

It's not business as usual in The Computer And Peripherals Industry. The group's sales growth seems to have slowed in the past year or two. Economic uncertainty has been causing businesses to be more cautious about purchasing computer equipment. Government spending cutbacks have hurt some computer makers. Multifunction mobile phones have been stealing sales from traditional personal computers.

Given the softer sales outlook, computer companies are slashing expenses, although they probably won't pare research and new product costs, given the need to recharge sales growth. Computer makers are also buying back stock in order to sustain share-net growth. But most of the computer makers probably won't be able to recapture their lost luster in the year ahead.

Several of the stocks in The Computer And Peripherals Industry are ranked favorably for Timeliness, and a number have worthwhile 3- to 5-year total return potential. But the group's dividend yields are generally modest, with a few large companies only recently having initiated payouts. And many computer company issues are a bit more volatile than most stocks, so conservative investors may want to tread carefully.

A Tough Operating Environment

Economic uncertainty is putting a dent in the computer industry's sales. Concerns regarding their own prospects apparently have caused some businesses to require employees to obtain additional approvals before placing orders for new computer equipment. Although information storage systems and software provider EMC is doing fairly well, its order bookings in the March and June quarters came in late in both periods, likely reflecting this drawn-out order process.

It's unclear whether government budget concerns have so far had much of an impact on sales of computer equipment. Defense industry-dependent companies like Mercury Systems have thus far borne much of the brunt of the cutbacks.

From a geographic perspective, sales of computer equipment in Europe remain mixed, although NetApp indicated that the northern European market, where it has some business, has stopped contracting. A few companies said growth in the June quarter slowed in developing nations, including China and Brazil. NetApp and IBM pointed to slower sales in Australia, a nation that sells a lot of raw materials to China. And a number of computer equipment manufacturers, including IBM, cited currency headwinds, which they expect to worsen in the coming months.

New Products And Technologies

Shifts in customer preferences and technological change seem to be outpacing much of the computer industry's ability to respond with innovative offerings. A big example is the popularity of tablet computers and multifunction mobile phones, which have stolen sales from makers of personal computers, like Dell and Hewlett-Packard. Even previously invulnerable Apple is encountering rising competition in the mobile phone/device space. Fears that it lost its knack for innovation sent the stock down earlier this year, although its new iPhone5C seems to have been a resounding success. The company reportedly sold nine million of its two new iPhones in the weekend following their

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introduction.

Another example is the increased use of popular Flash technology in the information storage arena. Both EMC and NetApp are adding Flash to their offerings in the face of increased competition, including from small upstart technology firms. Note that Hewlett-Packard lists a product mix weighted toward declining products, like traditional storage systems, as one of its problems.

Meanwhile, nowadays software is performing more of the functions previously done by computer servers. Recognizing software's growth potential, the larger computer equipment makers generally also have software and services businesses. In fact, software and services accounted for 82% of IBM's revenues in the June quarter.

Mixed Earnings Prospects For A Diverse Group

The earnings outlook for 2013 varies considerably within the Computer And Peripherals Industry. The storage systems companies EMC and NetApp, which are still experiencing decent sales growth, should see their earnings rise, albeit at a slower pace than in recent years, given the difficult operating climate. Those with declining sales, like IBM, are paring costs and buying back stock in order to keep their earnings per share on an incline. Hewlett-Packard, which is in the process of turning its fortunes around, now doesn't expect its sales to rise in 2013. Apple may have trouble matching the spectacular results it posted in 2012, partly due to the initial costs of its recently launched new iPhones, but its margins and earnings are probably still the envy of much of the computer industry.

Conclusion

The Computer And Peripherals Industry's Timeliness rank has risen significantly since our July report, and more than a handful of the stocks reviewed here are ranked 1 (Highest) or 2 (Above Average) for Timeliness. A number also have good, but in some cases not very well-defined, appreciation potential over the pull to 2016-2018. Some of the larger, more mature computer companies have initiated dividends in recent years, but most computer stocks don't stand out for income. And many of the issues reviewed here are a bit too volatile for conservative investors.

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