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Feb 06, 2020

Microchip Technology (MCHP)

$108.51 (As of 02/05/20)

Price Target (6-12 Months): **$125.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 02/06/20) Prior Recommendation: Neutral	**Outperform**
Short Term: 1-3 Months	**Zacks Rank:** (1-5) Zacks Style Scores: Value: C | Growth: D | Momentum: B	**1-Strong Buy** VGM:D

Summary

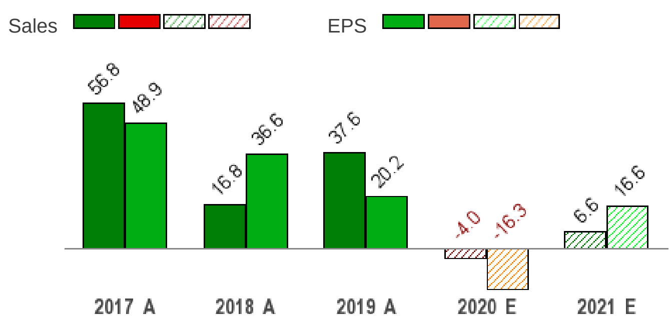
Microchip reported third-quarter fiscal 2020 results, wherein both earnings and revenues topped the consensus mark. The company's expanding product portfolio driven by new product roll outs is a key catalyst. Improvement in bookings across industrial, data center, and automotive end markets holds promise. Robust adoption of its 8-bit, 16-bit and 32-bit microcontrollers, bodes well. Moreover, strong demand for memory and analog and interface products remains noteworthy. Moreover, it is well poised to capitalize on synergies from accretive Microsemi and Atmel acquisitions. Additionally, new design wins for the company's latest PolarFire solutions are expected to drive FPGA revenues. Notably, shares of the company have outperformed the industry in the past six-month period.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$112.47 - $77.66**
20 Day Average Volume (sh)	**2,728,762**
Market Cap	**$26.0 B**
YTD Price Change	**3.6%**
Beta	**1.47**
Dividend / Div Yld	**$1.47 / 1.4%**
Industry	**Semiconductor - Analog and Mixed**
Zacks Industry Rank	**Top 9% (24 out of 255)**
Last EPS Surprise	**4.8%**
Last Sales Surprise	**1.1%**
EPS F1 Est- 4 week change	**1.8%**
Expected Report Date	**05/05/2020**
Earnings ESP	**2.2%**
P/E TTM	**19.2**
P/E F1	**19.8**
PEG F1	**1.5**
P/S TTM	**4.9**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	1,405 E	1,414 E	1,392 E	1,408 E	5,600 E
2020	1,323 A	1,338 A	1,287 A	1,360 E	5,255 E
2019	1,213 A	1,513 A	1,416 A	1,330 A	5,476 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	$1.52 E	$1.63 E	$1.59 E	$1.66 E	$6.39 E
2020	$1.41 A	$1.43 A	$1.32 A	$1.38 E	$5.48 E
2019	$1.61 A	$1.81 A	$1.66 A	$1.48 A	$6.55 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 02/05/2020. The reports text is as of 02/06/2020.

Overview

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

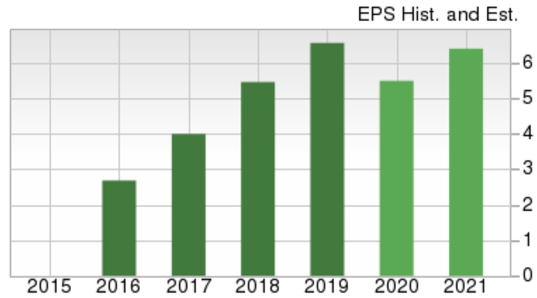
Total revenues increased 34.4% year over year to $5.349 billion in fiscal 2019.

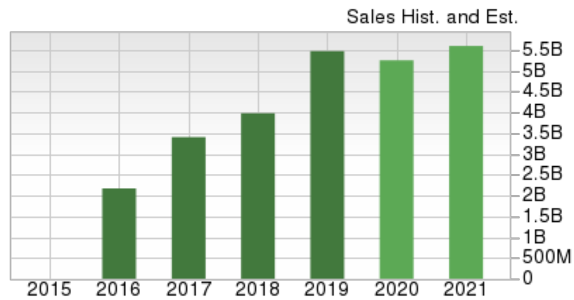
The company has five major product lines:

- **Microcontrollers** (54.6% of fiscal 2019 revenues)**:** This product portfolio comprises 8-bit, 16-bit and 32-bit PIC microcontrollers and 16-bit dsPIC digital signal controllers.

- **Memory products** (3.4%)**:** Memory products consist of Serial Electrically Erasable Programmable Read Only Memory (EEPROMs), which are used for non-volatile program and data storage in systems.

- **Analog** (28.6%) **:** 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** (2.5%) **:** 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** (5.7%)**:** The product line was primarily acquired as part of Microsemi acquisition.

- **Multi-market and Other** (5.2%) **:** This segment accounts for revenue from assembly and test subcontracting services as a result of the company's acquisition of Millennium Microtech Thailand (MMT) in the fourth quarter of fiscal 2011.

In fiscal 2019, Asia, Europe and Americas contributed approximately 52.3%, 22.6% and 25.1%, respectively to net sales.

Reasons To Buy:

> 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.

- Microchip is one of the fastest-growing providers of 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.

Risks

- 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 2019 came in from Asia (52.3% of total revenues), followed by Europe (22.6%) and Americas (25.1%). 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. The company had total debt (long-term plus current portion) position of $9.8 billion with cash and cash equivalents of only $402.3 million at the end of third-quarter of fiscal 2020. This amounted to a net debt of $9.58 billion. Thus, it had to constantly generate adequate amount of operating cash flow to service its debt.

- 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 4.84. This level compares unfavorably with what the industry witnessed in the last year. Consequently, the valuation looks slightly stretched from P/B perspective.

Last Earnings Report

Microchip Q3 Earnings & Revenues Beat Estimates

Quarter Ending	12/2019
Report Date	**Feb 04, 2020**
Sales Surprise	**1.06%**
EPS Surprise	**4.76%**
Quarterly EPS	**1.32**
Annual EPS (TTM)	**5.64**

Microchip Technology Incorporated (MCHP) reported third-quarter fiscal 2020 non-GAAP earnings of $1.32 per share, beating the Zacks Consensus Estimate by 4.8%. Notably, the figure declined 15.4% on a year-over-year basis.

Net sales declined 6.4% from the year-ago quarter to $1.287 billion. However, the figure surpassed the Zacks Consensus Estimate of $1.274 billion.

Management noted sluggish demand across communication and appliance end-markets.

Quarter in Detail

In terms of product line, microcontroller business (53.3% of net sales) declined 1.7% sequentially to $685.8 million.

Analog net sales of $363.3 million (28.2%) declined 7.8% sequentially.

FPGA revenues (7.2%) came in at $92.6 million, down 0.6% on a quarter-over-quarter basis.

Licensing, memory and other, or LMO product line (11.3%) reported revenues of $145.7 million, which declined 4.7% sequentially.

Geographically, revenues from Americas, Europe and Asia contributed 24.1%, 21.5% and 54.4% to net sales, respectively.

Margins

Non-GAAP gross margin contracted 90 basis points (bps) on a year-over-year basis to 61.5%.

Non-GAAP research & development expenses, as a percentage of net sales, expanded 80 bps year over year to 15.2%. Non-GAAP selling, general & administrative (SG&A) expenses, as a percentage of net sales, remained flat year over year at 11.1%. Non-GAAP operating expenses, as a percentage of net sales, expanded 90 bps year over year to 26.4%.

Consequently, non-GAAP operating margin contracted 170 bps on a year-over-year basis to 35.1%.

Balance Sheet & Cash Flow

As of Dec 31, 2019, cash and short-term investments came in at $402.3 million, compared with $405.1 million as of Sep 30, 2019.

As of Dec 31, 2019, total debt (long-term plus current portion) amounted to $9.58 billion compared with $9.80 billion as of Sep 30, 2019. Notably, the company paid down $257 million of debt during the quarter.

Cash flow from operating activities was $395.5 million during the quarter.

Notably, on Feb 4, 2020, Microchip's board of directors announced a cash dividend of 36.70 cents per share, payable Mar 6, 2020, to shareholders as on Feb 21, 2020.

Guidance

Microchip forecasts fourth-quarter fiscal 2020 net sales of $1.313-$1.403 billion (mid-point $1.358 billion).

Non-GAAP earnings are anticipated in the range of $1.35-$1.51 per share (mid-point $1.43 billion).

Non-GAAP gross margin is anticipated in the range of 61.5-61.9%.

For fiscal 2020, capital expenditures are projected between $76 million and $81 million.

Recent News

On **Jan 30, 2020**, Microchip announced engineering services collaboration with Arrow Electronics with an aim to deliver robust edge device and edge compute solutions, to simplify security and connectivity across smart building, industrial, and energy end-markets.

On **Jan 6, 2020**, Microchip provided an update on third-quarter fiscal 2020 revenues on consistent strength in bookings since October 2019 and improving demand across major end-markets. The company now anticipates fiscal third-quarter consolidated net sales to be in the band of $1.281 billion to $1.288 billion (approximately mid-point $1.285 billion), compared with prior revised range of $1.244-$1.298 billion (mid-point $1.271 billion).

On **Dec 3, 2019**, Microchip provided an update on third-quarter fiscal 2020 outlook. The company now anticipates consolidated net sales in the range of $1.244-$1.298 billion (mid-point $1.271) Non-GAAP earnings per share are projected in the range of $1.19-$1.30 per share (mid-point $1.24).

On **Nov 13, 2019**, Microchip enhanced its Adaptec Smart Storage adapters, in integration with AMI interoperability, to boost baseline remote management capabilities.

On **Nov 5, 2019**, Microchip declared a quarterly dividend of 36.65 cents per share payable on Dec 5, 2019, to shareholders as on Nov 21, 2019.

On **Oct 23, 2019**, Microchip unveiled PoE midspans and injectors that are compliant with IEEE 802.3bt-2018, enabled to deliver up to 90W of power over Ethernet-based infrastructure.

Valuation

Microchip Technology shares are up 23.7% in the past six-month period and 23.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 18.2% and 21.8% in the past six-month period, respectively. Over the past year, the Zacks sub-industry and the sector are up 26.7% and 30.9%, respectively.

The S&P 500 index is up 17.1% in the past six-month period and 22.7% in the past year.

The stock is currently trading at 17.35X forward 12-month earnings compared with 22.58X for the Zacks sub-industry, 22.62X for the Zacks sector and 19.09X for the S&P 500 index.

Over the past five years, the stock has traded as high as 20.7X and as low as 9.09X, with a 5-year median of 17.1X. Our Outperform recommendation indicates that the stock will perform better than the market. Our $125 price target reflects 20X 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	17.35	22.58	22.62	19.09
	5-Year High	20.7	22.79	22.62	19.34
	5-Year Low	9.09	13.42	16.87	15.18
	5-Year Median	17.10	18.14	19.28	17.46
P/S F12M	Current	4.67	4.68	3.70	3.54
	5-Year High	5.68	4.68	3.70	3.54
	5-Year Low	2.42	2.81	2.30	2.54
	5-Year Median	4.03	3.69	3.02	3
EV/Sales TTM	Current	6.39	5.20	4.40	3.35
	5-Year High	7.69	5.20	4.40	3.35
	5-Year Low	3.24	3.13	2.57	2.12
	5-Year Median	5.47	4.35	3.48	2.79

As of 02/05/2020

Industry Analysis Zacks Industry Rank: Top 9% (24 out of 255)

Top Peers

Cirrus Logic, Inc. **(CRUS)**	Outperform
Analog Devices, Inc. **(ADI)**	Neutral
Cypress Semiconductor Corporation **(CY)**	Neutral
Monolithic Power Systems, Inc. **(MPWR)**	Neutral
MACOM Technology Solutions Holdings, Inc. **(MTSI)**	Neutral
Maxim Integrated Products, Inc. **(MXIM)**	Neutral
Texas Instruments Incorporated **(TXN)**	Neutral
Xilinx, Inc. **(XLNX)**	Neutral

Industry Comparison Industry: Semiconductor - Analog And Mixed

Industry Peers

	MCHP Outperform	X Industry	S&P 500	ADI Neutral	CRUS Outperform	MXIM Neutral
VGM Score	D	-	-	D	B	C
Market Cap	25.99 B	6.40 B	24.26 B	43.05 B	4.67 B	17.38 B
# of Analysts	10	7	13	12	6	10
Dividend Yield	1.35%	0.00%	1.75%	1.85%	0.00%	2.98%
Value Score	C	-	-	D	D	C
Cash/Price	0.02	0.10	0.04	0.02	0.08	0.11
EV/EBITDA	19.69	19.43	14.19	18.84	25.50	19.17
PEG Ratio	1.47	1.95	2.04	1.97	1.34	2.37
Price/Book (P/B)	4.63	4.63	3.31	3.67	3.71	10.06
Price/Cash Flow (P/CF)	10.18	19.05	13.70	15.72	22.86	22.38
P/E (F1)	19.80	26.07	19.17	24.43	20.49	27.71
Price/Sales (P/S)	4.93	5.26	2.67	7.19	3.76	7.96
Earnings Yield	5.05%	3.85%	5.22%	4.10%	4.88%	3.61%
Debt/Equity	1.46	0.56	0.71	0.44	0.11	0.58
Cash Flow ($/share)	10.66	2.86	6.92	7.42	3.49	2.88
Growth Score	D	-	-	C	A	C
Hist. EPS Growth (3-5 yrs)	27.06%	13.72%	10.80%	21.84%	1.56%	13.72%
Proj. EPS Growth (F1/F0)	-16.27%	13.11%	7.35%	-7.27%	47.41%	-4.20%
Curr. Cash Flow Growth	25.06%	-12.10%	10.12%	-9.88%	-36.48%	-14.31%
Hist. Cash Flow Growth (3-5 yrs)	29.32%	25.11%	8.55%	24.75%	4.16%	2.00%
Current Ratio	0.90	3.48	1.20	1.32	4.01	6.60
Debt/Capital	59.29%	36.52%	42.91%	30.72%	9.61%	36.52%
Net Margin	12.23%	3.29%	11.79%	22.75%	12.52%	35.93%
Return on Equity	23.87%	13.04%	17.21%	16.39%	15.06%	33.82%
Sales/Assets	0.29	0.47	0.54	0.28	0.82	0.59
Proj. Sales Growth (F1/F0)	-3.95%	4.39%	4.15%	-5.46%	7.33%	-2.60%
Momentum Score	B	-	-	D	A	C
Daily Price Chg	6.69%	3.06%	1.40%	3.75%	0.22%	3.38%
1 Week Price Chg	-9.08%	-7.80%	-2.60%	-6.65%	-7.67%	-3.90%
4 Week Price Chg	-0.71%	1.27%	1.96%	-3.30%	-5.42%	4.74%
12 Week Price Chg	15.33%	10.41%	6.04%	2.20%	10.80%	10.33%
52 Week Price Chg	21.50%	23.85%	16.68%	13.93%	102.80%	14.81%
20 Day Average Volume	2,728,762	770,985	1,966,046	2,049,908	823,264	2,076,477
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	8.62%	0.22%
(F1) EPS Est 4 week change	1.78%	0.00%	0.00%	0.00%	15.02%	5.05%
(F1) EPS Est 12 week change	2.88%	-0.15%	-0.08%	-9.58%	15.02%	4.63%
(Q1) EPS Est Mthly Chg	6.30%	0.00%	0.00%	0.00%	132.50%	9.60%

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	D
Momentum Score	B
VGM Score	D

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.

Disclosures

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