

Only Major Surgery Can Revive Nortel

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Nortel Networks Ltd. ([NT](#)) just can't seem to get it right. Since autumn of 2001, as the industry depression spread through telecom, CEO Frank A. Dunn has announced four downsizings and rightsizings of the Brampton, Ontario, equipment manufacturer. The most recent came in late August, when Dunn announced a plan to cut the workforce to 35,000. Yet the company is still losing money and market share, and its stock price is hovering around \$1, down from an all-time high of \$143 in March, 2000.

It's time to take a more radical approach. Spending on North American telecom gear is expected to be down 41% this year and 10% more next year, according to Deutsche Bank. Barring a sudden and dramatic turnaround in the market--which no one expects--Dunn & Co. will have to move ahead with a structural makeover. So far, "they're just adjusting to the here and now," says **Anthony Scilipoti**, copresident of **Veritas Investment Research Corp.**, an equity research firm in Toronto.

Here's one roadmap back to fiscal health: abandon two divisions representing nearly \$4 billion in sales, and unload some 12,000 jobs. It's wrenching, but it would leave a potentially healthy \$7 billion company-- one with powerful positions in metro-area data networks and wireless markets. These are more promising areas, where Nortel is already gaining share.

Where might Nortel retreat? Dunn should quit the market for corporate Internet gear, where it is being trounced by Cisco Systems Inc. ([CSCO](#)) He should also exit the saturated market for optical equipment that sends data over long-distance networks. These moves would stanch the bleeding at Nortel.

The long-distance optical unit made Nortel a star in the late 1990s, but its heyday is history. Loads of its formerly free-spending customers, from WorldCom Inc. to Qwest Communications International Inc., are in financial straits, and nonessential capital spending has screeched to a virtual halt. Nortel's long-haul optical sales have dropped to an estimated \$1.4 billion in 2002 from \$8 billion in 2000, and the market, according to Merrill Lynch & Co., is falling by 42% this year. Rivals are gobbling up market share at Nortel's expense.

Dunn argues that his company leads in this industry and that it will bounce back someday. But the wait eats scarce cash. The prudent move is to stop manufacturing and only service existing customers.

The company would also do well to stop selling corporate Internet gear. Nortel's share in ethernet switches, for example, has shriveled to 5.4%, a far cry from Cisco's 68.5%. Dunn says Nortel products surpass Cisco's at voice over the Internet. "They don't need to be in it," says analyst Shawn Campbell of Northern Trust Co., which owns 11.9 million Nortel shares.

These strategic decisions would help push down Nortel's head count to about 24,000. At that level, according to **Scilipoti** at **Veritas**, its revenue per employee jumps to \$440,000--hiking each worker's contribution to the bottom line from \$90,000 to \$130,000, where Nortel can make a profit.

Once costs are stabilized, Nortel can focus on replacing lost growth. It should start by looking overseas. Right now, the company gets 55% of its sales from the U.S.--nearly as high as struggling Lucent

Technologies' 65%. That's too much, especially since Nortel's chief customers in North America are mired in financial strife. Spending in Europe is expected to decline only 15% this year, vs. a 41% drop in the U.S.

No doubt, such a restructuring would take months for Nortel to work through. But it would almost ensure an operating income in 2003, says telecom analyst Mark Lucey of TD Securities in Toronto. That won't bring the boom years back, but it would halt the bleeding and set Nortel up for long-term growth.