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Wintel's Identity Crisis

By MARK VEVERKA

Healthy earnings reports didn't do much for the shares of Microsoft and Intel. Investors seem to be dwelling on Microsoft's failure to sell enough operating systems and Intel's lackadaisical PC growth.

Both pillars of the once-mighty Wintel duopoly posted very solid earnings results last week, but the growth fans are long gone, and the value investors who have replaced them are grumpy. Consequently, shares of both **Microsoft** (ticker: MSFT) and **Intel** (INTC) did a whole lot of nothing.

Microsoft last week reported a 30% gain in profit, to $5.8 billion, or 69 cents a share, for its fiscal fourth quarter, driven by a healthy appetite for its business offerings, such as Windows Office, and its Xbox videogame business, which is thriving thanks to its game-changing Kinect system. Earnings beat consensus estimates by a dime, but it still didn't move the needle much among investors. Revenue also beat the Street, jumping by 8%, to $17.4 billion. The shares closed Friday at 27.53, up 2.8% from the previous Friday's close of 26.78.

What investors seemed to dwell on was a slight dip in sales for the Windows operating system for personal computers, as well as weakness in Internet-search revenues, including its partnership with **Yahoo!** (YHOO). "We still face monetization challenges, but we'll have this turned around by [Dec. 31]," Chief Financial Officer Peter Klein told investors on a conference call.

Meantime, sales in low-end Windows for netbooks plunged by around 41%, seemingly cut low by tablets—namely iPads. But the business-products side of the house, including servers and tools, whose revenues jumped 12%, continued to throw off cash. Stellar cash flow "allows us to capitalize on long-term growth opportunities," CFO Klein said. That kind of talk is what irks value-style shareholders, who would like to see Microsoft lose its ambition to remain a "growth company," says HighMark Capital Management Vice President Todd Lowenstein. The Los Angeles money manager, whose firm holds 1.9 million shares, calls Microsoft a "bad allocator of capital," and supports shareholder proposals to use cheap debt to increase dividends and buy back more shares (see *Barron's* Technology Trader, **"Memo to Microsoft,"** July 18).

"Microsoft is the perfect candidate for a leveraged recapitalization. It has been done with companies in other industries with less stellar balance sheets," Lowenstein argues. No matter how much pressure institutional investors try to apply to Microsoft, don't expect any kind of radical recap plan soon.

Current management isn't giving up on its growth plans for mobile and cloud computing.

INTEL INVESTORS FACE the same conundrum. As another big-cap tech company that has matured, Intel also has yet to throw in the towel on being a "growth company." Last week, the Santa Clara, Calif., chip giant's second-quarter profit of $2.95 billion, or 54 cents a share, beat analysts' estimates, and record sales of $13 billion edged out forecasts. The results were driven by robust sales in servers and data centers. But the company lowered its expectations for full-year PC growth from low-double-digits to a range of 8%-10%, which grabbed all of the headlines. Shares declined in trading after the earnings report; they closed Friday at 23.13, up 3.4% from 22.37 the previous Friday.

Charter Equity Research analyst Edward Snyder contends that Intel is making smart investments in tablets, mobile and security, but for now will live and die as a PC company in the eyes of investors. "A sustained appreciation in Intel won't occur until investors see tangible signs of success in large new markets like mobile phones," Snyder says. Could be a while.

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