FD

Forward-Looking Guidance within the Technology Sector

Summary and Key Findings

The past twelve months have seen drastic changes in the global economic environment that have challenged the visibility of technology companies like never before. Against this backdrop, determining an appropriate guidance practice has become an area of intense focus. Historically, guidance was considered sacred by the capital markets, but investors have come to realize that measuring performance in a changing environment requires more flexibility in guidance practices and the information provided by companies.

As the operating environment slowly begins to show signs of stabilization and we embark on 2010, companies are once again reviewing their guidance practices to determine whether or not any changes are warranted. When embarking on this discussion, it is critical to understand the best practices and trends in the broader technology space, as well as a company's specific sector.

To support companies in their decision-making, FD reviewed the guidance practices of 277 technology companies with market capitalizations greater than $500 million. Our key findings were as follows.

- The vast majority (81%) provided at least some forward-looking guidance;
- Of those companies that provided guidance, slightly less than half provided only a view of the next quarter. The rest were evenly divided between annual and a combination of annual and quarterly guidance;
- Despite the challenging operating environment of the past year, there was little change in guidance practices over the period. In those cases where guidance was changed, there was a relatively even split between companies that initiated guidance or increased the information content of their guidance, and those that suspended guidance or reduced the information content;
- Not surprisingly, companies in technology segments where there is more forward visibility, such as Software and Services, were more likely to maintain current practices and provided more specific guidance than companies in real-time operating businesses such as Distribution and Semiconductors; and,
- The most common guidance provided were top- and bottom-line metrics (revenue and EPS), but many companies provided other information, such as operating or cash flow metrics, to guide the capital markets.

Methodology

FD reviewed the guidance practices of U.S.-listed and U.S.-based technology companies with market capitalizations greater than $500 million to understand how companies were addressing the changing landscape.

We identified a total of 277 companies across the broad technology sector: Software (78 companies / 28% of sample), Hardware Distribution (9 companies / 3% of sample), Hardware OEMs (78 companies / 28% of sample), Semiconductors (58 companies / 21% of sample), and Technology Services (54 companies / 20% of sample). Of the 277 companies in the sample, 60% were small-caps (market capitalization less than $2 billion), 29% were mid-caps (market capitalization between $2 billion and $10 billion), and 11% were large-cap companies (market capitalization greater than $10 billion).

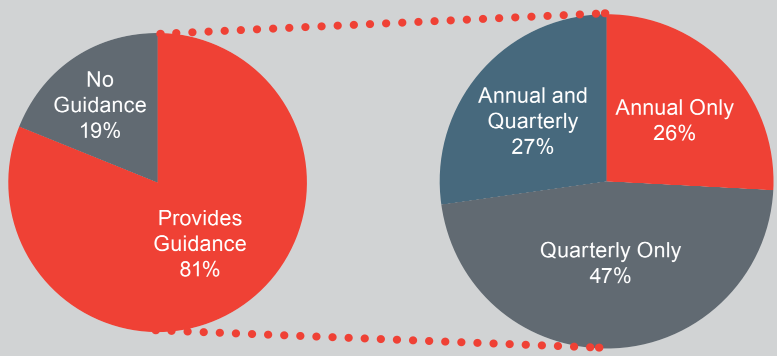
To identify the guidance practices of these companies, we utilized a variety of sources including CapitalIQ, as well as other publicly available sources, such as corporate press releases, earnings call transcripts, and investor presentations.

Overall Findings

Guidance Horizon

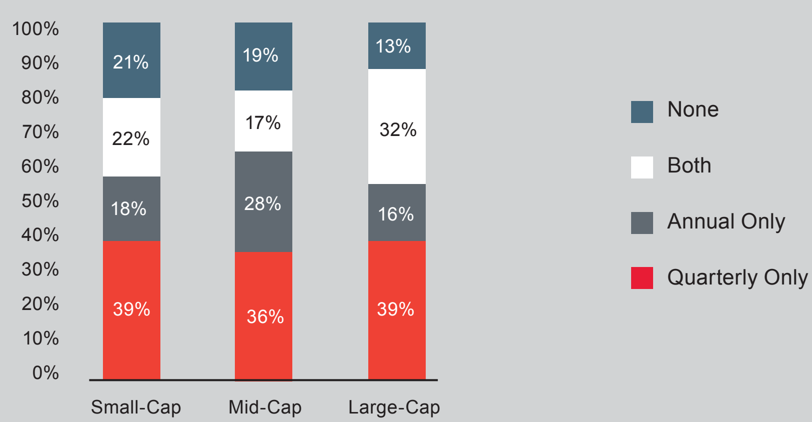
Within our sample of technology companies, a significant majority, or approximately 81%, issued at least some quantitative guidance as of the calendar 2009 third quarter. Of those that did provide guidance, approximately one-half provided guidance on only the next quarter, approximately one-fourth provided only full year, or annual, guidance, and the remaining companies provided both quarterly and annual metrics.

Tech Companies: Guidance Practices



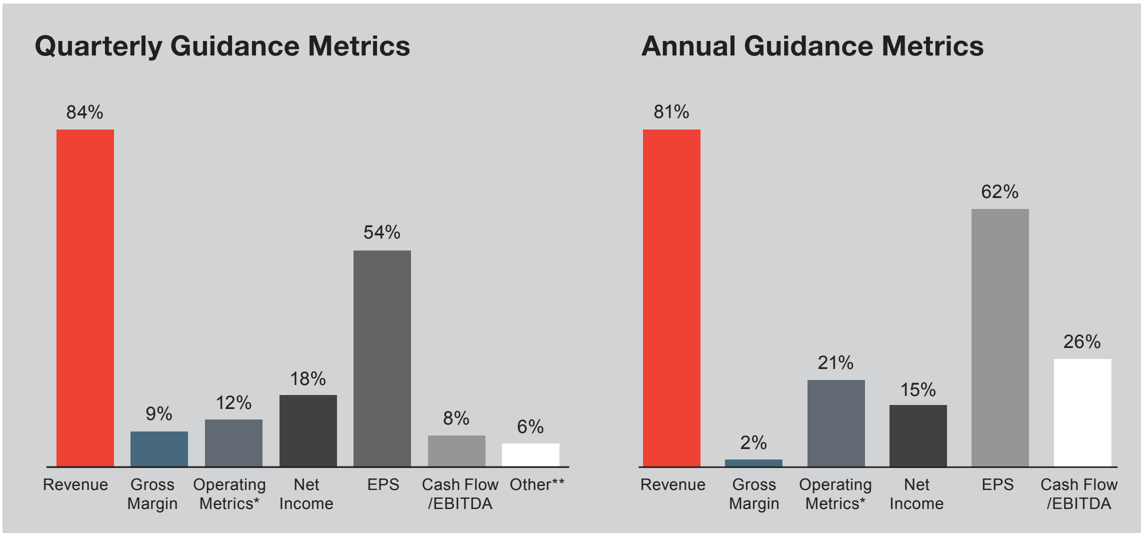
The use of different types of guidance practices was fairly consistent across market capitalizations, although larger companies had a slightly greater propensity to provide both annual and quarterly guidance and mid-caps exhibited a slightly greater tendency towards annual guidance.

Type of Guidance by Market Cap



Guidance Content

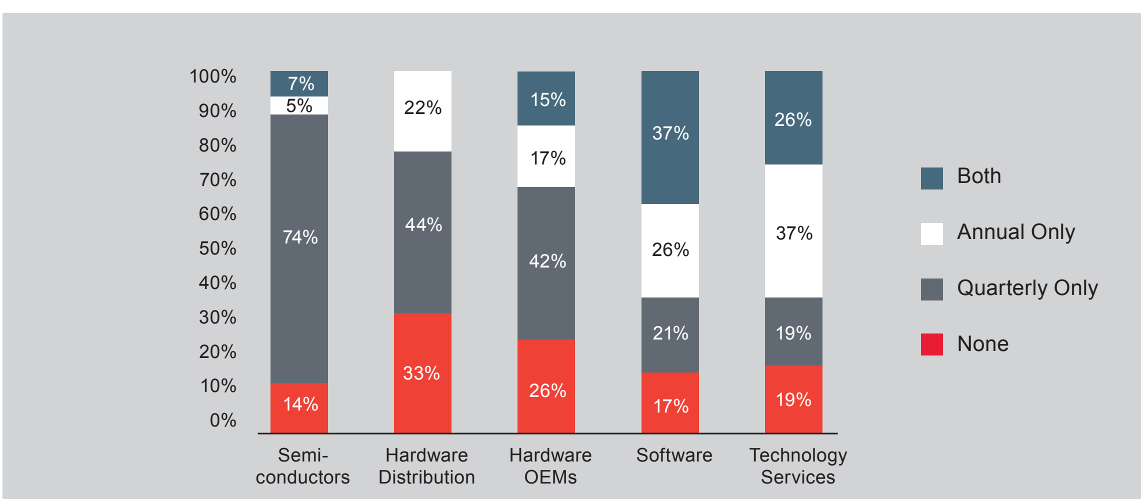
Revenue and EPS are far and away the most commonly used quantitative metrics for companies that issued guidance. Those that provided annual guidance had a greater propensity to offer more disclosure, such as information related to cash flow, operating profitability, or “other” areas, which was most often CapEx. Those providing quarterly guidance provided less granularity into their expectations in general, perhaps indicating that these companies have less visibility into near- and long-term performance.



** Operating income, Operating margin, Operating expenses, Operating Margin growth*
*** Other can include CapEx, SG&A, tax rate, and/or Interest income*

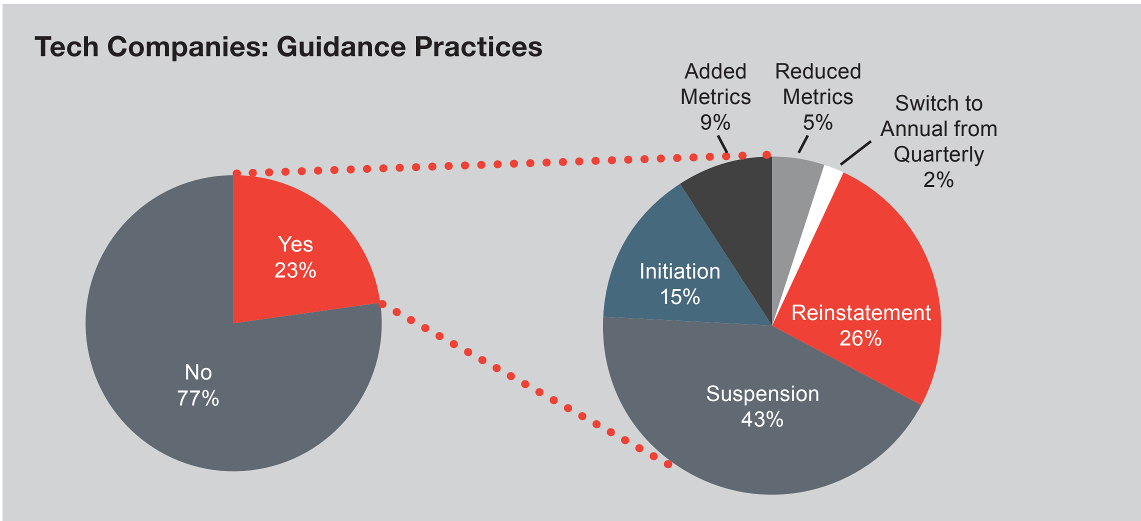
Since the technology sector is not homogeneous in terms of sensitivity to the economy or visibility, we separated the sector into five subsectors – Semiconductors, Hardware Distributors, Hardware OEMs, Software, and Technology Services.

As the following graph shows, companies in industry sectors that tend to experience less volatility and have more visibility into their future prospects, such as Software and Services, provided information over a longer term horizon, while those with more limited visibility, such as Distribution, Hardware OEMs, and Semiconductors, tended to provide quarterly guidance, looking only three months ahead.

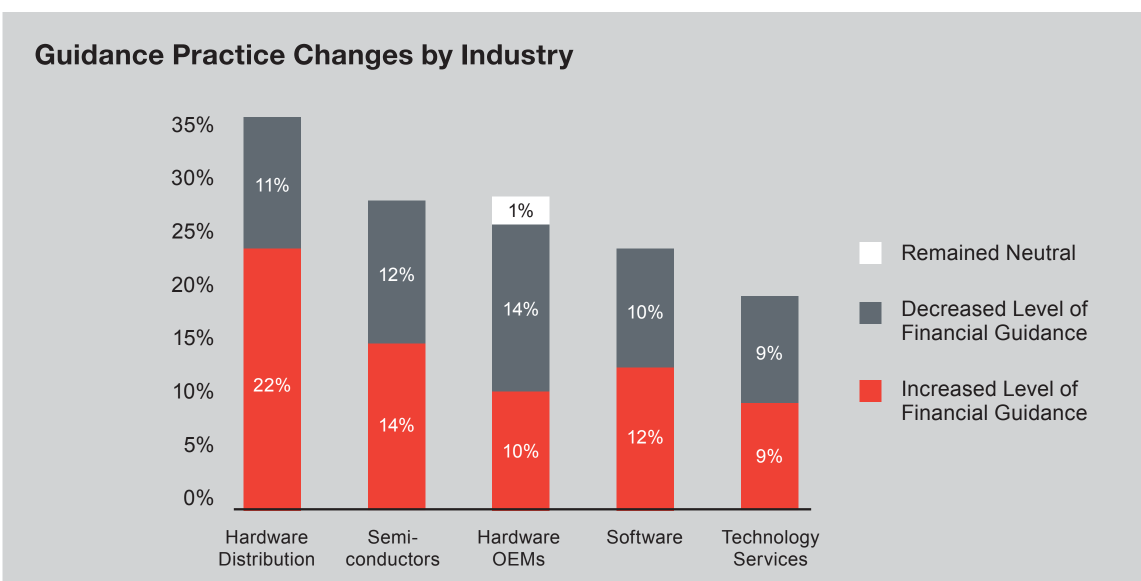


Year-Over-Year Comparison of Guidance Practices

Over the past 12 months there was very little change in the guidance practices of the companies we analyzed, despite the highly volatile macro-economic landscape and the heated debate surrounding guidance practices amidst limited visibility. As seen in the chart labelled “Percentage of Companies Changing Guidance Practice” below, the majority of companies (77%) did not change their level of disclosure about future prospects. Of those that did alter their guidance conventions, there was equal balance between those that reduced disclosure and those that increased disclosure.



In terms of guidance changes by subsector, the industries that had the greatest number of companies change guidance were also those that had typically provided quarterly guidance: Hardware Distribution, Semiconductors, and Hardware OEMs. However, in the case of Hardware Distribution, the majority of changes related to providing a greater level of financial detail, including reinstatements of guidance practices suspended prior to the twelve month period considered in this study, initiations of guidance, or the addition of financial metrics to their forecasts. The other sectors were fairly evenly distributed between companies increasing disclosure and companies decreasing disclosure.



Conclusion and Recommendations

In a year when visibility was at times an insurmountable challenge, the large majority of companies maintained their existing guidance practices. Moreover, our research shows that those that did make changes were as likely to increase their level of disclosure regarding their forward-looking expectations as decrease it. This result may be surprising to many, but it is clear by their actions that companies believe guidance is a critical element in setting investor expectations and competing for investable capital. As such, deliberations around changes in guidance practices should be a carefully thought out process that should align with shifting business conditions, internal expectations and the practices of peer companies that may be shifting toward more transparency.

While FD believes that companies should regularly consider their guidance practices as a matter of course, it has never been more important than now. Although there is obviously no single financial reporting template that is optimal for all industries or companies, it is fair to say that disclosure and transparency are highly valued by the capital markets. However, realizing this value is more than simply providing financial guidance. As companies consider the very timely question of guidance, it is worth reminding ourselves that investors use a wide variety of information on a company and consume it through numerous channels to form their investment theses. It is not just about the metric.

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For more information, please contact:

Sherrie Weldon
Managing Director
Technology Sector Leader
sherrie.weldon@fd.com
+1 212 850 5600

Beth Saunders
Managing Director
Capital Markets Communication Practice
beth.saunders@fd.com
+1 312 553 6700

www.fd.com