

The Computer and Peripherals Industry's year-ahead earnings prospects are mixed. Market conditions still aren't back to normal; competition remains intense; and changes in product and technological trends are posing challenges.

As economic fundamentals improve gradually over the next few years, however, so should the group's sales and earnings.

The Industry is ranked near the bottom of our universe of nearly 100 industries for Timeliness, but a number of stocks reviewed under the Computer Industry banner have attractive recovery potential to late decade.

Some of the stocks may have speculative appeal, as well, since the struggles of two of the larger players in the computer sector seem to be attracting interest from buyout investors.

Market Conditions

Although economic fundamentals in the United States appear to be gradually strengthening, market conditions for both companies that make personal computers and electronic devices for consumers, and for those that make servers and electronic gear for corporations and public-sector entities, still seem less than ideal.

Continued historically high unemployment, worries regarding the possible adverse effect of budget sequestrations on consumer finances, and the 2013 payroll tax hike all seem to have had a hand in dampening consumer demand for computers and peripheral devices. Purchases of items viewed as discretionary may be especially vulnerable to being postponed, although hot new devices, like tablet computers, are viewed by some as must-have items. As consumer confidence gradually strengthens going forward, we look for sales to follow suit.

Likewise, economic uncertainty and budget pressures appear to be causing businesses and public-sector customers, like local governments and schools, to take longer to approve investments in new computer equipment or to postpone purchases, in spite of the growing need for these entities to update their aging technology infrastructures. There's probably a lot of pent-up demand in the commercial market, so when business conditions improve, so should sales of servers and other electronic gear.

Note that Microsoft's rollout in October of its new *Windows 8* operating system may have pulled some sales of personal computers and laptops along with it, as new software often does. But it doesn't appear to have served as a significant sales catalyst so far, especially with many companies still upgrading to *Windows 7*. Moreover, *Windows 8* is considered by some as more difficult to learn.

In all, we look for both consumer and commercial/public sector demand for computer equipment to remain muted in the near term, with sales improvement likely to track economic activity.

Competitive Climate

In the current tepid demand environment, rivalry between computer makers remains intense, putting pressure on pricing. Even former industry darling *Apple* recently encountered heightened competition in the mobile products arena from South Korea-based *Samsung*. The competitive pressures probably will persist until market conditions improve.

INDUSTRY TIMELINESS: 90 (of 98)

Evolving Technology

Computer companies sometimes find themselves on the wrong side of changes in technology and product trends. In data centers, for example, software is increasingly doing the work once performed by mainframe computers and servers, and may account for some of the sluggishness in computer hardware sales. In the consumer arena, tablet computers, e-readers, and smartphones are now doing a lot of the work previously performed by personal computers and laptops. It takes time for computer makers to respond to technological trends with new product lineups.

Near-Term Earnings Outlook

The Computer and Peripherals Industry had a tough year in 2012. But many of the companies reviewed here probably can look forward to modestly better results in 2013 and further bottom-line progress in 2014, aided by a gradual pickup in economic growth in the United States, new products, and cost-reduction measures. The hard disk drive shortages experienced in late 2011 have been resolved. And some computer makers, including *IBM*, are increasing the portion of very profitable software in the sales mix, which should enhance their margins.

Conclusion

There are a number of stocks in the Computer and Peripherals Industry that have good comeback potential to the 2016-2018 time frame. But the group isn't especially timely, and only a handful of companies reviewed here pay dividends. Moreover, a lot of technology issues tend to be more volatile than the market averages, so conservative investors may want to tread carefully.

On the other hand, speculative investors should note that buyout activity in the Computer and Peripherals Industry has heated up recently. *Dell* has been struggling to right its ship during the past decade, and is now the focus of a three-way battle for control of the company. *Hewlett-Packard*, which seemed to have lost its way in the past few years, is also trying to turn itself around. Some investors have suggested that it break itself up into smaller pieces.

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