



Issue 345: Wednesday, November 19, 2008

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Telecom Overview: Stocks Enter Confessional Season

Since last week's edition of *The Telecom Connection*, a number of companies have preannounced earnings, almost all of the negative variety. They have been unusual, from my perspective, because of the speed and severity with which end-demand has contracted. In this week's newsletter, I talk about several of them and what they may mean going forward.

There have also been a number of developments within the DRAM industry over the past week that are worthy of note, given the current model portfolio positions in **Micron** (MU) and **Netlist** (NLST). In addition to those developments, I have seen calls for a government bailout of the Taiwanese memory companies -- highlighting just how bad economic conditions are today.

Dell (DELL) is set to report numbers Thursday night after the close. The company's outlook following the previous call was not particularly strong, and in subsequent statements Dell mentioned further deterioration in demand. Coupled with the **Intel** (INTC) comments last week, no one is expecting to hear a lot of positives, but I've summed up my thoughts below.

On the inventory front, there are literally no changes in the data. However, as readers can see below, commentary like what we heard from Intel does not bode well for the next couple of quarters.

Last, as I always do, I've updated the model portfolio earnings reporting schedule with the latest information.

Now let's look at some of the negative news.

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Earnings Preannouncements

To say that it's rare for a company to negatively preannounce before a quarter is only halfway completed is an understatement.

The only comparison that even comes close in my mind is the fourth quarter of 2000. I'm not certain, but I believe it was Gateway (when it was a decent company) that negatively preannounced immediately following the Black Friday shop-o-rama of that year. I remember thinking at the time how bad things must be when you know you'll miss your guidance with a full month left in the quarter.

Intel's preannouncement last week did Gateway one better. I commented on the significance of the Intel announcement in my comments on *RealMoney* but it certainly bears repeating here. Intel had reported only four weeks prior and, while acknowledging some areas of softness and a lack of visibility, the company thought that its unusually broad revenue guidance would address the issue. To come out only one month later and announce that the "conservative estimate" was too high by 15% says that demand not only softened in the succeeding weeks, it virtually disappeared.

Cypress Semiconductor (CY) also negatively preannounced that it will miss its guidance for the December quarter. The company reduced its revenue expectations by 11% from midpoint to midpoint, citing significantly reduced orders worldwide. As a result, Cypress expects to have a pro forma loss of 3 cents to 12 cents per share. I met with the CFO at an investment conference in New York this week, and he indicated that the weakness is broad-based: all geographies, all products, and all vertical markets.

Nokia (NOK) also announced that it was reducing its outlook for worldwide handset demand for the fourth quarter and 2009. The company now expects 2008 handset units to grow about 9% year over year, or about 1.24 billion units vs. the prior estimates of 10% growth. Management also indicated that it now expects 2009 units to be down vs. 2008.

During Nokia's Friday morning conference call, the company indicated that the collapse in demand was widespread and -- in some cases -- attributable to the inability to obtain credit or the redirection of priorities in light of severe foreign currency exchange swings.

What was interesting in Nokia's commentary was that it is still seeing solid demand for smartphones. If that's true for Nokia, it should be true for **Apple** (AAPL) and **Research In Motion** (RIMM) as well. Somewhat corroborating the smartphone comment was the monthly revenue report by Taiwanese flexible printed circuit board (FPCB) manufacturer Career Technology. Revenue in September and October was up 34% year over year and 52% year over year, respectively. Among Career's top customers are High Tech Computer, Research In Motion and Apple.

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Corning (GLW) withdrew its guidance for the fourth quarter and 2009, citing a dramatic decline in U.S. sales of LCD televisions since the first week in September. On a weekly basis, the company commented that year-over-year growth in units (based on NPD data) started the period at a strong 27% growth rate, but then proceeded to deteriorate each week and bottomed at 1% growth at the end of October.

The only “positive” from the market’s current actions is that the Taiwanese panel makers are apparently cutting orders far in excess of end-unit demand in order to reduce supply chain inventory, which has been an issue since last summer.

There are going to be many more negative preannouncements over the coming weeks, and the most important factor from an investment perspective will be the market’s reaction.

Additional Changes in the Memory Industry

Last week, I noted in my summary of the Netlist quarter that about 12% to 15% of the DRAM industry’s capacity is coming offline. That is largely being done by mothballing 8-inch wafer processing lines because they are no longer profitable at current prices. Now there are suggestions that we may see additional reductions, but of a more temporary nature.

An article in *DigiTimes* suggests that ProMOS Technologies and Nanya Technology are both shutting down for the month of January, and that Powerchip Semiconductor plans a two-week shutdown. The reasons for the shutdown being given vary, but it is estimated to represent about 6% of industry capacity.

Dell Earnings Expectations

Dell is set to report its fiscal third quarter Thursday night after the close. At this point, given the dour guidance from **Cisco** (CSCO) and **Qualcomm** (QCOM) coupled with the negative preannouncement from Intel, it’s obvious that spending has plummeted.

With that as the backdrop, I think anyone with a pulse is expecting poor numbers from Dell. Street consensus estimates have been declining since Dell laid an egg with its results last quarter. If you remember, the company had no problem with its top-line growth, but it was the spending (what Dell likes to call “investments”) that was out of control.

Given the current market conditions, the higher levels of spending are likely to magnify their impact on the bottom line. So I’ll be shocked if those numbers come anywhere near the 32 cents per share the Street is expecting.

One area that has been a problem for Dell in recent years has been customer service, or a lack thereof. This issue has been the catalyst behind some of their lost market share. I had my own anecdotal experience with the company last week, and if my experience is the new rule rather than the exception, maybe Dell has turned the quarter.

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The monitor on my new (four months old) PC was displaying a thin, red vertical line on Thursday. After the market close, I ran the appropriate diagnostics and then contacted tech support around 5 p.m. EST. Tech support agreed that the monitor had failed and they arranged to replace it given that it was still under warranty. I was shocked that the replacement was at my front door at 9:30 a.m. the next day.

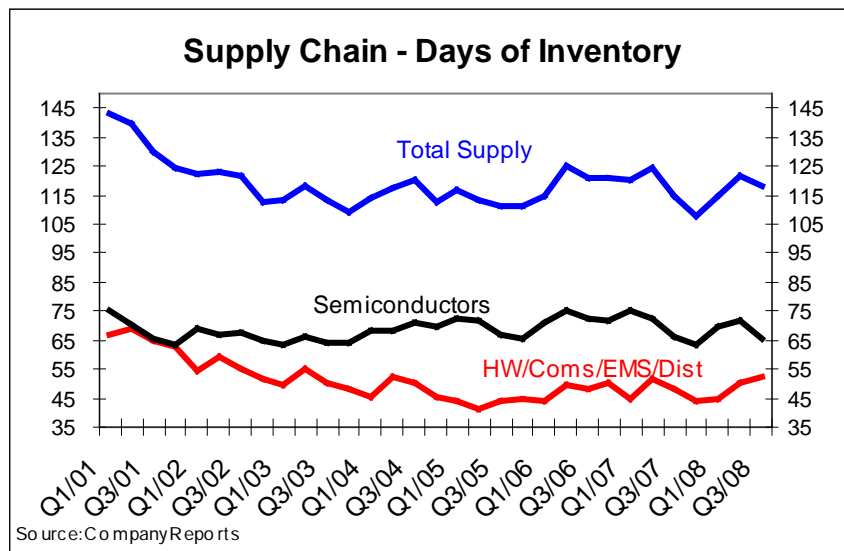
My comments about this on *RealMoney* generated several emails from subscribers indicating that their recent experiences were very similar to mine, suggesting that Dell may well have turned the page on its customer service issues.

All that may pay off when the economy turns, but right now all we can do is prep for some weak numbers and a weak outlook. However, following my comments on *RealMoney* and a response by another contributor highlighting Dell's valuation (0.22 enterprise-value-to-sales ratio), I thought it interesting that the stock closed up 6% on a rather bearish day.

All Quiet on the Inventory Front

Nothing has changed during the past week relative to inventory, other than a few more names going in the book. Nearly 90% of the 450 monitored companies that I monitor have reported thus far, and as you can see below, there has been no change in the inventory data this week. Total inventory days remains at 118, with semiconductors at 66 days and the customers at 52 days.

As I noted in last week's newsletter, I still believe that we'll drop another one to two days before the cycle is completed.



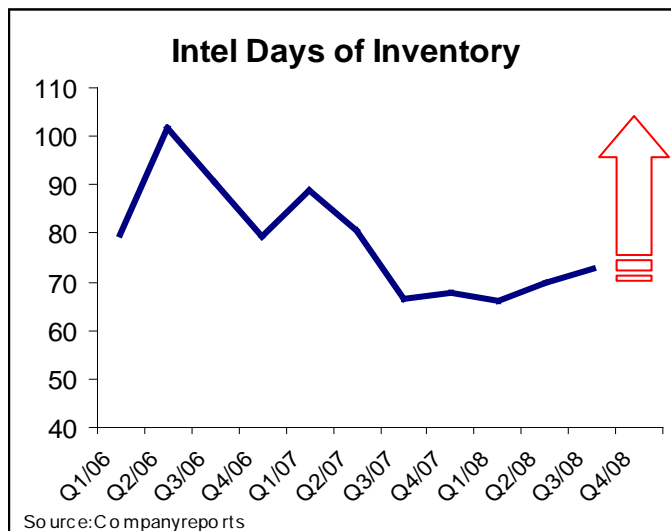
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Despite the “good news” on the semiconductor side, the preannouncement from Intel portends a world of hurt down the road. If you take a look at the graph below, Intel has had inventory issues in the past -- and certainly some of those have been related to flash memory. But flash is now off in a joint venture and the company has been bringing inventory down into the 65- to 75-day range in recent quarters.

With the original expectation of generating \$10.1 billion to \$10.9 billion in fourth-quarter revenue, the company would have been ramping its wafer starts at its manufacturing facilities; hence the bump up in the second and third quarters to 70 days and 73 days, respectively.

Now, with expectations that revenue will only be about \$9.0 billion (plus/minus \$300 million), we are looking at what could be an \$800 million to \$2.1 billion differential. The wafers needed to meet the original expectations were already started and they take about 10-12 weeks to process. They’re going to be dumped into inventory as they come out, and Intel’s inventory days could easily explode to more than 100 days.

The suddenness of the fall in demand will not allow Intel or any other company to adjust its wafer starts to mitigate the impact. We’ll see this same problem repeated throughout the semiconductor side of the inventory equation, and inventory days for the group will likely skyrocket in the fourth quarter.



Model Portfolio Reporting Schedule and Results

As usual, I have updated the reporting schedule with the latest available information.

Model Portfolio Earnings Reporting Schedule With Estimates, Results						
	Date	Conf. Call Time (EDT)	Current Consensus Estimates		Actual Results	
			Revenue	EPS	Revenue	EPS
Advanced Micro Devices (AMD)	Oct. 16	5:00 p.m.	\$1.48B	(\$0.40)	\$1.78B	(\$0.11)
Apple (AAPL)	Oct. 21	5:00 p.m.	\$8.05B	\$1.11	\$7.90B	\$1.26
Alvarion (ALVR)	Nov. 3	9:00 a.m.	\$75M	\$0.04	\$74M	\$0.05
Clearwire (CLWR)	Nov. 10	11:00 a.m.	\$56M	(\$0.96)	\$61M	(\$1.01)
Cisco (CSCO)	Nov. 5	4:30 p.m.	\$10.32B	\$0.39	\$10.33B	\$0.42
Cypress (CY)	Oct.16	11:30 a.m.	\$575M	\$0.30	\$600M	\$0.30
Dell (DELL)	Nov. 20	4:30 p.m.	\$16.37B	\$0.32	--	--
First Solar (FSLR)	Oct. 29	4:30 p.m.	\$339M	\$1.02	\$349M	\$1.26
Google (GOOG)	Oct.16	4:30 p.m.	\$4.06B	\$4.82	\$4.04B	\$4.92
Level 3 Communications (LVLT)	Oct. 23	10:00 a.m.	\$1.07B	(\$0.08)	\$1.07B	(\$0.08)
Motorola (MOT)	Oct. 30	8:00 a.m.	\$7.84B	\$0.02	\$7.48B	\$0.05
Micron (MU)	--	--	\$1.38B	(\$0.41)	--	--
Netlist (NLST)	Nov. 6	5:00 p.m.	\$29M	(\$0.03)	\$29M	(\$0.37)
Qualcomm (QCOM)	Nov. 5	4:45 p.m.	\$2.87B	\$0.60	\$3.33B	\$0.63
Research In Motion (RIMM)	Dec. 18	--	\$2.97B	\$0.91	--	--
Riverbed Technology (RVBD)	Oct. 23	5:45 p.m.	\$84M	\$0.14	\$86.5M	\$0.15
SunPower (SPWRA/SPWRB)	Oct.16	1:30 p.m.	\$350M	\$0.56	\$378M	\$0.60
Microtune (TUNE)	Oct. 23	5:00 p.m.	\$29M	\$0.06	\$31.9M	\$0.08

Source: Yahoo! Finance



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The Telecom Connection Portfolio

Company Name	Date Initiated	Cost Basis per Share	No. of Shares	Amount Invested	Current Price	% Gain/Loss	IXTC at Buy Date	IXTC Return
Apple AAPL	2/15/06	\$100.56	300	\$30,168.00	86.29	-14.19%	235.36	-44.42%
Alvarion ALVR	2/22/07	\$8.98	2,510	\$22,538.00	3.01	-66.48%	244.9	-46.59%
Clearwire CLWR	11/12/07	\$13.50	500	\$6,750.00	5.80	-57.04%	257.91	-49.28%
Cisco Systems CSCO	3/30/05	\$22.51	800	\$18,009.00	15.08	-33.01%	223.36	-41.43%
Cypress Semiconductor CY	7/10/08	\$5.36	2,000	\$10,720.00	2.99	-44.22%	230.96	-43.36%
Dell (call options) DLYAD – 20 contracts	12/6/07	\$6.80	2,000	\$13,600.00	0.05	-99.26%	259.97	-49.68%
First Solar FSLR	8/28/08	\$263.55	150	\$39,533.00	101.13	-61.63%	239.62	-45.41%
Google GOOG	2/9/06	\$494.76	75	\$37,106.70	280.18	-43.37%	243.87	-46.36%
Level 3 LVLT	6/19/08	\$3.76	3,000	\$11,280.00	0.75	-80.05%	263.91	-50.43%
Netlist NLST	2/14/08	\$1.46	3,500	\$5,095.00	0.30	-79.39%	232.75	-43.8%
Qualcomm QCOM	8/14/08	\$55.02	500	\$27,510.00	30.01	-45.46%	256.15	-48.93%
Research In Motion RIMM	11/19/07	\$113.82	200	\$22,763.75	45.33	-60.17%	247.44	-47.13%
Riverbed Technology RVBD	7/26/07	\$32.56	450	\$14,654.25	8.45	-74.05%	244.32	-46.46%
SunPower SPWRA	2/14/08	\$89.70	300	\$26,910.00	24.24	-72.98%	239.54	-45.39%
SunPower SPWRB	9/29/08	\$70.95	548	\$38,880.60	15.80	-77.73%	190.17	-31.21%

(The model portfolio continues on the next page)



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Microtune TUNE	2/8/07	\$5.23	2,500	\$13,075.00	1.86	-64.44%	244.96	-46.6%
Micron (call options) WGYAZ – 125 contracts	8/28/08	\$2.26	12,500	\$28,250.00	1.15	-49.12%	251.83	-48.06%

The Telecom Connection Portfolio – Performance

Total Average Return	- 57.39%	Performance results listed here reflect values of stocks as of the close of the most recently completed trading day, and do NOT take into account dividends paid, interest earned or commissions. Results are updated overnight and posted prior to the market open the following business day. Sales are taken from the most recent purchase of that stock unless otherwise stated. The 2008 YTD Return figures reflect changes since the beginning of 2008. The Total Average Return figures reflect changes since inception on 8/14/2001.
2008 YTD Return	- 64.13%	

Nasdaq Telecom Index Performance

	Portfolio Inception	Open Level	Current Level	% Gain/Loss Since Portfolio Inception	2008 YTD Return
Nasdaq Telecom Index (IXTC)	8/14/2001	262.84	130.81	-50.23%	-45.17%

At the time of publication, Mr. Faulkner was long CLWR, CY, MU, NLST, TUNE, TUNE calls.

To see the full Telecom Connection model portfolio, including closed positions, visit <http://www.thestreet.com/k/tc/portfolio.html>



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