



I also recall a couple of years ago when management called a business cycle turn in an accurate and timely manner, and posed its argument with an unusual level of detail about its business. While I was extremely impressed with the comprehensive nature of the argument at the time, the fact is that the company never had before (and probably never will again) provided such extensive detail about its business, that provided such valuable insight at the time.

**Profitable—but Boring--Products:** Microcontrollers (MCUs) are computing engines on a single chip: basically a processor, memory and I/O all contained in a single, inexpensive chip whose function is optimized by the end-user via software programming as facilitated by development kits. MCUs are highly versatile, convenient and cost-effective for a wide variety of extremely diverse applications and end-markets. However, it cannot compete with customized offerings in terms of performance and price that serve the extremely large markets that economically justify those customized ICs: think PCs, cell phone handsets, disk drives and flat panel displays. Hence, MCUs are inherently advantageous for a wide variety of smaller volume applications. The good news is that this supports unit-based profitability and end-market diversification. The bad news is that it boxes the company out of extremely high-volume and/or extremely high-growth end-market opportunities. Touch-screen controllers (think Synaptics) have been a bright spot of growth for MCUs in recent years, although it has not been clear to me that MCHP has benefited as much as it should have. Cypress Semiconductor (CY) has been a big winner in this space, but virtually all MCU suppliers have addressed it.

**Decent Acquisition:** I am not against the pending acquisition of SSTI, although I struggle to get very enthusiastic about it. The bottom line is that I think MCHP is at least not over paying for SSTI revenue. I am very familiar with SSTI and its NOR flash offering, which is no longer a growth business in the midst of a significant supplier shake-out that I believe will ultimately result in a steady, cash-generating business of this legacy, albeit critical technological cog in the realm of microelectronics hardware. Basically, another boring product category. SSTI is not profitable, CY09 sales \$250M, run-rate of \$300M, run-rate prior to downturn \$400M/year. MCHP is paying \$3.05 per share, or \$300M, on approximately 100M shares, but getting \$180M in cash from SSTI. I assume MCHP will get no EPS benefit and \$350M in annual sales from SSTI next year.

I also have to say I was disappointed that the proposed MCHP acquisition of MCU competitor ATML (with ONNN picking up the rest of ATMLs business) did not come to fruition last year. This was a case that the bankers constructed that appeared to make of lot of strategic sense, in my opinion, with MCHP significantly expanding its core MCU business with a pretty respectable player. I am familiar with ATML and have followed it in the past.

**Problematic Valuation:** I have both general and specific problems considering the fundamental valuation of MCHP. In general, I am not convinced MCHP should trade to the significant premium that it does compared to its competitive peers in the microcontroller business that include ATML, CY, TXN and STM. In fact, the shares trade against comparables in the high-performance analog product sector that garner probably the highest valuations in the semiconductor industry. While I have to agree that MCHP profitability and financial reliability are well suited to that of its analog peers, I do not consider the technological complexity of its microcontroller offering to be anywhere close to that associated with the black art of analog. This general discomfort renders me inherently skittish when addressing the relatively robust fundamental valuations the shares have reflected—and continue to reflect.

At first glance I consider the current share price to be very consistent with historical fundamental valuations, and therefore not offering potential investors any meaningfully favorable risk-reward trade off. It is already trading at 28.2-times trailing 12-month pro forma EPS against an historical average of 31.4 and my more comfortable level for the sector around 20-times that reflects past industry growth. It is also trading at 6.4-times trailing sales compared to an historical average of 6.0-times, which is also quite robust when compared to blue-chip companies such as INTC and TXN with averages of 4.6-times and 3.1-times, respectively. It is also trading amongst the highest of all kinds of peers in terms of relative valuation, as reflected in the tables on Pages 4 and 5 of this report.

The shares become marginally attractive discounting FY11 on a P/E basis, rendering a mid-\$30 price target for the current share price at \$28.50 using a 20-times multiple. And this could arguably also be boosted into the high-\$30 range if using 6-times sales for that period. This methodology results in my 12-month target price of \$36. While a potential 26% return over 12-months probably ain't bad for most equities, I am much more comfortable embracing opportunities with at least 50% potential upside in the highly cyclical and volatile semiconductor industry. Hence my less-than-enthusiastic Hold/Weak-Buy(?) recommendation at current price levels.

However, things get interesting when factoring in the pending SSTI acquisition. While it doesn't necessarily bring any earnings to MCHP, it does bring a current annual revenue run-rate of \$300M that could easily recover to its historical \$400M over the next couple of quarters. I give it credit for \$350M in the table below.

EPS	F4Q10	F1Q11	FY10	FY11	FY11 +SSTI	Target Price	
						20-times	30-times
Consensus	\$0.37	\$0.38	\$1.11	\$1.61	\$0.00	\$32.20	\$48.30
Highest Estimate	\$0.39	\$0.40	\$1.13	\$1.70	\$0.00	\$34.00	\$51.00
Lowest Estimate	\$0.35	\$0.37	\$1.07	\$1.50	\$0.00	\$30.00	\$45.00
					w/SSTI		
Revenue					+ \$350M	6-times	w/o SSTI
Consensus	\$269.9	\$278.8	\$939.6	\$1,140.0	\$1,490.0	\$47.05	\$36.00
Highest Estimate	\$270.2	\$282.2	\$940.0	\$1,180.0	\$1,530.0	\$48.32	\$37.26
Lowest Estimate	\$267.6	\$275.0	\$937.3	\$1,080.0	\$1,430.0	\$45.16	\$34.11

Theoretically, a mid- to high-\$40 price range could easily be justified for MCHP assuming it holds its 6-times revenue valuation with the addition of the SSTI sales. And this would render a pretty attractive risk-reward scenario at the current price level. Nevertheless, I'm not going to embrace or support such an argument. First, that incremental revenue is only worth 2-times sales, or maybe \$3.50 worth of price target upside. Second, I think the lower price targets afforded to the relatively more robust earnings multiple compared to the sales multiple will keep a lid on share price bullishness. Third, we are talking nose-bleed magnitude sales multiples during a time when the overall equity markets are experiencing valuation multiple compression due to macroeconomic uncertainty. This is reflected in the richness of MCHPs fundamental valuation compared to its peers.

Finally, and most importantly, is current macroeconomic uncertainty as a factor weighing against the company's highly diversified revenue model that I have always viewed as nothing more than a proxy for GDP growth. Ironically, I think the strength of MCHPs business diversity is currently more of a liability than an asset in an environment where the business outlook for semiconductors and technology, in general, appears to be more certain than that for the overall economy. Typically, plodding macroeconomic growth provides a backdrop of support against the highly volatile and cyclical semiconductor business. Right now this is reversed, with semiconductor industry business visibility throughout the first half of 2010 more comfortable to company managements than economic health is to economists. While this is a highly unusual situation, I do not believe that it favors MCHP.

**Chip Sector Fundamental Valuation Background:** Intrinsic Valuation reflects fundamental equity valuation metrics compared against the history of those metrics for the life of that equity. Specifically, I compare current trailing-12-month price-sales and price-earnings ratios against the average history of those criteria for a specific equity issue. I use the Bloomberg data base to capture historical price-earnings, price-book and price-sales ratios on a weekly basis. I then capture the high and low numbers and calculate the mean average for each ratio.

I do not consider price-book to be a meaningful ratio for the chip industry, in general, mostly because of the huge variance in book values between integrated manufacturers, foundries, fabless and IP business models, but also because of a significant portion of intangible book value reflected in goodwill and acquisition-related intangibles on balance sheets across the sector. While book value appears to be a more relevant metric for valuing the share prices of semiconductor capital equipment issues, it does not appear to carry much relevance for semiconductor suppliers.

Price-earnings is an extremely robust fundamental valuation metric. However, it is inherently problematic in the highly cyclical and volatile chip sector. The volatility of the business itself leads to a very wide range of earnings over the course of a business cycle, and the cyclical nature of the sector results in meaningful periods of financial losses that render historical datasets incomplete and truncated to a significant degree. Even worse, periods of highly depressed earnings render meaningless quadruple-digit price-earnings ratios that skew averages into useless magnitudes in the mid- and high-double digits. Very few issues have big enough data sets available to calculate meaningful averages, and those relatively limited datasets are polluted by exorbitant ratios associated with periods of depressed earnings. Complicating matters even further is the extensive use of pro forma earnings with the lack of consistent definitions thereof. I generally use price-earnings ratios consistent with expected long-term growth rates to establish price targets—but only in concert with other valuation metrics. Specifically, price-sales.

Price-sales is by far the best fundamental valuation metric to employ when addressing the semiconductor sector: the historical datasets are comprehensive and extensive, and the inherent volatility of the sector is limited to the single-digit multiple variances in revenue gyrations across business cycles.

**Microchip Technology**

**Valuation**

**Relative Valuation**

Company	Ticker	Price 3/25/2010	52-Week		CY EPS				CY P/E				Diluted Shares(mil)	CAP (\$ mil)	Price-Sales			FY Ends	Qtr Div/sh	Div Yield	
			Low	High	2008	2009	2010	2011	2008	2009	2010	2011			TTM	Cur FY	Nxt FY				
Microchip Technology	MCHP	28.50	19.66	29.56	1.54	1.01	1.56	1.74	18.5	28.2	18.3	16.4	188	5,355	6.4	5.7	4.8	Mar	\$0.34	4.8%	
Atmel	ATML	5.01	3.25	5.40	0.17	-0.07	0.15	0.34	29.5	NM	33.4	14.7	477	2,388	2.0	1.7	1.5	Dec			
Cypress	CY	11.78	6.25	12.55	0.20	0.64	0.64	0.81	58.9	18.4	18.4	14.5	194	2,282	3.4	2.7	2.4	Dec			
Texas Instruments *	TXN	24.79	16.00	27.00	1.58	1.26	2.14	2.37	15.7	19.7	11.6	10.5	1,257	31,161	3.0	2.4	2.2	Dec	\$0.12	1.9%	
STMicroelectronics	STM	9.73	4.61	10.28	0.44	-0.73	0.47	0.76	22.1	NM	20.7	12.8	878	8,546	1.0	0.9	0.8	Dec-ADR	\$0.03	1.2%	
Average									31.5	19.0	21.0	13.1				2.3	1.9	1.7			

\* Tokeneke estimate

Source: consensus as of 3/25/10

**Relative Valuation**

**Major Analog Companies**

Company	Ticker	Price 3/25/2010	52-Week		CY EPS				CY P/E				Diluted Shares(mil)	CAP (\$ mil)	Price-Sales			FY Ends	Qtr Div/sh	Div Yield	
			Low	High	2008	2009	2010	2011	2008	2009	2010	2011			TTM	Cur FY	Nxt FY				
Analog Devices	ADI	28.94	18.59	32.19	1.55	1.22	2.07	2.23	18.7	23.7	14.0	13.0	305	8,824	4.1	3.4	3.2	Oct	\$0.20	2.8%	
Linear Technology	LLTC	27.91	20.26	31.21	1.99	1.37	1.63	1.85	14.0	20.4	17.1	15.1	228.4	6374.644	7.1	6.0	5.3	Jun	\$0.23	3.3%	
Maxim Integrated Products	MXIM	19.37	12.89	21.00	0.48	0.52	1.12	1.43	40.4	37.3	17.3	13.5	310	6,007	3.6	3.1	2.7	Jun	\$0.20	4.1%	
National Semiconductor *	NSM	14.59	9.89	16.20	1.42	0.33	1.28	1.28	10.3	44.2	11.4	11.4	243	3,538	2.7	2.5	2.2	May	\$0.08	2.2%	
STMicroelectronics	STM	9.73	4.61	10.28	0.44	-0.73	0.47	0.76	22.1	NM	20.7	12.8	878	8,546	1.0	0.9	0.8	Dec-ADR	\$0.03	1.2%	
Texas Instruments *	TXN	24.79	16.00	27.00	1.58	1.26	2.14	2.37	15.7	19.7	11.6	10.5	1,257	31,161	3.0	2.4	2.2	Dec	\$0.12	1.9%	
Average									20.2	29.0	15.3	12.7				3.6	3.0	2.7			

\* Tokeneke estimate

Source: consensus as of 3/25/10

**Historical Valuation**

Company	Ticker	Price 3/25/10	Trailing 12-month								
			Price/Earnings		Price/Sales		Price/Book				
			Current	Historical*	Current	Historical*	Current	Historical*			
Microchip Technology	MCHP	\$28.50	31.4		6.4		3.6				
			Average	31.4	Average	6.0	Average	5.2			
			High	72.7	High	11.7	High	11.6			
			Low	12.5	Low	0.9	Low	2.2			

\* weekly since 1993

INTRINSIC VALUATION  
Prices as of 3/24/10

Ticker	Close	Change	Price/Earnings									Hist data	Price/Sales						ps del	Tang gross net as Qtr								
			Current					Historical					FYE	since	Current			Historical			Pr/Bk	Tok ck	Pr/Bk	cash/sh	cash/sh	of	Div/shr	
			TTM	Tok	Ck	Curr FY	Next FY	Avg	High	Low	Cur FY				Nxt FY	Avg	High	Low										
NETL	28.55	-1.77	N/A	16.99	24.19	20.99	36.3	97.3	15.3	Dec	2004	4.8	10.0	2.4	2.1	5.0	9.2	1.9	-3.9%	4.1	2.0	9.3	1.51	1.51	4Q			
POWI	41.74	-0.49	50.8	35.68	20.97	19.32	41.4	177.0	12.2	Dec	1998	5.6	5.4	4.1	3.7	5.0	16.2	0.2	12.6%	4.1	4.3	4.3	6.73	6.73	4Q	0.05		
EXAR	7.33	-0.09	N/A	-40.72	N/A	48.87	61.9	286.0	5.7	Mar	1990	2.7	2.7	2.4	2.1	5.1	20.6	0.4	-47.6%	1.2	1.2	1.3	4.97	4.97	4Q			
CAVM	24.71	-0.83	N/A	617.75	43.35	27.46	46.3	66.1	22.5	Dec	2007	11.4	11.0	6.4	5.1	5.2	8.0	2.6		7.1	7.4	15.5	1.26	1.26	4Q			
SIMO	4.02	0.11	N/A	-15.60	N/A	50.25	19.6	27.3	13.3	Dec-ADR	2005	1.3	1.2	1.1	1.0	5.4	7.5	3.7		0.6	0.6	1.1	2.22	2.22	4Q			
OIIM	6.75	-0.13	N/A	-96.43	23.28	17.76	55.0	156.0	10.9	Dec-ADR	2000	2.0	2.0	1.8	1.7	5.6	18.4	0.8	-64.8%	1.4	1.4	1.4	3.45	3.45	4Q			
MCRL	10.55	-0.34	41.2	29.31	17.30	14.65	62.3	901.0	8.9	Dec	1995	3.0	3.1	2.4	2.2	5.9	25.3	1.5	-49.0%	3.7	3.6	3.6	1.34	1.16	4Q	0.035		
<b>MCHP</b>	<b>28.56</b>	<b>-0.51</b>	<b>32.0</b>	<b>28.28</b>	<b>25.73</b>	<b>17.74</b>	<b>31.4</b>	<b>72.7</b>	<b>12.5</b>	<b>Mar</b>	<b>1993</b>	<b>6.4</b>	<b>6.4</b>	<b>5.7</b>	<b>4.8</b>	<b>6.0</b>	<b>11.7</b>	<b>0.9</b>	<b>6.1%</b>	<b>3.6</b>	<b>3.6</b>	<b>3.6</b>	<b>7.98</b>	<b>6.18</b>	<b>4Q</b>	<b>0.341</b>		
RFMD	5.13	-0.08	N/A	21.38	11.66	10.06	93.9	599.0	4.8	Mar	1997	1.6	1.6	1.5	1.4	6.1	52.6	0.2	-73.0%	2.8	3.0	5.0	0.71	-0.35	4Q			
SLAB	48.37	-0.63	30.8	24.55	19.66	16.97	106.8	1794.0	16.6	Dec	2000	5.2	5.1	4.4	3.9	6.6	23.7	2.4	-20.6%	3.6	3.7	4.8	9.10	9.10	4Q			
XLNX	25.81	-1.51	23.7	24.35	21.69	14.50	42.8	298.0	10.2	Mar	1990	4.2	4.5	3.9	3.4	6.8	29.2	2.2	-37.8%	3.7	3.5	3.5	7.15	5.88	4Q	0.16		
ALTR	24.52	-1.14	29.0	27.24	15.42	14.26	37.6	102.0	9.9	Dec	1990	6.2	6.4	4.7	4.4	6.9	23.9	1.6	-10.6%	7.0	6.8	6.8	5.15	3.48	4Q	0.05		
MRVL	20.77	-0.37	38.4	21.19	13.85	12.51	63.2	300.0	6.3	Jan	2000	5.0	4.8	4.1	no est	7.1	19.1	0.9	-30.0%	3.0	3.2	6.2	2.72	2.72	4Q			
MTLK	1.3	-0.12	N/A	-2.36	N/A	N/A	118.3	308.0	42.5	Dec-ADR	2000	0.5	0.7	no est	no est	7.2	16.3	1.7	-93.6%	N/A	-2.1	-2.1	1.49	-0.20	3Q			
UMC	3.62	-0.06	N/A	67.04	16.45	13.92	30.7	144.0	5.8	Dec-ADR	1992	3.4	3.6	2.4	2.1	7.2	33.9	2.3		1.5	1.4	1.4	1.54	1.35	4Q	0.0475		
MIPS	4.19	-0.09	N/A	11.32	13.52	9.31	55.3	587.0	8.8	Jun	1998	3.2	3.2	2.9	2.4	7.4	34.9	1.0	-56.8%	5.8	5.7	5.8	1.04	0.83	4Q			
MXIM	19.5	-0.24	73.0	37.50	20.74	15.48	34.9	90.0	10.3	Jun	1990	3.6	3.6	3.1	2.8	7.8	22.4	1.8	-53.2%	2.4	2.4	2.4	2.70	2.70	4Q	0.2		
QCOM	40.19	-0.33	32.3	19.51	18.02	16.21	63.7	486.0	11.5	Sep	1992	6.4	6.4	6.4	5.7	8.0	26.5	0.8	-19.6%	3.2	3.2	4.1	11.19	11.19	4Q	0.19		
HITT	44.15	-0.48	28.5	28.67	23.12	21.33	27.7	43.7	16.1	Dec	2005	8.1	8.3	6.4	5.9	8.0	12.5	4.5	1.5%	4.8	4.8	4.8	7.35	7.35	4Q			

Enter Ticker Here: **MCHP**

Price/sh 3/25/10  
\$28.50 -0.06

Financials as of: 4Q  
FYE: Mar

<b>Price Changes</b>	Shares(mil): 187.9
Week: 0.9%	Cap(\$mil): 5,355
MTD: 5.3%	Avg Volume: 2,844,930
QTD: -1.9%	QTR Div/share: \$0.3410
YTD: -1.9%	Annual Yield: 4.8%
52wk Lo-Hi: 19.66 - 29.56	Cash/share: \$7.98
percent lo: 44.96%	Net Cash/share: \$6.18
percent hi: -3.59%	
<b>MACD</b>	<b>TTM</b>
50-day: 4.18%	Revenue(\$mil): \$843.0
200-day: 5.45%	pro forma EPS: \$1.01

<b>Valuation Metric</b>	since: 1993		
	<b>Avg</b>	<b>Hi</b>	<b>Lo</b>
Price/Sales TTM	6.4	6.0	11.7
Cur FY	5.7		
Next FY	4.8		
Price/Earnings TTM	28.2	31.4	72.7
Cur FY	25.7		
Next FY	17.7		
Price/Book Pr/Bk	3.6		
Tangible Pr/Bk	3.6		

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*Semiconductor Analyst*

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