

EZCH Shortfall, MXL Acquisition

EZChip (*EZCH, \$24.73 +0.31, Rated Short in my latest Chip Investment Ideas*)

3Q Shortfall: EZCH preannounced expected 3Q weakness this morning due to carrier networking equipment customers adjusting inventory and delaying orders. Original guidance called for a sequentially flat quarter at \$22M in sales, and this has now been lowered to a decline of -14% or \$19M. Management believes the weakness is temporary; is expanding into other markets with its NPS offering; plans to report 3Q on November 12; and continues to expect to close its acquisition of privately-held Tileria 4Q. Nevertheless, bad news for EZCH.

EZCH has a great business, but at nearly 10-times trailing sales has been trading up in the ozone—hence my Short Recommendation. Its highly-profitable IP-business model yields a limited revenue base; is concentrated among a handful of customers; and the unprofitable Tileria acquisition will be dilutive—although so would any other deal given EZCH's 81% gross margin. From a chip sector perspective, this is now the third negative preannouncement calling for a 3Q sequential decline in revenue after ENTR and MXL (although DIOD did reiterate an expected gain of +3+7%). And I don't think it will be the last.

MaxLinear (*MXL, \$6.98 +0.00, Rated Long—But Distressed in my latest Chip Investment Ideas*)

Physpeed Acquisition: MXL announced the intended acquisition of privately-held Physpeed this morning, expanding its high-speed, mixed-signal CMOS offering for broadband markets to include expertise in InP, GaAs, and SiGe technologies for data center, optical, and telecom markets in the 40-100Gbps performance range, extending to 400Gbps. MXL will pay \$11M in cash plus a \$750K earn-out for a company that has just commenced production at a tier-1 customer, and the deal is expected to close 4Q and be dilutive by one- to two-cents per share until 2016.

Looks to me to be a cost-effective way to significantly increase MXL's SAM given \$75M in cash and no debt, although the timing could have been better given the company's recent negative preannouncement.

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