

February 4, 2010

Ticker Symbol	SSTI	Avg. Daily Vol.	464K
Price	\$2.85	Short Interest	2.4% of Float
Cash & Invest	\$212	52 week L-H	\$1.30-\$2.88
Total Debt	\$0	Fiscal Year End	Dec
FD Shares Out	98.9		
Equity Mkt. Cap	\$282		
EV - mm	\$70		

## MCHP Acquiring SSTI for \$2.85/Share Cash

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**Summary:** I happen to be following SSTI because it has been in the “cross-hairs” of activists due to long-standing corporate governance issues and a lackluster financial and stock performance. Oh, and also because the Co had, as of Q309, \$2.14 per share in cash & investments, \$0.40 per share in net working capital and zero debt. Management had struck a “Go-Private” deal with a PE Fund to purchase SSTI for \$2.10 per share and the only shareholders allowed to retain equity in the private Co are the CEO and COO. As I said, SSTI has serious corporate governance issues.

Today, SSTI investors got another offer. Microchip (MCHP) announced that it was acquiring SSTI for \$2.85 per share in cash. While a significant premium to the Go-Private deal, when you look at the cash/working capital at SSTI, \$2.85 is still pittance.

Having said that, if the MCHP deal goes through “as is”, it could boost MCHP’s EPS significantly. Most Microchip Street analyst were taken by complete surprise by today’s announcement and conceded on the conference call that they knew little about SSTI.

My guess is that when they work through the numbers, they will see how little MCHP is paying for this acquisition and how accretive the deal can be for MCHP. I will be surprised if they don’t nicely up their EPS estimates and the stock doesn’t appreciate on EPS revisions.

**MCHP’s LTM EPS is \$1.00 per share. The stock trades at \$27 or a P/E of 27x. If I add the earnings accretion from SSTI acquisition and use the same multiple, I come up with MCHP’s Proforma EPS of up to \$1.26 per share and fair value of up to \$34 or 26% higher than its current stock price.** The one argument I heard on the call was that now that MCHP was adding a memory business to its portfolio, it was taking the risk of greater earnings volatility and a lower multiple could be warranted. (Cont’d)

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Here is a simple Proforma model. Microchip stated in its earnings call that it had signed the deal only last night and has to work out what SSTI's revenues it will keep and what it will divest. So I caution that this model is too preliminary

Qtr Ended	MCHP						SSTI using MCHP operating ratios					Qtr Ended	MCHP+SSTI						
	Mar-09	Jun-09	Sep-09	Dec-09	2009		Mar-09	Jun-09	Sep-09	Dec-09	2009		Mar-09	Jun-09	Sep-09	Dec-09	2009		
Revenue	173	193	227	250	843	100%	50	58	71	70	249	Revenue	223	251	298	320	1,093	100%	
COGS	89	96	103	104	391	46%	23	27	33	32	115	46%	COGS	112	122	135	136	506	46%
GP	84	97	124	146	452	54%	27	31	38	38	135	54%	GP	111	129	162	184	587	54%
SG&A	33	36	41	43	153	18%	9	11	13	13	45	18%	SG&A	42	47	54	56	199	18%
R&D	26	28	30	30	113	13%	7	8	10	9	33	13%	R&D	32	35	39	40	147	13%
EBIT	25	34	54	73	186	22%	11	13	16	16	56	22%	EBIT	37	47	70	89	241	22%
Other Exp	2	3	2	1	8								Other Exp	2	3	2	1	8	
Pre Tax Inc	23	31	52	72	178								Pre Tax Inc	35	44	68	87	234	
Taxes	3	4	7	9	22	13%							Taxes	4	6	8	11	29	
NI	21	27	45	63	155								NI	30	39	59	76	204	
Option Exp	7	8	8	8	31								Option Exp	7	8	8	8	31	
Adj. NI	28	35	53	70	186								Adj. NI	37	46	67	84	235	
EPS	0.15	0.19	0.28	0.37	1.00								EPS	0.20	0.25	0.36	0.45	1.26	
FD Shares	184.2	185.5	186.9	187.9	186.1								FD Shares	184.2	185.5	186.9	187.9	186.1	

Now let me talk about some flaws in the above model.

- (1) Steve Sanghi, the CEO of MCHP stated in today's conference call that he will not compromise Co gross margins and operating margins in this acquisition. This seems like a stretch, given that SSTI's gross margins have stayed between 25%-30% over the last eight years. The last time SSTI's gross margins exceeded 30% was in 2000, arguably an enormous Tech Bubble. Nonetheless, I have used MCHP's gross margin on SSTI's revenues to get to the pro-forma GM for the combined company.
- (2) If it is in fact possible to slice and dice SSTI and keep the businesses which allow MCHP to maintain 54% gross margins, then that should mean that MCHP will only retain a portion of SSTI's revenues whereas I have used all of its revenues for the pro-forma model.
- (3) I have used MCHP's tax rate not knowing the tax rate for the combined businesses.
- (4) I have made an assumption that MCHP can maintain its R&D expense at 13% of revenues and SG&A at 18% after the combination. SSTI had been running at much higher levels.

As you can see, there are many unknowns. However, we do know that MCHP is paying next to nothing (\$33 mm after you subtract cash, investments and net working capital) for a business which is generating \$280 mm run rate in annual revenues. Of these, \$40 mm is licensing revenue, which has 100% gross margin. It's a steal, any which way you look at it.

**What could happen next?** One possibility is that some of the unhappy SSTI shareholders (assuming that they are still unhappy after today's offer) make a fuss about the low-ball price and put up a fight. The risk, in such a scenario, would be that if MCHP pulls the offer, then we will all be back to the last offer of \$2.10. So it is very likely that this deal goes through at \$2.85, unless another bidder materializes.

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