



Microchip Technology Incorporated (MCHP)

Updated February 3rd, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$87	5 Year CAGR Estimate:	11.5%	Market Cap:	\$46.5 B
Fair Value Price:	\$78	5 Year Growth Estimate:	12.0%	Ex-Dividend Date:	02/17/2023
% Fair Value:	111%	5 Year Valuation Multiple Estimate:	-2.2%	Dividend Payment Date:	03/07/2023
Dividend Yield:	1.6%	5 Year Price Target	\$137	Years Of Dividend Growth:	22
Dividend Risk Score:	C	Retirement Suitability Score:	D	Rating:	Buy

Overview & Current Events

Microchip Technology develops, manufactures, and sells smart, connected and secure embedded control solutions used for a wide variety of applications. These include disruptive growth trends such as 5G, artificial intelligence, Internet of Things (IoT), and autonomous driving, amongst others, in key end markets such as automotive, aerospace and defense, communications. The company's strategic focus is that these solutions are cost-effective, offer high performance, with a wide voltage range operation, at extremely low power usage. Microchip Technology generates around \$6 billion in annual revenues and is based in Chandler, Arizona.

On February 2nd, 2023, Microchip Technology raised its dividend by 9.1% to a quarterly rate of \$0.358. On a year-over-year basis, the dividend grew by 41.5%.

On the same day, Microchip Technology also reported its Q3-2023 results for the quarter ending December 31st, 2022. Net sales were a record \$2.17 billion, up 23.4% from the comparable period last year and 4.6% higher sequentially. Higher revenues were again powered by exceptional execution on delivering Microchip's backlog and strong underlying demand, as well as improvements in the supply chain. Due to a higher production scale, GAAP gross margins reached a record of 67.8% for the quarter, leading to a record net income of \$580.3 million or \$1.04 per diluted share. On a non-GAAP basis, EPS was \$1.56 versus \$1.20 in Q3-2022.

Non-GAAP results are more meaningful in understanding Microchip's operating performance as it excludes its high share-based compensation, manufacturing excursion, high depreciation & amortization, and other factors. We use non-GAAP figures to accurately value the stock and assess its future returns, but all other figures in the table are GAAP-based, as officially shown in the company's filings with the SEC. For fiscal 2023, we forecast non-GAAP EPS of \$6.00, with the company's backlog remaining at record levels and the company bringing in additional manufacturing capacity online.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$0.33	\$1.00	\$0.92	\$0.80	\$0.38	\$0.55	\$0.75	\$1.19	\$0.67	\$2.23	\$6.00	\$10.57
DPS	\$0.70	\$0.71	\$0.71	\$0.72	\$0.72	\$0.72	\$0.73	\$0.73	\$0.75	\$0.91	\$1.43	\$3.28
Shares¹	389.2	396.6	401.9	406.8	434.4	465.8	472.4	477.8	519.2	555.5	555.4	650.0

Microchip Technology's EPS has struggled to improve meaningfully over the past decade despite the company growing its revenues relatively consistently. This has been mostly due to higher operating and R&D expenses, as well as increased financial expenses. However, with management's goal to expand margins while taking advantage of the ongoing sky-high demand for chips, non-GAAP EPS has started to snowball, as was the case in the company's latest results. The company is currently attempting to grow its production capacity to service its growing delivery backlog. Hence we expect EPS growth of around 12% in the medium-term. In terms of its dividend, Microchip has hiked it for 21 years, usually sequentially. These quarter-over-quarter increases were quite marginal in some cases (look at 2014-2021). That said, we forecast DPS growth of 18% moving forward to reflect the recent DPS growth acceleration and management's goal to grow the dividend sequentially by around 9% going forward.

¹ Share count is in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	61.5	21.6	27.7	38.4	113.2	64.5	62.3	50.2	118.5	30.6	14.5	13.0
Avg. Yld.	3.5%	3.3%	2.8%	2.3%	1.7%	2.0%	1.6%	1.2%	0.9%	1.3%	1.6%	2.4%

Microchip currently trades at a P/E of 14.5 based on our expected FY2023 non-GAAP EPS estimates. While the company is currently enjoying favorable market conditions and expanding margins, the high CAPEX needs of the industry could compress net income, as was the case in the past. We remain optimistic regarding Microchip's profitability growth prospect but believe that shares are modestly overvalued. We retain our fair multiple for the stock to 13, reflecting the ongoing macro uncertainties that could threaten demand for chips and the rising interest rates. Investors should expect the low yield to remain a token of the stock's total return prospects for the time being.

Safety, Quality, Competitive Advantage, & Recession Resiliency

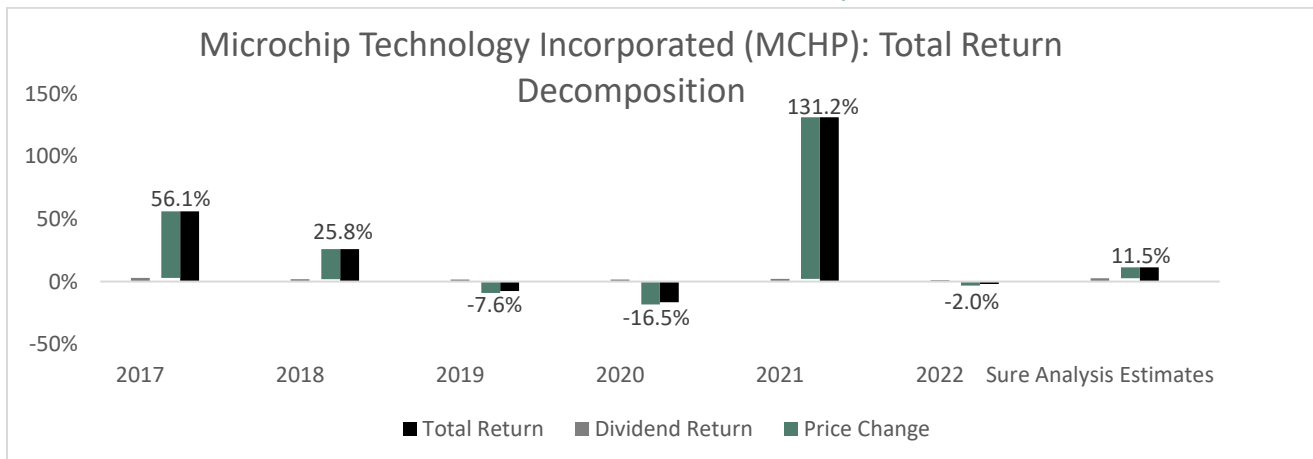
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	212%	71%	77%	90%	189%	131%	97%	61%	112%	41%	24%	31%

Microchip's dividend should be quite safe, being covered multiple times by operating cash flows. The normalized payout ratio seems high only due to the company's GAAP results, which carry heavy stock-based compensation expenses and depreciation & amortization (a non-cash item). The company enjoys several qualities and positive catalysts, including a robust backlog that should provide stable and predictable cash flows moving forward, expanding margins, and a declining long-term debt position (currently \$6.6 billion vs. \$9.55 billion in 2019). Still, the company faces several noteworthy risks, including fierce competition, global industrial cyclicity effects, limited visibility to product shipments, and international risks such as FX fluctuations due to its global clientele. A global recession could adversely impact the company's results, though global demand for chips remains far ahead of supply capabilities, at least for now.

Final Thoughts & Recommendation

Microchip Technologies has rallied massively over the past decade, with the company's sales expanding during this time as a result of the increased demand for chips. With higher margins, the company should continue to grow EPS at a rapid pace as its production capacities increase to service its growing backlog. Additionally, management is committed to growing the dividend sequentially, which should add to total returns. Along with the possibility for a modest multiple contraction, we estimate annualized returns of 11.5% through fiscal year 2028. Shares continue to earn a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	1,582	1,931	2,147	2,173	3,408	3,981	5,350	5,274	5,438	6,821
Gross Profit	838	1,129	1,230	1,206	1,757	2,421	2,931	3,242	3,379	4,450
Gross Margin	53.0%	58.4%	57.3%	55.5%	51.6%	60.8%	54.8%	61.5%	62.1%	65.2%
SG&A Exp.	261	267	275	302	500	452	683	677	610	719
D&A Exp.	204	189	278	283	469	616	876	1,216	1,153	1,144
Operating Profit	211	462	428	356	374	954	748	694	1,000	1,879
Operating Margin	13.3%	23.9%	20.0%	16.4%	11.0%	24.0%	14.0%	13.2%	18.4%	27.5%
Net Profit	127	395	369	324	165	255	356	571	349	1,286
Net Margin	8.1%	20.5%	17.2%	14.9%	4.8%	6.4%	6.7%	10.8%	6.4%	18.9%
Free Cash Flow	409	563	572	647	984	1,213	1,446	1,476	1,824	2,473
Income Tax	25	37	(19)	(43)	(81)	482	(151)	(420)	(10)	197

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	3851	4068	4781	5538	7687	8257	18350	17426	16479	16200
Cash & Equivalents	528	467	608	2093	909	901	429	401	280	317
Accounts Receivable	230	242	274	290	478	564	881	934	998	1070
Inventories	242	263	279	307	417	476	712	686	665	854
Goodwill & Int. Ass.	801	722	1076	1619	4447	3961	13350	12367	11465	10720
Total Liabilities	1918	1932	2720	3387	4416	4977	13063	11841	11142	10300
Accounts Payable	76	74	87	79	149	144	226	247	292	345
Long-Term Debt	983	1021	1827	2453	2951	3068	10307	9482	8904	7687
Shareholder's Equity	1933	2135	2045	2151	3271	3280	5288	5586	5337	5895
LTD/E Ratio	0.51	0.48	0.89	1.14	0.90	0.94	1.95	1.70	1.67	1.30

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	3.7%	10.0%	8.3%	6.3%	2.5%	3.2%	2.7%	3.2%	2.1%	7.9%
Return on Equity	6.5%	19.4%	17.7%	15.4%	6.1%	7.8%	8.3%	10.5%	6.4%	22.9%
ROIC	4.8%	13.0%	10.5%	7.6%	3.0%	4.1%	3.2%	3.7%	2.4%	9.2%
Shares Out.	205.8	217.6	223.6	217.4	234.8	248.9	249.9	256.2	270.6	565.9
Revenue/Share	7.69	8.87	9.60	10.00	14.51	15.99	21.41	20.59	20.10	12.05
FCF/Share	1.99	2.59	2.56	2.97	4.19	4.87	5.79	5.76	6.74	4.37

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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