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MARKET PLACE

Telecoms Not Impressing Investors

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FOUR years after the collapse of the Internet bubble, phone companies and equipment makers are finally producing steady profits. But their turnaround has failed to impress investors, who have lingering doubts about the industry's outlook.

The reasons for hesitancy are many, but they boil down to this: Growth in the next-generation services and wireless products now being offered by phone companies only partly makes up for the declines in their older, traditional phone businesses.

The market response to earnings on Thursday from SBC Communications is typical. SBC, the large local phone provider, earned $2.1 billion in the third quarter, a 72.2 percent jump from the same period in 2003. Sales grew 1.4 percent, the second straight year-over-year increase after three years of declines, because of demand for its wireless and high-speed Internet products.

Yet SBC's share price fell 2 percent after the release of the numbers as investors continued to fret about the decline in the company's traditional local phone business. The company's shares have slipped 3.3 percent so far this year. Like its rivals, SBC is relying on growth in other areas, most notably mobile phones. Cingular, which is 60 percent owned by SBC, added a net 657,000 new customers in the quarter, beating analysts' expectations.

Cingular will get an additional boost on Monday, when regulators are expected to sign off on its purchase of AT&T Wireless.

Yet there, too, investors worry that spending by wireless customers has stopped rising, even though mobile-phone companies are spending billions of dollars to build new, high-speed networks that can transmit more data.

The net result is that although phone companies' revenue is rising over all, thanks to their wireless divisions, those gains have not been enough to quiet investors' qualms.

"Phone companies are moving from the businesses that are struggling and shifting to where there's upside," said Todd Rosenbluth, a telecommunications analyst at Standard & Poor's. He says he does not see the stocks of phone companies "as growth stories. Their days of big moves are in the past."

Not surprisingly, the phone companies' difficulties are trickling down to the equipment makers. Lucent Technologies, the nation's largest telecommunications equipment maker, said Wednesday that after losing nearly $29 billion in the last three years, it earned a full-year profit in 2004. Sales also grew for the first time since 2000, rising 7 percent in fiscal year 2004. Lucent's shares rose 3 percent after the numbers were released, but they are down nearly 10 percent since April, when they hit their peak for this year.

Lucent's chief executive, Patricia J. Russo, noted that her company had won a $5 billion order from Verizon Wireless to build its next-generation cellphone network, as well as several big contracts from mobile-phone carriers overseas.

But the picture in its fixed-line equipment business, Lucent's bread-and-butter for years, is murkier. While demand for Lucent's new optical switches, routers and other equipment for new Internet-based networks is improving, demand for its old circuit-switch equipment is falling.

This dynamic mirrors the spending budgets of Lucent's biggest customers, the Bell companies. Verizon will spend 14 percent less on fixed-line equipment in 2004 than it did last year, while the capital spending budgets of SBC and BellSouth will be mostly unchanged, according to analysts.

Lucent said it expects revenue to grow in the "mid-single digits" in 2005, about the same as this year, with most of the gains coming from orders for new wireless network equipment. But it is unclear if consumers will pay more for high-speed wireless services, and if they do not, analysts said, the market for equipment to provide those services may soften, too.

"It's tough for the equipment manufacturers to make money when their customers are not spending," said Brett Azuma, the head of research at RHK, a telecommunications consultant based in San Francisco. And the build-out of high-speed fiber-optic networks by the regional Bells is still modest, he said.

Even if more companies offer faster Internet connections, the prices they charge for those services are bound to fall, according to Edward Snyder, an analyst at Charter Equity Research in San Francisco. Mr. Snyder drew a parallel to the computer industry, where the prices for processors fell even as their speeds rose.

That means the carriers will have to focus on finding new customers, Mr. Snyder said. And this prospect may actually cause them to build their new networks more slowly, which would be bad news for equipment manufacturers.

Of course, the bad news has already arrived for the long-distance carriers, including one of Lucent's biggest clients, its former parent, AT&T, the nation's largest long-distance company. AT&T, which is retreating from the residential phone market, plans to invest $1.8 billion this year on new equipment, less than half of what it spent in 2002. MCI, the No. 2 long-distance company, spent far less between 2002 and 2004, when it was operating under bankruptcy court protection.

When AT&T reported a $7.1 billion quarterly loss on Wednesday, its shares rose 1.4 percent on hopes that the company is cutting costs fast enough to offset its falling sales. For the year, the company's stock is down 24 percent.