

Microchip

DecQ warning: one more cut brings estimates closer to trough

Maintain Rating: BUY | PO: 105.00 USD | Price: 85.64 USD

Breaking News

- MCHP reduced DecQ sales by \$100mn on continued customer weakness, no profit metrics and no MarQ outlook provided
- Assuming ADI like 25-30% peak-trough sales correction suggests scenario "trough" CY24E pf-EPS of \$4/sh for MCHP
- Maintain Buy on implied 20-22x implied scenario PE on "trough" CY24E PE, below peers ADI/TXN trading at 26x

DecQ sales \$100mn below expectations

Post-close MCHP warned DecQ sales could decline by -22% QoQ or to \$1.76bn, about \$100mn lower than prior \$1.86bn or down 15-20% QoQ decline outlook. MCHP attributed the weakness to weaker macro, customer inventory adjustments and extended shutdowns/holidays. No indication was provided for DecQ profitability, not for any MarQ outlook. Assuming lower sales drive a further say 100bps cut to GM suggests DecQ pf-GM of 63.5% and pf-EPS at \$1/sh below current consensus \$1.13/sh.

Correction trends inline with close peer ADI

While the inventory correction is still unfolding, our first take is MCHP is looking at a cyclical correction of around 25-30% in sales and about 45-50% in pf-EPS from peak levels in 1HCY23. Trends are very similar to close peer ADI where sales peaked in Apr23Q and indicated to be down by 27% YoY in Apr24Q - which is assumed to be the trough for this cycle. Assuming a similar troughing for MCHP, and a below seasonal say further -7.5% QoQ decline in Mar24Q sales suggests \$1.63bn in sales, 63% GM, 37.5% EBIT margins and 87c in scenario pf-EPS in Mar24Q.

Valuation attractive even at CY24E scenario EPS of ~\$4/sh

We maintain our Buy rating and keep estimates unchanged. If we assume seasonal trends get back from Jun24Q, then pf-EPS trajectory could be close to around \$4/share for CY24E, only 10% lower than current consensus at \$4.35. Expressed differently, MCHP stock is trading at 20-22x CY24E cyclical trough scenario EPS, well below peer ADI (and TXN) trading closer to 26x. MCHP reports earnings on Feb-1.

Deeper trough could drive sharper rebound from 2H24E

The industrial/auto sector ranks below *Cloud* computing and *Complexity* (semicap equipment, design automation software), but above smartphones and consumer exposed stocks, within our sector preference. Within auto/industrial our top picks are auto exposed (NXPI, ON) though we maintain Buys on industrial exposed MCHP and ADI (and Neutral on TXN) as their deeper 1H24 cyclical correction could drive a sharper rebound in 2H24, depending on macro conditions. Meanwhile, solid FCF generation (40%+ FCF margins) for industrial semis provide a relative stock cushion for the stocks, in our view.

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Stock Data

| | |
|---------------------------------|-----------------------|
| Price | 85.64 USD |
| Price Objective | 105.00 USD |
| Date Established | 15-Dec-2023 |
| Investment Opinion | B-1-7 |
| 52-Week Range | 68.75 USD - 94.30 USD |
| Mrkt Val (mn) / Shares Out (mn) | 48,404 USD / 565.2 |
| Free Float | 97.9% |
| Average Daily Value (mn) | 389.66 USD |
| BofA Ticker / Exchange | MCHP / NAS |
| Bloomberg / Reuters | MCHP US / MCHP.OQ |
| ROE (2024E) | 44.2% |
| Net Dbt to Eqty (Mar-2023A) | 95.3% |
| ESGMeter™ | High |

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Glossary

MCHP: Microchip

ADI: Analog Devices

GM: Gross margin

NXPI: NXP Semiconductors

ON: onsemi

TXN: Texas Instruments

Exhibit 1: iQ ratings of stocks discussed in this report

iQ ratings of discussed stocks

| Ticker | Rating | QRQ | Price | PO | Potential Upside |
|--------|---------|-------|----------|----------|------------------|
| ADI | BUY | B-1-7 | \$188.98 | \$225.00 | 19.1% |
| TXN | NEUTRAL | B-2-7 | \$168.54 | \$175.00 | 3.8% |
| NXPI | BUY | B-1-7 | \$212.17 | \$280.00 | 32.0% |
| ON | BUY | C-1-9 | \$77.94 | \$100.00 | 28.3% |
| MCHP | BUY | B-1-7 | \$85.64 | \$105.00 | 22.6% |

Source: Bloomberg, BofA Global Research Estimates

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Price objective basis & risk**Analog Devices Inc. (ADI)**

Our \$225 PO is based on 34x CY2025E EV/FCF, within its historical 15x-33x range, and justified based on ADI's best in class profitability and differentiated/secular comms exposure.

Downside risks to our price objective: 1) Economic downturn, which could reduce demand for automotive, industrial products, impacting gross margins, especially given recent capital expenditures and higher fixed cost footprint. 2) Inability to realize the planned cost synergies from the Maxim combination. 3) Competition from larger vendors, such as TXN, which have lower-cost production facilities.

Microchip (MCHP)

We assign a \$105 PO based on 24x our 2025E EV/FCF. This is in line with the comparable peers trading at 16x-27x range and justified due to MCHP's mix of growth, execution, profitability, and leverage, which is in line with/quickly approaching analog peers.

Upside risks to our PO: FCF returns that are the upper end of the peer group, but not fully reflected in the company's multiple which trades at a discount to peers, inflecting/greater FCF growth going forward as MCHP deleverages its balance sheet and accelerates returns to shareholders. Downside risks to our PO: macro headwinds related to trade/COVID-19, increased competition capping any market share gains, tougher compares, GMs approaching the upper end of historical range and long term model

NXP Semiconductors NV (NXPI)

Our PO of \$280 is based on 19x 2025E EV/FCF, in line with median diversified auto/industrial compares which trade in a range of 16x-32x CY24E EV/FCF.

Downside risks: 1) Semiconductor cycle risks, 2) Lumpy nature of projects in key identification segment, 3) Some exposure to and growth driven by Apple, which could add volatility, 4) Execution risk surrounding management's capability to reengage following two-year hiatus, 5) Macroeconomic supply/demand disruption.

onsemi (ON)

Our PO of \$100 PO is based on 17x 2025E P/E, in line with ON's 7x-27x trading range, in our view justified given improving profitability, though partially offset by the heavier capex required for SiC ramp.

Downside risks to our PO are: 1) Macro/cyclical risks, given high exposure to automotive and industrial markets, make ON susceptible to any potential global trade tensions/tariffs, 2) Prolonged COVID-19 headwinds limiting pace of automotive/industrial recovery, impacting utilization levels, 3) Difficulty in ramping

300mm fabrication facility limiting gross margin improvement, 4) sustained elevated capex levels relative to peers.

Texas Instruments Inc. (TXN)

Our \$175 PO is based on 34x CY25E EV/FCF. In-line with historical 15x-42x range, which we believe is warranted based on TXN's best in class FCF generation and returns, and based on incremental cash flow from US CHIPS Act grants.

Risks to our price objective: 1) Macro/cyclical risks given high exposure to automotive, industrial, and telco capex markets, also makes TXN susceptible to any potential global trade tensions/tariffs, 2) Increasing capex intensity and higher depreciation burden could be a headwind to gross margins, 3) Increased R&D spending pressure to maintain an edge versus the competition, 4) Inventory cycles and potential double ordering by customers that can often create mismatches between real supply and demand, 5) Exposure to several mature markets such as PC and other consumer.

Analyst Certification

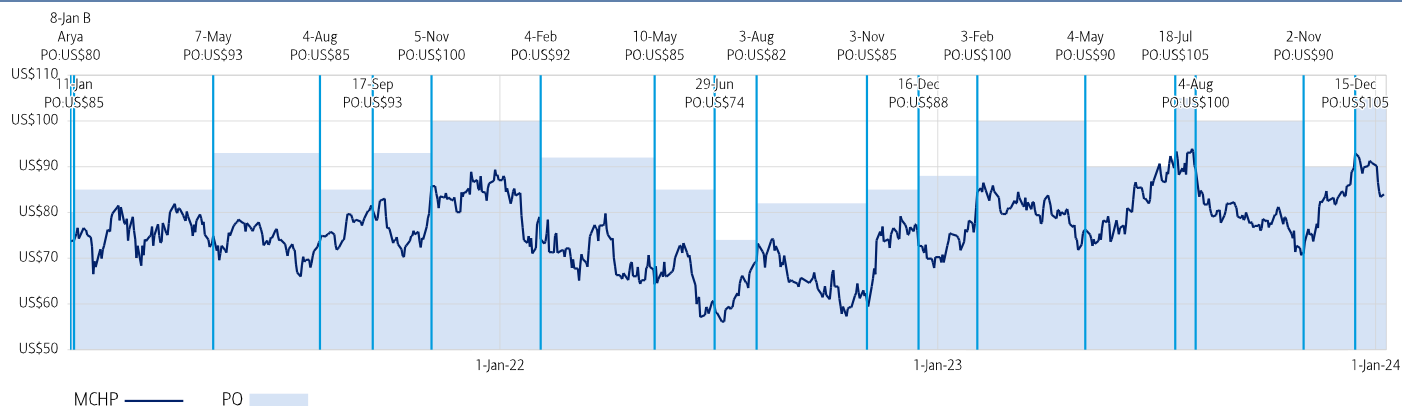
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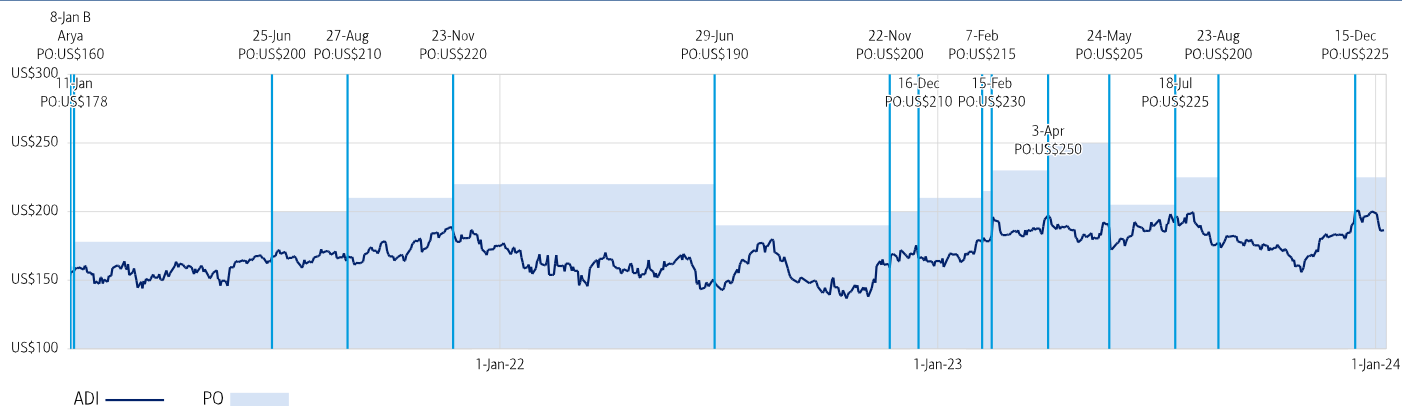
Microchip (MCHP) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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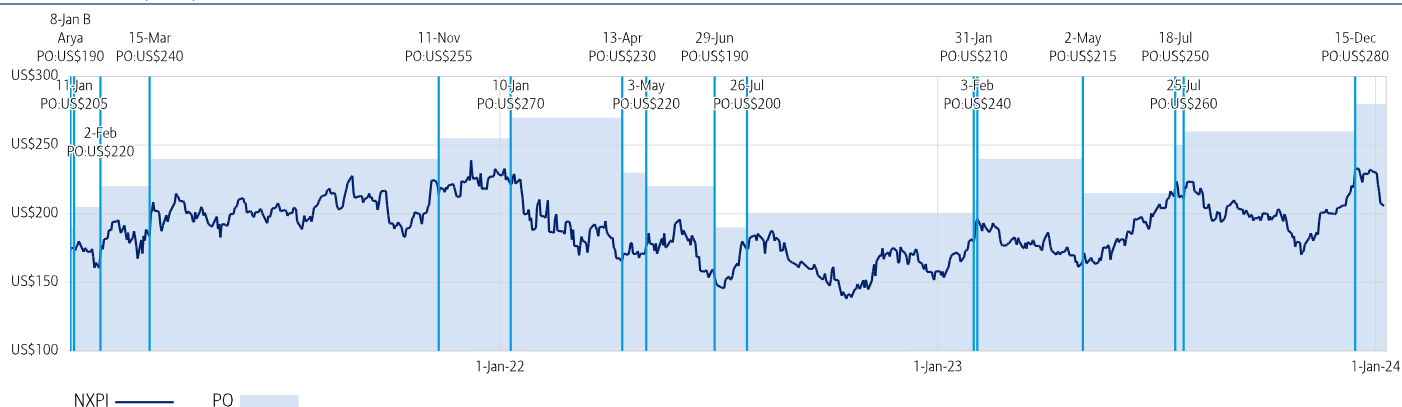
Analog Devices (ADI) Price Chart



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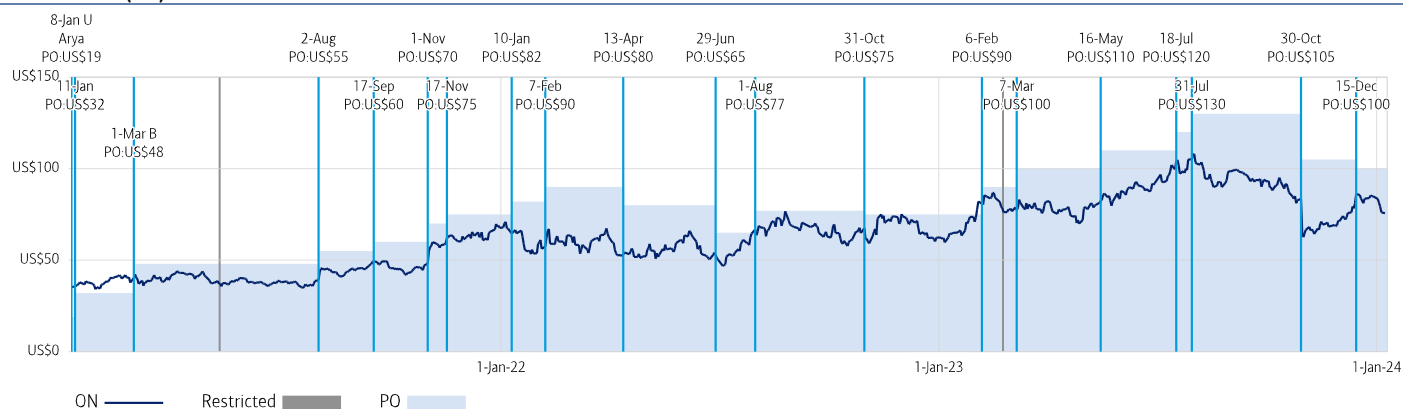
NXP Semiconductors (NXPI) Price Chart



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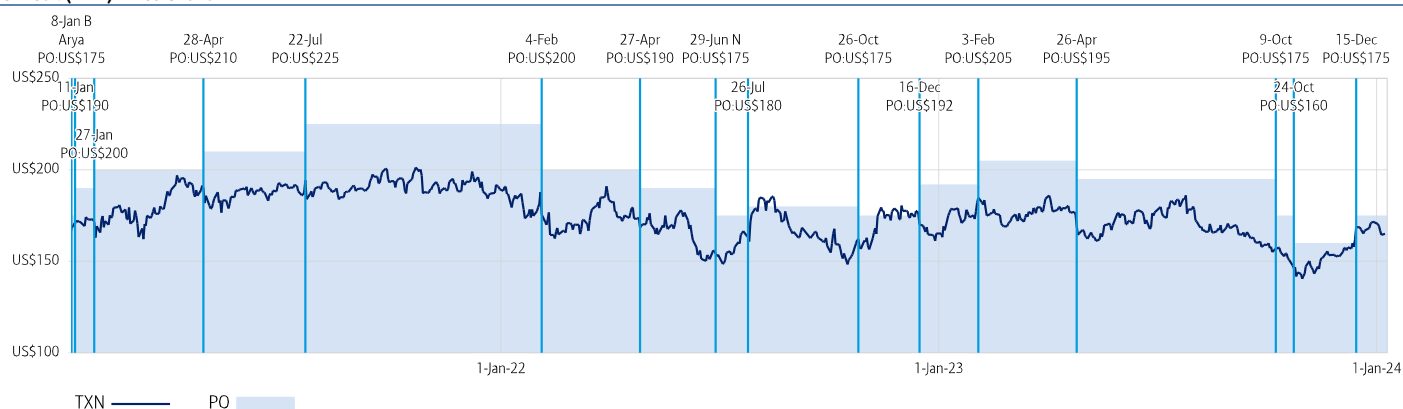
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ON Semiconductor (ON) Price Chart



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Texas Instr. (TXN) Price Chart



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Equity Investment Rating Distribution: Electronics Group (as of 31 Dec 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 32 | 54.24% | Buy | 13 | 40.63% |
| Hold | 11 | 18.64% | Hold | 3 | 27.27% |
| Sell | 16 | 27.12% | Sell | 4 | 25.00% |

Equity Investment Rating Distribution: Technology Group (as of 31 Dec 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 215 | 53.09% | Buy | 111 | 51.63% |
| Hold | 97 | 23.95% | Hold | 45 | 46.39% |
| Sell | 93 | 22.96% | Sell | 24 | 25.81% |

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 1895 | 53.62% | Buy | 1083 | 57.15% |
| Hold | 832 | 23.54% | Hold | 454 | 54.57% |
| Sell | 807 | 22.84% | Sell | 383 | 47.46% |

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster ^{R2} |
|-------------------|---|--|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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