**Skyworks Solutions Inc**

  SWKS

### Morningstar's Take  as of 5/1/15

## SWKS

* **Analyst**

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| --- | --- | --- |
| **Price**06-16-2015 | **Fair Value Estimate** | **Uncertainty** |
| 106.33 USD | 75 USD | High |
| **Consider Buy** | **Consider Sell** | **Economic Moat** |
| 45 USD | 116.25 USD | None |
| **Stewardship Rating** |
| Standard |
| **Bulls Say** |
| • | Skyworks should continue to see higher dollar content per phone as customers in developed and emerging markets shift away from basic handsets toward more complex 3G and 4G smartphones. |
| • | 4G LTE networks use many different spectrum frequencies, which require more complex antenna and signal technology, allowing Skyworks to sell higher-value, more advanced RF content into smartphones and tablets. |
| • | As more and more devices become connected to the Internet via cellular networks, Skyworks may continue to find new industries that may require additional RF chip content. |

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| **Bears Say** |
| • | The smartphone market is dominated by a handful of large OEMs that might be able to exert pricing pressure on suppliers such as Skyworks over time, and Skyworks’ earnings would take a hit if a large customer like Apple were to ever cut the firm out of the loop. |
| • | Based on its R&D muscle and dominant position in mobile processors, Qualcomm looms as a credible threat to Skyworks in the RF space. |
|  |
| • | Skyworks' analog business focuses on underserved niche segments, such as electrical meters and keyless entry for automobiles. However, there are many larger competitors in the analog market. |
|  |

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### [Competitors](http://library.morningstar.com/Stock/industry-peer?t=XNAS:SWKS)

## [SWKS](http://library.morningstar.com/Stock/industry-peer?t=XNAS:SWKS)

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| --- | --- | --- | --- | --- |
| Name | Price | % Chg |   | TTM Sales $ mil |
|  |
| **Skyworks Solutions Inc** | **$106.33** | **0.21** |  | **2,873** |
| [Intel Corp](http://library.morningstar.com/Stock/quote?t=0P000002X8) | $31.64 | 0.78 |  | 55,887  |
| [Taiwan Semiconductor Manufacturing Co Ltd ADR](http://library.morningstar.com/Stock/quote?t=0P000005AR) | $23.58 | 1.38 |  | 27,056  |
| [Texas Instruments Inc](http://library.morningstar.com/Stock/quote?t=0P000005EI) | $53.09 | 0.08 |  | 13,212  |
| [Broadcom Corp](http://library.morningstar.com/Stock/quote?t=0P000000VU) | $53.74 | -0.83 |  | 8,502  |
| [Avago Technologies Ltd](http://library.morningstar.com/Stock/quote?t=0P0000KU35) | $141.99 | -0.79 |  | 6,108  |

**Skyworks' RF chips are becoming increasingly important components in many popular smartphones.**



by[Brian Colello, CPA](http://library.morningstar.com/Stock/analyst-report-author?t=SWKS&region=usa&culture=en-US)

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**Investment Thesis** 05/01/2015

Skyworks is a leading supplier of radio frequency chips to smartphone makers and other electronics manufacturers. Although the company faces an intense competitive landscape, Skyworks should succeed in the coming years as the handset industry focuses on high-end smartphones, which usually require higher RF dollar content per phone.

The company's core RF products are used to switch, filter, and amplify wireless signals in a variety of smartphones and other wireless applications. Skyworks has thrived in recent years for several reasons. First, the smartphone market is still growing at a fast pace as customers shift away from basic handsets. Second, instead of basic handsets including a single amplifier that costs less than $1, high-end smartphones that work on several 3G and 4G networks require additional RF chip content at higher prices. Third, complexity associated with 4G LTE networks has made high-quality RF chip design an even more important piece of the smartphone value chain, leading to stickier design wins than in basic phones. Finally, Skyworks has the size and scale advantages to take on orders for hundreds of millions of chips per year, giving the firm a leg up on new entrants.

Nonetheless, we doubt Skyworks will ever gain a stranglehold on the entire smartphone RF market. Several competitors have similar product offerings, and traditionally, handset makers have split their business enough among these RF firms to prevent a single firm from dominating the market over time. Although Skyworks counts Apple as a key RF customer, for example, Apple also uses RF content from Qorvo in each phone. This buying power may someday lead to pricing pressure for Skyworks, as wireless firms seek to reduce the cost of their phones in a brutally competitive market. We’re highly encouraged by Skyworks’ diversification into nonhandset end markets, especially as connectivity is becoming more ubiquitous in other industries such as automotive. Although the firm has seen robust growth from these end markets, we still suspect that the company's fortunes will remain tied to the wireless industry for quite some time.

**Economic Moat** 05/01/2015

We do not believe Skyworks Solutions has an economic moat. Skyworks has executed quite well in recent years by significantly expanding operating margins, diversifying its business into nonhandset opportunities, and still gaining market share and higher-value sockets in a host of highly advanced, popular smartphones. In turn, Skyworks has generated excess returns on capital in recent years, and we expect this trend to continue over the next five to 10 years.

However, Skyworks has significant customer concentration with Apple (34% of fiscal 2014 revenue) and we suspect that a part of Skyworks’ outstanding near-term performance in calendar 2014 is tied to additional dollar content sold to Apple in future iPhones. Although Skyworks’ supplier relationship with Apple appears secure, if not strengthening, over the next two years, if Skyworks were to ever completely miss out on an Apple design cycle and lose 100% of its business with Apple for an extended period of time, we estimate that Skyworks’ returns on capital from its remaining handset and nonhandset customers could potentially fall below the firm’s cost of capital. Skyworks’ returns could fall even further if losses at Apple were combined with losses at other smartphone customers, perhaps due to either a disruptive technology or increased competition from Qualcomm, which has focused on the RF space. While we think that a total loss of Apple’s business is only a remote possibility today, and perhaps even less likely than it was a couple of years ago thanks to design efforts to resolve complexities around 4G LTE technologies, such a loss would likely lead to major value destruction, which in turn inhibits us from assigning the firm a narrow economic moat.

We think Skyworks is on the right track in terms of diversifying its business from a single smartphone customer, although such progress has been clouded a bit because (fortunately) Skyworks’ revenue from other customers and industries has been matched by healthy growth from Apple as well. If Skyworks were able to grow its non-Apple business at a faster pace than its Apple business over the next few years, thus reducing its reliance on a single customer and a handful of smartphone models, we would likely reconsider our no-moat rating for the firm. Skyworks’ profitability and returns on capital are on par with, if not better than, other narrow-moat chipmakers in our coverage universe.

[**Valuation**](http://quicktake.morningstar.com/StockNet/StockValuation.aspx?Country=USA&Symbol=SWKS&culture=en-US) 05/01/2015

We are raising our fair value estimate for Skyworks to $75 per share from $59, due to more optimistic near-term and long-term revenue assumptions. We have also lowered our cost of equity for Skyworks to 9% from 10%. Our change in methodology is based on our expectations for lower inflation in the long run and to better align with returns that equity investors are likely to demand over the long term. Our new fair value estimate implies fiscal 2015 price/free cash flow of 19 times. Skyworks’ recent revenue growth has far outpaced the broader chip industry, thanks to higher RF dollar content sold into the booming smartphone market and key design wins into popular devices like Apple’s iPhone. Skyworks is off to a tremendous start this year, and we project that the firm will generate 44% revenue growth in fiscal 2015. Longer term, we expect revenue growth to moderate and average 8% from fiscal 2016 to fiscal 2019. Skyworks should continue to benefit from the rapid adoption of smartphones and tablets and further expand into nonhandset opportunities, but we are concerned that pricing may face some headwinds as LTE technologies mature. Higher sales levels have enabled Skyworks to benefit from operating leverage in recent years, and we expect this trend to continue in the long term. On an adjusted basis, the company earned a 30% operating margin in fiscal 2014, but we project further expansion to 36% in fiscal 2015 and the mid-30% range in the long-term. Skyworks has set goals of a $5.00 adjusted annual EPS run rate (or $1.25 per quarter) in the near term and $7.00 in the long-term. We anticipate that the firm will eventually reach both goals over time. Our fair value uncertainty rating for Skyworks is high, considering the cyclical nature of the semiconductor industry, the company's highly concentrated customer base, and additional risk associated with Qualcomm's entry into the RF space.

**Risk** 05/01/2015

We view Skyworks’ greatest risk as its highly concentrated customer base that consists of large handset makers like Apple and Samsung. These firms may be able to exert pricing pressure on Skyworks and limit its ability to generate exceptional returns, in our opinion. Weak performance by any major customer will drag on the company's earnings even further. Skyworks' RF chip revenue from handsets should continue to hinge on key design wins--supplier relationships with Apple products have undoubtedly given the company an earnings boost in recent years, but the firm could suffer if Apple ever cut Skyworks out of the loop in future generations of these devices. Qualcomm's entry into the RF chip space poses a large risk to RF chipmakers, in our view, if the company can leverage its market leadership position in mobile processors into the RF space as well. Finally, although Skyworks has done well to diversify a portion of its business into nonhandset opportunities, the firm squares off against a host of well-capitalized firms in the analog chip space with decades of design experience.

**Management** 05/01/2015

We view Skyworks as a well-run company and good stewards of shareholder capital. CEO David J. Aldrich took the top job in June 2002, when the merger of Alpha Industries and Conexant Systems' wireless business created Skyworks. Before that, he had held various senior executive positions at Alpha Industries since 1995. Skyworks has generated solid sales growth and profitability over the past few years, and we applaud the firm’s relatively recent initiation of a dividend, in order to better return cash to shareholders. The firm continues to buy back stock in a reasonable manner as well. On the M&A front, Skyworks made two big moves in 2011, acquiring SiGe Semiconductor and Advanced Analogic Technologies in order to diversify and expand its product portfolio. At this point, it appears that both moves have paid off, as the firm has generated strong revenue growth in nonhandset end markets, all while continuing to expand operating margins. The firm’s recent joint venture with Panasonic also helped the firm secure a steady supply of high-quality filters used in the firm’s front end modules, and should aid in further gross-margin accretion. Finally, although we still believe that Skyworks does not yet have an economic moat and plays in a highly competitive industry, it is undeniable that Skyworks’ execution over the past few years has been stellar and has contributed to the firm’s healthy revenue and earnings growth.

**Overview**

**Profile:**

Skyworks Solutions produces semiconductors for wireless handsets that are used to enable wireless connectivity. Its main products include power amplifiers, integrated front-end modules, and direct conversion radios that support functions such as voice and power management. Skyworks' customers are mostly large smartphone and tablet manufacturers, but the firm also has a growing presence in non handset applications.