

# An Introduction to Microchip Technology (MCHP)

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Microchip Technology, Inc., (MCHP) is a leading provider of mixed-signal microcontrollers (MCU), analog integrated circuits and other semiconductors. The company offers approximately 100,000 products to over 125,000 customers in the industrial, automotive, data center, appliance and communications end markets. The company's MCU and analog businesses combined generate over 85% of its revenue.

The history of Microchip Technology dates to 1987 when it was spun off from its former parent company, General Instruments. In 1989, Microchip Technology became a fully independent company, and over the next 30-plus years, now executive chairman Stephen Sanghi led the company through two phases of business development which have enabled the company to become a top competitor in most of its primary markets. The first phase, Microchip 1.0 (1990-2017), focused on creating sustainable revenue streams, taking share in microcontrollers, and building scale through internal efforts and acquisitions. Microchip 2.0 (2018-2021) channeled efforts to integrate multiple acquisitions, technology tools, and manufacturing into what the company calls Total System Solutions – a strategic approach to win more business per customer order.

After three decades as CEO, Mr. Sanghi turned that role over to 20-year executive Ganesh Moorthy. Moorthy is now leading the company through its "Microchip 3.0" phase which is focused on leveraging the Total Systems Solution (TSS) strategy, driving sustained above-market organic growth, and expanding margins.

## Understanding Microchip Technology's Offerings

As mentioned, Microchip Technology's products include **mixed-signal microcontrollers (MCUs)** and **analog integrated circuits** – both of which are important components to many of the electronics, smartphones, vehicles, appliances, and more devices that we use every day. An MCU is a simple miniature computer comprised of many components and used either to control several small features of a larger system or be the complete "brains" of a smaller one. Analog integrated circuits provide power management, signal conversion, security, timing, and other functionality needed to run electronics and digital devices. These products are typically used in applications where the accuracy of captured data is critical.

A helpful example of how Microchip Technology's products and its TSS strategy works is something that is in everybody's home – a refrigerator. The fridge has an analog chip which measures the temperature inside to ensure the air stays at a constant temperature, say 37 degrees. Presume your child opens the door and spends a few minutes contemplating life while deciding whether to have juice or milk, and when done, the temperature has risen to 39 degrees. This information is sent from the analog temperature sensor to the microcontroller which then sends a signal to the compressor to turn on (powered by an analog power management chip) and cool the fridge back to the desired 37 degrees. Microchip Technology's TSS strategy would be to earn the refrigerator company's business to provide MCUs or one of the analog chips and then use its ability to package the combination into a single offering or grouped offerings, thereby allowing it to leverage a single customer relationship into the sale of multiple products.

## Microchip Technology's Competitive Positioning

Through our long-term ownership of Texas Instruments, Inc., (TXN) and Analog Devices, Inc., (ADI) which are both primarily analog integrated circuit manufacturers, we are well versed in the regular cyclicity of the semiconductor industry. While cyclical, we believe the MCU and analog integrated circuit category offers the favorable dynamics of businesses we like to own. Some of these characteristics include high gross margins, engineered intellectual property, and components which are critical to operation but with relatively low prices that prevent easy substitution. Microchip, Analog Devices and Texas Instruments also share the favorable attribute of having large customer bases and a wide diversity of products so no one customer, product, or category has outsized influence on results. The microcontroller and analog segments of the industry have also consolidated over the past 20 years, and as such, we believe are more rational from a pricing and capacity standpoint compared to other times in history.

Microchip Technology identified, and is benefiting from, the adoption and expansion of several tailwinds which are driving digitization and the demand for the company's products. The Microchip 3.0 strategy is focused on leveraging its TSS strategy to capitalize on six secular megatrends: 5G, Internet of Things (IoT), data centers, autonomous vehicles, electrified transport, and sustainability. Combined, revenue from the six megatrends represented 45% of the company's fiscal year 2023 revenue. Microchip Technology believes these tailwinds are durable, and the company estimates that megatrend-related revenue will grow at twice the rate of the remaining business which, itself, should grow at rates close to global gross domestic product (GDP). Over time, the company believes it will take share in its relevant markets.

## Navigating Obstacles

As has been the case for many businesses, the COVID pandemic and its aftermath have been difficult for Microchip Technology to navigate. The company first dealt with a significant fall off in orders early in the pandemic and was then overwhelmed by demand for and shortages of its products as consumers and businesses shifted from buying services to goods such as automobiles, appliances, and computers. The company was faced with unprecedented backlogs which are now unwinding, and investors are concerned it will be faced with a significant inventory correction. We believe it is likely that customers will need a period of digestion which may result in lackluster sales and earnings growth, but we have yet to encounter evidence that the secular growth tailwinds described above have been curtailed. We expect that the company's results in any one period may be volatile, but we believe over our 3–5-year horizon, the company's growth trajectory is relatively predictable.

## Potential for a Bright Future

In addition to our experience with Texas Instruments and Analog Devices, we were drawn to Microchip Technology as it appears to be early in its journey of returning more capital to shareholders. The company rightly (in our opinion) prioritized acquisitions to capitalize on the opportunity to build out its product and technology lineup to solidify its competitive position. Since the closing of the acquisition of MicroSemi Corporation (a provider of semiconductor and systems solutions for aerospace/defense, communications, data center, and industrial markets) in 2018 – which was the company's last material transaction – Microchip Technology has focused on paying down debt, increasing its dividend, and repurchasing shares. The company is in the middle of executing a plan to return 100% of its free cash flow in the form of dividends and share repurchases by the fourth quarter of fiscal year 2024. We believe this return of capital, combined with the potential for revenue and earnings appreciation, presents a compelling opportunity for shareholders.



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Barton joined Weitz Investment Management in 2007. Prior to joining the firm, he was a research analyst at Oak Value Capital Management and Trilogy Capital Management. Prior to his investment management experience, Barton worked at George K. Baum & Company and was a certified public accountant at Deloitte & Touche LLC. Barton has a bachelor's in accounting from the University of Missouri and an MBA from Washington University in St. Louis.



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As of 09/30/2023, the following portfolio company constituted a portion of the net assets of Conservative Allocation Fund, Large Cap Equity Fund, Multi Cap Equity Fund, and Partners III Opportunity Fund as follows:

- Analog Devices, Inc.: 0.0%, 4.5%, 0.0%, and 0.0%.
- Microchip Technology: 0.0%, 2.1%, 0.0%, and 0.0%.
- Texas Instruments, Inc.: 0.0%, 0.0%, 2.5%, and 2.7%.

Holdings are subject to change and may not be representative of the Fund's current or future investments.

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