

**LET'S TALK COMMON SENSE, SHALL WE ?**

When one starts from a very low base, an improvement, even of a relatively small one, is magnified and, statistically, things have the appearance of looking better than they, really, are.

Take the situation of a company that, at Year One, writes off everything in sight, only to write back, in Year Two, say, 30 percent of the Overprovisions of Year One.

The resultant effect is that Management may boast that, through its hard work, the Bottom Line has improved, Year-on-Year, by 32 percent – the 30 percent, being the write-back of Year-One's Overprovisions, plus a figure of 2-percent, which is, truly, the situation.

The Chairman's Statement to Shareholders would, then, read:

*'I am happy to report that the situation in our company is much better for the Financial Year, ended March 31, 2002, compared with the previous Year, with Profits up 32 percent ...'.*

Had it not been for the Overprovisions in Year One, the Chairman might have written:

*'It has been a challenging year for your company, but I am happy to report that, through the hard work of our team, we still managed to record a Net Profit Attributable to Shareholders that was 2% higher than the Net Profit of the previous year ...'.*

The above is an example of a logical fallacy, known in the study of philosophy as 'Figures Prove'.

Over the course of the next 6 months or so, there are going to be quite a number of seemingly bullish reports, that this company has done this, and that that company has done that.

But one has to remember that one is starting from a very depressed base in the first place.

It is true that corporate profits will improve for the most part in most industries, and that those figures will appear to be very bullish when compared with the like period, one year earlier.

But the figures will appear to be much better than they, really, are.

One must take into account the fact that the base, from which the improvements were calculated, was the dismal situation that existed in the previous period when the US economy was in the grips of a recession.

Further, massive Provisions were considered prudent and necessary in respect of the previous period(s).

Today, some of those Provisions of the previous period(s) may well be considered to have been a slight overkill, which Management will, now, put right.

The tentative turnabout, about which one hears in respect of the US economy, belies, to a great extent, the fact that new-term prospects continue to be weak.

A strong rebound in the US economy should not be expected until one year from now – at the earliest.

And, for the telecommunications industry, it may well be even longer before one sees much of a turnabout.

Regardless, whatever levels Management of an entity might claim, today, those levels will still be far below the levels of prior years.

Further, those 1.70 million-odd workers that were sacked in the US between the middle of 2000 and today still have not been rehired, by and large.

As at March 16, 2002, Continuing Claims for Unemployment Insurance in the US stood at about 3.53 million Claims, which translates into a 2.62-percent gain on the March 9 statistic.

Employment will, definitely, lag financial performance improvements.

Across the board, in the US, last year, profits declined by about 16 percent, Year-on-Year.

In the history of the US, the declines in profits in the US, last year, were the highest on record.

In the telecommunications industry, net income was negative.

The largest declines were, of course, in the high-tech entities – semiconductor producers, computer manufacturers and computer accessory manufacturers, etc – in spite of the fact that many of these corporate entities managed to keep their proverbial heads above the financial waterline.

In Japan, however, one saw one corporate giant after another report losses, which, in aggregate, were in the hundreds of trillions of yen.

Many North Pacific and South Pacific countries' national budgets are smaller than the 2001 losses of, say, Fujitsu Ltd, Hitachi Ltd and their ilk.

Fujitsu, Japan's second-largest personal computer manufacturer, has already reported that it lost \$US2.13 billion for the first 9 months of its Financial Year, to December 31, 2001.

As for Hitachi Ltd, it announced, on February 28, 2002, that, for the Financial Year, ended March 31, 2002, it expected to suffer a Net Loss of about 480 billion yen (about \$US3.69 billion).

In Fiscal 2000, Hitachi posted a Net Profit of about 104.38 billion yen (about \$US870 million).

### **Inventory Levels**

As TARGET expected, inventory levels in the US were permitted to fall to very low levels, last year, because nobody was quite certain when the economy would struggle out of its economic malaise.

The successful drawing down of inventory levels has seen their value put at about \$US170 billion since the high spot in the middle to last quarter of 2000.

The Inventory-to-Sales Ratio was estimated to be at record lows although few economists are willing to be more definitive than that because there are no accurate records of the diminution in inventory levels over the past 18 months.

In the motor-vehicle industry, however, one can see the depletion of inventory levels as most producers, through in cash incentives to prospective purchasers – just to move stocks and to ensure a steady and ample cash-flow.

That made things look better than they, really, were.

But it is, also, going to mean that the Big 3 motor-car manufacturers of the US will be facing a barrage of questions at their annual general meetings when investors are told of the bad news in respect of earnings.

Motor-car manufacturers are, today, increasing production, and will continue to do so for the first half of this year, at least.

The reduction in inventory levels has come to mean more orders for industry in order to replenish stocks.

This bodes well for the short term.

### **The Flip Side**

Interestingly enough, however, the flip side of the coin is that orders for computers and electronic products fell in the month of March.

While orders for aeroplanes and aeroplane accessories and parts grew in the last few months, such improvements are unlikely to be sustained.

Despite all of the bullish news, investment in business investment has yet to materialise.

It is likely to be months before one sees this take place.

Constraints will, no doubt, be placed on investment spending for most of the remainder of the year.

Meanwhile, there is a huge gap between that which is being manufactured in IT (Information Technology) entities and the total manufacturing capacity in the industry.

In the past decade, it is estimated that IT capacity has risen by about 1,400 percent.

Capacity utilisation in computer, telecommunications and semiconductor industries continues at near rock bottom – about 60 percent.

In short, this industry cannot make money at this level of utilisation, in the same way that the only way that an airline can make money is when its aeroplanes are flying, with seats, full or near full.

It is difficult for Management to set large budgets for new investment while business confidence remains at a low level.

One may expect a great deal of resistance to spend more unless there are definite signs that the US economy is reviving.

And that has yet to materialise, regardless of apparent isolated pockets of bullishness.

The telecommunications industry is unlikely to pull up its socks and one may expect negative net income for the next year, at least.

One may expect to see aerospace and semiconductor producers to post lower profits, this year.

What this all translates into is a continuing, pretty grim picture of the US economy for the near term.

However, it is unlikely that the Government of the biggest single economy of the world will just sit back and do nothing.

The Administration of George W. Bush cannot afford to be seen to be doing nothing with regard to the economy, in the same way that it could not sit idly by last year when it declared war on the Taleban Regime of Afghanistan, following the cowardly attacks on the US homeland, last September 11, by Arab madmen, who killed some 3,000-odd unarmed civilians.

For Asia, which 'feeds' the US with everything from condoms to coconuts, the above scenario would appear to mean that things will not recover in the short term ... or even the intermediate term.

The earliest appreciable improvement, TARGET would suggest, will come in the middle of 2003.

In the meantime, industry leaders will have to content themselves with creative accounting practices and hope that their shareholders are myopic, in the extreme.

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