

Mellanox Technologies (MLNX)

\$120.15 (As of 02/04/20)

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

Long Term: 6-12 Months

Zacks Recommendation:

Outperform

(Since: 02/03/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

1-Strong Buy

Zacks Style Scores:

VGM:A

Value: D

Growth: A

Momentum: A

Summary

Mellanox reported stellar fourth-quarter results. Also, both earnings and revenues improved on a year-over-year basis. Robust demand of Ethernet adapters, switches and LinkX cables drove the top line. Further, strong adoption of Mellanox's InfiniBand solutions is a key catalyst. The company has also won several contracts, which reflects sturdy demand for its solutions. Additionally, the growing clout of Spectrum switches and HDR 200 gigabit InfiniBand, particularly in accelerating super computers deserves a special mention. Notably, NVIDIA has inked a definitive agreement to acquire Mellanox for a total enterprise value of around \$6.9 billion. The company refrained from issuing any guidance due to the pending acquisition of NVIDIA.

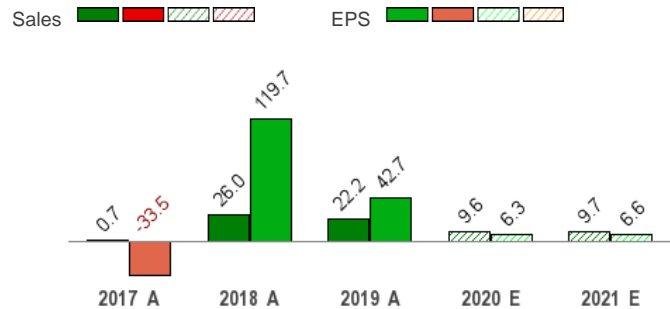
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$122.10 - \$96.11
20 Day Average Volume (sh)	503,788
Market Cap	\$6.7 B
YTD Price Change	2.5%
Beta	0.51
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Electronics - Semiconductors
Zacks Industry Rank	Top 6% (16 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	40.9%
Last Sales Surprise	14.7%
EPS F1 Est- 4 week change	7.1%
Expected Report Date	04/21/2020
Earnings ESP	0.0%
P/E TTM	16.9
P/E F1	15.8
PEG F1	0.8
P/S TTM	5.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					1,601 E
2020	346 E	357 E	370 E	386 E	1,459 E
2019	305 A	310 A	335 A	380 A	1,331 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$8.10 E
2020	\$1.75 E	\$1.83 E	\$1.94 E	\$2.09 E	\$7.60 E
2019	\$1.59 A	\$1.52 A	\$1.69 A	\$2.31 A	\$7.15 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, except sales and EPS estimates, is as of 02/04/2020. The reports text and the analyst-provided sales and EPS estimates are as of 02/05/2020.

Overview

Mellanox Technologies is a fabless semiconductor company that develops high-speed interconnects solutions. Founded in 1999, the company's business headquarters are in Sunnyvale, CA. The company's semiconductor-based, interconnect products are utilized in server, storage, data centers, the world's most powerful supercomputers, and mission critical embedded applications.

On Mar 11, 2019, Mellanox entered into a definitive agreement with NVIDIA, by which NVIDIA will buy shares of Mellanox for \$125 per share in cash, indicating a total enterprise value of around \$6.9 billion.

The company's Virtual Protocol Interconnect solution enables standard communication protocols to operate over any converged network (InfiniBand, Ethernet, Data Center Ethernet) with the same software solution.

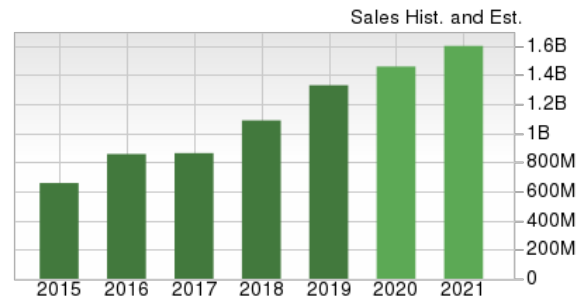
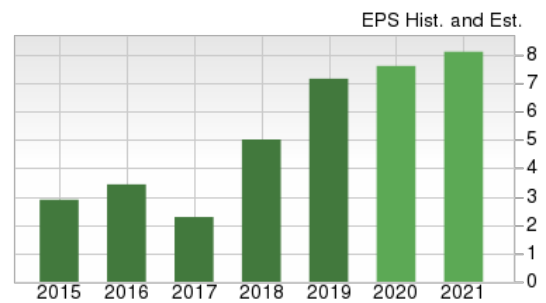
InfiniBand is highly scalable and its off-loading capabilities that reduce load on CPUs are attracting AI, machine learning and deep learning providers.

Mellanox is one of the major suppliers of 25, 50, and 100GB Ethernet adapters, switches, and cables to the market. The company's remote direct memory access (RDMA) over Ethernet or "RoCE" ConnectX Ethernet network adapters offer low latency and high throughput levels. RDMA technology provides low CPU load, high bandwidth and low latency attributes, which in turn bolsters network performance. RoCE network adapters utilize the full potential of RDMA, making it a preferred alternative over non-RDMA solutions.

The company products also include integrated circuits ("ICs"), adapter cards, switch systems, multi-core and network processors, systems on a chip ("SOCs"), cables, modules, software, services and accessories. Moreover, the company has a significant number of patents in design, software and reference platforms to its credit.

In fiscal 2019, Mellanox reported revenues of \$1.331 billion, up 22.2% year over year. Notably, InfiniBand revenues increased 29% year over year on robust adoption of 200 gigabit per second HDR solutions in the HPC or high performance computing, AI, cloud, and storage verticals.

In the semiconductor market, Intel, Broadcom and Marvel are Mellanox's main competitors. Further, Cisco Systems, Juniper Networks and Arista Networks continue to be its other rivals.



Reasons To Buy:

- ▲ Demand for Mellanox's interconnect products and solutions based on the Ethernet and InfiniBand solutions are a key catalyst. InfiniBand is highly scalable and its off-loading capabilities that reduce load on CPUs are attracting artificial intelligence (AI), machine learning and deep learning providers. The company is one of the major suppliers of 25, 50, and 100GB Ethernet adapters, switches, and cables to the market today. Its Ethernet and InfiniBand interconnect solutions are built on AMD's latest EPYC processors to tackle increasing workloads related to Cloud, Web2.0, Big Data, and high-performance computing (HPC). InfiniBand-based product revenues improved 29% year over year in fiscal 2019. Market research firm IDC forecasts that by 2025, the global datasphere will grow to 175 zettabytes (that is a trillion gigabytes), from 33 zettabytes in 2018. This exponential growth of data bodes well for Mellanox's interconnect solutions due to growing demand for higher network speeds for fast processing of data.
- ▲ Mellanox's inorganic strategy for expansion bodes well. The company strengthened its portfolio through acquisitions and collaborations that are expected to drive profits. The addition EZchip (2016) has enabled the company to become one of the leading supplier of intelligent interconnect solutions for the software-defined data centers.
- ▲ Mellanox had collaborated with Microsoft's Azure to develop a simple and cost-effective solution via the company's Spectrum switches and adapters. The solution will extend cloud connectivity for on-premise data centers to Microsoft Azure. Mellanox recently announced integration with Check Point, with an aim to bolster adoption of its Ethernet switches. Integration of Check Point's hyperscale network security platform "Maestro" with Mellanox's Ethernet switches is a positive. The company's previous collaborations with the likes of NEC Corporation, Atos, VMware, Hewlett Packard Enterprise and Microsemi Corporation have helped it expand footprint in the cloud and datacenter as well as high performance computing market. The company also won contract from Tel-Aviv Stock Exchange ("TASE"). Ethernet solutions of Mellanox will enable TASE to provide market operators with state-of-the-art services globally. Furthermore, the company has won contracts from the likes of Alibaba, Netflix, NetApp, the University of Toronto and NASA Ames Research Center, which reflects strong demand for its solutions. This will boost its customer base going forward.
- ▲ Mellanox boasts of a robust portfolio. The company had released a Spectrum-based Ethernet Network Operating System, Mellanox Onyx. The company also crossed one million volume shipments of 100 gbps QSFP28 ports which include LinkX optical transceivers, Direct Attach Copper Cables and Active Optical Cables. Mellanox recently introduced Ethernet Cloud Fabric (ECF) technology aimed at enhancing the performance of its Spectrum-2 family of Ethernet switches, which offer data transfer speeds of 100/200/400 Gb/s (or Gigabits per second). Mellanox also unveiled new 100G and 200G/400G LinkX products. Furthermore, the company started shipping BlueField chips, resulting from EZchip acquisition, which has been experiencing increased market traction. The company has emerged as a formidable player in the field of semiconductor technology. The new products and upgrades provide Mellanox a competitive edge in the industry which is likely drive sales going ahead.

Strong customer adoption of the company's Gigabit EDR solutions and robust demand for Mellanox's InfiniBand solutions is a key catalyst.

Risks

- Mellanox depends on few big customers for a substantial portion of its net revenues. The company faces customer concentration risk as revenues from its top ten customers accounted for approximately 53% of total revenues in 2018, 56% in 2017, 55% in 2016 and 57% in 2015, which is quite significant. Further, the company had one customer which contributed more than 10% of total revenues for fiscal 2018. Dell EMC accounted for 12% of total revenues. The loss of any customer may reduce orders, consequently impacting revenues and operating results.
 - A substantial portion of the company's sales is derived from outside the United States. During fiscal 2018, 2017, 2016 and 2015 approximately 63%, 62%, 55% and 54%, respectively, of total revenues were garnered in currencies other than the U.S. dollar. This exposes the company to exchange rate fluctuations and counterparty default risk. Consequently, an economic condition, which impacts foreign currency exchange rates, does result in transaction exposure, which leads to profit fluctuation.
 - Mellanox's acquisitions have escalated integration risks. Moreover, we note that the buyouts negatively impacted the company's balance sheet in the form of high level of goodwill and net intangible assets, which comprised of almost 29.5% of total assets as of Dec 31, 2019.
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Last Earnings Report

Mellanox Tops Earnings & Revenues Estimates in Q4

Mellanox Technologies, Ltd. reported fourth-quarter 2019 non-GAAP earnings of \$2.31 per share, beating the Zacks Consensus Estimate by 40.85%. Further, the bottom line surged 62.7% from the year-ago quarter.

Revenues of \$379.8 million improved 30.9% from the year-ago quarter and comfortably outpaced the Zacks Consensus Estimate of \$331 million. Robust adoption of Ethernet adapters, switches and LinkX cables drove the top line. Solid momentum in InfiniBand demand was an added positive.

Further, the company reinforced its dominant position in the 25 gigabit per second (Gbps) and above merchant adapter market in the reported quarter.

Apart from this, Mellanox's Ethernet switch revenues improved 25% sequentially, driven by growing cloud of Spectrum switches.

Infiniband revenues improved 19% on a quarter-over-quarter basis.

It is to be noted that on Mar 11, 2019, Mellanox entered into a definitive agreement with NVIDIA, by which the acquirer will buy shares of Mellanox for \$125 per share in cash, indicating a total enterprise value of around \$6.9 billion.

Operating Results

Non-GAAP gross margin in the fourth quarter of 69.1% expanded 10 basis points (bps) on a year-over-year basis.

Non-GAAP operating expenses in the quarter were up 18.6% year over year and came in at \$144.1 million.

Non-GAAP operating income totaled \$118.2 million up 50.2% year over year. Non-GAAP operating margin expanded 400 bps on a year-over-year basis to 31.1%.

Balance Sheet & Cash Flow

Mellanox exited the fourth quarter with cash & short-term investments worth \$875.9 million compared with \$742.5 million in the previous quarter.

In the fourth quarter, the company generated cash of \$147.8 million from operations compared with \$130 million in the previous quarter.

Guidance

Mellanox refrained from providing first-quarter guidance due to the pending acquisition by NVIDIA.

Quarter Ending **12/2019**

Report Date	Jan 29, 2020
Sales Surprise	14.68%
EPS Surprise	40.85%
Quarterly EPS	2.31
Annual EPS (TTM)	7.11

Recent News

On Jan 20, 2020, Mellanox announced that native and upstream support for virtualization over HDR 200 gigabit InfiniBand network has been added to the OpenStack software.

On Jan 13, 2020, Mellanox declared that its 200 Gigabit HDR InfiniBand has been adopted by the European Centre for Medium-Range Weather Forecasts (ECMWF), with an aim to accelerate to the latter's supercomputer, driven by Atos' latest BullSequana XH2000 technology.

On Nov 20, 2019, Mellanox declared that its HDR InfiniBand has been adopted by Meteo France, with an aim to accelerate two new large-scale supercomputers, at SUPERCOMPUTING CONFERENCE.

On Sep 25, 2019, Mellanox announced ASIC-to-Protocol (A2P) customer support solutions for the SONiC Network Operating System (NOS) on Mellanox Spectrum switches.

On Aug 26, 2019, Mellanox unveiled SmartNIC and BlueField offerings, aimed at enabling data centers to enhance performance, efficiency and security capabilities.

Valuation

Mellanox shares are up 11.3% in the past six-month period and 21.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 26.2% and 19.2% in the past six-month period, respectively. Over the past year, the Zacks sub-industry and sector are up 32.6% and 24.9%, respectively.

The S&P 500 index is up 13.4% in the past six-month period and 18.1% in the past year.

The stock is currently trading at 4.74X forward 12-month sales, which compares to 6.71X for the Zacks sub-industry, 3.63X for the Zacks sector and 3.45X for the S&P 500 index.

Over the past five years, the stock has traded as high as 5.1X and as low as 1.98X, with a 5-year median of 3.24X.

Our \$125 price target reflects NVIDIA's acquisition purchase value.

The table below shows summary valuation data for MLNX

Valuation Multiples - MLNX					
		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	4.74	6.71	3.63	3.45
	5-Year High	5.1	6.72	3.63	3.45
	5-Year Low	1.98	2.89	2.30	2.54
	5-Year Median	3.24	5.85	3.02	3
P/B TTM	Current	4.3	8.48	5.49	4.44
	5-Year High	4.87	9.03	5.61	4.54
	5-Year Low	1.97	3.27	3.13	2.85
	5-Year Median	2.92	5.65	4.23	3.62
EV/Sales TTM	Current	4.45	6.69	4.31	3.26
	5-Year High	5.42	6.9	4.31	3.29
	5-Year Low	1.96	2.69	2.57	2.12
	5-Year Median	3.38	5.29	3.47	2.79

As of 02/04/2020

Industry Analysis Zacks Industry Rank: Top 6% (16 out of 255)



Top Peers

NVIDIA Corporation (NVDA)	Outperform
Arista Networks, Inc. (ANET)	Neutral
Broadcom Inc. (AVGO)	Neutral
Cisco Systems, Inc. (CSCO)	Neutral
Intel Corporation (INTC)	Neutral
Juniper Networks, Inc. (JNPR)	Neutral
Marvell Technology Group Ltd. (MRVL)	Neutral
VMware, Inc. (VMW)	Neutral

Industry Comparison Industry: Electronics - Semiconductors				Industry Peers		
	MLNX Outperform	X Industry	S&P 500	ANET Neutral	AVGO Neutral	INTC Neutral
VGM Score	A	-	-	C	B	A
Market Cap	6.67 B	743.36 M	24.31 B	17.67 B	123.95 B	279.97 B
# of Analysts	2	2	13	11	13	14
Dividend Yield	0.00%	0.00%	1.78%	0.00%	4.17%	1.92%
Value Score	D	-	-	D	C	B
Cash/Price	0.11	0.18	0.04	0.14	0.04	0.05
EV/EBITDA	27.44	8.03	13.98	48.49	18.36	8.38
PEG Ratio	0.82	1.99	2.01	1.69	1.26	1.75
Price/Book (P/B)	4.24	2.55	3.29	6.65	NA	3.61
Price/Cash Flow (P/CF)	20.63	11.26	13.58	29.30	9.17	8.59
P/E (F1)	15.81	21.26	18.82	25.75	13.47	13.13
Price/Sales (P/S)	5.01	2.93	2.66	7.51	5.49	3.89
Earnings Yield	6.33%	2.61%	5.30%	3.88%	7.43%	7.62%
Debt/Equity	0.00	0.08	0.71	0.03	-214.36	0.33
Cash Flow (\$/share)	5.82	0.73	6.92	7.90	33.97	7.62
Growth Score	A	-	-	A	B	A
Hist. EPS Growth (3-5 yrs)	33.23%	3.58%	10.80%	53.22%	28.58%	20.24%
Proj. EPS Growth (F1/F0)	6.29%	21.57%	7.40%	-5.92%	8.70%	2.38%
Curr. Cash Flow Growth	105.73%	0.75%	10.22%	52.91%	8.07%	6.53%
Hist. Cash Flow Growth (3-5 yrs)	58.28%	12.15%	8.55%	65.05%	48.32%	9.99%
Current Ratio	3.93	2.94	1.21	5.91	1.44	1.40
Debt/Capital	0.00%	8.84%	42.91%	3.18%	54.64%	24.62%
Net Margin	15.41%	1.09%	11.79%	32.68%	12.06%	29.25%
Return on Equity	21.26%	2.76%	17.24%	28.94%	46.16%	29.01%
Sales/Assets	0.72	0.69	0.55	0.70	0.32	0.54
Proj. Sales Growth (F1/F0)	9.67%	8.65%	4.10%	-1.38%	10.72%	2.20%
Momentum Score	A	-	-	D	B	B
Daily Price Chg	0.28%	2.48%	1.49%	2.69%	2.09%	1.61%
1 Week Price Chg	1.21%	-6.88%	-2.60%	-6.18%	-5.81%	-6.63%
4 Week Price Chg	2.34%	-0.24%	0.51%	12.92%	-0.33%	11.08%
12 Week Price Chg	4.67%	5.05%	4.44%	19.26%	-1.25%	12.47%
52 Week Price Chg	23.41%	16.09%	14.65%	3.25%	15.41%	30.89%
20 Day Average Volume	503,788	181,763	1,935,862	681,310	2,736,804	24,941,836
(F1) EPS Est 1 week change	7.95%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	7.12%	0.00%	0.00%	0.00%	0.43%	5.60%
(F1) EPS Est 12 week change	7.12%	0.00%	-0.10%	0.33%	-1.41%	5.58%
(Q1) EPS Est Mthly Chg	9.38%	0.00%	0.00%	0.00%	0.46%	25.02%

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	D
Growth Score	A
Momentum Score	A
VGM Score	A

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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