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THE WALL STREET JOURNAL.

Monday, November 17, 2008

B1

Cellphone Makers Brace for the Shake-Up

Motorola and Sony Ericsson Look Particularly Vulnerable as Budget-Conscious Consumers Decide to Postpone Upgrades

BY AMOL SHARMA AND SARA SILVER

THE CELLPHONE industry is poised for its first major shake-up since the beginning of the decade as the global economic downturn hurts sales of handsets and components, leaving some companies better protected than others.

One bellwether of the slowdown is **Nokia Corp.**, which makes one in four cellphones sold world-wide. The company warned last week that it expects tepid demand during the holiday season and a shrinking global handset market next year as consumers cut spending.

That news follows a range of other sobering developments in all sectors of the wireless industry. **Qualcomm Inc.** recently projected a dramatic contraction in its sales of cellphone chips, and wireless operator **Vodafone Group PLC** warned that its full-year revenue will fall short of previous forecasts.

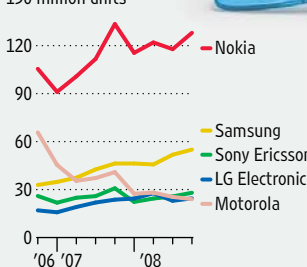
Handset manufacturers are a leading indicator of the down-



Global Gadgets

World-wide mobile handset shipments

150 million units



Sources: Strategy Analytics; Nokia (photos)

turn, analysts say, because consumers during tough times are less likely to upgrade their phones when their existing ones work fine. Replacement cellphones make up 75% of overall sales.

After 15% growth in handset sales during the first half, demand is falling off. Shipments are expected to decline 1% next year, according to market-research firm Strategy Analytics. Wall Street analysts are predicting steeper declines—as much as 9%—next year.

"This slowdown presages a

shakeout, especially among companies whose balance sheets were not in great shape to begin with," says Deutsche Bank telecom analyst Brian Modoff. "This

exacerbates the pressure on the weaker players throughout the industry."

The downturn won't affect all handset makers equally. Those with high-end smart phones with the latest features, like touch-screens and fancy Internet capabilities, are forecast to weather the storm best. Companies that make most of their profits in midtier phones, those with ordinary features such as a built-in camera, will have a harder time luring consumers to upgrade, analysts say.

Handset makers have moved

into emerging markets to try to feed the demand for first-time cellphone buyers, but there too, sales have slackened. Bonny Joy, of Strategy Analytics, says that sales in the second half of 2008 are expected to grow at a 9% clip, slowing from 20% in the first half of the year. Sales in the Middle East and Africa are still growing around 20%, but have dropped substantially in India and China.

Among the companies better positioned for the shake-up include BlackBerry-maker **Research In Motion Ltd.**, which this week is releasing the touch-screen Storm through Verizon Wireless. **Apple Inc.**, whose iPhone continues to sell rapidly around the world, also is situated well. Analysts also cite **HTC Corp.**, maker of the touch-screen G1 phone, the first based on **Google Inc.**'s Android software.

Motorola Inc., of Schaumburg, Ill., and **Sony Ericsson** are among the companies that could have a tougher time.

Sony Ericsson, a joint venture of Japan's **Sony Corp.** and Sweden's **Telefon AB L.M. Ericsson**, banked on customers paying a premium for its CyberShot camera phone and Walkman music phones. "But at the beginning of 2008, customers shifted to phones offering new display technologies and suddenly decided they weren't willing to pay that premium anymore," says Tero Kuittinen, senior analyst at Global Crown Capital LLC.

"We were among the first companies to raise the flag in mid-July about the challenging economic conditions and announced a restructuring to position ourselves for growth," said Aldo Liguori, global spokesman for Sony-Ericsson.

At Motorola, more than half of the company's sales comes from its midrange W-series phones. Management turmoil and steep cost cuts have stymied the company's ability to roll out lower-end devices or newer email phones to replace the Q series, which has sold poorly.

A Motorola spokeswoman said the company "has put aggressive plans in place to rebuild and reposition the business for the future." Please turn to page B9

Small Firms Shiver as Health Premiums Rise

BY VANESSA FUHRMANS

Already struggling in a tough economy, many small employers are about to face another big hit: markedly higher increases in health-insurance premiums as they head into 2009.

For many of these companies, the steeper increases couldn't come at a worse time, when the economy is weakening and credit is harder to come by.

"We can't pass these costs on to our customers; the market just won't bear it," said Daniel Lance, who owns E.CAB, a St. Petersburg, Fla., firm that produces finishes and fixtures for elevator-cab interiors.

After no increase last year, E.CAB's premiums jumped 75% to about \$6,800 a month when its annual Blue Cross Blue Shield of Florida policy came up for renewal this month. Much of the jump was triggered by the hiring of a few older workers by the 25-employee firm, pushing it into a higher-cost actuarial bracket. E.CAB couldn't get a better price from rival insurers.

Rather than pass the cost on to his employees, who aren't required to contribute premiums for themselves though they do for family members, Mr. Lance said he's forgoing new wood-cutting equipment he had planned to purchase. "I just felt

it was a bad time [to pass on costs]," he said. "The employees are having a tough enough time, too."

As hard as it has been for businesses to absorb ever-higher health-care costs each year, the collective premiums they paid had actually climbed at a slower

Tamed for a Time

Quarterly employment cost index for health insurance; change from a year earlier



Source: Labor Department

rate in recent years. But as small businesses begin to receive their annual renewal notices, employers and health-insurance brokers in the South, Midwest and California report noticeably steeper rises. Some premium increases being quoted to employers are double those quoted just a few months ago.

In a nationwide survey of 30 insurance brokers released by

Citigroup last week, more said insurers were raising premiums at a faster rate than those who reported slowing increases.

The clearest evidence of acceleration comes directly from insurers themselves. As they released third-quarter earnings in recent weeks, **WellPoint Inc.**, **UnitedHealth Inc.** and **Humana Inc.** all reported less aggressive pricing by competitors in a number of markets, making it easier to charge premiums that would assure a solid profit.

"Generally speaking, we've been increasing our pricing over the last several months and last several quarters with the thought in mind that it's going to be a lot more conservative in terms of the pricing environment and we're beginning to see that," said James Murray, Humana's chief operating officer, in its earnings conference call with analysts late last month.

For-profit health insurers have seen profit margins shrink this year in the face of higher-than-expected medical costs and pricing missteps, not to mention membership declines as more businesses drop or cut back coverage. While companies with 500 or more employees might have leverage to negotiate, health insurers are "being much more rigid" with smaller firms, said Edward Kaplan, national practice leader at Segal Co., an employee benefits consultancy.

Adding to upward pressure on prices could be dozens of not-for-profit Blue Cross and Blue Shield plans, whose investment portfolios have taken a beating in the recent market turmoil. In recent years, the not-for-profits have been under political pressure in their states to reduce their big surpluses from flush years by providing price breaks to customers. Analysts say they now may have more cause to not.

"Now that investment income is significantly less, we could see less concern about an embarrassment of riches and more about battenning down the hatches," said Matthew Borsch, a Goldman Sachs analyst.

C. Steven Tucker, a health insurance broker for small businesses in Illinois, said his clients have been getting increases ranging between 28% and 31% this month, compared to typical increases of 18% to 20%. In Florida, brokers say many plans hit with high increases are high-deductible plans eligible to be used with a health savings account.

A few years ago, health insurers tried to win business with the new health savings accounts by charging low premiums, but since the most popular ones pay 100% of costs after a \$1,500 to \$3,000 deductible, their costs have been higher than anticipated. "Now the insurers are catching up," said John Sinibaldi, an employee-benefits consultant in Seminole, Fla.

Dottie Jessup, who owns bicycle shops in Clearwater and Palm Harbor, Fla., with her husband, Tom, said they and their 25 employees, who share premium costs 50-50, couldn't handle a 12.5% increase set to go into effect next month. "We don't know what kind of year we're going into," she said.

Instead, they went with their only other option: to raise one plan's deductible to \$2,500 from \$2,000 and the other to \$3,500 from \$2,850, in exchange for just a slight premium increase.

"Our concern is that we're getting to the point where we're wondering where this is all heading, because you can only reduce benefits and contain costs so much," she said. "What's our ability to provide benefits to our staff going to look like in the future?"

G. Leo DuMouchel, an Atlanta-area employee-benefits consultant, said that after years of negotiating smaller increases by raising deductibles and paring benefits, many of his small-business customers have run out of that option.

"They've pushed [cost-sharing] to the limit," said Mr. DuMouchel, who added he hasn't seen a premium increase for his clients below 17% since October, compared to 6% to 8% increases last summer. "They know employees can't handle any more."

Home Depot's New Web Site Opens Door To Hispanics

BY ANN ZIMMERMAN AND MIGUEL BUSTILLO

Home Depot Inc. is aiming to tap into the nation's burgeoning Hispanic population with a new Spanish-language version of its Web site, joining only a handful of other large U.S. retailers offering the online option.

The home-improvement retailer's Spanish site, which launches Monday, replicates its English language e-commerce site, with 40,000 products available to online shoppers.

Home Depot, like many other national retailers, views Hispanics as a lucrative growth opportunity. A study of English and Spanish-language consumers conducted last year by Forrester Research Inc. found that one-fourth of Hispanics must be served in Spanish if retailers want their business. More than half of Hispanics who shop online—7.1 million people, by Forrester's count—prefer Spanish.

Hispanics accounted for one-half of the U.S. population growth between 2004 and 2005 and are expected to reach 102.6 million people by 2050. Forrester expects Hispanic shoppers online to exceed 17 million

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Pirates Prey on Blu-Ray DVD Format

BY GEOFFREY A. FOWLER

HONG KONG—Movie pirates are going after Blu-ray, using a technological twist that makes their illicit copies both cheap and tough for consumers to spot.

Pirates are taking advantage of the fact that many viewers can't tell the difference between Hollywood's new high-definition, higher-priced Blu-ray movie format and a bootleg format—called AVCHD—that's a grade lower: AVCHD uses 720 horizontal lines of resolution instead of Blu-ray's 1,080, but still offers a sharper picture than an ordinary DVD on high-definition television sets.

The movies are pulled off Blu-ray discs using easily available software. Because of the lower resolution, they can be put on ordinary blank DVDs instead of more costly blank Blu-ray discs. That makes them quite profitable for pirates to make, warns the Motion Picture Association, the industry group that battles piracy on behalf of the studios owned by **Walt Disney Co.**, **Viacom Inc.**, **Sony Corp.**, **News Corp.**, **Time Warner Inc.**, and **General Electric Co.**

"We are concerned and are as-

signing priority to this issue," said Mike Ellis, the Asia-Pacific managing director for the MPA.

Some eBay Inc. merchants are warning customers to look out for counterfeit Blu-ray discs, or ordinary DVDs passed off as Blu-rays. One tip-off: Real Blu-ray discs attract fingerprints more easily than the pirated discs.

The industry took notice last month when authorities raided a big stash of the new pirated discs in China, which is often at the leading edge of piracy trends. Authorities in the southern Chinese city of Shenzhen last month unearthed a pirated warehouse collection with 800 of the discs, with titles ranging from "Harry Potter and the Philosopher's Stone" to "Transform-

ers." The pirates had packaged them in Blu-ray's recognizable blue boxes, including holograms to try to make them look like the real thing.

"Pirated DVDs from this region...have been exported all over the world in the last few years. These syndicates are very quick to spot market opportunities," said Mr. Ellis.

The MPA estimates that within the next six months the high-definition discs could account for 10% of \$224 million that its member companies lose from piracy in China. While a legitimate Blu-ray disc costs about \$30, a pirated Chinese disc goes for as little as \$7.

The new piracy threat comes as the industry tries to push Blu-ray to compensate for softening sales of regular DVDs. Entertainment companies hope consumers will upgrade their libraries to the newer discs. In the four weeks ended Oct. 26, Blu-ray discs accounted for 6% of the home-video market, according to Nielsen VideoScan. Retailers and electronics companies re-

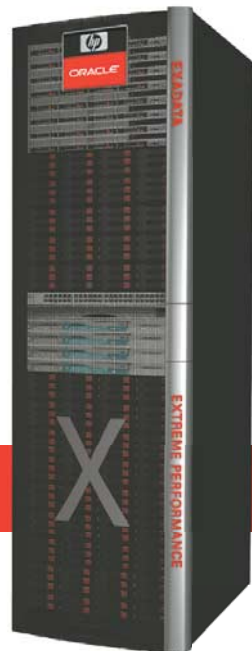
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Geoffrey A. Fowler/The Wall Street Journal

Pirated Blu-ray disks seized by Chinese authorities.

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