

BLYTH FUND | PMCS WATCH LIST PROPOSAL

By Charles Najda

Date: 11-04-02
Proposal: PMC Sierra Watch List Proposal
Ticker: PMCS
Current price: 6.29 (close 11-01-02)
Analyst: Charles Najda
Profile: PMC-Sierra, Inc. is a supplier of high-performance integrated circuits, principally used by equipment manufacturers in the telecommunications industry. The Company has more than 100 revenue-producing products in its portfolio. Its networking products are communications semiconductors, including microprocessors that are used in different types of equipment that form the Internet infrastructure. Its non-networking segment is comprised of a single chip used in a consumer medical device. (From *Yahoo! Finance*)

The Numbers:

Shares Outstanding:	167.3 mln	Market Cap:	\$814.6 mln
Median Target Price 12 months	\$9.50	EPS Growth – 5 years	40.0%
P/book	3.68	P/sales	3.83
Gross Margins	62.0%	Net Margins	N/A
Cash:	\$421.9 mln	Debt/Equity	1.22
EPS (02)	\$-0.28	EPS (03)	\$-0.19
52 week high / low	\$29.32 / \$2.70	Cash Per-share	\$2.47

Earnings History:

	Dec 2001	Mar 2002	Jun 2002	Sep 2002	Dec 2002
Estimate	-0.16	-0.12	-0.08	-0.06	-0.07
Actual	-0.15	-0.09	-0.07	-0.05	N/A
Difference	0.01	0.03	0.01	0.01	
% Surprise	6.3%	25.0%	12.5%	16.7%	

Improving Financials:

- PMC-Sierra, which ended the third quarter with \$293 million in net cash, will burn through less than \$20 million for the full year even given the losses because it has generated positive operating cash flow for the past two quarters.
- During 2000, PMCS's fiscal year end pre-tax profit margin of 25.60% was higher than the five-year mean of 25.44%. It's also higher than the five-year industry average of 3.83%. PMC Sierra outperformed its competitors even during 2000 and only saw conditions deteriorate in 2001.
- Over the last two years stockholders equity has remained stationary at about \$250 mln, which indicates that assets and liabilities are not fluctuating a great deal.
- For the year ended December 2001 PMCS had \$34 mln in inventory, compared to \$55 mln in inventory for the year ended December 2000.

Product Mix:

- The company has put more effort into selling chips for consumer electronics and storage-area networks; however, it has remained vulnerable recently to the steep downturn in telecom equipment investment.
- About one-third of PMC-Sierra's revenue in the past quarter came from outside the debt-burdened telecom sector and the chip maker company has set a target of raising that share to one-half.
- PMC Sierra recently introduced a new MIPS based processor (RM9000x1), which is part of its strategy to diversify its business away from networking chips. The new RM9000x1 is ideal for use in core and edge routers, DSLAMS, multi-service switches, high-end laser printers, storage area network (SAN) applications, and wireless base stations.

Contrarian

- Last week both Goldman Sachs and Thomas Weisel downgraded PMCS, at the 52-week

BLYTH FUND | PMCS WATCH LIST PROPOSAL

By Charles Najda

Indicator:

low. Since then the trading of the stock and the improving fundamentals seem to indicate that these downgrades are not substantive and that they together are a contrarian indicator.

- Goldman cut its 2003 estimate for earnings to a loss of 19 cents from a loss of 7 cents and for revenue to \$232 million from \$290.7 million. However, PMCS' 2003 consensus estimate was already at \$-0.19. Thus, Goldman's downgrade to "market perform" from "market outperform" is a non event.

Closing Thoughts:

- Competitors like AMCC and Triquint Semiconductor have also been beaten down like PMC Sierra; however, their expected EPS growth is lower.
- Recently analysts have been cautiously raising their growth rates for PMCS, which indicates that well informed market participants believe that PMC Sierra's business will improve going forward.
- PMC Sierra is aggressively recovering from a brief one year slump in sales. The company is quickly narrowing its earnings loss and is no longer burning through cash, because the company is now cash flow positive.
- Based on its fundamentals, I believe that PMC Sierra is now at an attractive valuation.

Key Ratios:

	Current	5-Yr. Low	5-Yr. High	Industry
Trailing P/E	NA	12.80	623.20	NA
Price/Sales	3.83	3.06	59.70	1.30
Price/Cash Flow	NA	-3.10	224.10	10.70
Price/Book	3.46	4.56	68.14	1.07
Return on Equity	NA	8.80%	38.20%	NA

10 Year Revenue, Net Income, and Cash Flow Figures (mln):

Year	92	93	94	95	96	97	98	99	00	01
Revenue	92.3	83.4	108.6	188.7	188.4	127.2	161.8	262.5	694.7	322.7
Net Income	11.8	-13	-8.6	24	-48.2	34.3	-2.9	90	75.3	-639
Cash Flow	17.3	-6.7	-1.9	32.9	-37.3	43.5	11.3	113.6	185.7	-499.2

1 Year PMCS Chart:

