The Computer and Peripherals Industry began the year on a weak note, hurt by lackluster economic activity and changes in technology. Nonetheless, cost reductions and stock buyback activity may support modest earnings gains in 2013.

The sector is still ranked unfavorably for Timeliness, but may interest long-term investors that are both patient and not too risk-averse.

INDUSTRY TIMELINESS: 89 (of 97)

A Disappointing Start To 2013

The March period wasn't the computer industry's quarter to shine. Some of the largest players in the sector, with the best earnings track records over the past five years, turned in mixed performances.

Among them, long high-flying *Apple* posted an 18% earnings decline amid heightened competition from rival Samsung in the smartphone market and due to margin pressures. Meanwhile, technology bellwether and Dow Component *IBM* logged its fourth consecutive period of lower year-to-year revenues in the opening quarter of 2013, and its earnings momentum slowed. The company blamed poor sales execution for the disappointing results. Too, information storage systems, software, and services provider *EMC's* reported earnings per share slipped a penny year to year. That company's strong comeback from the 2008 recession appears to have moderated.

The industry laggards, including *Dell* and *Hewlett-Packard*, also underperformed. *Dell*, the recipient of a buyout offer from its founder, already seems to be operating like a private company to the detriment of earnings. It slashed its personal computer prices in the period in an apparent effort to strengthen market share. Meantime, *Hewlett-Packard* made limited progress in stabilizing operations.

A Challenging Operating Climate

The uneven pace of economic growth is taking its toll on technology spending by consumers and companies, as financially strapped customers make do with their existing computer equipment. *EMC* noted that its order bookings in the March quarter came in late in the period, with many companies requiring a higher level of executive sign-off for final approval of purchases. And in the U.S., the budget sequester may be starting to hurt government technology purchases.

On a geographic basis, sales of computer hardware in developing nations apparently have slowed. *IBM's* sales in these so-called growth markets rose only 1% in the March quarter. Meanwhile, prospects for more moderate economic expansion in China are a concern.

Changes In Computing

Technological changes are responsible for much of the upheaval in the computer hardware sector in the past few years. Technology research firm IDC estimates that sales of personal computers (PCs, including desktop and laptop computers) will decline nearly 8% in 2013. PC users have been shifting to smaller mobile devices, like tablet computers and multifunction mobile phones. This is especially bad news for companies like *Dell*, which derive much of their revenues from PCs. That company ignited a price war in the PC market in the March quarter that may have hurt rival *Hewlett-Packard*. (Asian PC makers apparently also stepped up price competition.) PC makers are scrambling to bring out new electronic devices to replace lost PC sales. Both *Dell* and *Hewlett-Packard* have been struggling to regain their lost luster, with turnarounds at both companies likely to take a few years. Even China's Lenovo Group, which bought *IBM's* PC business in 2005, is looking for new avenues of growth.

Technological change is also taking a toll on sales of the servers and information storage systems purchased by companies, institutions, and governments, as computer software does more of the work previously done by computer hardware. *IBM's* mainframe computer revenues declined in the March quarter, and the company reportedly wants to sell its x86 server business.

Earnings Prospects

Although the difficult market conditions are likely to depress some computer makers' sales this year, a number of companies in the sector have major cost-reduction programs under way that ought to support modest earnings growth in 2013. Companies like *EMC* have also recently upped their share-repurchase activity, which should enhance earnings per share. But in the March quarter, some computer makers took advantage of the reinstatement of research & develoment tax credits in the United States to significantly lower their tax expense. Without similar credits, their tax rates are likely to rise over the balance of 2013.

Prospects for 2014 are a bit cloudy. For now, we assume that economic activity will pick up a bit next year, and the computer industry's efforts to recharge top-line growth will support some sales improvement. Too, more of the benefits of cost-reduction programs should kick in, lifting earnings in 2014.

Conclusion

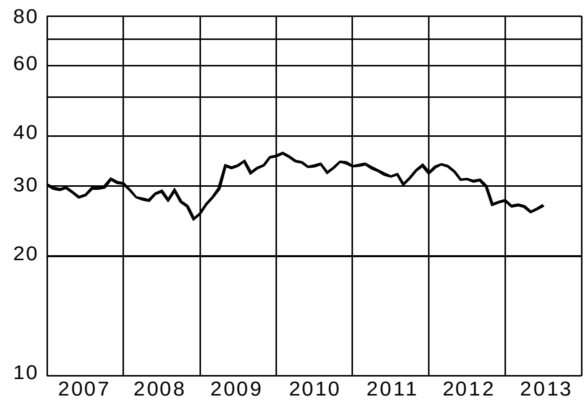
The Computer And Peripherals Industry isn't especially timely at present, but a number of stocks reviewed here have decent, though not very well-defined, recovery potential over the pull to 2016-2018. *Hewlett-Packard* appears to be slowly righting its ship, though it has a long way to go. Meantime, investors will vote shortly on a plan led by *Dell's* founder, Michael Dell, to take the computer maker private.

In what may be a sign that the computer industry is maturing, two large information storage system companies, *EMC* and *NetApp*, both initiated cash dividends on their common stock recently. But dividend-paying stocks are still in the minority in the computer industry, due to the importance of spending for research & development and acquisitions of startup firms with innovative technology.

Theresa Brophy

Computer & Peripherals

RELATIVE STRENGTH (Ratio of Industry to Value Line Comp.)



Index: June, 1967 = 100