

THE

Real Spelce

AUSTIN LETTER

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Dear Client:

It's a terrible time to be selling computers – unless you're Austin's Michael Dell, who is slashing prices and stealing share from less efficient rivals. Dell looms over the PC landscape like a giant, casting a shadow over all his unfortunate competitors.

Those comments come from the 1/21/01 issue of *FORTUNE* Magazine that goes on to say “This is a terrible time in a difficult business. PC sales were down for the first time last year. Dell's sales will be down, too, also for the first time. Yet even with that, even with recession, even with the threat of a Hewlett-Packard/Compaq Goliath, **this is the only PC maker you can count on to grow and grow and grow.**”

These are strong words from an opinion-setting, respected national publication about the Austin area's largest private employer. The reason for the magazine's conclusion: **“a kind of domination never seen before among PC makers.”** You'll recall we told you back on 5/11/01 (when Dell announced layoffs of 4,000 workers) that “Dell is laser-focused on **becoming even more dominant** (increasing market share) as its competitors struggle in the tightening marketplace.” What we told you *then*, *FORTUNE* magazine is *now* documenting.

“Dell is on track to **earn over \$1.7 billion in 2001, taking almost every single dollar of profit** among makers of Windows-based PCs,” writes **Andy Serwer**. “And Dell is gaining market share. That's not true for any other major PC maker. **Dell seems well on its way to becoming the Wal-Mart of the PC industry.** With its huge and growing volume, it demands – and gets – more and more and more from companies that supply it with PC components.” And that means Dell can keep lowering its prices for its products.

Says Michael Dell: “We keep lowering prices.” To which Serwer responds: “Can't argue with that. Once again, think of Wal-Mart. **Dell could well keep growing to what we once thought was an impossible size**, squeezing out competitors – some of which we will be sad to see go. But when was the last time you heard about Wal-Mart raising prices?” “As with Wal-Mart,” Serwer concludes, “with Dell you get the feeling that **it's not if this stock will take off again, but when.**”

There's more important info about Dell. See the next item.

In the world of Personal Computers, Dell has a 14% global market share. That's huge. But, if Dell stock is going to take off again, Dell must be even more dominant. How dominant? Dell's #2 Kevin Rollins is quoted as saying "We think 40% market share is possible."

"That's a remarkable goal; what's more remarkable is that it really is attainable," writes **Andy Serwer** in the 1/21/02 issue of *FORTUNE* magazine. "Don't look for Dell to hit that kind of number anytime soon. Rather, the company's **growth will come from grinding out gains on several existing fronts, while shrewdly expanding into new target markets.** But the growth *will* come – just ask Oracle CEO **Larry Ellison**," whom Serwer quotes as saying "If you want to be in the PC business, you have to compete against Dell and that is very, very difficult."

"The reason is simple: **There's no better way to make, sell and deliver PCs than the way Dell does it, and nobody executes that model better than Dell,**" Serwer explains. "By now most business people can recite the basic tenets of Dell's direct sales model. Dell machines are made to order and delivered directly to the customer. There is no middleman. The customer gets the exact machine he wants cheaper than he can get it from the competition. The company gets paid by the customer weeks before it pays suppliers."

As we've reported time and again, a growing, healthy Dell is essential for a strong local business environment, as it is for the thousands of local Dell shareholders. Serwer had a unique way of describing Dell's impact on Austin: "The company that famously started in Austin out of a University of Texas dorm room now **dominates this city the way giant steelworks once lorded over old mill towns.**"

"Dell has some 24 facilities in and near Austin and employs more than 18,000 local workers. **Dell did over \$30 billion in sales in 2000**, ranking 48th on the FORTUNE 500, ahead of names like Walt Disney, Johnson & Johnson, and Du Pont. **Michael is the richest man under 40 in the world**, worth \$16 billion."

By the way, you may have noticed when it was widely reported last September that **Michael Dell went out on the open market and bought tens of millions of shares of Dell stock** that was selling then for under \$20. It's now bumping up against \$30.

So what does Dell expect for the short term? What about the rest of this year? Michael Dell makes this case for a second-half recovery for his company: "You've got 150 million computers that are over three years old, 45 million of which are in the large corporate account sector in the United States of America, where Dell has about 40% market share. **If we capture our 40% share of those 45 million, that alone would be 18 million units** – which is what people expect us to do for the entire year."

Dell may be right, but some PC industry analysts think he's wrong, arguing today's machines are so high-powered that **companies are likely to put off upgrades.** But, as many Dell competitors have found out to their dismay – don't underestimate Dell.

The next business growth cycle could begin in just a few months as we move into the second half of the year. Or it could be delayed until 2003. But it *will* come and when it does “Austin’s economy will be growing at approximately twice the rate of the US economy, which is something we have seen in the past.”

That quote is from Austin-based economist **Angelos Angelou**, who will be presenting his detailed 2002 forecast from 7-9 am 1/23/02 at the Austin Convention Center. Angelou goes on to say that “**when we *do* recover from all of this we will see some of the brightest days for Austin’s economy.**” He notes that, in spite of the loss of jobs in the high tech sector, “people are not leaving town; they are staying here and I think they will weather the storm.”

Even though the Austin area has lost about 23,000 mostly high tech jobs during this downturn according to Angelou, he says “overall I think we’ve managed to do quite well”. Is that just whistling past the graveyard? Not really. “**Last year, the record will show that we’ve still created about 15,000 new jobs, which is remarkable,**” Angelou said.

Where have the new jobs been created? The Texas Workforce Commission reports that the **government and services sector of the Austin area economy both grew by more than 2% last year.** That’s important to remember. Finance, Insurance & Real Estate, Trade, Transportation & Public Utilities and even Construction also showed job gains – though to a lesser extent.

Only Manufacturing dropped and it took a huge 6% dip. More significant, though, than just the loss of jobs in one sector is **the *type* of jobs – those that pay big bucks – that were lost.** The Workforce Commission reports the Manufacturing sector accounts for the highest annual wage per worker (\$64,376). So, when you lose manufacturing jobs, you pull a lot of money out of circulation in Austin.

Be that as it may, many economists agree the immediate future looks bright. For instance, a senior economist at the Federal Reserve Bank in Dallas, **Keith Phillips**, this past week told a group of Austin business people gathered by the Greater Austin Chamber of Commerce the Texas economy will likely pick up with the US economy sometime in the **second quarter and that Austin should pick up with the high tech sector about the same time.** Phillips says the Texas economy will outperform the nation’s and Austin will outperform Texas.

Well, what about the *national* recession? How bad is it and how bad will it be in retrospect? Frankly, not bad. One New York business consultant, **Rob Norton**, says if you look at the national unemployment rate (which is higher than that of Texas and Austin, in particular), **this recession stands to be one of the mildest in more than 25 years.** As he put it: “If the end result of the current recession is that unemployment goes no higher than 7% and then begins to recede toward 4% as the recovery takes hold, it will be a triumph for the US economy.” For a perspective, the latest (Dec/2001) unemployment figures for the nation were 5.4%, Texas was 5.1% and the Austin metro area was 4.5% — all way below that 7% top benchmark. So the peak could be even lower.

In these days of quickly-changing airline procedures, it's more important than ever to be sure you know which make/model of aircraft is being used on your flight. That's because many of the hub-oriented, long-haul carriers are replacing some of their larger jets with the smaller regional jets.

Take Delta, for example. Delta offered 111 flights from D/FW on its larger jets before 9/11/01. Delta, as you know, joined the other hub carriers and reduced capacity. It now offers only 91 larger jet flights out of D/FW. **But, as of next month, Delta will be offering 107 flights on smaller, regional jet aircraft out of D/FW – up from 77 before 9/11/01.** And Delta is hinting at additional usage of the smaller-capacity jets this summer.

Look for American Airlines to follow suit. But the nation's largest carrier is embroiled in "discussions" with its pilots about increasing its regional jet service and they've not yet come to an agreement. That will come, in due course. **Southwest doesn't use regional jets and doesn't plan to.** In fact, Austin's largest air carrier has placed orders for more of its standard, large, reliable Boeing 737's – the only make/model in its vast fleet.

There's still no word from Intel on when/if /what it will do with the incomplete shell of a building in downtown Austin that has become a very visible symbol of the dot-com debacle. But, the world's largest chipmaker got some good news this week.

Intel's 4th quarter earnings beat Wall Street's expectations, and shipped a record number of microprocessors. **The results suggest the company may have hit the bottom of the downturn.** And a turnaround in Intel's financial condition is necessary if Intel wants to keep the building and finish construction, in order to consolidate and expand its Austin operations.

When **Dr. Louis Overholster** interviews job applicants, he tries to get a feeling for the person's personality by asking questions such as "If you could have a conversation with someone living or dead, who would it be?" He hired the person who answered: "The living one!"

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