Technology quarterly 3Q21

Insights from the earnings season

The technology sector is beginning to feel margin pressure

During the 3Q21 results earnings calls, technology companies talked about how supply chain constraints are impacting sales and margins. The component shortage is getting worse, as companies are running out of options to take mitigating actions. Cost increases are hitting margins, especially when large order backlogs and subscription models are delaying the effects of price increases. There was also a lot of focus on sustainability during the calls.

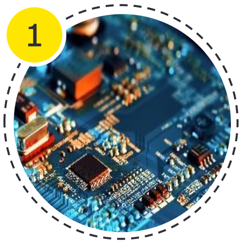
> "The current supply and cost pressures are going to require tech companies to bring out their best operationally to maintain their growth commitments. In addition, margin pressures will likely continue until price increases offset existing backlog commitments for enterprise customers.
>
> Ken Englund, EY Americas Technology Sector Advisory Leader

This report analyzes the issues addressed by leading global technology company leaders during their earnings calls for the third quarter of 2021. It provides a snapshot of the main themes representing the top-of-mind issues of technology leaders and investors.

1. Component shortage is worsening
2. Custom silicon is gaining traction
3. Inflationary pressure is taking a bite out of margins
4. From show and tell to show and sell in ESG

Key themes taken from earnings calls with analysts

1



Component shortage is worsening

Companies reported a deterioration in the shortage of chips for the quarter.

Since the start of the pandemic, companies have increased their efforts to find alternative sources for the chips they need. Today, even the most resourceful supply chain teams are running out of options and shifting their efforts to procuring components that complete a set required to manufacture an end product. This could worsen the shortage as demand will focus on components that are already scarce. The shortage is expected to dampen sales growth over the next quarters, until additional capacity comes online.

2

Custom silicon is gaining traction

There was a lot of attention for innovation and new product development during the earnings calls, with specific attention to custom silicon.

Product innovations often rely on advanced semiconductor content. For the large use cases, such as cloud infrastructure, device ecosystems, AI accelerators and IoT applications, this justifies the development of customized chips. Through in-house design, tech companies can speed up innovation and reduce third-party dependence in the semiconductor ecosystem.

> “
> Over US$1 trillion of new fab investments have been announced, with Samsung’s US$17 billion plant in Texas a recent example. The investments are being driven by the current shortages and a desire to boost domestic semiconductor industries. The new fabs will remove bottlenecks and provide further growth opportunities for in-house semiconductor design.
>
> Ron Hofmeister, EY Parthenon Strategy and Transactions

3

Inflationary pressure is taking a bite out of margins

Analysts queried management on how companies were planning to mitigate inflationary pressure.

Increasing prices of commodities, wages, fuel and support services are driving up costs. Analysts want to know if companies plan to absorb the cost increases or pass them on to their customers. Price increases could have far-reaching consequences for future growth and margins, depending on the type of product, the competitive positioning, the sales contracts and the possibilities to mitigate costs through additional measures. Subscription offerings and order backlogs could delay any impact. Scenario analyses are needed to estimate the impact and duration of inflationary pressures.

Key themes taken from earnings calls with analysts

4

From show and tell to show and sell in ESG

The reporting season overlapped with the climate change conference COP26, so it is not a surprise that companies focused on sustainability during their earnings calls.

The topic was approached from two angles that were explicitly linked to each other. On the one hand, companies talked about their ambitions, about when and how they would achieve zero-waste and zero-carbon, about running their data centers on renewable energy and about how they will be reporting about this. On the other hand, companies talked about how their service offerings enable other companies to achieve their ambitions. They discussed the effects of remote collaboration; they talked about the introduction of new tools to measure and report environmental, social and governance (ESG); and they stressed the contribution to ESG ambitions of IT solutions that run on carbon-neutral cloud infrastructures.

> “Sustainability already has a prominent place on the management agenda, but we are only at the start of a very long transformation path. By looking at the full value chain, the technology sector is uniquely positioned as an enabler for ESG, but has to show its own ambitions.
>
> Greg Cudahy, EY Global TMT Industry Leader

Recurring topics during the earnings calls

Top revenue drivers	Top company responses
1 Market recovery	1 Supply chain resilience
2 IoT and edge computing	2 Chips, components and hardware
3 COVID-19 uncertainty	3 ESG
4 5G	4 Double down on R&D
5 Cloud migration	5 Long-term cost reductions
6 Hardware spending	6 Investments and capex
7 Data analytics	7 Customer experience focus

Rankings are based on conversation topics during the quarter’s earnings calls, which are grouped into influences, issues and themes. Tallying is highly subject to interpretation and is by no means objective.

EY resources, methodology and contacts

EY resources

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Methodology

This analysis reviews the top initiatives and issues of 26 leading global technology companies during the latest financial reporting season. The number of companies analyzed in this report may vary depending on the timing and availability of scheduled earnings calls and published transcripts. The analysis was limited to the review and examination of summaries and transcripts of the latest earnings conference calls that were available to EY authors at the time this report was created. This review does not take into consideration information from other sources, such as news reports, annual reports and company press releases.

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