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Silicon Valley's New Pessimists Talk of Pain Beyond the PC

By JOHN MARKOFF

SAN FRANCISCO, July 11 — Hopes that the second half of 2002 would see the end of technology's business decline seem to be retreating.

Not so long ago, a range of Silicon Valley chief executives were holding out the prospect of a recovery led by purchases of personal computers and other electronic devices. As recently as the beginning of June, the semiconductor giant Intel was telling investors that it expected a "seasonally strong" second half of the year.

But recent days have instead seen new caution among some executives and analysts. Dell Computer said today that its second-quarter revenue and profit would be higher than expected, not because the market was growing but because it was "continuing to gain market share in the midst of weak overall demand."

And last week, Advanced Micro Devices, Intel's chip competitor, cut its revenue projections for the second time in two weeks, citing weakness in its microprocessor line, which is heavily dependent on consumer purchases of personal computers. Its newest revenue expectations were $600 million, down from an original $900 million.

"The challenge for us is unlike our competitor, which has an enterprise business," an A.M.D. spokesman, Morris Denton, said. "It's early to make predictions, but we haven't started to see the early signs from back-to-school, which would indicate that we're coming out of the decline."

Some analysts are seeing weakness beyond the chip market. Merrill Lynch's personal computer analyst, Steven M. Fortuna, last week lowered his revenue expectations for Dell for the second half of 2002 by $800 million. He also changed his forecast to project a revenue decline in the personal computer industry of 6.7 percent for the year, with average unit prices down 9 percent compared with 2001.

National Semiconductor, another of the Valley's large chip companies, was downgraded last week by Jonathan Joseph of Salomon Smith Barney, who expressed worry in a note to investors that the cellphone market might be softening.

Eroding consumer confidence could be a particular blow to the semiconductor industry, which had been projecting a second-half turnaround as recently as last month. The Semiconductor Industry Association reported continued strength in non-PC chip markets like flash memory and digital signal processors, that are dependent on the consumer market.

To be sure, many longtime experts in the Valley said they still expected a turnaround by the end of the year, but they are becoming increasingly cautious.

"I think by the end of the year we're going to see rising employment," said Steven Levy, an economist at the Center for the Continuing Study of the California Economy in Palo Alto, Calif., "but there is all of this wild card stuff." And Michael Murphy, who publishes The California Technology Stock Letter, argued last week that spending on PC's and cellphones would grow this year and more quickly next year as companies seek technology solutions to reduce expenses.

But the prolonged stagnation of the PC market — which for more than two decades has provided almost assured double-digit growth — suggests that Silicon Valley may be approaching a shift that goes beyond the collapse of dot-com stocks.

Increasingly, personal computers have become a replacement rather than a growth market, and Silicon Valley collectively is still waiting for the Next Big Thing.

"This has been the perfect storm," said David Readerman, a partner and director of growth equity strategy at Thomas Weisel Partners, the San Francisco-based investment firm. "We had Y2K, the Internet build-out and the biggest of all" — overbuilding in telecommunications.

Growth, he said, is now seen from sectors of the economy that for more than a decade Silicon Valley has thought of as passé. Military contracting and domestic security are areas that might emerge as economic factors.

To grasp the depth of the Valley's decline from its peak, it is only necessary to review the fortunes of the Fast 50, an annual list of the region's fastest-growing companies maintained by Joint Venture: Silicon Valley, a coalition of government, corporate and civic groups.

Of the top 10 companies on the list in 2001, only one, eBay, was profitable in the last quarter. Two companies, Excite@Home and Exodus Communications, filed for bankruptcy protection and have since been acquired. Seven others on the list had losses in each of the last four quarters, including Commerce One, which reported a staggering $220 million loss in the first quarter of this year. Finally, the stocks of four of the eight survivors in this group are now trading for less than $1.

At the same time, unemployment levels in Santa Clara County, the heart of Silicon Valley, declined in May, the most recent month for which there is data. The rate was 7.1 percent, down from 7.6 percent in April but more than double the 3.4 percent a year earlier. From May 2001 to May 2002, the county lost 27,400 jobs, with the largest losses occurring in communications equipment and electronic components, according to the California Economic Development Department.

This somewhat positive job news may have been largely offset by the continued gloom nationwide in the telecommunications industry, which had been driving growth among the suppliers of data and voice infrastructure equipment in Silicon Valley.

"I am not as optimistic as I was a month ago," said Andrew Seybold, publisher of Outlook 4Mobility, an industry newsletter in Los Gatos, Calif., covering wireless data. The wireless industry has been edging toward its next generation of data and voice handsets, and a set of new products are planned beginning in August.

The world of wireless data is poised to create a proliferation of hand-held gadgets that could be a powerful driver for Silicon Valley. But the disarray in the telecommunications market has cast a pall over the idea that the rollout will happen quickly.

This kind of pushing back of new markets that might have spurred a rebound seems to be quickly becoming the norm around the Valley.

"We've been saying that it's really not until the fourth quarter of '03 that you return to earlier levels, and maybe even that's suspect," Mr. Readerman said.