TURNING ON THE CORPORATE TAP

Companies that cut off capital outlays are starting to spend again, and that could help spur a global recovery

By Tara Kalwarski

Are companies ready to spend?

As the economy went into a tailspin last year, many companies stopped investing in their operations. For months they've refused to buy new computers, trucks, and other capital goods in an effort to stave off losses. The downturn in capital spending has been the worst since the Great Depression.

Now some U.S. corporations are opening up their wallets, laying the groundwork for a global recovery. A *Business Week* analysis of companies in the Standard & Poor's 500-stock index found that 45% increased their global capital expenditures in the second quarter from the prior one. Only 19% did so in the first quarter. American Express, ExxonMobil, Verizon Communications, Wal-Mart Stores, and 106 others even upped their spending on a year-over-year basis. And those that continue to cut spending are doing so less drastically; expenditures overall have slipped just 3% in the latest quarter, vs. a 31% decline in the first. "Folks have changed their mindset toward cutting," says Steven Wieting, an economist at Citigroup.

The changing sentiment is another glimmer of hope for the global economy. Companies generally don't shell out money on new equipment, software, and buildings unless they think demand is picking up and profits are sustainable. The second quarter was encouraging: Earnings for the S&P 500, although still down from last year, were roughly 40% higher than in the first.

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Capital spending will also be a critical growth driver in the coming years, especially given the dire state of consumers. The "expenditures will support a global recovery," says Kent Engelke, chief economic strategist at Capitol Securities Management. Already the European and Asian economies are benefiting from the uptick in spending by American multinationals. The U.S. economy, however, may lag somewhat as these companies continue to invest more of their dollars overseas. Capital spending within the U.S. fell 4% in the second quarter from the first—a bit worse than the drop in global expenditures among S&P 500 companies.

There's plenty of risk ahead. First,

credit is scarce and costly, which makes it difficult to pay for outlays. St. Louis utility Ameren spent an extra $44 million in the latest quarter, vs. a year earlier. But the company says it was a one-time bump for equipment upgrades required by regulators. "We're reducing capital expenditures," says spokeswoman Susan Gallagher. "Credit is still very expensive for us right now." Second, spending in some areas will continue to suffer for a while. Given the glut of office space and rising vacancy rates, business construction is especially vulnerable.

BETTER CREDIT QUALITY

The companies that are spending fall into two camps: those that are playing catch-up and those that are more optimistic about their prospects. The first group includes health insurer Cigna, which increased expenditures by $16 million in the latest quarter. But Cigna's spending is off its peak, a level the company says it won't reach again until at least 2010. Such companies "cut back on capital spending much more than the fundamentals would have needed," says Milton J. Ezrati, senior economist at mutual fund firm Lord Abbett.

Companies such as American Express account for the second group. The credit-card company, which has suffered as defaults have risen and consumer spending has dropped, spent just $88 million on capital goods in the first quarter—the smallest amount since 2002. But credit quality at the company is improving: Delinquencies, those accounts more than 30 days past due, fell 14% in the latest quarter. With the problems abating, AmEx is plowing more money into the business, some $246 million in the latest quarter. At an analyst meeting on Aug. 5, CEO Kenneth I. Chenault said, "Initially our plan was to reduce investments this year by $1.5 billion.... Our intent is now to restore a portion of these investment cuts during the remainder of the year."

Some companies are allocating the extra money to technology, software, and other equipment that boost productivity. That's especially true for companies that have cut staff to the bone. "Companies can only defer CapEx for so long," says Kenneth J. Bentsen, president of the Equipment Leasing & Finance Assn., a trade group. "At some point, they have to replace their hardware and other equipment." The additional spending should be a boon for semiconductor makers such as Intel, Samsung, and Texas Instruments. Roger Wery, a partner at consultancy PRTM, expects global spending for chips to jump 33% next year.

Government largesse is spurring spending as well. The stimulus package offers subsidies for business investments in renewable energy initiatives. "There seems to be a great willingness to approve projects that serve the public interest," says Philip C. Adams, a senior bond analyst at researcher Gimme Credit in Chicago. ITC Holdings, a utility, is gearing up for green energy demand: It boosted spending to $109 million in the second quarter, a 10% increase over the previous year. "You can't change where the wind blows or where the sun shines," says ITC Chief Financial Officer Cameron M. Bready. And the company has to build infrastructure to use that energy.

Other companies are plowing dollars into new products or markets. J.M.

WILLING TO SPEND

After cutting capital spending dramatically, some sectors spent more in the second quarter

QUARTERLY CHANGE IN CAPITAL SPENDING (%)	
Consumer Discretionary	-4.0
Consumer Staples	0.4
Energy	-10.5
Financials	7.5
Health Care	6.4
Industrials	-10.3
Information Technology	-4.9
Materials	3.0
Telecom Services	15.4
Utilities	-2.1
S&P 500	-3.2

Data: Thomson Reuters

Smucker spent $80 million over the last three quarters of its fiscal year, up 29% from a year earlier. Most of the money went to Folgers Coffee, the brand it purchased last November from Procter & Gamble for $3 billion. Verizon is using extra funds to build telecommunications networks in Europe and India. The company estimates capital spending could top $17.8 billion this year, compared with $17.2 billion last year.

Many companies are spending on overseas operations, where they see stronger opportunities for growth. Campbell Soup slimmed down last year by selling off Godiva Chocolatier but plans to increase capital spending by more than 30%. A growing number of the overall investment dollars have been funneled into the company's new Russian and Chinese ventures, markets in which per capita soup consumption is among the world's highest.

A truly sustained global recovery will need more big spenders like ExxonMobil. The oil giant has spent more than $10 billion so far this year, including a large investment in a new natural gas facility in Qatar. Overall, it expects to invest $125 billion globally through 2012. Says Kenneth J. Kremar, an analyst at IHS Global Insight, a research firm: "We're a ways off from a solid recovery, but the verdict is we're moving in the right direction."

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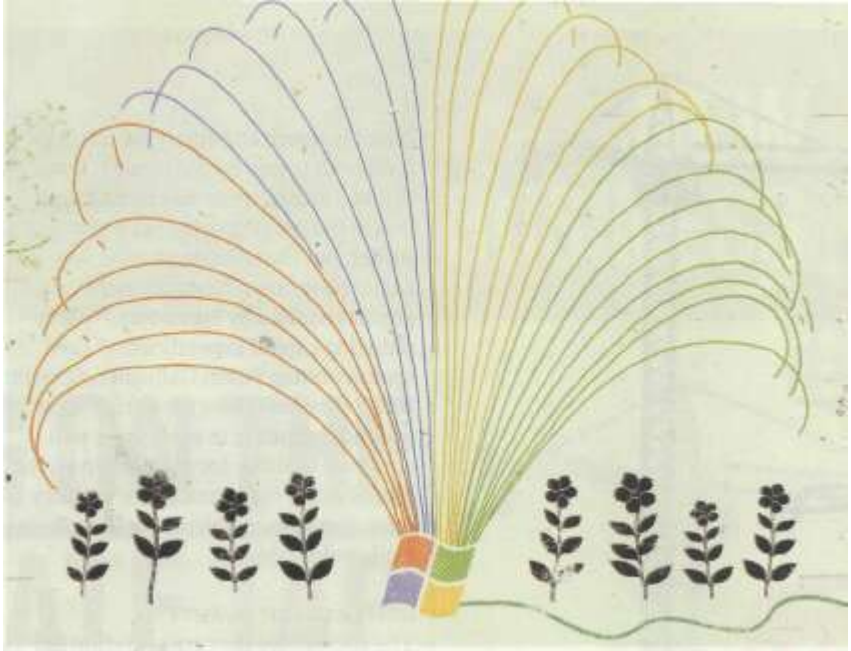
A Tax Bite?

A study found that cutting capital spending may actually cost companies during a recession, according to a February article on CFO.com. The analysis, conducted by two business professors at Georgia Institute of Technology, shows companies often pull back on business investment during a downturn. But the slowdown in spending can trigger tax liabilities that hurt cash flow.

To read the full article, go to **bx.businessweek.com/capital-investment/reference/**



WILL WINDOWS 7 REBOOT PC SALES?

Why the boost to the tech business from Microsoft's new operating system may disappoint the bulls

By Peter Burrows

For the first time in years, the PC market is starting to draw serious attention from Wall Street. Dell shares surged after the company beat earnings expectations for the second quarter. The next day chip giant Intel gave the sector another lift by raising its forecast for PC processor sales. Hopes are building among investors that the industry will see a revival in growth as Microsoft unveils its new operating system, Windows 7, on Oct. 22 to replace its troubled Windows Vista. "I think the uplift is going to be significant," says Brian Blair, an analyst with equity research firm Wedge Partners.

The question is how significant. Before Vista, a new Windows release could set off a corporate and consumer buying binge—not only for PCs, but also printers, mice, and software. Some analysts have pointed out that the Windows pop this time could be especially pronounced, since many people never bothered to buy Vista and some 600 million PCs are running the nine-year-old Windows XP.

But the tech bulls may be disappointed. Given the weak economy, PC unit sales are expected to rise 6.9% worldwide in the fourth quarter, according to research firm IDC. That would be the first quarter-over-quarter increase this year, but far short of the boost from releases such as Windows 95. "A lot of people are going to have to rethink their assumptions," says IDC analyst David Daoud. The firm expects PC sales to rise 6.1% in 2010.

Microsoft declined to comment for this story. But even the software giant has tried to tamp down expectations for the new operating system. "[The impact is] likely to be elongated over a couple of years, to be honest," Bill Koefoed, the company's investor relations chief, told shareholders in August.

That's not a reflection on Windows 7 itself. In preliminary testing the

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By Christopher Palmeri

Ever so cautiously, some businesses seem to be spending again. A handful of industries are even showing large increases in investment, among them health care, telecommunications, and financial services. To try to capitalize on any nascent pickup in corporate capital spending, investors can identify companies that are likely to be the beneficiaries of that money flow.

Some stock market strategists say early signs of loosening corporate purse strings mean now is the time to buy shares of tech behemoths, as well as industrial goods makers and transportation companies, that will see an uptick in orders as businesses bulk up again. "You want to be in trucking, heavy machinery, industrial companies, mining and minerals," says James Swanson, chief investment strategist at MFS Investment Management. "It's Old World industries and tech—a Jekyll and Hyde theme."

But with the iShares S&P Global Industrials Sector Index Fund, an exchange-traded fund loaded with big industrial companies, already up 60% from the stock market's March low, investment managers such as Arthur Moretti of the $900 million Neuberger Berman Guardian Fund prefer to look farther afield. Moretti scouts for companies that have invested in research and development and created proprietary products that will benefit from a rebound in business spending. His favorite holdings include Altera, whose programmable chips are used in medical equipment and industrial automation gear. He also likes Intuit. The company, best known for its TurboTax consumer tax preparation software, generates one-third of its sales from units that supply small businesses with payroll processing, accounting, and credit-card payment software. Intuit expects earnings per share to climb 10% to 16% for the fiscal year that just began.

Karl Mills, portfolio manager of the Counterpoint Select Fund, also tries to get in front of big waves of business investment. He figures companies will need to invest in wireless technology because it enhances productivity and because there's a natural cycle of obsolescence in technology that requires more spending. Some of his largest holdings are Cisco Systems, the king of Internet routers; data storage leader EMC; and Qualcomm, which owns much of the technology needed for next-generation wireless data services. Such companies are already big players, but in difficult markets "the stronger not only get stronger, they get much stronger," says Mills.

Since all of that new high-tech gear requires juice to run, Mills also thinks it is early days for a surge of investment in electricity generation and power-saving devices. To play that trend, the fund manager holds large stakes of General Electric, Siemens, and Swiss industrial giant ABB.

FOLLOWING THE MONEY

These sectors and companies should attract increased capital spending, say fund managers

SEMICONDUCTORS

Chipmakers with proprietary products, such as Altera, could profit from a pickup in capital expenditures.

WIRELESS

Any technology that can enhance productivity, such as wireless, should benefit. Cisco, EMC, and Qualcomm should continue to do well.

POWER

Bigger outlays for tech may mean a greater need for electricity and power-saving devices, so GE, Siemens, and ABB could gain.

BIGGER SPENDERS

These Standard & Poor's 100 companies had double-digit hikes in capital spending in the second quarter of the 2009 calendar year, which could bode well for their suppliers

COMPANY/ TICKER	CAPITAL EXPENDITURES Q2 (MILLIONS)	YEAR-OVER-YEAR CHANGE
Altria/MO	$69	73%
Hewlett-Packard/HPQ	1,091	66
Merck/MRK	365	25
Exelon/EXC	732	19
Wal-Mart Stores/WMT	3,137	19
American Express/AXP	246	18
H.J. Heinz/HNZ	49	17
Amazon.com/ AMZN	78	13
Entergy/ETR	491	11

Data: Capital IQ, *BusinessWeek*

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