

Microchip Technology (MCHP)

\$103.73 (As of 01/06/20)

Price Target (6-12 Months): **\$113.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/07/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:C

Value: B

Growth: D

Momentum: C

Summary

Microchip is benefiting from strength in microcontroller business. The company is well poised to gain from strong demand for memory and analog and interface products. We believe that the company's expanding portfolio driven by new product roll outs will continue to expand customer base. Moreover, it is well poised to capitalize on synergies from accretive Microsemi and Atmel acquisitions. However, Microchip is bearing the brunt of increasing lead time, slim demand trends in ZTE and Bitcoin business domains. Further, Huawei ban and significant exposure to Asian markets amid imposition of tariff owing to the United States and China trade war is likely to weigh on margin expansion. Moreover, significant debt burden amid increasing expenses on product development remain major concerns.

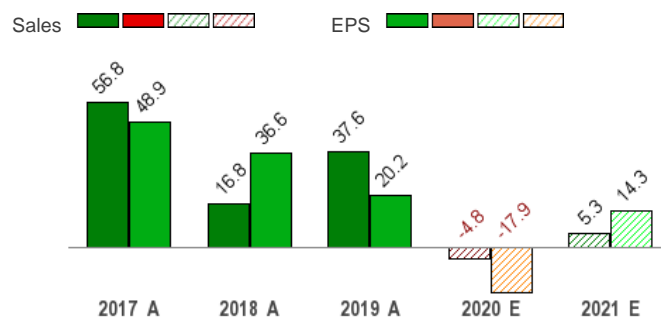
Price, Consensus & Surprise



Data Overview

| | |
|----------------------------|---|
| 52 Week High-Low | \$108.09 - \$68.71 |
| 20 Day Average Volume (sh) | 2,174,959 |
| Market Cap | \$24.8 B |
| YTD Price Change | -1.0% |
| Beta | 1.43 |
| Dividend / Div Yld | \$1.47 / 1.4% |
| Industry | Semiconductor - Analog and Mixed |
| Zacks Industry Rank | Bottom 28% (183 out of 254) |

Sales and EPS Growth Rates (Y/Y %)



| | |
|---------------------------|-------------------|
| Last EPS Surprise | 0.0% |
| Last Sales Surprise | -1.0% |
| EPS F1 Est- 4 week change | 0.0% |
| Expected Report Date | 02/04/2020 |
| Earnings ESP | 0.0% |
| P/E TTM | 17.4 |
| P/E F1 | 19.3 |
| PEG F1 | 1.4 |
| P/S TTM | 4.6 |

Sales Estimates (millions of \$)

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|------|---------|---------|---------|---------|---------|
| 2021 | 1,345 E | 1,384 E | 1,365 E | 1,377 E | 5,488 E |
| 2020 | 1,323 A | 1,338 A | 1,265 E | 1,286 E | 5,212 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 | \$1.45 E | \$1.56 E | \$1.53 E | \$1.59 E | \$6.15 E |
| 2020 | \$1.41 A | \$1.43 A | \$1.23 E | \$1.31 E | \$5.38 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 01/06/2020. The reports text is as of 01/07/2020.

Overview

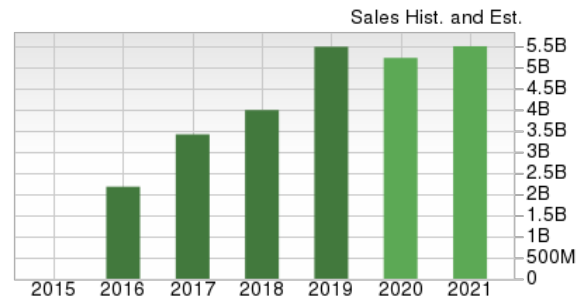
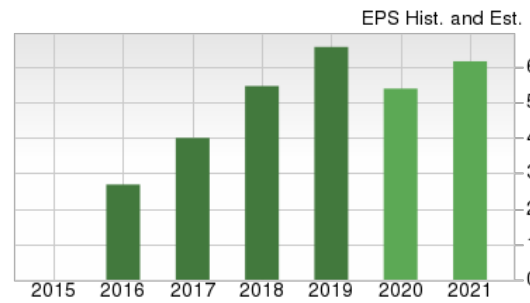
Chandler, AZ-based, Microchip Technology Inc. develops and manufactures microcontrollers, memory and analog and interface products for embedded control systems, which are small, low-power computers designed to perform specific tasks.

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 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.

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 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 \$405.1 million at the end of second-quarter of fiscal 2020. This amounted to a net debt of \$9.39 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 4.62. 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 Q2 Earnings In Line, Revenues Miss Estimates

Microchip Technology Incorporated reported second-quarter fiscal 2020 non-GAAP earnings of \$1.43 per share, in line with the Zacks Consensus Estimate. The figure was within management's guided range of \$1.37-\$1.49 per share. Notably, the figure declined from \$1.81 reported in the year-ago quarter.

Net sales declined 6.6% from the year-ago quarter to \$1.338 billion on a non-GAAP basis. The figure also missed the Zacks Consensus Estimate of \$1.353 billion. Notably, the top line was lower than the mid-point of management's guided range of \$1.323-\$1.375 billion (mid-point \$1.349 billion).

Notably, the impact of Huawei shipment limitations acted as the primary tailwind during the reported quarter. Further, negative developments pertaining to the U.S.-China trade war added to woes.

Microcontrollers and analog contributed approximately 53.3% and 28.7%, respectively, to total revenues in the fiscal second quarter. Notably, Microcontroller business was down 1.3% on a sequential basis, while analog business was up 0.2% quarter over quarter.

Margins

Microchip reported non-GAAP gross margin of 62.2% expanding 90 bps on a year-over-year basis.

Non-GAAP operating expenses, as percentage of revenues, were up 90 bps year over year to 25.6%. The increase can primarily be attributed to higher research & development (R&D) and selling, general & administrative (SG&A) expenses.

Consequently, non-GAAP operating margin contracted 20 bps from the year-ago quarter to 36.7%.

Balance Sheet & Cash Flow

The company exited the quarter under review with \$405.1 million of cash and short-term investments compared with \$437.1 million reported in the previous quarter. Total debt (long-term plus current portion) amounted to \$9.8 billion compared with \$10.08 billion in the previous quarter.

Cash flow from operating activities was \$396 million during the quarter.

Notably, the company paid \$315.5 million of total debt during the quarter.

During the reported quarter, the company announced a quarterly cash dividend of 36.65 cents per share.

Quarter Ending 09/2019

| Report Date | Nov 05, 2019 |
|------------------|--------------|
| Sales Surprise | -0.98% |
| EPS Surprise | 0.00% |
| Quarterly EPS | 1.43 |
| Annual EPS (TTM) | 5.98 |

Recent News

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.

On **Oct 1, 2019**, Microchip unveiled Microchip's Trust Platform for its CryptoAuthentication family which helps organizations to simply implement secure authentication.

Valuation

Microchip Technology shares are up 18.9% in the past six-month period and 44.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 15.2% and 14.4% in the past six-month period, respectively. Over the past year, the Zacks sub-industry and the sector are up 44.9% and 33.4%, respectively.

The S&P 500 index is up 10.8% in the past six-month period and 27.8% in the past year.

The stock is currently trading at 17.42X forward 12-month earnings compared with 22.42X for the Zacks sub-industry, 22.32X for the Zacks sector and 18.79X 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 17.08X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$113 price target reflects 18.99X 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 F 12M | Current | 17.42 | 22.42 | 22.32 | 18.79 |
| | 5-Year High | 20.7 | 22.78 | 22.32 | 19.34 |
| | 5-Year Low | 9.09 | 13.42 | 16.86 | 15.17 |
| | 5-Year Median | 17.08 | 18.12 | 19.24 | 17.44 |
| P/S F12M | Current | 4.57 | 4.61 | 3.59 | 3.48 |
| | 5-Year High | 5.68 | 4.61 | 3.59 | 3.48 |
| | 5-Year Low | 2.42 | 2.81 | 2.3 | 2.54 |
| | 5-Year Median | 4.02 | 3.68 | 3.01 | 3 |
| EV/Sales TTM | Current | 6.11 | 5.08 | 4.22 | 3.25 |
| | 5-Year High | 7.69 | 5.18 | 4.22 | 3.3 |
| | 5-Year Low | 3.24 | 3.13 | 2.56 | 2.16 |
| | 5-Year Median | 5.44 | 4.35 | 3.44 | 2.8 |

As of 01/06/2020

Industry Analysis Zacks Industry Rank: Bottom 28% (183 out of 254)



Top Peers

| | |
|--|--------------|
| Cirrus Logic, Inc. (CRUS) | 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 |
| Analog Devices, Inc. (ADI) | Underperform |

| Industry Comparison Industry: Semiconductor - Analog And Mixed | | | | Industry Peers | | |
|--|--------------|------------|-----------|------------------|--------------|--------------|
| | MCHP Neutral | X Industry | S&P 500 | ADI Underperform | CRUS Neutral | MXIM Neutral |
| VGM Score | C | - | - | C | B | D |
| Market Cap | 24.79 B | 6.31 B | 23.72 B | 43.06 B | 4.78 B | 16.30 B |
| # of Analysts | 10 | 9 | 13 | 13 | 6 | 10 |
| Dividend Yield | 1.41% | 0.00% | 1.79% | 1.85% | 0.00% | 3.19% |
| Value Score | B | - | - | F | C | D |
| Cash/Price | 0.02 | 0.10 | 0.04 | 0.01 | 0.05 | 0.11 |
| EV/EBITDA | 19.13 | 18.99 | 13.90 | 18.85 | 26.75 | 17.92 |
| PEG Ratio | 1.43 | 1.96 | 2.00 | 1.97 | 1.74 | 2.33 |
| Price/Book (P/B) | 4.61 | 4.63 | 3.34 | 3.68 | 4.06 | 9.15 |
| Price/Cash Flow (P/CF) | 9.73 | 18.33 | 13.67 | 15.75 | 23.73 | 20.90 |
| P/E (F1) | 19.28 | 30.20 | 18.72 | 24.44 | 24.40 | 27.18 |
| Price/Sales (P/S) | 4.62 | 5.32 | 2.66 | 7.19 | 4.01 | 7.38 |
| Earnings Yield | 5.19% | 3.35% | 5.31% | 4.09% | 4.10% | 3.69% |
| Debt/Equity | 1.57 | 0.55 | 0.72 | 0.44 | 0.11 | 0.56 |
| Cash Flow (\$/share) | 10.66 | 2.86 | 6.94 | 7.42 | 3.49 | 2.88 |
| Growth Score | D | - | - | C | A | F |
| Hist. EPS Growth (3-5 yrs) | 27.06% | 15.13% | 10.56% | 21.84% | 2.84% | 15.13% |
| Proj. EPS Growth (F1/F0) | -17.89% | 11.70% | 7.42% | -7.10% | 28.47% | -8.81% |
| Curr. Cash Flow Growth | 25.06% | -6.04% | 14.83% | -9.88% | -36.48% | -14.31% |
| Hist. Cash Flow Growth (3-5 yrs) | 29.32% | 25.11% | 9.00% | 24.75% | 4.16% | 2.00% |
| Current Ratio | 0.90 | 3.49 | 1.23 | 1.32 | 3.38 | 7.08 |
| Debt/Capital | 61.08% | 35.79% | 42.92% | 30.72% | 10.15% | 35.79% |
| Net Margin | 7.15% | 5.11% | 11.08% | 22.75% | 9.81% | 34.87% |
| Return on Equity | 25.60% | 12.94% | 17.16% | 16.39% | 13.04% | 34.55% |
| Sales/Assets | 0.30 | 0.49 | 0.55 | 0.28 | 0.82 | 0.58 |
| Proj. Sales Growth (F1/F0) | -4.74% | 2.46% | 4.15% | -5.46% | 2.30% | -4.20% |
| Momentum Score | C | - | - | A | A | A |
| Daily Price Chg | -1.43% | -1.10% | 0.10% | -1.17% | -1.09% | -1.82% |
| 1 Week Price Chg | -0.23% | -0.53% | -0.30% | -0.95% | 0.36% | -0.31% |
| 4 Week Price Chg | 4.76% | 6.53% | 2.33% | 2.01% | 12.05% | 5.34% |
| 12 Week Price Chg | 8.41% | 8.36% | 7.02% | 5.96% | 49.85% | 4.43% |
| 52 Week Price Chg | 46.04% | 45.32% | 24.61% | 40.51% | 157.47% | 19.09% |
| 20 Day Average Volume | 2,174,959 | 479,644 | 1,589,897 | 1,619,627 | 570,345 | 1,629,191 |
| (F1) EPS Est 1 week change | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| (F1) EPS Est 4 week change | 0.00% | 0.00% | 0.00% | 0.05% | 0.00% | -0.40% |
| (F1) EPS Est 12 week change | -8.79% | -8.45% | -0.56% | -9.78% | 30.83% | 0.77% |
| (Q1) EPS Est Mthly Chg | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | -0.89% |

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 | B |
| Growth Score | D |
| Momentum Score | C |
| VGM Score | C |

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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