Nortel goes under the knife again

Phone equipment maker faces longer recovery

By Jeffry Bartash, CBS.MarketWatch.com
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WASHINGTON (CBS.MW) -- The latest corporate overhaul by Nortel Networks will shear the company of all its manufacturing operations and leave it with 70 percent fewer workers than it had four years ago.

Nevertheless, it'll still have trouble turning a profit.

On Thursday, Nortel said it would eliminate an additional 3,500 jobs in a cost-cutting measure designed to boost profit margins.

The company's shares closed 14 cents higher at $3.74 in Thursday's regular session. Combined with a decision earlier this year to sell its manufacturing operations, Nortel expects to end the year with just 30,000 employees. That's down nearly 70 percent from the company's all-time high payroll figure.

In spite of Nortel's efforts to slim down, analysts aren't ready to declare the company's corporate weight-loss program a success.

"You can't cut your way to prosperity," said Ed Snyder of Charter Equity Research. Besides cutting costs quickly, analysts say, Nortel has to shore up its roster of products, improve its overall strategy and adjust better to market realities -- slower long-term growth and stiffer competition.

Tougher times
Since the end of the late 1990s boom, industry sales have plunged from the heady 30 percent-plus levels to mid- and single-digit rates, which is closer to the historical norm. Back then, a temporary confluence of events juiced up sales. First the Internet exploded into public view. Then the wireless phone business took off, spurring carriers to spend billions to expand. And U.S. regulatory reform later spawned a host of new local and long-distance providers, which spent billions more to build their own networks.

Nowadays, wireless carriers have mostly built out their networks and they are only expanding gradually, particularly in light of stiff competition within their own industry. At the same time, competition in the equipment market has sharply intensified across the globe. The rise of new North American vendors initiated the trend, but now emerging China-based rivals are out for a piece of the action.

Indeed, Nortel Chief Executive William Owens pointed to new overseas competitors as a reason for declining industry margins during a conference call with analysts Thursday.

"These players in our marketplace are professional and lower-cost," he said.
Charter Equity's Synder agreed: "There's a lot of competition in the market. You are not going to see skyrocketing profit margins like in the past."

Brief, shining moment

It was far different in the pre-Internet age, when Nortel and a few other vendors held a lock on the phone networking business.

In 1995, for example, Nortel earned $400 million on sales of $10.7 billion, at a time when it had 65,000 workers and owned substantial manufacturing assets.

Things got even better during the go-go years of the late 1990s, when telecom sales exploded and vendors couldn't hire workers fast enough. By 2000, the company had surged to a whopping $30 billion in revenue, doubling its sales in just three years. Employment peaked at nearly 100,000.

"A decade ago, demand seemed almost endless," said Mark Sue, an analyst at RBC Capital Markets.

By early 2001, however, the tide had clearly turned. Nortel was forced to conduct its first major round of layoffs in January and it issued the first of many profit warnings just one month later. In the second quarter of that year, Nortel recorded a staggering loss of $19.4 billion, one of largest in corporate history.

Fast-forward to 2004. This year, Nortel will be fortunate to break even on a level of sales similar to 1995's, even though it has less than half the workers and far fewer manufacturing operations.

Sell, sell, sell

Yet cutting workers and getting rid of manufacturing plants won't cure all of Nortel's problems. "Downsizing is not a strategy," said Bill Leisur, director at Technology Business Research.

RBC Capital Markets analyst Mark Sue points out that Nortel has one of the lowest rates of productivity per worker in the industry. Cost cuts will help drive that number higher, he added, but the company also has to find a way to lift sales.

Owens acknowledged that Nortel has to do a better job of getting its products to buyers. To that end, the company will hire a chief strategy officer and a chief marketing officer to better coordinate Nortel's efforts to develop cutting-edge products and to get them into the hands of customers as soon as possible.

"We know this has been something of a weakness for us in the past," Owens said.
Analysts also say Nortel executives have to continue to "break down the kingdoms" within the far-flung company as wireless and wireline networks converge. Big phone

carriers want integrated networking products increasingly based on Internet-related standards. Owens added that the company is making progress in this area as well. Fortunately for Nortel, the company already offers an array of products for wireless and wireline networks, while catering to both carriers and corporate customers.

If Nortel can tie its best technologies together, according to analysts, the company could be well positioned to eventually regain its place as one of the industry's leading performers. ■

Jeffry Bartash is a reporter for CBS.MarketWatch.com in Washington.