

Microchip Technology (MCHP)

\$108.79 (As of 06/03/20)

Price Target (6-12 Months): **\$114.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 03/11/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: B

Momentum: B

Summary

Microchip is expected to benefit from solid demand for its microcontrollers. The company is anticipated to witness strength in the medical end market, driven by growth in demand for hospital equipment. Improving demand across office equipment and communication infrastructures, courtesy of requirement for cloud computing solutions amid the coronavirus crisis-led work-from-home wave also bodes well. Microchip has also improved its guidance for fiscal first quarter due to easing of supply chain disruptions and reopening of customers' factories. Notably, shares have outperformed the industry on a year-to-date basis. Sluggish demand across automotive, industrial and consumer home appliance end-markets owing to coronavirus-induced broad-based macroeconomic weakness is expected to weigh on near-term revenues.

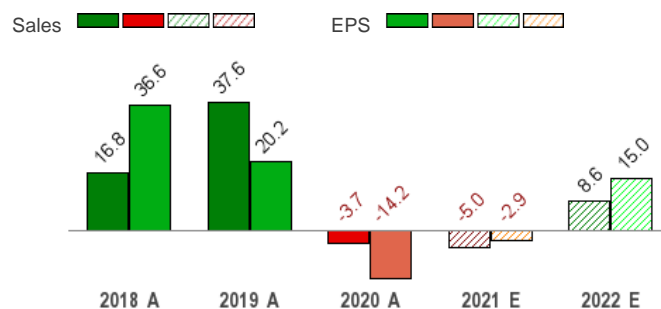
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$112.47 - \$53.15
20 Day Average Volume (sh)	3,665,771
Market Cap	\$26.1 B
YTD Price Change	3.9%
Beta	1.61
Dividend / Div Yld	\$1.47 / 1.4%
Industry	Semiconductor - Analog and Mixed
Zacks Industry Rank	Top 19% (47 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	6.6%
Last Sales Surprise	-0.0%
EPS F1 Est- 4 week change	4.9%
Expected Report Date	08/04/2020
Earnings ESP	0.0%
P/E TTM	19.4
P/E F1	19.9
PEG F1	1.5
P/S TTM	4.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	1,349 E	1,391 E	1,368 E	1,383 E	5,440 E
2021	1,266 E	1,221 E	1,252 E	1,297 E	5,011 E
2020	1,323 A	1,338 A	1,287 A	1,326 A	5,274 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$1.59 E	\$1.65 E	\$1.58 E	\$1.62 E	\$6.28 E
2021	\$1.33 E	\$1.29 E	\$1.37 E	\$1.44 E	\$5.46 E
2020	\$1.41 A	\$1.43 A	\$1.32 A	\$1.46 A	\$5.62 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/03/2020. The reports text is as of 06/04/2020.

Overview

Chandler, AZ-based, Microchip Technology Inc. develops and manufactures microcontrollers, memory and analog and interface products for embedded control systems, which are small, low-power computers designed to perform specific tasks.

Microchip reported total revenues of \$5.27 billion in fiscal 2020.

The company has four major product lines:

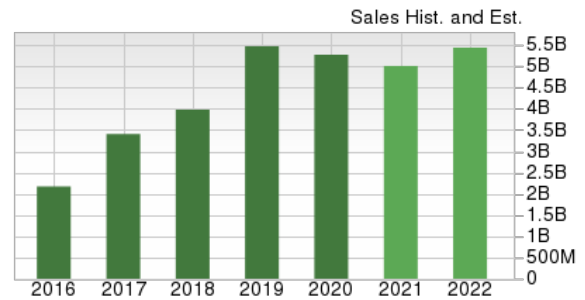
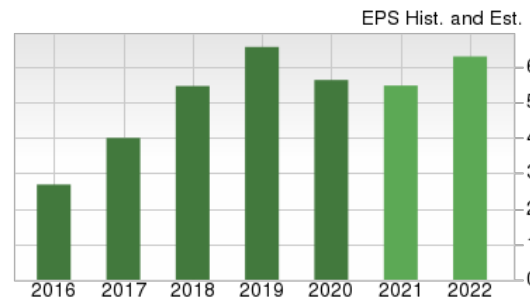
Microcontrollers (53.4% of fiscal 2020 revenues): This product portfolio comprises 8-bit, 16-bit and 32-bit PIC microcontrollers and 16-bit dsPIC digital signal controllers. Microchip's expanding product portfolio driven by new microcontrollers' roll outs aids it in expanding customer base and sustain its leading position in the market.

Analog (28.7%): These products consist of several families with approximately 800 power management, linear, mixed-signal, thermal management, RF Linear drivers, safety and security, and interface products. The line of mixed-signal products primarily includes data converters that convert data from analog to digital or vice versa.

Licensing, memory and other, or LMO (10.8%): Technology licensing revenue comprises a combination of license fees and royalties related to SuperFlash technology, and fees for engineering services. Microchip licenses its SuperFlash technology to foundries, integrated device manufacturers and design partners across the world.

FPGA (7.1%): The product line was primarily acquired as part of Microsemi acquisition.

In fiscal 2020, Asia, Europe and Americas contributed 52.1%, 22% and 25.9%, respectively to net sales.



Reasons To Buy:

- ▲ Microchip is one of the fastest-growing providers of 8-bit, 16-bit and 32-bit microcontrollers in the world. The microcontroller business of the company continued to outperform the industry and enabled it to gain significant market share. Microchip expects to continue this momentum and strengthen its position as the best-performing microcontroller franchise in the industry. The company is increasingly expanding its touch business beyond handsets and tablets in areas, such as automotive industrial applications. The Analog business has also become one of the largest analog franchises in the market. In order to further capitalize on this burgeoning business potential, Microchip is developing and introducing a wide range of innovative and proprietary new products. All these initiatives augur well for the long-term growth prospects of the company.
- ▲ The Semiconductor Industry serves as a driver, enabler and indicator of technological progress. The Internet of Things (IoT) is creating newer avenues and is largely believed to be the next semiconductor growth opportunity with the potential for billions of connected devices. The company continues to develop and introduce a wide range of innovative and proprietary new linear, mixed signal, power, interface, and timing products to fuel the future growth of the analog business. These enable the company to maintain sustainable revenue growth and expand margins.
- ▲ High quality standards, solid performance, reliability features, ease of use, pricing and diversity of products make Microchip one of the better-positioned companies in the semiconductor universe. With a diligent focus on right-sizing the various components of inventory holding, Microchip's investment strategy takes a holistic view of the rapidly evolving market and deploys a dynamic capital allocation approach. Over the years, Microchip has consistently returned significant cash to its shareholders through dividends and share repurchases. All these offer a lucrative investment proposition for investors seeking to own blue-chip stocks that promise a healthy return on investments.
- ▲ The company has been active on the acquisition front of late. Buyouts have aided growth by expanding its product portfolio and adding competence. We believe acquisitions of Microsemi (2018), Atmel (2016), among others, will enable Microchip to fortify its competitive position in the microprocessor market.

Microchip's growth is expected to ride on strong demand for 16-bit and 32-bit microcontrollers and analog products, robust product pipeline and excellent semiconductor industry growth prospects.

Reasons To Sell:

- ▼ We are concerned about lead times (the period of time between the initiation of any process of production and the completion of that process), which continue to increase due to manufacturing constraints. Microchip is reducing wafer starts in the fabs and putting fab personnel on a rotating time-off schedule in order to reduce costs and maintain staff to ramp up production as and when required. This process is expected to impact gross margins.
- ▼ Microchip derives a significant proportion of its revenues from outside America, subjecting the company to exchange rate volatility. By geographical regions, bulk of the revenues in fiscal 2020 came in from Asia (52.1% of total revenues), followed by Europe (22%) and Americas (25.9%). Unfavorable movement in exchange rates continue to adversely impact the top line of the company and undermine its growth potential to some extent.
- ▼ Microchip has a highly-leveraged balance sheet. As of Mar 31, 2020, the company had a net debt of \$9.08 billion. Moreover, total debt to total capital of 62.9% is higher than the industry's figure of 46.1%. Further, times interest earned stands at 1.3X, compared to the industry's figure of 4X. Thus, it has to constantly generate adequate operating cash flow to service its debt. The high-debt level can not only jeopardize its ability to sustain dividend payout (0.29) and buyback shares but also pursue accretive acquisitions.
- ▼ Moreover, the company is trading at premium in terms of Price/Book (P/B). Microchip currently has a trailing 12-month P/B ratio of 4.67. This level compares unfavorably with what the industry witnessed in the last year. Consequently, the valuation looks slightly stretched from P/B perspective.

Increasing lead time and significant exposure to Asian markets subjecting Microchip to exchange rate volatility are the primary concerns weighing on margin expansion and limiting growth prospects.

Last Earnings Report

Microchip Q4 Earnings Top Estimates, Revenues Lag

Microchip Technology Incorporated reported fourth-quarter fiscal 2020 non-GAAP earnings of \$1.46 per share, beating the Zacks Consensus Estimate by 6.6%. However, the bottom line declined 1.4% on a year-over-year basis.

Net sales declined 0.3% from the year-ago quarter to \$1.326 billion. The top line lagged the Zacks Consensus Estimate of \$1.327 billion.

Management noted sluggish demand across automotive, industrial and consumer home appliance end-markets due to coronavirus crisis-induced broad-based macroeconomic weakness.

Nevertheless, revenues improved 3% sequentially, driven by strength in growth in bookings in the fiscal fourth quarter. The upside can be attributed to coronavirus crisis-induced supply chain disruptions. Further, demand across communication and data center end-markets favored top-line growth sequentially.

Quarter in Detail

In terms of product line, microcontroller business (54.7% of net sales) improved 5.9% sequentially to \$726.1 million. Microchip benefited from robust demand for its 8-bit, 16-bit and 32-bit microcontrollers.

The company has rolled out a new cryptography enabled 32-bit microcontroller developed with an aim to stop malware for systems. We believe that Microchip's expanding product portfolio driven by new microcontrollers' roll outs will aid it in expanding customer base and sustain its leading position in the market. Moreover, the company is well poised to capitalize on synergies from accretive Microsemi and Atmel acquisitions.

Analog net sales of \$367.5 million (27.7%) improved 1.2% sequentially.

FPGA revenues (7.3%) came in at \$96.7 million, up 4.4% on a quarter-over-quarter basis.

Licensing, memory and other, or LMO product line (10.3%) reported revenues of \$136.1 million, which declined 6.6% sequentially.

Geographically, revenues from Americas, Europe and Asia contributed 26.7%, 22.1% and 51.2% to net sales, respectively.

Margins

Non-GAAP gross margin contracted 20 basis points (bps) on a year-over-year basis to 62%.

Non-GAAP research & development expenses, as a percentage of net sales, expanded 50 bps year over year to 15.2%. Non-GAAP selling, general & administrative (SG&A) expenses, as a percentage of net sales, remained contracted 80 bps year over year at 10.2%. Non-GAAP operating expenses, as a percentage of net sales, contracted 40 bps year over year to 25.4%.

Consequently, non-GAAP operating margin expanded 20 bps on a year-over-year basis to 36.6%.

Balance Sheet & Cash Flow

As of Mar 31, 2020, cash and short-term investments came in at \$403 million, compared with \$402.3 million as of Dec 31, 2019.

As of Mar 31, 2020, total debt (long-term plus current portion) amounted to \$9.48 billion compared with \$9.58 billion as of Dec 31, 2019. Notably, the company paid down \$236 million of debt during the quarter.

Cash flow from operating activities was \$371.7 million compared with \$395.5 million reported in the prior quarter.

Guidance

In an update provided on Jun 3, Microchip improved its business outlook for first-quarter fiscal 2021.

Notably, the company anticipates fiscal first-quarter consolidated net sales in the range of \$1.247-\$1.326 billion, or between flat and down 6% sequentially (mid-point of 3% decline). Net sales were previously expected in the range of \$1.2-\$1.3 billion, which suggested a decline of 2-10% sequentially (mid-point of 6% decline).

Moreover, non-GAAP earnings are projected between \$1.35 and \$1.53 per share, compared with the prior guided range of \$1.25-\$1.45.

Quarter Ending **03/2020**

Report Date	May 07, 2020
Sales Surprise	-0.02%
EPS Surprise	6.57%
Quarterly EPS	1.46
Annual EPS (TTM)	5.62

Recent News

On Jun 3, Microchip increased its revenue and earnings guidance for fiscal first quarter due to easing of COVID-19-induced supply chain disruptions and reopening of customers' factories in China, Europe and North America.

On May 27, Microchip announced the pricing of \$1.0 billion in aggregate principal amount of senior secured notes due Sep 1, 2023 and \$1.2 billion in aggregate principal amount of senior notes slated to mature on Sep 1, 2025. The Senior Secured Notes will bear interest at an annual rate of 2.67% and the Senior Notes will bear interest at annual rate of 4.25%. The offering of the Notes is expected to close on May 29, conditional on customary closing conditions. The senior notes offering is expected to aid the company enhance liquidity position.

On May 18, Microchip announced the launch of VectorBlox Accelerator Software Development Kit (SDK), which allows developers to create low-power, flexible overlay-based neural network applications without learning any FPGA tool flow.

On May 7, Microchip's board of directors announced a cash dividend of 36.75 cents, up from prior dividend payment of 36.70 cents per share, payable Jun 4, to shareholders as on May 21.

On Mar 16, Microchip expanded its portfolio of Power Electronics with the introduction of smaller and highly efficient new Silicon Carbide (SiC) power modules.

On Mar 11, Microchip expanded IoT solutions portfolio with embedded development solutions, to aid developers to securely connect to cloud platform utilizing Bluetooth, Wi-Fi, and narrow band 5G technologies.

Valuation

Microchip Technology shares are up 3.9% year to date and 32.1% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 6.5% while the same in the Zacks Computer & Technology sector are up 6.1% year to date. Over the past year, the Zacks sub-industry and sector are up 16.1% and 25.5%, respectively.

The S&P 500 index is down 4.4% in the year-to-date period but has gained 9.1% in the past year.

The stock is currently trading at 19.54X forward 12-month earnings, which compares with 26.03X for the Zacks sub-industry, 24.7X for the Zacks sector and 22.3X for the S&P 500 index.

Over past five years, the stock has traded as high as 20.7X and as low as 9.09X, with a 5-year median of 17X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$114 price target reflects 20.5X forward 12-month earnings.

The table below shows summary valuation data for MCHP

Valuation Multiples - MCHP					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	19.54	26.03	24.7	22.3
	5-Year High	20.7	26.03	24.7	22.3
	5-Year Low	9.09	13.42	16.72	15.23
	5-Year Median	17	18.09	19.26	17.49
P/S F12M	Current	5.16	4.68	3.75	3.47
	5-Year High	5.68	4.68	3.75	3.47
	5-Year Low	2.37	2.81	2.32	2.53
	5-Year Median	3.98	3.69	3.11	3.02
EV/Sales TTM	Current	6.55	5.1	4.25	3.01
	5-Year High	7.69	5.52	4.43	3.46
	5-Year Low	3.24	3.13	2.55	2.13
	5-Year Median	5.51	4.4	3.6	2.83

As of 06/03/2020

Industry Analysis Zacks Industry Rank: Top 19% (47 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
MACOM Technology Solutions Holdings, Inc. (MTSI)	Outperform	1
Analog Devices, Inc. (ADI)	Neutral	3
Cirrus Logic, Inc. (CRUS)	Neutral	3
IPG Photonics Corporation (IPGP)	Neutral	3
Monolithic Power Systems, Inc. (MPWR)	Neutral	3
Maxim Integrated Products, Inc. (MXIM)	Neutral	3
Texas Instruments Incorporated (TXN)	Neutral	3
Xilinx, Inc. (XLNX)	Neutral	3

Industry Comparison Industry: Semiconductor - Analog And Mixed				Industry Peers		
	MCHP	X Industry	S&P 500	ADI	CRUS	MXIM
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	C	C	C
Market Cap	26.06 B	6.74 B	22.50 B	44.81 B	4.22 B	16.15 B
# of Analysts	10	9	14	12	6	10
Dividend Yield	1.35%	0.00%	1.88%	2.04%	0.00%	3.17%
Value Score	C	-	-	C	D	C
Cash/Price	0.02	0.08	0.06	0.02	0.07	0.11
EV/EBITDA	17.25	18.66	12.98	19.46	16.12	17.86
PEG Ratio	1.46	2.28	3.05	2.28	2.68	2.77
Price/Book (P/B)	4.67	4.67	3.11	3.87	3.44	9.97
Price/Cash Flow (P/CF)	9.72	18.70	12.18	16.39	18.55	21.01
P/E (F1)	19.64	35.72	22.19	28.49	22.83	27.70
Price/Sales (P/S)	4.94	4.88	2.40	8.08	3.30	7.33
Earnings Yield	5.02%	2.81%	4.31%	3.51%	4.39%	3.62%
Debt/Equity	1.59	0.57	0.76	0.44	0.11	0.61
Cash Flow (\$/share)	11.19	2.91	7.01	7.42	3.88	2.88
Growth Score	B	-	-	D	C	C
Hist. EPS Growth (3-5 yrs)	23.61%	14.19%	10.87%	16.81%	1.44%	12.23%
Proj. EPS Growth (F1/F0)	-2.79%	-4.12%	-10.74%	-17.10%	-16.89%	-10.04%
Curr. Cash Flow Growth	6.11%	-12.47%	5.48%	-9.88%	10.42%	-14.31%
Hist. Cash Flow Growth (3-5 yrs)	31.92%	22.53%	8.55%	24.75%	3.55%	2.00%
Current Ratio	1.35	2.56	1.29	1.30	4.10	5.95
Debt/Capital	61.37%	38.02%	44.75%	30.73%	9.51%	38.02%
Net Margin	10.82%	2.31%	10.59%	20.05%	12.45%	37.00%
Return on Equity	23.63%	12.00%	16.29%	14.51%	16.46%	35.31%
Sales/Assets	0.30	0.47	0.55	0.26	0.81	0.60
Proj. Sales Growth (F1/F0)	-5.00%	-5.91%	-2.65%	-12.20%	-8.77%	-6.83%
Momentum Score	B	-	-	A	B	B
Daily Price Chg	12.34%	4.56%	2.42%	4.13%	1.74%	3.17%
1 Week Price Chg	9.35%	2.93%	4.60%	1.70%	-1.36%	2.78%
4 Week Price Chg	29.88%	15.04%	13.40%	15.55%	-0.37%	14.52%
12 Week Price Chg	48.22%	37.39%	12.78%	28.82%	14.82%	22.25%
52 Week Price Chg	32.14%	26.09%	0.89%	21.78%	79.79%	8.98%
20 Day Average Volume	3,665,771	1,071,682	2,528,787	2,377,135	634,324	2,107,203
(F1) EPS Est 1 week change	1.20%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	4.85%	0.00%	-0.14%	-1.16%	-8.88%	0.00%
(F1) EPS Est 12 week change	-14.11%	-14.25%	-16.00%	-10.09%	-27.65%	-6.10%
(Q1) EPS Est Mthly Chg	2.02%	0.00%	-0.02%	0.35%	-15.39%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	B
Momentum Score	B
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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