

Microchip Technology (MCHP)

\$107.35 (As of 08/18/20)

Price Target (6-12 Months): **\$115.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 08/06/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: B

Momentum: D

Summary

Microchip's fiscal first-quarter revenues declined year over year on sluggishness across industrial and automotive verticals owing to coronavirus-induced macroeconomic weakness. Moreover, softness in FPGA domain impacted top-line performance. Also, bleak view for fiscal second quarter remains a concern. Notably, shares of Microchip have underperformed the industry in the year-to-date period. However, strength in the medical end market, driven by growth in demand for hospital equipment, holds promise. Further, improving demand across office equipment and communication infrastructures, amid the coronavirus crisis-led work-from-home wave also bodes well. Microchip is also expected to benefit from dominance of its 8, 16 and 32-bit microcontrollers. Nevertheless, significant debt burden amid increasing expenses on product development are major woes.

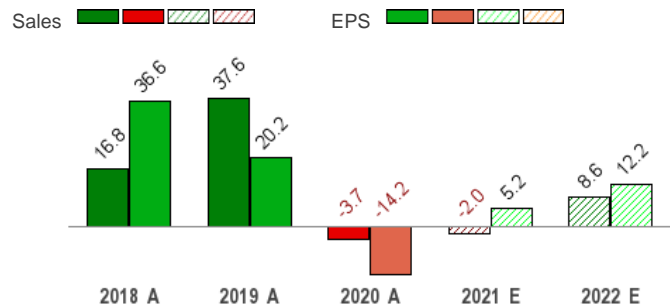
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$113.28 - \$53.15
20 Day Average Volume (sh)	2,533,462
Market Cap	\$27.1 B
YTD Price Change	2.5%
Beta	1.57
Dividend / Div Yld	\$1.47 / 1.4%
Industry	Semiconductor - Analog and Mixed
Zacks Industry Rank	Top 22% (55 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	9.1%
Last Sales Surprise	2.2%
EPS F1 Est- 4 week change	-0.9%
Expected Report Date	11/03/2020
Earnings ESP	0.0%
P/E TTM	18.6
P/E F1	18.2
PEG F1	1.4
P/S TTM	5.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	1,374 E	1,418 E	1,392 E	1,411 E	5,614 E
2021	1,310 A	1,258 E	1,284 E	1,320 E	5,171 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	\$1.62 E	\$1.70 E	\$1.63 E	\$1.68 E	\$6.63 E
2021	\$1.56 A	\$1.42 E	\$1.45 E	\$1.51 E	\$5.91 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 08/18/2020. The reports text is as of 08/19/2020.

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:

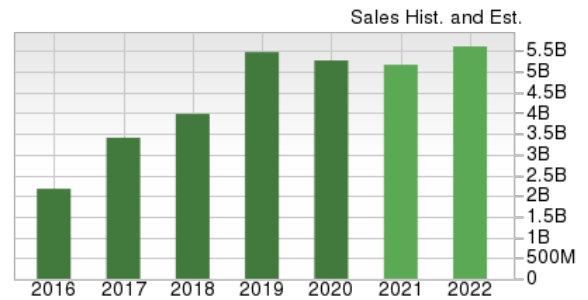
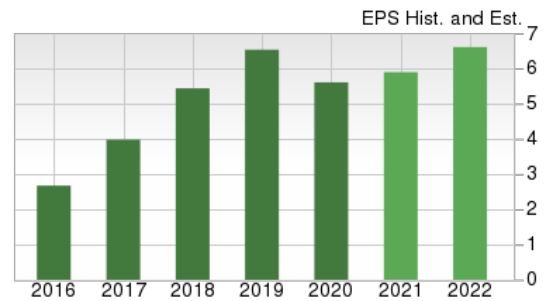
Microcontrollers (53.4% of fiscal 2020 revenues): This product portfolio comprises 8-bit, 16-bit and 32-bit PIC microcontrollers and 16-bit dsPIC digital signal controllers. Microchip's expanding product portfolio driven by new microcontrollers' roll outs aids it in expanding customer base and sustain 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. 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.
- ▲ Improving demand across data center, office equipment and communication infrastructure, driven by requirement for cloud computing solution amid coronavirus crisis induced work-from-home wave, bodes well. The company is also anticipated to witness strength in medical end market, driven by growth in demand for hospital equipment like ventilators, oxygen monitors, respirators, ultrasound machines and other COVID-19 related items.

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. Moreover, coronavirus crisis-induced broad-based macroeconomic weakness across automotive and industrial end-markets, remain a concern.
- ▼ Microchip has a highly-leveraged balance sheet. As of Jun 30, 2020, the company had a net debt of \$8.95 billion. Notably, total debt to total capital of 62.9% is higher than the industry's figure of 48.5%, indicating a higher liability in repaying the debt. Further, times interest earned is 1.4X, compared with the industry's figure of 3.4X. Owing to significant debt levels, the company 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 (0.28) 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 4.93X. This level compares unfavorably with what the industry witnessed in the last year. Additionally, the ratio is higher than the average level of 4.24X and is near the high end of the valuation range in this period. 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 Q1 Earnings & Revenues Top Estimates

Microchip Technology Incorporated reported first-quarter fiscal 2021 non-GAAP earnings of \$1.56 per share, beating the Zacks Consensus Estimate by 9.1%. Moreover, the bottom line improved 10.6% on a year-over-year basis.

Net sales declined 1% from the year-ago quarter to \$1.31 billion. However, the top line surpassed the Zacks Consensus Estimate by 2.2%.

Revenues declined 1.3% sequentially, led by coronavirus crisis-induced broad-based macroeconomic weakness across automotive and industrial end-markets. However, strength in demand across computing and data center, and medical end-markets was a positive.

Quarter Ending 06/2020

Report Date	Aug 04, 2020
Sales Surprise	2.17%
EPS Surprise	9.09%
Quarterly EPS	1.56
Annual EPS (TTM)	5.77

Quarter in Detail

In terms of product line, **microcontroller** business (54.9% of net sales) declined 1.3% sequentially to \$716.4 million. Nevertheless, management noted that the decline was lower than anticipated.

During the reported quarter, Microchip rolled out Adaptec SmartRAID 3100E RAID adapters that are designed to provide reliable hardware RAID protection for customer data in cost-sensitive end applications. Moreover, the company expanded its maXTouch portfolio with the new MXT288UD touch controller family, comprising compact automotive grade packaged touch screen controllers.

We believe that Microchip's expanding product portfolio driven by new microcontroller roll outs will aid it in expanding customer base and sustaining its market-leading position. Moreover, the company is well poised to capitalize on synergies from accretive Microsemi and Atmel acquisitions.

Analog net sales of \$370.2 million (28.1%) improved 0.7% sequentially.

FPGA revenues (6.7%) were \$86.8 million, down 10.3% on a quarter-over-quarter basis. The decline was led by shut down of operations across "one significant aerospace customer" owing to COVID-19 restrictions.

Licensing, memory and other, or LMO product line (10.4%) reported revenues of \$136.3 million, almost flat sequentially.

Geographically, revenues from Americas, Europe and Asia contributed 26.2%, 18.7% and 55.1% to net sales, respectively.

Margins

Non-GAAP gross margin contracted 30 basis points (bps) on a year-over-year basis to 61.7%.

Non-GAAP research & development expenses, as a percentage of net sales, contracted 150 bps year over year to 13.6%. Non-GAAP selling, general & administrative (SG&A) expenses, as a percentage of net sales, contracted 120 bps year over year at 9.5%. Non-GAAP operating expenses, as a percentage of net sales, contracted 270 bps year over year to 23.1%.

Consequently, non-GAAP operating margin expanded 240 bps on a year-over-year basis to 38.6%.

Balance Sheet & Cash Flow

As of Jun 30, 2020, cash and short-term investments came in at \$380.2 million, compared with \$403 million as of Mar 31, 2020.

As of Jun 30, 2020, total debt (long-term plus current portion) amounted to \$9.33 billion compared with \$9.48 billion as of Mar 31, 2020. Notably, the company paid down \$394 million of debt during the quarter.

Cash flow from operating activities was \$501.8 million compared with \$371.7 million reported in the prior quarter.

Guidance

Microchip forecast second-quarter fiscal 2021 net sales of \$1.205-\$1.310 billion.

For the fiscal second quarter, non-GAAP earnings are anticipated in the range of \$1.30-\$1.52 per share.

Non-GAAP gross margin is anticipated in the range of 61.2-62.2%. Non-GAAP operating margin is anticipated in the range of 37-39%.

Recent News

On Aug 18, Microchip unveiled EQCO125X40 family of CoaXPress devices in compliance with the CXP 2.0 standard. The new devices significantly boost machine-vision processing throughput by allowing cameras and capture cards to transfer four to eight times faster when compared with alternative solutions.

On Aug 4, 2020, Microchip's board of directors announced a cash dividend of 36.8 cents, up from prior dividend payment of 36.75 cents per share, payable Sep 4, 2020, to shareholders as on Aug 21, 2020.

On Jul 28, Microchip unveiled Ethernet-based physical layer transceiver (PHY) — LAN8770 — with OPEN Alliance TC10 sleep standard and featuring low sleep current — less than 15 μ A. The compact PHY is aimed at accelerating advanced space-constrained applications including infotainment and telematics modules or Advanced Driver Assistance Systems (ADAS).

On Jun 30, Microchip expanded its maXTouch portfolio with the new MXT288UD touch controller family, compact automotive grade packaged touch screen controllers.

On Jun 23, Microchip rolled out a major software update for its BlueSky GNSS Firewall product that provides a higher level of protection against GPS vulnerabilities for systems dependent on GPS signal reception.

On Jun 15, Microchip rolled out Adaptec SmartRAID 3100E RAID adapters that are designed to provide reliable hardware RAID protection for customer data in cost-sensitive end applications.

On Jun 10, Microchip unveiled the MDA3KP Transient Voltage Suppressor (TVS), a 3kW diode family of more than 25 products with different screening levels, polarities and qualification standards. The latest offering protects circuits from voltage spikes and electrostatic events.

Valuation

Microchip Technology shares are up 2.6% in the year-to-date period and 20.7% over the trailing 12-month period. Stocks in the Zacks sub-industry and Zacks Computer & Technology sector are up 59.8% and 22.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are up 46.1% and 37.6%, respectively.

The S&P 500 index is up 5.2% in the year-to-date period and 17.1% in the past year.

The stock is currently trading at 17.35X forward 12-month earnings compared with 25.57X for the Zacks sub-industry, 26.54X for the Zacks sector and 22.91X for the S&P 500 index.

In the past five years, the stock has traded as high as 21.11X and as low as 9.09X, with a 5-year median of 17.12X. Our Neutral recommendation indicates that the stock will perform in line with the the market. Our \$115 price target reflects 18.59X 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	25.57	26.54	22.91
	5-Year High	21.11	27.04	26.54	22.91
	5-Year Low	9.09	13.42	16.72	15.25
	5-Year Median	17.12	18.16	19.61	17.58
P/S F12M	Current	5.07	5.02	4.12	3.72
	5-Year High	5.68	5.02	4.12	3.72
	5-Year Low	2.37	2.81	2.32	2.53
	5-Year Median	4.02	3.74	3.14	3.05
EV/Sales TTM	Current	6.55	5.82	4.8	3.31
	5-Year High	7.69	5.83	4.7	3.46
	5-Year Low	3.24	3.13	2.59	2.14
	5-Year Median	5.55	4.45	3.63	2.87

As of 08/18/2020

Industry Analysis Zacks Industry Rank: Top 22% (55 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Analog Devices, Inc. (ADI)	Outperform	2
Cirrus Logic, Inc. (CRUS)	Outperform	2
Maxim Integrated Products, Inc. (MXIM)	Outperform	2
Texas Instruments Incorporated (TXN)	Outperform	1
IPG Photonics Corporation (IPGP)	Neutral	3
Monolithic Power Systems, Inc. (MPWR)	Neutral	3
MACOM Technology Solutions Holdings, Inc. (MTSI)	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	-	-	Outperform	Outperform	Outperform
Zacks Rank (Short Term)	3	-	-	2	2	2
VGM Score	B	-	-	D	D	D
Market Cap	27.10 B	7.48 B	23.71 B	43.43 B	3.46 B	18.37 B
# of Analysts	10	9	14	12	6	10
Dividend Yield	1.37%	0.00%	1.63%	2.10%	0.00%	2.79%
Value Score	C	-	-	C	D	D
Cash/Price	0.02	0.08	0.07	0.02	0.09	0.09
EV/EBITDA	17.21	19.72	13.45	18.92	13.08	20.52
PEG Ratio	1.38	2.48	3.01	1.89	2.34	2.77
Price/Book (P/B)	4.93	5.51	3.18	3.75	2.72	11.08
Price/Cash Flow (P/CF)	9.59	22.31	12.70	15.88	15.27	25.37
P/E (F1)	18.57	35.69	21.98	25.19	18.18	27.75
Price/Sales (P/S)	5.15	6.05	2.46	7.83	2.69	8.38
Earnings Yield	5.51%	2.80%	4.33%	3.97%	5.50%	3.60%
Debt/Equity	1.41	0.74	0.76	0.44	0.10	0.60
Cash Flow (\$/share)	11.19	2.82	6.94	7.42	3.88	2.72
Growth Score	B	-	-	D	D	D
Hist. EPS Growth (3-5 yrs)	21.61%	11.63%	10.44%	16.81%	1.88%	10.54%
Proj. EPS Growth (F1/F0)	5.18%	9.34%	-5.97%	-9.13%	-14.13%	9.87%
Curr. Cash Flow Growth	6.11%	-10.25%	5.22%	-9.88%	10.42%	-8.10%
Hist. Cash Flow Growth (3-5 yrs)	31.92%	22.53%	8.52%	24.75%	3.55%	-0.43%
Current Ratio	0.83	2.54	1.33	1.30	4.23	5.11
Debt/Capital	58.42%	42.20%	44.50%	30.73%	9.25%	37.49%
Net Margin	12.23%	3.58%	10.13%	20.05%	13.47%	29.88%
Return on Equity	24.31%	10.54%	14.59%	14.51%	16.75%	36.29%
Sales/Assets	0.30	0.50	0.51	0.26	0.79	0.61
Proj. Sales Growth (F1/F0)	-1.97%	1.94%	-1.54%	-7.99%	-7.59%	3.86%
Momentum Score	D	-	-	B	B	C
Daily Price Chg	3.86%	-0.52%	-0.41%	0.37%	-2.29%	-0.10%
1 Week Price Chg	1.24%	0.30%	1.09%	0.74%	-6.54%	-0.13%
4 Week Price Chg	0.62%	0.67%	3.41%	2.88%	-8.37%	-0.14%
12 Week Price Chg	14.39%	20.15%	9.80%	4.60%	-19.54%	18.36%
52 Week Price Chg	20.77%	23.74%	3.43%	6.88%	8.39%	26.65%
20 Day Average Volume	2,533,462	766,941	1,894,669	3,475,757	854,246	4,006,200
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.66%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.92%	5.82%	1.86%	0.66%	7.40%	1.60%
(F1) EPS Est 12 week change	7.57%	21.30%	2.86%	8.29%	7.40%	12.35%
(Q1) EPS Est Mthly Chg	-4.75%	9.42%	0.80%	0.94%	-0.66%	2.96%

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	D
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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