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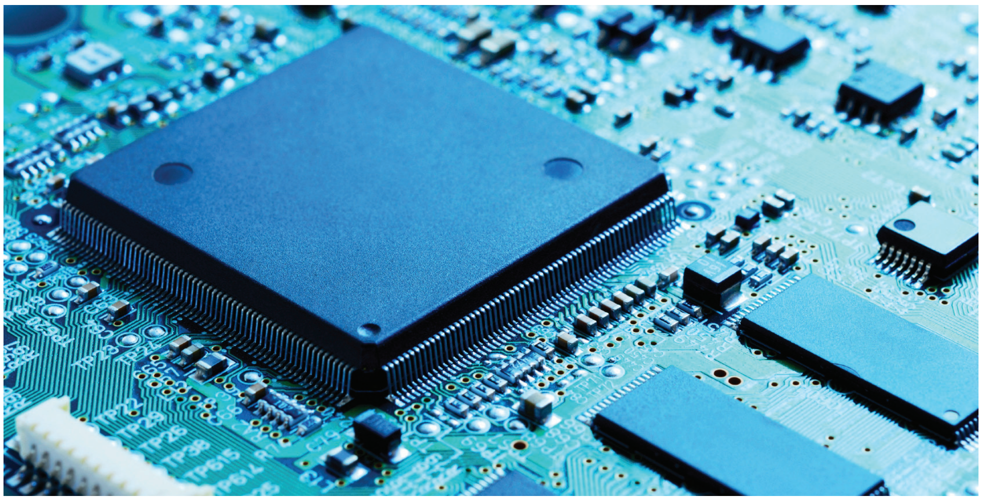
BDO TECH



DESPITE RECORD REVENUES, RISKS LOOM IN THE SEMICONDUCTOR INDUSTRY

By Slade Fester and Bryan Gendron

Sales are surging in the semiconductor sector. Worldwide sales for 2010 reached a record high of $298.3 billion, a 31.8 percent increase from the $226.3 billion reported in 2009, according to the Semiconductor Industry Association. This marks a historic milestone for the industry, particularly in light of the severe global macroeconomic downturn experienced in 2008 and 2009. Opportunities are abundant in this charged environment; however, today's dynamic marketplace has made even the most common and consistent risks more threatening than ever. In order to successfully navigate the terrain separating corporate success and failure, companies need to recognize, manage and react to risks in a timely manner.

▶MERGERS AND ACQUISITIONS CONTINUE TO DOMINATE THE SECTOR

In today's market, deals are getting larger and any company can be an acquisition target. Rising pressure to sustain revenue growth and diversify products has led to some of the biggest deals we've seen this year – Applied Materials purchased Varian Semi Conductor for $4.9 billion and Texas Instruments acquired National Semiconductor for $6.5 billion. As a result, the playing field is shrinking in the analog subsector and other semiconductor businesses. With more complicated applications, and an increased focus on solutions as opposed to products or components, companies are finding niche

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DID YOU KNOW...

According to ***The 2011 BDO 600 Survey of Board Compensation Practices of 600 Mid-Market Public Companies***, board directors in the tech sector are the most highly compensated compared to other industries.

Forty-two percent of organizations said their IT department reports to the CFO, according to a study by ***Gartner***.

According to ***Dealogic***, dealmakers announced 851 transactions with U.S. technology companies as the target, together valued at $54.7B, during the first five months of 2011.

IDC reports that over 70% of tech leaders expect at least 30% of all IT departments will offer cloud services to partners and customers by 2014.

Seventy-four percent of investment bankers predict more tech IPOs during the second half of 2011, according to the ***2011 BDO IPO Halftime Report***.

PC shipments are expected to grow 9.3% in 2011, reaching 385 million units, according to ***Gartner***.

CONTINUED

RISKS LOOM IN THE SEMICONDUCTOR INDUSTRY

areas to grow their businesses. This makes semiconductor companies prime targets for organizations looking for solid revenue growth and synergistic opportunities. We saw this trend in our *2011 RiskFactor Report for Technology Businesses*, which found that M&A activity, as well as competition and consolidation, are among the top 10 risks cited by tech companies. Whether companies are striving for increased market share in a particular geography, compatible technology, design center, manufacturing capacity or otherwise, we expect the appetite for deal-making in the semiconductor space to continue.

SUPPLY CHAIN MANAGEMENT IS CRITICAL TO SURVIVAL

The production of raw materials and the ability to obtain them at favorable prices is another key component to corporate success in the hardware industry. This can present challenges in a volatile market as wafer production is controlled by a relatively small group of large contract manufacturers located primarily in Asia. According to the *RiskFactor Report*, companies are feeling this pressure more than ever. The availability and pricing of raw materials is a risk cited by 34 percent of companies surveyed, 79 percent more than in 2010 (19%). Global supply chain issues are also noted by a vast majority (86%) of companies. The earthquake and tsunami in Japan in March 2011 further strained the supply chain, with some companies impacted directly and others feeling the effects despite being several steps removed.

In order to mitigate supply chain risks, some semiconductor companies maintain their own fabrication facilities, but these operations are often not large enough to supply 100 percent of the company's raw material needs. Still, too much capacity in a down market can be worse than not producing enough product to meet demand, particularly since the expenses associated with extra capacity can take a toll on the bottom line. In addition, wafer fabrication operates in an oligopolistic market, making it difficult for companies to get quality, high-yield products at favorable pricing. For those who have their own fabrication facilities, the availability and pricing of the conductive materials used in the wafer fabrication and semiconductor assemblies have substantially increased in a short period of time, making this cost difficult to pass on to customers. The price of copper, in particular, has hit record highs in recent months and is almost double the average price from only two years ago. This trend is expected to continue through at least the end of the year due to shrinking copper production and stockpiles, and if copper prices do stabilize, they are estimated to level off at these higher prices. Companies that were able to negotiate long-term, cost-effective contracts for precious metals, through hedging or other means, are far ahead of their competitors.

THE WORLD IS GETTING SMALLER – IS YOUR TECHNOLOGY SECURE?

Risks associated with international operations are on the rise as companies' touch points become increasingly global. Inconsistent and often unenforced trade restrictions with certain foreign countries have put products and intellectual property at risk. Companies are also threatened by unfavorable foreign currency fluctuation, as well as environmental and regulatory compliance risk. The use of distributors to sell products internationally increases regulatory risks, as products may be sold in countries subject to trade restrictions, leaving the manufacturer, not the distributor, ultimately responsible for this regulatory [and potential IP] infraction. At the same time, the global economy has demanded a larger international presence earlier in a company's life cycle, which intensifies the risk.

Concerns over data security breaches in the global market are also growing. For semiconductor companies, data theft can be far-reaching and can consist of something as simple as the unwanted interception of a chip design emailed to a contract manufacturer. Additionally, if the chip were to be used for a U.S. government project, the ramifications of a theft or data breach is that much more significant. To mitigate these risks, companies must focus on robust regulatory and legal compliance programs and tighten controls over distributor agreements.

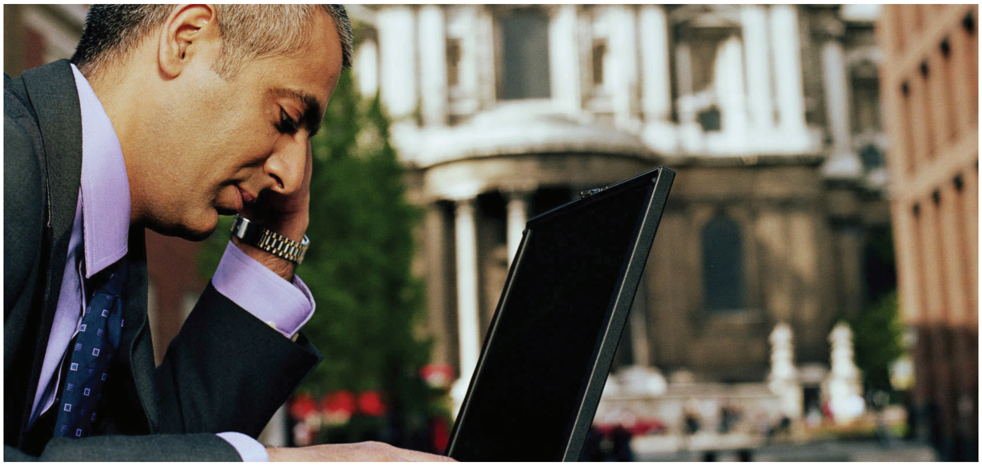
WHAT'S NEXT?

Recent analyst reports from Gartner suggest that companies might be scaling back their inventory in light of heightened uncertainty on end-demand forecasts into the second half of 2011 and reports that supply chain managers are adopting more cautious practices. Additionally, some believe that the Japan earthquake and related anxiety over product allocation has caused an acceleration of orders into March and April leading to unsustainable booking levels. Still, Gartner projects a 5.1 percent growth for the sector in 2011.

While we do not have a crystal ball to show us what the future holds for the semiconductor industry, one thing is clear: companies that recognize the potential risks to their business and are prepared to react quickly are best positioned for success.

Slade Fester is a partner and Bryan Gendron is a senior manager in the Technology & Life Sciences practice.

THE TECH INDUSTRY'S NEXT BIG THREAT: FOREIGN CORRUPT PRACTICES ACT



By Glenn Pomerantz, CPA, CFE and Brian J. Mich, JD, CAMS, BDO Consulting

In the last several years, both the U.S. Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) have focused their U.S. Foreign Corrupt Practices Act (FCPA) enforcement efforts on specific industries, such as oil and gas, pharmaceutical, defense products and financial services. Events during the first half of this year provide strong reason to believe that technology companies are now the focus of these heightened enforcement efforts: In April 2011, IBM, Maxwell Technologies and Comverse Technology, Inc. all entered into agreements to resolve FCPA charges in which they agreed to multimillion dollar financial penalties. In addition, both Hewlett-Packard and Veraz Networks Inc. have disclosed in public filings that they are the subjects of FCPA investigations.

These increased enforcement efforts make compliance with the FCPA and other anti-corruption laws around the globe one of the biggest challenges facing multinational technology companies today. The FCPA contains two provisions: (1) an anti-bribery provision, which prohibits paying, offering or promising anything of value to a foreign official in order to obtain or retain business; and (2) a "books and records" provision which requires a company listed on a U.S. exchange to maintain accurate books and records and to implement a system of internal controls designed to prevent instances of corruption. An important aspect of the law, and one that is of particular concern for corporations and their management, is that a company does not have to be directly involved in a bribe payment to be liable under the statute; rather, it can be held liable if management knew or had reason to know that a third-party acting on the company's behalf was offering or making improper payments.

The DOJ and SEC, which, respectively, have criminal and civil enforcement jurisdiction under the FCPA, have brought an increased number of enforcement actions against both corporations and individuals over the past ten years. These efforts have resulted in substantial jail sentences and fines imposed upon guilty individuals, as well as heavy monetary penalties, costly internal investigations, and debarment for companies in violation.

The technology industry is especially susceptible to FCPA risks for several reasons. First, because technology companies are subject to a great deal of regulation and often sell their products to governments or state-owned entities, they commonly interact with foreign officials. Second, technology companies often rely upon third-party representatives, such as agents, consultants, distributors and resellers for business development especially in foreign locales. Third, technology companies, particularly those in new sectors, need to grow quickly to be competitive. This growth creates compliance challenges as companies hire new employees and engage additional third-party representatives.

To avoid being swept up in this wave of increased enforcement in the U.S., technology companies must implement a robust anti-corruption compliance program, which should include, among other things:

- A corruption risk assessment
- A code of conduct
- A strong, explicit and visible commitment to eradicating corruption from senior management
- Anti-corruption policies and procedures tailored to the company's specific corruption risks
- Internal controls, including an automated process of continuous controls monitoring, reasonably designed to ensure the maintenance of fair and accurate books, records and accounts to ensure that they cannot be used for the purpose of foreign bribery or concealing such bribery
- Due diligence procedures focused on corruption risks when hiring third-party representatives or evaluating a merger or acquisition
- A mechanism for employees to anonymously report violations of the company's anti-corruption policies or applicable anti-corruption laws
- Thorough investigation of allegations of corruption and discipline of those found to have violated company policy or applicable anti-corruption laws
- Periodic testing and monitoring of the compliance program's effectiveness, including substantive testing of transactions
- A process of periodic assessment and revision, as needed, of the company's anti-corruption policies and procedures.

Glenn Pomerantz is a partner and Brian Mich is a managing director in the New York office of BDO Consulting. They lead the firm's Anti-Corruption Compliance & Investigations practice.

2011 CALENDAR

The following is a list of upcoming conferences and seminars from the leading technology associations and business bureaus:

AUGUST

Aug 15-19
11th Annual International Conference on Nanotechnology
Portland Marriott Downtown Waterfront
Portland, OR

Aug 23-25
2011 NoSQL Now Conference
San Jose Convention Center
San Jose, CA

Aug 30-Sept 2
DreamForce Cloud Computing Conference
Moscone Center
San Francisco, CA

SEPTEMBER

Sept 7-9
BioPharm America 2011
Westin Boston Waterfront
Boston, MA

Sept 7-10
CEDIA Expo
Indiana Convention Center
Indianapolis, IN

Sept 11-13
InformationWeek 500 Conference
St. Regis
Monarch Beach, CA

Sept 19-20
CSO's The Security Standard Conference
Marriott Brooklyn Bridge
New York, NY

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