Lattice to Acquire Silicon Image

Silicon Image _(SIMG, $5.90 +0.02, Hold, Target Price $7, 2015: $0.24 on $230M, 2016: $0.27 on $247M)_
Lattice Semiconductor _(LSCC, $6.59 -0.03, Rated Hold/Not Compelling in my latest Chip Investment Ideas)_

LSCC Buys SIMG: LSCC announced plans to acquire SIMG early this morning for $7.30 per share totaling $600M in an all cash deal via a tender offering. This reasonably-priced deal offers LSCC significant benefits, while SIMG sides-steps its current MHL hiccup at major customer Samsung while 60GHz wireless opportunities continue to germinate ahead of a ramp that may not occur for another year or two.

This is a wonderful acquisition for LSCC in terms of scale, IP, gross margin, market expansion, and 'stickiness' of its product offering—all at a not unreasonable price. LSCC adds SIMG's $250M in sales to its $370M in a giant step to achieve its goal of $1B in annual sales; it gets valuable IP in terms of HDMI, MHL and 60GHz wireless; it gets accretive gross margins; it significantly increases its exposure to consumer electronics markets, which is one of its objectives; and it gets a longer-tail of the product lifecycle by adding SIMG's ASSPs and royalty streams. The scale itself buys leverage at both customers and vendors, as well as expected cost savings.

A tender offer for SIMG shares is to be launched in 10 days and expected to close by the end of March (subject to regulatory approvals); the deal is expected to be immediately accretive on a non-GAAP basis; and $32M in annual savings are expected to be realized by the end of the first year. The combined entity is expected to generate non-GAAP gross margin of 56-60% and operating margin over 20%. LSCC has cash of $257M, SIMG has $148M, and Jefferies is offering a $350M term loan. Neither company carries debt at this time. 3Q results for LSCC and SIMG, respectively, included: revenue of $86.6M and $70.3M; gross margin at 58.7% and 61.1%; net income margin of 10.9% and 12.5%; share counts of 121M and 79.7M; total assets at $502M and $272M; and shareholder equity at $434M and $207M. The deal values SIMG at just over 2-times sales, which also approximates where LSCC is trading.

This deal appears to be about scale, in my opinion. Both companies have competitive offerings generating respectable profits, but are stymied in a persistently low-growth business environment. The combined entity will approximately double each company's relevance and leverage to their respective customers and suppliers. G&A synergies are obvious, S&M synergies could be meaningful, and at least some incremental manufacturing cost savings appears reasonable, in my opinion—all of which could realistically result in the advertised $32M in annual cost savings. But the very different product offerings would appear to limit R&D synergies to the sharing of technology and site-consolidation in Sunnyvale and Shanghai: LSCC can add SIMG's high-speed interfaces to its programmable FPGA devices and SIMG will likely be able to accelerate time-to-market with preliminary FPGA implementations, but other than that there doesn't appear to be much overlap available to leverage and/or trim.

I give this combination an enthusiastic two-thumbs-up for LSCC, although my enthusiasm is tempered from a SIMG perspective due to the limited synergies associated with disparate products and technologies—which is reflected in the lack of a more significant valuation premium associated with the price of the deal, in my opinion.

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