Tech 2011 outlook: Cloudy, chance of takeovers

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From Apple's iPad to cloud computing, hot investment themes abounded in tech in 2010.

And even as the rest of the economy struggles to get back on its feet, the sector is likely to see more expansive growth in the coming year thanks to the relative strength of company balance sheets, strong consumer interest and ongoing demand for technology to drive efficiency gains in business.

"The tech sector is, arguably, one of the strongest by a financial perspective," said Channing Smith, co-manager of the Capital Advisors Growth Fund, in Tulsa, Okla. "From a consumer side, they want tech at their fingertips, and from a business perspective, the most efficient way to drive profits is through investment (in technology)."

And investors had no shortage of activity to get behind during 2010.

There was the long-awaited emergence of tablet computers, led by Apple Inc. and its release of the iPad. Anticipation was so high over the iPad's release, and demand was so strong for the touch-screen device that the iPad was considered one of the main driver's of Apple's stock surging this year.

Then there was the rise of Netflix Inc. from a niche, mail-order DVD company to one of the biggest providers of streaming videos online, with a new, streaming-only video subscription service, and with a stock price that climbed almost 250 percent from the end of 2009. Netflix has become such a force that the amount of its online video traffic was at the center of a dispute over fees charged by cable giant Comcast Corp. to Web-content delivery companies such as Level 3 Communications Inc., which delivers videos from Netflix online.

And then there was all the talk about the billions in cash war chests built up by many of the leading tech companies and what they should do with all that money.

Part of that was answered by all the acquisitions that took place throughout the year.

Intel Corp. was very active with its $7.7 billion deal for security-software company McAfee Inc. and its $1.4 billion buy of Infineon's mobile-chip unit. EMC Corp. cut a $2.25 billion deal for data-storage technology company Isilon Systems Inc. And in the cage-fight of the year, Hewlett-Packard Co. and Dell Inc. battled to acquire data-storage technology company 3Par Inc., which drove the price of 3Par up from Dell's original offer of $1.15 billion to HP's final acquisition price of $2.4 billion.

All the activity is probably good news for 2011 as well.

"The data center market did well in 2010, and I certainly expect it to an area of significant focus and investment next year, as well," said Erik Suppiger, managing director of Signal Hill Capital Group. "There's a growing need for work-related applications and a growth in dynamic, bandwidth-intensive content that's driving content providers to think about where to invest for their needs."

One of the companies that Suppiger is high on for next year is Equinix Inc., a provider of data-center operations that companies often use for hosting their applications and information in a so-called "cloud" environment. On Oct. 6, Equinix shares plunged more than 33 percent after the company issued revenue warnings for its third quarter and entire fiscal year. That warning took down many other data-center operators along with Equinix.

But Suppiger said he believes the selloff was overdone. "The (stock) pullback made them even more attractive," Suppiger said. "Right now, a lot of investors are trying to determine whether the market is reaching maturity. We believe the demand is still there and there will be a need for more data center capacity."

Capital Advisors' Smith said opportunities in the mobile Internet market are numerous, as the sector is practically still in its nascent phase.

Smith points to data from research firm Gartner Inc., which estimates 3G wireless penetration at around the 20 percent to 25 percent level worldwide and smart phones expected to grow from around 16 percent of all mobile phones this year to 45 percent by 2014.

"I think what you have to do is look at the tech sector for opportunities. Some parts are more risky than others," Smith said. "We think the mobile Internet has big opportunities and we continue to focus there. "I think it's the biggest tech cycle we have ever seen."

From Smith's perspective, investors that are interested companies that are in the mobile Internet market can't afford to ignore either Apple or Google Inc. next year, since the companies' iPhones and Android-based smart phones are so embedded in the public mind that many people don't know the names of any other mobile phones.

But Smith also said that another company to consider is Qualcomm Inc., which earns royalties from the CDMA wireless technology used in many mobile phones, including those with Google's Android operating system. And Smith said if, as expected Apple's iPhone comes to the Verizon network next year, Qualcomm should see its fortunes continue to rise.

"That emergence (of Android) has helped Qualcomm," Smith said. "The Android phones are selling better than the iPhone is some parts and the expectations are that when Verizon gets the iPhone, Qualcomm's royalties will be even bigger."

Patrick Becker, a principal partner of Becker Capital Management, says that for 2011, some of the tech titans that are not normally associated with rapid growth could be worth some attention. Becker cites seemingly old-school tech giants as Microsoft Corp., Hewlett-Packard Co. and Cisco Systems Inc. as companies with stocks that may actually be undervalued based on their recent performances. As of Dec. 10, Microsoft's shares were down 10 percent for the year, while H-P and Cisco had fallen 17.5 percent each. By contrast, the S&P 500 index was up by 11.2 percent.

"These companies aren't perceived to be 'growth' companies," Becker said. "But even Cisco grew its earnings when it gave that disappointing (second-quarter) forecast (in November). If the market were to continue to do well next year, these companies could get earnings growth and multiple expansions and investors could see some nice gains."

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