

Mellanox Technologies (MLNX)

\$117.55 (As of 01/03/20)

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

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/29/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: C

Growth: A

Momentum: B

Summary

Mellanox is benefiting from robust demand for Ethernet adapters, switches and LinkX cables. Solid demand of its Gigabit EDR solutions in AI, HPC, ML, database, and storage bode well. Further, strong adoption of Mellanox's InfiniBand solutions is a key catalyst. The company has also won several contracts from the likes of NetApp and NASA Ames Research Center, which reflects sturdy demand for its solutions. Notably, NVIDIA inked a definitive agreement to acquire Mellanox for a total enterprise value of around \$6.9 billion. However, exposure to foreign currency and significant customer concentration remain headwinds. Notably, shares of Mellanox have underperformed the industry in the past year.

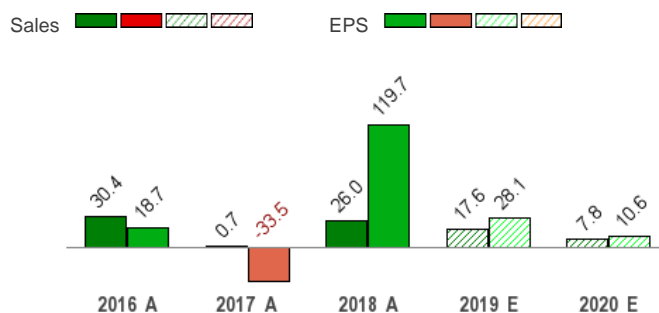
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$121.13 - \$79.24
20 Day Average Volume (sh)	487,887
Market Cap	\$6.5 B
YTD Price Change	0.3%
Beta	0.49
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Electronics - Semiconductors
Zacks Industry Rank	Top 25% (63 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	7.0%
Last Sales Surprise	6.6%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	01/29/2020
Earnings ESP	0.0%
P/E TTM	18.9
P/E F1	16.6
PEG F1	0.9
P/S TTM	5.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	326 E	340 E	353 E	363 E	1,381 E
2019	305 A	310 A	335 A	331 E	1,281 E
2018	251 A	268 A	279 A	290 A	1,089 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.60 E	\$1.73 E	\$1.83 E	\$1.87 E	\$7.10 E
2019	\$1.59 A	\$1.52 A	\$1.69 A	\$1.64 E	\$6.42 E
2018	\$0.98 A	\$1.25 A	\$1.33 A	\$1.42 A	\$5.01 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 01/03/2020. The reports text is as of 01/06/2020.

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 buyout is expected to close by the end of calendar year 2019.

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.

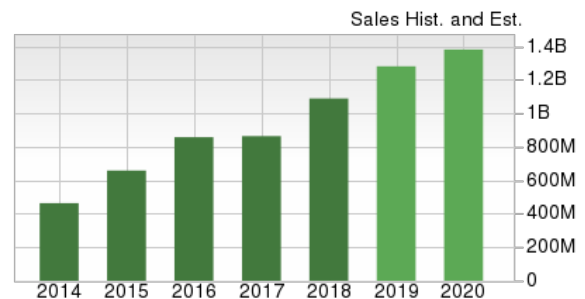
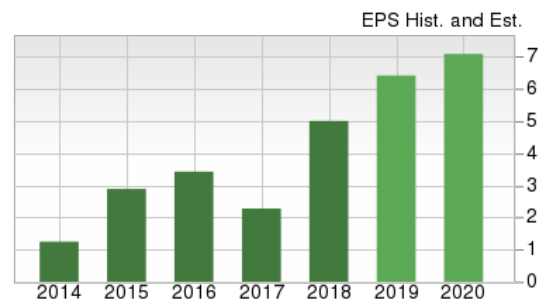
InfiniBand is highly scalable and its off-loading capabilities that reduce load on CPUs are attracting AI, machine learning and deep learning providers.

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 2018, Mellanox reported revenues of \$1.088 billion, up 26% year over year. Ethernet revenues increased 54% year over year to approximately \$618 million in fiscal 2018. InfiniBand increased 8% year over year to \$438 million in fiscal 2018.

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 of \$438 million grew 8% year over year and contributed 40.3% of total revenues in fiscal 2018. 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.

Reasons To Sell:

- ▼ 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 32.3% of total assets as of Sep 30, 2019.
- ▼ The company is trading at premium in terms of Price/Earnings (P/E). Mellanox currently has a trailing 12 month P/E ratio of 23.94. This level compares unfavorably with what the S&P 500 witnessed in the last year. Hence, valuation looks slightly stretched from P/E perspective.

Significant customer concentration, exposure to foreign currency with noteworthy dependence on China and competition from peers remain headwinds.

Last Earnings Report

Mellanox Tops Earnings & Revenues Estimates in Q3

Mellanox reported third-quarter 2019 non-GAAP earnings of \$1.69 per share, beating the Zacks Consensus Estimate of \$1.58 per share. Further, the bottom line improved from the year-ago quarter figure of \$1.33.

Revenues of \$335.3 million improved 20.1% from the year-ago quarter and also outpaced the Zacks Consensus Estimate of \$315 million. Robust demand of Ethernet adapters, switches and LinkX cables drove the top line. Robust demand for InfiniBand product 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.

Quarter Ending **09/2019**

Report Date	Oct 30, 2019
Sales Surprise	6.55%
EPS Surprise	6.96%
Quarterly EPS	1.69
Annual EPS (TTM)	6.22

Quarter in Details

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.

Notably, the Israel-based Mellanox is one of the major suppliers of 25, 40, 50 and 100GB Ethernet adapters, switches and cables. The company enjoys robust demand for its InfiniBand solutions. Mellanox's customers include datacenter owners and companies that build datacenters. Alibaba, Dell and Hewlett Packard Enterprise are some of its notable clients. These factors made the company a lucrative acquisition target.

This apart, Mellanox's Ethernet business is doing well. Markedly, the need to access and process data at a faster speed due to data growth is fueling demand for high-speed Ethernet adapters.

Recently, Mellanox introduced its latest LinkX Cables & Transceivers at CIOE, Shenzhen, China and ECOC, Dublin, Ireland 2019. These are aimed at enhancing the performance of its Spectrum-2 family of Ethernet switches, which offer data transfer speeds of 200/400 Gbps.

Mellanox recently unveiled ConnectX-6 Dx SmartNICs and BlueField-2 I/O Processing Unit (IPU) interconnect solutions at VMworld 2019, San Francisco, CA.

Growing clout of Ethernet adapters and InfiniBand solutions in high growth datacenter and HPC market remains a tailwind.

Operating Results

Non-GAAP gross margin in the third quarter was 68.1%, down 150 bps on a year-over-year basis.

Non-GAAP operating expenses in the quarter were up 9.9% year over year and came in at \$133.2 million. Non-GAAP operating income totaled \$95.1 million compared with \$73.2 million reported in the year-ago quarter. Non-GAAP operating margin was 28.4% compared with 26.2% in the year-ago quarter.

Balance Sheet & Cash Flow

Mellanox exited the third quarter with cash & investments worth \$742.5 million compared with \$610.6 million in the previous quarter.

In the third quarter, the company generated cash of \$130 million from operations compared with \$58.6 million in the previous quarter.

Guidance

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

Recent News

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 5.9% in the past six-month period and 37.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 57.3% and 34% in the past six-month period, respectively. Over the past year, the Zacks sub-industry and sector are up 46.7% and 19.8%, respectively.

The S&P 500 index is up 10.4% in the past six-month period and 28.5% in the past year.

The stock is currently trading at 4.72X forward 12-month sales, which compares to 6.98X for the Zacks sub-industry, 3.57X for the Zacks sector and 3.47X 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	4.72	6.98	3.57	3.47
	5-Year High	5.1	6.98	3.57	3.47
	5-Year Low	1.98	2.58	2.30	2.54
	5-Year Median	3.24	5.84	3.01	3
P/B TTM	Current	4.2	8.74	5.33	4.41
	5-Year High	4.87	8.91	5.38	4.45
	5-Year Low	1.97	3.25	3.13	2.85
	5-Year Median	2.91	5.59	4.21	3.6
EV/Sales TTM	Current	4.66	6.89	4.19	3.23
	5-Year High	5.42	6.9	4.2	3.3
	5-Year Low	1.96	2.69	2.56	2.16
	5-Year Median	3.38	5.28	3.44	2.8

As of 01/03/2020

Industry Analysis Zacks Industry Rank: Top 25% (63 out of 252)



Top Peers

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

Industry Comparison Industry: Electronics - Semiconductors				Industry Peers		
	MLNX Neutral	X Industry	S&P 500	ANET Underperform	AVGO Neutral	INTC Neutral
VGM Score	A	-	-	B	C	A
Market Cap	6.52 B	747.63 M	23.66 B	15.34 B	124.98 B	261.44 B
# of Analysts	3	2	13	12	13	14
Dividend Yield	0.00%	0.00%	1.79%	0.00%	4.14%	2.10%
Value Score	C	-	-	D	C	B
Cash/Price	0.11	0.18	0.04	0.16	0.04	0.05
EV/EBITDA	26.77	8.43	13.88	41.12	15.82	8.43
PEG Ratio	0.86	2.02	1.99	1.47	1.27	1.70
Price/Book (P/B)	4.15	2.79	3.36	5.78	NA	3.52
Price/Cash Flow (P/CF)	20.18	12.53	13.62	25.44	9.25	8.83
P/E (F1)	16.54	22.74	18.74	22.38	13.60	12.73
Price/Sales (P/S)	5.26	2.75	2.67	6.52	5.53	3.71
Earnings Yield	6.03%	3.63%	5.32%	4.47%	7.35%	7.85%
Debt/Equity	0.00	0.08	0.72	0.03	-214.36	0.32
Cash Flow (\$/share)	5.82	0.73	6.94	7.90	33.97	6.81
Growth Score	A	-	-	A	B	B
Hist. EPS Growth (3-5 yrs)	40.26%	3.58%	10.56%	53.22%	28.58%	19.47%
Proj. EPS Growth (F1/F0)	10.46%	21.57%	7.41%	-5.91%	8.51%	2.42%
Curr. Cash Flow Growth	105.73%	0.75%	14.83%	52.91%	7.86%	23.02%
Hist. Cash Flow Growth (3-5 yrs)	58.28%	12.15%	9.00%	65.05%	48.32%	11.64%
Current Ratio	3.93	2.96	1.23	5.91	1.44	1.20
Debt/Capital	0.00%	9.10%	42.92%	3.18%	54.64%	24.20%
Net Margin	14.03%	1.09%	11.08%	32.68%	12.06%	27.46%
Return on Equity	18.84%	2.76%	17.10%	28.94%	46.16%	28.28%
Sales/Assets	0.70	0.69	0.55	0.70	0.32	0.54
Proj. Sales Growth (F1/F0)	7.82%	8.24%	4.20%	-1.38%	10.72%	1.56%
Momentum Score	B	-	-	B	C	C
Daily Price Chg	-0.21%	-1.03%	-0.61%	-1.89%	-2.54%	-1.22%
1 Week Price Chg	1.59%	0.40%	0.13%	-0.83%	-0.77%	1.92%
4 Week Price Chg	2.74%	7.80%	2.60%	4.80%	0.96%	7.17%
12 Week Price Chg	7.56%	12.50%	8.87%	-11.80%	14.48%	17.59%
52 Week Price Chg	39.19%	36.04%	29.34%	0.63%	36.04%	35.09%
20 Day Average Volume	487,887	172,784	1,603,615	697,942	2,329,526	17,806,440
(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%	0.00%	-1.83%	-0.02%
(F1) EPS Est 12 week change	-0.35%	0.00%	-0.57%	-17.56%	-1.83%	6.34%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-7.03%	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	A
Momentum Score	B
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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