

## MARKET CALLS

### Intel: No News is Big News

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**Intel's blockbuster guidance revision shouldn't have been a surprise -- but it may signal the beginning of the end for whacky techstock valuations.**

With yesterday's drop the S&P 500 moved into undervalued territory for the first time since October 1998, according to our "yield gap" analysis (see ["Return to Normalcy?"](#) Tuesday, June 4, 2002). The NASDAQ remains richly -- though no longer insanely - overvalued. But yesterday's one-two punch in the psychologically critical semiconductor sector may signal -- at last - the beginning of the final, painful leg of the long journey back toward normal valuation of technology stocks.

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The final leg of the journey will be characterized by deterioration in sentiment out of proportion to the deterioration in fundamentals. That's what we saw yesterday when **Merrill Lynch's** semiconductor analyst **Joe Osha** downgraded **Intel** from a rating of "Strong Buy" all the way to "Neutral," along with several other semiconductor companies. Osha's call was based on Intel's stalled-out revenue growth, poor visibility, and steep valuation -- that is to say, it was *not* based on a single *new* piece of information. Rather, it was based on facts that have been available for months to anyone willing to face them -- at Trend Macro we have been writing about such things since late last year (see, for example, ["Intel: Dead in the Water"](#) March 8, 2002). All that is new is that, yesterday, Joe Osha finally decided to face the facts. That he did so publicly was sufficient to knock Intel's price down 4.2%.

After the close yesterday Intel issued its mid-quarter business update for the second quarter, and shocked the market by lowering its revenue guidance for the quarter to a range of \$6.2 to \$6.5 billion, almost entirely blowing through its previous forecast of \$6.4 to \$7.0 billion made less than two months ago. It will be ironic if Osha's downgrade ends up being regarded as prescient -- in his report yesterday morning he totally failed to anticipate the magnitude of Intel's guide-down, forecasting instead that they would simply focus guidance to the lower-middle of the previous range at \$6.5 to \$6.8 billion. No, Osha wasn't prescient -- he was just depressed. And that's an example of the kind of sentiment deterioration that will characterize the final leg.

It will be even more ironic -- and an even better signal of the beginning of the final leg -- if the market today ends up treating Intel's revised earnings guidance as significantly negative news. It is *not*. Nothing of importance in Intel's [published statement yesterday](#) or in their [conference call last night](#) was new, and nothing in it indicates that business conditions facing the technology industry have gotten any worse than they already were. Even Intel's big drop in margins was nothing more than a logical reflection of having shipped a greater percentage of low-price Celeron processors than in the first quarter -- a quarter in which Intel's "value" processor was known to have been in short supply. The only revelation of any sort yesterday was that Intel's forecasts -- and those of the Wall Street analysts whose work consists of little more than putting

a story-telling gloss on company guidance -- turned out to be too optimistic. Yet Intel fell another 10.1% in after-hours trading, for a total of 13.8% on the day, and NASDAQ 100 and S&P 500 futures contracts traded sharply lower all night.

Weary resignation was the dominant tone of the analyst question-and-answer session in last night's conference call. Totally absent were the usual upbeat, hopeful questions. No one bothered to ask when the technology recession would turn around. No one was hopeful enough to ask when the corporate upgrade cycle would kick in. And no one gave enough of a damn about the technology to ask about how things were going with the high-end Itanium processor, or whatever other whiz-bang save-the-world gizmo Intel is supposed to be working on. No, this time it was all nuts and bolts about average selling prices and regional demand patterns -- all aimed at nothing more than trying to make better forecasts *next* quarter than anyone made *this* quarter.

**Intel CFO Andy Bryant** said over and over in the call that he had been too optimistic in forecasting the second quarter, after the first quarter turned out better than expected. The key forecasting error seems to have been to mistake inventory restocking for an increase in actual demand. As Bryant said last night, "The first quarter was somewhat stronger than we expected - - the second quarter was somewhat weaker. What I believe really happened is we shipped some parts in the first quarter that ended up in inventory, and consumption has been about as expected."

This unraveling of inventory illusion may be the template for the earnings season to come -- not just in technology companies, but across the entire economy. But there are no new facts in this template -- just a new understanding and a new acceptance of a reality that has existed all along, and a waning of false hopes. *That's* what it means for valuations to come back to normal. The final leg may be at hand. **TM**