Tech Corporation, July 2006[1]

With approximately $40 billion in revenues at the end of 2005, Tech Corporation is the largest company in its industry. The company has an impressive 80% market share, one that is has held for over a decade. At the end of 2005, Tech's equity was worth nearly $150 billion.

Tech produced record profits of over $8.6 billion in 2005, for a profit-to-sales of well over 20%. In the prior two years, revenues grew at a compounded annual growth rate (CAGR) of 14%, and net income at a CAGR of 22%. The company is reputed for being at the cutting edge of innovation in its industry. Tech committed over $5 billion to research and development during the past year, making it one of the world's largest corporate spenders on R&D. Tech employs 102,500 people. (*Exhibit 1* provides summary financials for this company for fiscal years [FY] 2004 and 2005).

Despite such impressive past performance, the company's stock price had taken a beating in 2006. Relative to its stock price at the start of the year, Tech's price had dropped nearly 30% by end-July 2006. This decline wiped out nearly $40 billion from Tech's equity value. The financial fundamentals reflected in the company's most recent quarterly filings seemed to exacerbate the market's sense of unease. (*Exhibit 2* provides summarized half-yearly income statements and balance sheets based on data for the first and second quarters of 2006. It also provides comparative data for equivalent half-year in 2005.)

Commentators and analysts were starting to express major concerns about Tech's continued ability to stay at the cutting edge. Based on estimates for the rest of the year, many were suggesting that urgent action might be required to get the company's stock price back on track. (*Exhibit 3* provides forecasts of the summary financials for Tech for all of FY2006, in addition to some relevant capital markets data as of end-July 2006.)

Questions

Is the market correct in its assessment that Tech's financial fundamentals are cause for serious worry? (This will require an analysis of Tech's operating cash flows and free cash flows). Even if that were the case, does the situation rise to the level of "urgent actions" being necessary? What should the CEO do?

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[1] *This case was developed by Professor Anant K. Sundaram of the Tuck School of Business at Dartmouth College solely as a basis for class discussion. The name of the company has been disguised for pedagogic purposes.*

Exhibit 1

A. Tech Corporation Income Statement – Annual (Fiscal Years 2004 and 2005; US$ millions)

	Dec-04	*Dec-05*
Revenue	$34,460	$38,826
Cost of Goods Sold	$14,463	$15,777
Gross Profit	$19,746	$23,049
SG&A	$ 4,838	$ 5,688
R&D	$ 4,778	$ 5,271
EBIT	$10,130	$12,090
Non-operating Income (Expense)	$ 287	$ 520
Taxes	$ 2,901	$ 3,946
Net Income	**$ 7,516**	**$ 8,664**

Note: Depreciation and Amortization are included in CGS and SGA, and was $4,889 million in FY2004, and $4,595 million in FY2005.

B. Tech Corporation Balance Sheet – Annual (Fiscal Years 2004 and 2005; US$ millions)

	Dec-04	*Dec-05*
Cash & Marketable Securities	$17,172	$12,772
Receivables	$ 2,999	$ 3,914
Inventory	$ 2,621	$ 3,126
Other Current Assets	$ 1,266	$ 1,382
Total Current Assets	$24,058	$21,194
Total Assets	**$48,143**	**$48,314**
Current Liabilities	$ 8,006	$ 9,234
Long Term Liabilities	$ 904	$ 2,419
Equity	$39,233	$36,661
Total Liabilities + Equity	**$48,143**	**$48,314**

Note: Capital expenditure amounted to $3,843 million in FY2004, and $5,818 million in FY2005. Based on FY2003 data (not provided) change in non-cash/non-debt working capital was $200 million in FY2004.

Exhibit 2

A. Tech Corporation Income Statement – Half-Yearly (First Half for Fiscal Years 2005 and 2006; US$ millions)

	1H 2005	*1H 2006*
Revenue	$18,665	$16,949
Cost of Goods Sold	$ 7,864	$ 7,835
Gross Profit	$10,801	$ 9,114
SG&A	$ 2,682	$ 3,266
R&D	$ 2,438	$ 3,058
EBIT	$ 5,681	$ 2,790
Non-operating Income (Expense)	$ 224	$ 337
Taxes	$ 1,689	$ 885
Net Income	**$ 4,216**	**$ 2,242**

Note: Depreciation and Amortization are included in CGS and SGA, and was $3,429 million in 1H2005, and $3,434 in 1H2006.

B. Tech Corporation Balance Sheet – Half-Yearly (First Half for Fiscal Years 2005 and 2006; US$ millions)

	1H 2005	*1H 2006*
Cash & Marketable Securities	$14,824	$ 7,643
Receivables	$ 3,448	$ 3,178
Inventory	$ 2,739	$ 4,332
Other Current Assets	$ 1,179	$ 1,602
Total Current Assets	$22,190	$16,755
Total Assets	**$46,513**	**$46,088**
Current Liabilities	$ 7,780	$ 8,422
Long Term Liabilities	$ 748	$ 2,341
Equity	$37,985	$35,325
Total Liabilities + Equity	**$46,513**	**$46,088**

Note: Capital expenditure amounted to $4,905 million in 1H2005, and $5,254 in 1H2006.

Exhibit 3

A. Tech Corporation Forecasted Income Statement – 2nd Half and All of FY2006 (US$ millions)

	2H2006 (Est)	*All of 2006 (Est)*
Revenue	$18,433	$35,382
Cost of Goods Sold	$ 9,329	$17,164
Gross Profit	$ 9,104	$18,218
SG&A	$ 3,383	$ 6,649
R&D	$ 2,607	$ 5,665
EBIT	$ 3,114	$ 5,904
Non-operating Income (Expense)	$ 445	$ 782
Taxes	$ 1,150	$ 2,035
Net Income	**$ 1,964**	**$ 4,651**

Note: Depreciation and Amortization are included in CGS and SGA, and estimated to be $1,478 million in 2H2006, thus forecasted to be $4,912 million for all of FY2006.

B. Tech Corporation Forecasted Balance Sheet –FY2006 (US$ millions)

	FY2006 (Est)
Cash & Marketable Securities	$ 9,000
Receivables	$ 2,709
Inventory	$ 4,314
Other Current Assets	$ 1,255
Total Current Assets	$17,278
Total Assets	**$47,368**
Current Liabilities	$ 8,514
Long Term Liabilities	$ 2,102
Equity	$36,752
Total Liabilities + Equity	**$47,368**

Note: Capital expenditure is expected to be $5,779 million in FY2006.

C. Tech Corporation – Some Relevant Capital Markets Data

	July 31, 2006
Equity Market Capitalization ($ million)	$112,307
% Change in Equity Value Since January 1, 2006	−30.3%
Stock Price – end-July 2006	$ 19.63
Stock Price – 2006 High	$ 26.47
Stock Price – 2006 Low	$ 16.86
Equity Beta	2.03
No. Shares Outstanding (millions)	5,801
Credit Rating (Moody's)	AA
US Equity Market Risk Premium	5.00%
US 30-Year Treasury Bond Yield	5.06%
AA Corporate Bond Risk Premium over T-Bond	0.92%