



# FOCUS CAPITAL

— MANAGEMENT —

Mordechai Yavneh

Founder & Manager

[myavneh@focuscapitaladvisers.com](mailto:myavneh@focuscapitaladvisers.com)

**Silicon Motion (SIMO):**

**The Merger Arbitrage for People Who Don't Like Merger Arbitrage**

November 8, 2022

# Focus Capital Management

We focus and concentrate our time, energy, and resources on a few select opportunities — allowing us to achieve superior returns

- Our focus allows us to do **deep research and analysis** and to really understand the company we are investing in
- Our focus drives higher returns because we only pick our **best ideas**
- Our focus **reduces risk** by thoroughly vetting and stress-testing every investment

# Why We Don't Like Merger Arbitrage

## Two Unattractive Scenarios

1. Picking up nickels in front of a steamroller
2. Moderate to large spread — due to large, binary, opaque risk

# Silicon Motion (SIMO)

**The Merger Arbitrage  
for  
People Who Don't Like  
Merger Arbitrage**

# SIMO Merger Deal

- $\$93.54 + .388 \text{ MXL shares per SIMO share} = \sim \$106$
- Present SIMO price (11/4/2022):  $\$59.84 = \underline{\underline{77\% \text{ spread!!}}}$
- Closing estimated by Q2/Q3 2023
- US company buying Taiwanese company in semiconductor industry
- Risk is Chinese approval from SAMR
- Compare to INTC buying TSEM — only 32% spread, also needs Chinese approval

## Win-Win

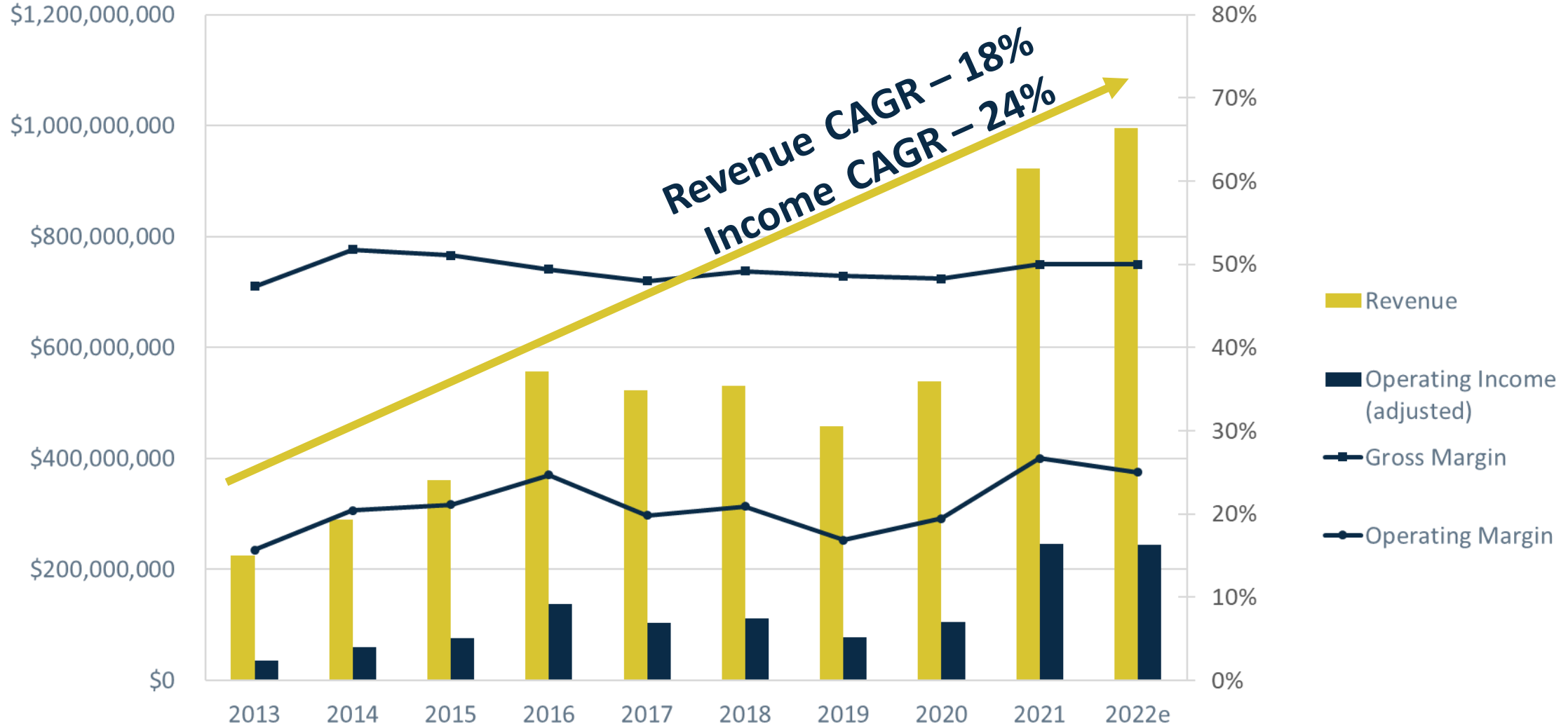
**If merger falls through, shareholders  
will likely do even *better* long-term  
due to SIMO's fantastic business and  
ultra-cheap valuation**

# One-minute Overview

- Highly profitable
- Extreme growth (71% growth in '21, estimated 8%+ growth in '22)
- Secular growth market
- Gaining share within the market
- Competition diminishing, ceding the market to them long term
- Fortress balance sheet (27% in current assets, no debt)
- Ultra-cheap valuation (P/E only ~10, ex-cash P/E ~7.5)
- By 9/30/23 (if deal falls through), will have ex-cash P/E of ~6.5!!

# Financials

## Silicon Motion 2013-2022





# Diminishing Competition

## What Happened in 2021–2022?

### eMMC

- With Samsung's exit mid-2021, Silicon Motion is essentially **the only significant merchant supplier of eMMC controllers**, a long-tailed market which is still growing significantly due to low-end smartphones and IoT
- Exclusive supplier for SK Hynix's eMMC division; more NAND Flash makers outsourcing to them as well
- Supplies a slew of Chinese module makers for eMMC, who have been selling eMMC throughout the chain

### UFS

- Lost SK Hynix UFS business in 2019, but did extremely well as exclusive supplier to Micron's UFS business
- Added second UFS customer in 2021, five more in 2022

### Client SSD

- Supplies about 70% of module maker merchant controller needs
- Historically only about 30% of OEM contracts, but increasing share (higher value, higher volume, stickier)
- OEM: 25%-30% (PCIe Gen3) → 40% (2021) → 50% (2022)
- Growth both from customers gaining share and adding new customers
- 1 NAND Flash customer (2020) → 2 (2021; first iteration of PCIe Gen4 ) → 7 (2022; second iteration)

**Permanent step-up in revenues and margins — unlikely to reverse market share gains, with more growth to come**

# Diminishing Competition

## Competitors Exiting

### Marvell

- Unsuccessful in competing in Client SSD space and pivoted to focus on enterprise SSDs in 2018, ceding Client SSD space to Silicon Motion

### Kingston

- Used to exclusively use Phison controllers (and was major shareholder in Phison)
- Began using Silicon Motion controllers in 2019, ramped up through 2020 and 2021, with Silicon Motion continuing to gain significant share with Kingston

### Samsung

- Exiting eMMC controller market

### Internal Controller Teams

- Increasingly outsourcing controllers to Silicon Motion, both for UFS and Client SSD
- Only small portion of overall Flash costs; makes sense to leave to specialists and focus on their Flash manufacturing
- Merchant suppliers can spread development costs over greater volume than captive teams
- Main long-term risk substantially reduced

## Diminishing Competition

**In much of the market,  
the flash controller wars are over  
and  
Silicon Motion has won**

## Valuation

<b>Price (11/04/22)</b>	—	<b>\$59.84</b>
Market Cap	—	\$2.0 billion
2022e Net Income	—	\$192 million
<b>P/E</b>	—	<b>10.3</b>
Net Current Assets	—	\$530 million (27% of market cap!)
Debt	—	\$0
<b>P/E ex-cash</b>	—	<b>7.6</b>

**Meanwhile, cash piles up on the balance sheet (as dividends and share buybacks are paused) to the tune of about 10% of the market cap per year!**

# Thesis is Simple

**I challenge you to find such a combination of high growth and high profitability with low risk at a P/E of just 10 (P/E ex-cash under 8!)**