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"Israel is the first place I'd look for an opportunity to expand"

A year after acquiring it, Californian integrated circuit company Microsemi is unstinting in its praise of Israel's PowerDsine. "Globes" heard why.

Shmulik Shelah — 9 Jan 08 18:42

It is now a year since Californian integrated circuit company Microsemi Corp. (Nasdaq: MSCC) acquired Israeli company PowerDsine and set up an R&D center here. The acquisition, says Microsemi, has been a resounding success. As conclusive proof of this, they bring up the company's market cap on Wall Street, which were it not for the fear of the consequences of the company's restructuring, would have climbed 70% last year. It still rose 25% in 2007 to \$1.7 billion. The PowerDsine acquisition, it will be recalled, was closed at the beginning of 2007 for \$245 million, and considering Microsemi's own size, it is actually more like a merger.

Analog focus

Microsemi is a veteran company, and was in the semiconductor industry long before the current market leaders existed. The company has stuck to its traditional field of expertise as a producer of integrated circuits (IC), with a focus on analog products. The company's products are used in markets that are relatively gray - aviation, defense, medical equipment, and entertainment - with an emphasis on voltage management, and the quantification of other external factors. It was into this framework that PowerDsine, which develops and provides solutions for transmitting electrical power over Ethernet networks, eliminating the need to connect computing products to power outlets, was integrated last year.

Igal Rotem, formerly CEO of PowerDsine and now its operations manager, opens the conference call with Microsemi CEO James Peterson, and executive VP analog and mixed signal group Steven Litchfield with an enthusiastic welcome, "Hi Jimmy!" Judging by the alacrity in Peterson, Litchfield, and Rotem's voices, Microsemi appears to be on a roll.

"I think this is the most successful acquisition ever made by an American company in Israel," Peterson sums up. "It has definitely exceeded our expectations. I think that the most important thing was that we were honest and what we found on the other side was a group of a very high caliber people. Each side respected the beliefs and perspectives of the other during the process, and I think this overcame the main barrier to success."

"What we tried to do was take the groups from both sides and restructure them," says Litchfield. "We reformed the groups by changing the management structure and as a result we got a new perspective on everything. This is probably the most successful team that Microsemi has ever acquired. We also need to work on the group's revenue and expenditure and I believe we'll make progress on this as well in 2008 and 2009."

Globes: So what plans do you have for your activity in Israel?

Peterson: "One thing that I know now is that Israel has capabilities in engineering that are unmatched anywhere else, so strengthening the capabilities of the engineering center in Israel is a must. Beyond that, when we feel the trial period is up, we'll start looking at other opportunities in Israel that are suited to Microsemi. I'm not sure how that sounds in Israel, but it's a popular decision at Microsemi. It's definitely the first place I will be looking to expand in - by hiring more people and acquisitions as well."

Which fields would you be interested in here?

"Clearly, given Microsemi's presence in Israel, high performance mixed signal analog components is a natural choice for us. At any rate, I think there are companies in Israel that make a contribution to the aviation markets - both on the commercial and on the military side - and there are companies in the defense market. (Microsemi's traditional field of expertise, S.S.).

"I think that there are opportunities for integration between our power supply management components and existing military technologies in Israel. A large portion of the technologies in the US come from the military field, and were simply 'civilianized' for use in business applications. Correct me if I'm wrong, but I believe it works the same way in Israel too."

Rotem concurs eagerly. "There are companies in both the fields PowerDsine operates in - analog components and chips for the defense and aviation industries - which can contribute to our activity. And, incidentally, since the acquisition the team in Israel has suggested the company a number of opportunities in the field."

Buying us? Not on the cards

The success to which the Microsemi managers refer was seen in its results for its fiscal 2007, which ended two months ago. The company ended 2007 with sales of \$442 million, 20% growth compared with 2006. A significant part of the growth was delivered by the company's results in its connectivity and RF businesses, in which sales increased by 75% to \$60 million, as a result chiefly of the contribution made by PowerDsine. Microsemi's figures were also the cause of the 10% loss overnight in its market cap when it published its results in mid-November.

The book-to-bill ratio - a commonly-used method to measure supply versus demand in the chip market - that

Microsemi disclosed in its quarterly report troubled an analyst at Morgan Stanley, who cut his rating for its share. His counterparts at CIBC, on the other hand, called the same ratio "impressive" and reiterated their "Outperform" rating.

Either way, Microsemi realizes that there is scope for more expansion in the coming years. One source of satisfaction at present is the power-over-Ethernet (PoE) customer base that PowerDsine brought with it. It transpired, a month after the acquisition, that Cisco Systems Inc. (Nasdaq: CSCO), which reportedly controls 75% of the PoE market, had become a customer. "Our PoE business is excellent," claims Litchfield, when asked whether there was a chance that Cisco would expand its business with the company. "The relationship with Cisco has only just begun and it is proceeding according to plan."

Getting Cisco as a customer was just one of the new developments in PowerDsine's business over the past year. It also resumed work on its Midspan product range, a class of communications device whose development it halted as part of a change in strategy. Says Litchfield, "Essentially, as a small company, PowerDsine was faced with a tough decision, but when Microsemi took over the product line, we invested more R&D funds in it, and we're really very pleased with its performance. We expect it to continue growing over the next 3-5 years. Part of the issue is simply the difference between a small company and a larger one. Not only is Midspan alive, but it also made a sizable contribution to the success of our activity this year."

Were you surprised by the product's comeback?

"Not really. When we entered the company, we realized that we had to rearrange our R&D funding around this."

Rotem: "As a small company on Nasdaq, we had to decide what we were - a chip producing company or a systems company. (Midspan is PowerDsine's systems solution, S.S.). Microsemi's platform was flexible enough to allow for more investment in the field."

There's a feeling that there is a shortage of analog engineers and lack of knowledge about the field in general. Have you also noticed this?

Peterson: "I think there are opportunities everywhere. If you have a company with the right technology which is headed in the right direction, you can bring people and perhaps train them to a certain degree. I wouldn't let it stand in our way."

Rotem: "30% of the people at PowerDsine attained the level of knowledge they possess through in-house training. I agree that people are bit apprehensive about this, but this is why Microsemi, for example, is so highly respected, because this is a field with very high entry barriers."

Jim, Microsemi, despite everything, is still a small company specializing in a highly technical field. Is there a chance that someone could acquire you?

Peterson (after a fairly long pause): "Well my friend, my answer is that it certainly won't happen today."

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