

The Computer and Peripherals Industry likely closed the books on a disappointing 2013, despite expectations of some sequential-period improvement late in the calendar year.

We look for the group to make only limited progress in 2014, since the year may start out slowly.

Nonetheless, a number of stocks in the industry are timely, and some are now favorably priced, so investors with long-term horizons may also want to take a look. Moreover, a few computer company stocks have decent dividend yields from well-covered payouts.

Wrapping Up The Year

Many computer and peripheral device makers probably will post only modestly higher earnings for 2013. The industry's top-line performance through the first nine months of the year was disappointing, and we think some companies' December-quarter revenues also fell short of expectations. As the year drew to a close, some companies in the group were pushing hard to make up for ground lost earlier in the year.

As in 2012, economic uncertainty caused commercial customers to subject technology purchases to greater scrutiny and defer some purchases not viewed as essential. In addition, government budget concerns and the Federal shutdown restrained EMC's and NetApp's sales of storage systems last fall. Too, slower growth in developing nations, like Brazil and China, and unfavorable currency shifts, depressed IBM's revenues.

In the consumer market, strong demand for tablet computers and multifunction mobile phones continued to steal sales from laptop computers and desktops. Notably, Apple's sales and earnings in the December quarter may have been helped by two iPhone releases last fall. The company no doubt is still the envy of many of its rivals in the mobile computing space.

The top-line weakness reduced the industry's operating leverage, but many computer makers offset the pressure on margins by slashing expenses. A richer product mix, due to an increased focus on their most profitable lines, including software (which generally has very wide gross margins), likely also helped offset the margin pressure. Finally, stock repurchases probably lifted a lot of the computer makers' earnings per share in the waning months of 2013.

Meanwhile, Hewlett-Packard's bottom line moved back into the profit column in its recently ended fiscal year in the absence of the sizable restructuring costs that it incurred in fiscal 2012, though its earnings in 2013 remained well below the fiscal 2010 record level.

Ring In 2014

Economic activity in the United States appears likely to strengthen in the new year, but it's unclear whether the improvement will be sufficient to spark a meaningful pickup in technology spending. Many companies certainly need to replace aging computer equipment, but they probably will postpone doing so until they are confident that business activity is firmly on the upswing. It's also uncertain whether federal and state budget woes will continue to restrain government outlays for new servers and desktop computers. Too, it make take a year or so for growth in some key developing nations to revv up enough to support better sales of computer equipment.

INDUSTRY TIMELINESS: 29 (of 97)

On the other hand, despite continued relatively high unemployment, demand for hot new consumer mobile devices, like tablet computers and multifunction mobile phones, probably will remain strong. Indeed, Apple's recently launched thinner, lighter iPad should attract consumer interest. But sales of notebook and desktop computers, which have been declining, may not rebound until companies start replacing older office computer equipment.

Meanwhile, we expect competition in the computer equipment sector to remain intense. Upstarts, like Nimble Storage, a hybrid data storage products company that recently went public, threaten over time to lure some sales from established information storage system companies, like EMC and NetApp, although the latter two have much larger sales forces than the newcomers. Likewise, telecommunications equipment maker Nokia recently unveiled its first tablet computer, heightening competition in that market. Also, note that although Dell went private in 2013, it is still a force to be reckoned with in the personal and corporate computing markets, perhaps more so than when the company had to cater to the needs of stockholders. The company recently introduced an aggressively priced tablet computer.

In sum, year-ahead prospects for companies in the Computer and Peripherals Industry seem rather mixed at this early juncture, with most companies likely to offset the negative effect on earnings per share of weak or declining sales with cost reductions and stock repurchases.

Conclusion

The Computer and Peripherals Industry still resides in the upper half of the Value Line universe of nearly 100 industry groups. A number of computer issues are ranked favorably for Timeliness. And some have good recovery potential to 2016-2018. However, long-term investors may need to be patient, since we expect the industry to get off to a slow start in 2014.

In recent years, a number of the computer companies reviewed here have initiated dividends on their common stock. Roughly half of the companies in the group now pay dividends. Of those that do, about half of the stocks have above-average dividend yields.

Theresa Brophy

