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Research Bulletin

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Can Client/Server Revive Tandem?

The third quarter of 1993 will probably be known as one of the most promising yet disappointing periods in Tandem Computers, Inc.'s corporate history. Having made newspaper headlines for both the introduction of a new line of client/server hardware platforms and for posting the largest quarterly loss in its history, Tandem still walks through the Valley of Silicon fearing layoffs and further financial shortfalls.

Good News

Like many of the major players in the platform business, Tandem has identified client/server computing as the key strategic focus for the foreseeable future. At a press teleconference held July 20, 1993, the company officially introduced its new generation of fault-tolerant, high-availability hardware platforms. With references to Sir Edmund Hillary and his faithful companion Tenzing Norgay, Tandem President and CEO Jim Treybig presented the NonStop Himalaya Range of scalable server platforms to the press, industry analysts, and 93 Tandem sites worldwide.

The Himalaya Range itself consists of three configuration offerings:

- The NonStop Himalaya K1000, a midrange, RISC-based parallel server
- The NonStop Himalaya K10000, the high-end, parallel platform that runs in compact, noncomputer room environments and is based on MIPS R4400 RISC technology

The first two configurations will be available in September 1993, while the K10000 is not scheduled for release until the fourth quarter of 1994. The computers will respectively cost \$25,000, \$137,000, and \$339,000. According to Tandem, the line is designed to be highly scalable, enabling entry-level K100 customers to expand their computing power up to the K10000 level.

Jim Treybig introduced the Himalaya Range using Tandem's theme of "Instant Information Everywhere," a phrase that summarizes the company's newly defined product and strategic directions. According to Treybig, client/server computing is the primary and fundamental focus Tandem has chosen. Treybig stated that, in order to follow this focus, the company remodeled its research and development direction basing it more on RISC-based architecture and the UNIX operating system. "Client/server architecture is the future, and fundamental to Tandem's strategy is providing high reliability and availability, fault tolerance, parallelism, and data integrity across client/server networks," Treybig said.

- The NonStop Himalaya K100, the entry-level server designed for LAN-based office and deskside environments

During the conference, Treybig and company explained that this new direction is the key to Tandem's growth, because it is intended to lower the price for Tandem hardware without creating the additional expenses traditionally associated with fault-tolerant systems. The K10000 server, for example, is substantially less costly than the \$1.2 million price of the Guardian series.

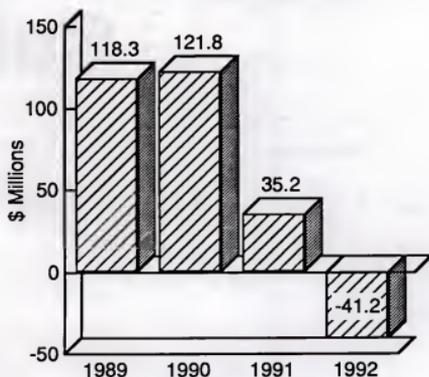
Tandem also seeks to reduce customer software costs by providing open systems that accommodate Tandem's existing proprietary operating software as well as the popular UNIX environment. NonStop Kernel, the new operating system for the Himalaya Range, incorporates support for both Tandem's proprietary Guardian operating system and for the POSIX flavor of UNIX, thereby accommodating existing proprietary customers and new customers seeking open systems. The company's vision is for the NonStop Himalaya Range to become the basis for an electronic infrastructure that incorporates Apple Computer, Inc.'s Newton devices accessing business applications through Motorola cellular systems. Apple CEO John Scully and Jack Scanlon, Senior Vice President of Motorola's Cellular Infrastructure Group, gave brief presentations in support of Tandem's new direction and overall vision.

Bad News

Yet just over one week after presenting his company's new strategic direction, Jim Treybig had the unpleasant task of announcing the largest quarterly loss in Tandem's history. From a lackluster net income of nearly \$30 million in the second fiscal quarter of 1993, Tandem dropped to a third fiscal quarter loss of \$550 million. The largest loss Tandem had prior to this was one of nearly \$100 million in the first quarter of 1992. Exhibit 1 shows the company's net income figures for the last four fiscal years.

Exhibit 1

Tandem Computers Inc. Net Income, 1989-1992



Source: Tandem Computers, Inc.

Tandem also announced it intends to layoff 15% of its 10,500 employees. This latest move will affect roughly 1,700 Tandem workers, considerably more than the 700 the company laid off in early 1992. For remaining employees, the company will impose a one-year 5% pay cut and eliminate a stock-based employee retirement plan. One of the more visible employees leaving Tandem's service was Ralph Ungermann, the CEO of Ungermann-Bass, Tandem's networking subsidiary. Ungermann will also leave the parent company's board of directors.

In defending both the financial loss and the employee downsizing and pay cutting, Jim Treybig said Tandem has begun the process of reorganizing in order to be profitable and competitive in the lower-priced hardware market it entered with the NonStop Himalaya Range. In addition to dwindling prices, high discounting, and fierce competition, Tandem's CEO also blamed recessions in both Europe

and Japan and the negative impact these have had on the company's sales in these regions. Sales in Europe and Japan contributed 27% and 13%, respectively, of the company's total sales for the third fiscal quarter of 1993.

Subsequent to announcing its third-quarter losses, Tandem has indicated that it may lose money in the fourth quarter of 1993 due to its ongoing restructuring. The company expects that its layoffs, which will be completely implemented by the end of calendar 1993, will decrease possible financial losses.

Where To Go From Here?

In order to succeed within the new information technology paradigm, a company must be willing to change both its products and its business strategies on a continuing and increasingly rapid basis. Unfortunately for Tandem, its recent product and strategy overhaul may prove to be too little and too late.

Basically, the NonStop Himalaya Range of computers and its accompanying client/server focus provides an intelligent path. Recent financial performance aside, Tandem has wisely chosen to bring its fault-tolerant, high-availability experience into the client/server market place. As client/server computing becomes more popular and pervasive, computing needs will require fully reliable, scalable servers that will run seven days-per-week and 24 hours-per-day in order to support business-critical applications and growing client/server networks. The company became an industry leader by building and selling fault-tolerant parallel processing mainframes. By applying these concepts to client/server technology, Tandem has achieved a unique market position, and its Himalaya Range has the potential of becoming a market leader in client/server computing platforms.

Unfortunately, Tandem is now in the difficult position of not just wanting the Himalaya Range to be accepted, but needing it to be accepted. Clearly, these new computer offerings have been devised as a way for Tandem to improve the uninspiring financial performance the company has been delivering for the past several years. In the aftermath of the third-quarter loss announcement, Jim Treybig predicted that the Himalaya Range will eventually generate 80% of Tandem's sales. This aggressive assertion means the company is confident in the Himalaya Range's potential, but it may also mean Tandem is putting all of its eggs in one basket.

Bank On Client/Server Market Growth

A recent INPUT survey of 1,748 information services users indicated that 34% of companies queried plan to initiate client/server computing projects in the next one to three years. The survey also revealed that 21% of the same sample plan to downsize their computer systems within the same time frame. Tandem has proven it can achieve market leadership, and pursuing opportunities in client/server technology is the best way the company can recover from its recent restructuring difficulties.

However, regardless of the popularity of client/server technology, any new product has to prove itself. Tandem's financial performance over the last several years indicates that the company's existing customer base may not be a robust source of revenue, and so new sources must be found if the company is to recover. The Himalaya Range may offer Tandem a source of new customers, but this cannot be determined until the computers are available in late September 1993. In addition to computer hardware, services may be a viable revenue

generator for the company. In Tandem's fiscal 1991, 24% of the company's revenues were from services. By fiscal 1992, that figure decreased 2%. However, the service revenue figure for both years, \$371 million, was the same. Tandem has plenty of knowledge and experience it can use to upgrade current services and devise new services in order to generate revenues.

Essentially, Tandem is in a make-or-break situation. Even with the support of Apple and Motorola, Tandem cannot provide "Instant Information Everywhere" without its own products, and the profits they generate, to form the foundation for the company's vision. While not completely dead, the mainframe computer market, in which Tandem succeeded for so long, continues to shrink by roughly \$5 billion-per-year, making molehills of even the biggest mountains.

What this means is the company must quickly demonstrate the viability of its new products and have the marketing savvy to position them to the greatest possible advantage for the company and its customers. Tandem has demonstrated that it has the vision and the strategy to be profitable and progressive; now all it needs is to show that it also has the products, marketing skill, and agility to achieve its goals.

This Research Bulletin is issued as part of INPUT's Information Services Market Analysis Program. If you have questions or comments on this bulletin, please call your local INPUT organization or Bob Goodwin at INPUT, 1881 Landings Dr., Mountain View, CA 94043-0848 (415) 961-3300