

DIOD Buys BCDS—M&A Done Right

Diodes (DIOD, \$17.14 +0.23, *Upgrading to Buy—Upside Incremental from Hold*)

BCD Semiconductor (BCDS, \$7.41 +3.43, *Downgrading to Buy—Upside Incremental from Buy--Distressed*)

M&A Done Right: DIOD announced its acquisition of BCDS for \$8.00 per share in cash late-Wednesday and then held a conference call mid-day yesterday to describe the deal, and I have to opine how refreshing it is to see a good deal done well. DIOD is getting an immediately accretive deal at book value with product, market, manufacturing and financial synergies without the need to make any cuts, while BCDS gets global scaling at twice the share price—as well as liquidity that has been sorely lacking for some of its original investors. DIOD has never captured my enthusiasm due to the relatively light-weight technology factor associated with its core discrete product offering, but its demonstrated business and financial success and growth have proven quite respectable over the years. Because of this deal I can argue some 35% upside potential to DIOD share price as well as BCDS up to \$8.00/share.

DIOD will finance the deal with cash and debt—it still has \$20M available on a \$60M BofA credit line in addition to facilities from Asian banks and closed last quarter with \$168M in cash and \$51M in debt after \$18M in operating cash flow and zero free cash flow after capital expenses. DIOD will pay \$151M for all outstanding BCDS ADRs for a net outlay of \$112M after considering gross cash at BCDS last quarter of \$39M, restricted cash of \$10M, debt of \$25M, operating cash flow of \$4M, but cap ex of \$9M and a share repurchase of \$4M. And even though the deal is all cash, DIOD gets a minimum 2-year employment guarantee from BCDS' CEO, President and Sales VP, and 18-months from its COO. The boards have approved the deal and shareholder and regulatory approvals will hopefully support a closing in the March/April 2013 timeframe.

Market Synergy: BCDS is China-centric, whereas DIOD is focused on the US and Europe. DIOD gets insider sales access to China, and BCDS gets resources to chase design wins at multinationals in the US and Europe.

Product Synergy: DIOD gets strength in AC-DC switch mode power supply devices for chargers and adapters which have been missing in its analog ASSP offerings, as well as predominantly complementary products to its standard linear ICs, sensor ASSPs, and power management ASSPs. BCDS gets to bundle a solution with DIOD's discrete, standard logic ICs, audio ASSPs, and digital broadcast satellite ASSPs.

Manufacturing Synergy: BCDS has its own analog wafer fab in Shanghai (and is ramping a second one during 2013 next door) and outsources package assembly. DIOD has its own discrete fabs in Kansas City and the UK, but is underutilizing its captive package assembly in Germany, Chengdu and Shanghai—and some 80% of BCDS' products can be built in those facilities.

Financial Synergy: 3Q pro forma gross margins were 26.2% at DIOD and 29.1% at BCDS, although both companies have target financial models approximating 30%+ gross margins and <20% operating expenses. Estimated combined 2012 revenue of \$776M (\$634M DIOD + \$142M BCDS) at 26.4% gross margin and \$83M EBITDA (\$69M + \$14M) from a total of 4,950 employees (3,650 + 1,300).

DIOD Upside Potential: DIOD is currently trading at its historical average TTM price-sales ratio of 1.3x and 1.2x consensus 2013 sales of \$689M. If I give it credit for another \$150M in sales next year from BCDS and apply 1.3-times sales, I get a 12-month target price of \$23 per share which is a 35% premium to yesterday's close. Not a real table-pounder, but there are certainly a lot more lesser potential investment opportunities out there right now, in my opinion.

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