

November 29, 1999

November 29, 1999

BARRON'S
Online

WEEKDAY TRADER

A version of this column
 originally appeared November 23
 in Barron's Online

The Inside Story

Is the party over for chip-equipment makers?

BY CAROLYN WHELAN

SINCE BOTTOMING OUT DURING last year's Asian financial crisis, shares of semiconductor-equipment manufacturers have been on a tear.

Stocks such as Applied Materials, KLA-Tencor and Novellus Systems have quadrupled from their two-year lows of September and October 1998. Shares of another manufacturer, Lam Research, have shot up ninefold.

And the fundamentals appear intact: Asian economies continue to recover, and growing World Wide Web and wireless phone usage drives demand for more chips — and the equipment that produces them.

But some on Wall Street don't expect share prices to follow.

"The stocks have moved a lot faster than the business fundamentals have improved," observes Gerald S. Fleming, an analyst at Tucker Anthony Cleary Gul. He and several other Wall Street analysts recently cut their ratings on the stocks.

Their concern: A business whose up cycles normally last around three years. Many believe that the robust growth expected over the next two years is already in the price of the shares.

"The easy money's been made," says Elliott Rogers, an analyst at Credit Suisse First Boston. Last month, Fleming downgraded KLA-Tencor to Hold from Accumulate when it hit his firm's price target in the 70s. "I thought it was getting ahead of itself," he explains. (It closed Friday at \$9 15/16.) John Colligan, an analyst at Olde Discount Corp., recently lowered his ratings on Novellus to Accumulate from Buy because of price.

And the pace of downgrades has picked up. David Wu of ABN Amro just cut Applied Materials, Novellus Systems and Lam Research to Outperform from Buy, because, he explains, they're "really selling in 2001 peak earnings."

Susan Crossley of First Security Van Kasper also recently lowered her rating on Lam to Accumulate from Buy. Her explanation: "When it got up to the high 60s, it was getting pretty close to fully valued."

Indeed, valuations of some of these stocks are looking pretty stretched, even though they're slightly off their highs.

At its recent price of 102 7/8, Applied Materials changes hands at 31 times times expected earnings of \$3.27 (for the fiscal year ending October 2000), a premium to its 25% projected long-term annual earnings growth and to its average P/E of 28 over the past five years.

Similarly, KLA-Tencor is near the high of 94 7/8 that it set in November, and sells at a lofty 45x expected earnings of \$2 for the fiscal year ending in June 2000 — a huge premium to its 25% estimated long-term annual earnings growth rate and to its average P/E of 30 over the past five years.

Finally, at 86 7/8, Novellus Systems is 11% off the high of 97 1/8 it scaled in November and changes hands at 27 times expected 2000 earnings of \$3.20. That's still a premium to its 25% long-term earnings growth rate and to its average P/E of 21x over the last five years.

Meanwhile, as the stock prices rose, so did the level of insider selling at these companies.

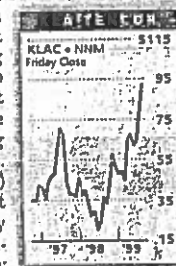
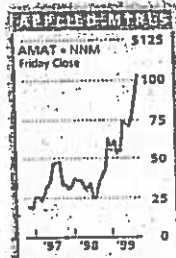
In mid-September, for example, KLA-Tencor vice president Neil Richardson proposed selling 32,459 shares of stock with a total value of \$2.5 million. Around then, Applied Materials vice president Julio Aramovich and CFO Joseph R. Bronson each offered 30,000 shares for sale, positions worth \$2.2 million each. And a vice president, N.K. David Wang, likewise offered up 44,000 shares valued at nearly \$3.4 million, at around \$80. A KLA-Tencor spokesperson declined comment, and Applied Materials didn't return telephone calls by publication time.

Those sales took place a couple of months ago. But Bob Gabele, director of insider research at First Call/Thomson Financial, points out that insiders tend to sell early — and he says these sales are notable.

"We're seeing persistent profit-taking over time, and [it has] been going on for months," Gabele says. "It's also been happening to a number of companies in the group."

Fleming thinks the rest of the market will begin to take some profits, too. "We worry that [the stocks are] due for a rest," he says.

It looks as if after partying all spring and summer and into the fall, investors in semiconductor-equipment stocks may have to hunker down for a cold, hard winter. ■



"The stocks have moved a lot
 faster than the business
 fundamentals have
 improved," observes analyst
 Gerald S. Fleming.