Shipments of personal computers have historically closely mirrored the broader economy. If that correlation holds, Mr Kay says, a slowdown in gross domestic product growth could hit computer makers and, eventually, their Asian suppliers.

“It looks as if the [PC] growth rate in 2008 could throttle back by a third. We’re not falling off a cliff. It’s just that the growth rate isn’t quite what it used to be.”

Still, Mr Kay says: “If the US economy tanks, where is the Chinese export market going to go?”

In spite of this, some industry-watchers say there are reasons to believe fallout from a recession in 2008 may not be as severe as in 2000, which brought with it a catastrophic fall in stock prices that savaged the technology sector.

One difference is that the technology bubble of the late 1990s was driven in part by internet companies that had sky-high stock valuations but lacked significant cash flow.

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This time around may also be painful but there is a difference. Many technology companies' balance sheets are flush with cash – a fact that should help them in an environment of slowing sales and tighter credit.

Another difference is that technology companies, particularly PC makers, have become better at managing inventory in recent years, and this balancing act can have a big impact on a company's bottom line.

Just as new cars lose much of their value as soon as they are driven off the lot, the value of computers and other IT products falls quickly as soon as they leave the factory floor.

"If you hold inventory, you're losing money," says Mr Kay at Endpoint.

That makes managing inventory important. Too much inventory can quickly eat into profits.

Many technology companies were already struggling to cut down on swollen inventories when they were hit by a sales downturn in 2000.

Recent supply chain improvements mean that many companies' inventories are thinner today than they were during the go-go days of the dotcom boom. Some technology companies have already begun to cut inventories even further in anticipation of slower sales.

Andrew Neff, an analyst at Bear Stearns, says savvy companies should be looking for ways to make the most of an economic slowdown by cutting costs and using their cash to invest in activities that can help them increase their market share.

Mr Neff points to Dell, HP's biggest rival, which was able to use its low cost base to carve out market share during the recession of 2000-2003.

"The world doesn't end when there is or is not a recession," Mr Neff says. "You have to look at who is well positioned to get through it."

Is a new bubble on its way?

At the end of the dotcom boom in 2000, a collapse in online spending spelled doom for many internet start-ups. But this time could be different, says a recent report from Forrester Research.

"In the last recession, much of the online money came from dotcoms and venture funding, a source that rapidly dried up in bad economic times," Forrester says. "But the mainstream consumer companies know advertising won't evaporate so quickly."

Advertisers who are feeling the pinch are likely to turn to technologies such as internet search, which can offer a better return on investment than TV and print ads. That could bode well not just for companies such as Google, but for smaller companies working on technologies that improve search performance.

Meanwhile, Facebook and other social media sites offer markers a cost-effective way to spread their brand message without resorting to more costly ad campaigns.

"In a recession, social applications with measurable results will pay off," Forrester says.

Nevertheless, with social networks and other online start-ups drawing huge valuations (Facebook, which had sales of $150m last year, was valued at $15bn in a recent investment round), there are lingering concerns that a second internet bubble could be heating up just as the broader economy is cooling down.

Fonte: Financial Times, 23 Feb. 2008, Companies International, p.9.

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