

# INSTITUTIONAL RESEARCH

## INDUSTRY: SEMICONDUCTOR CAPITAL EQUIPMENT

### *THE URGE TO MERGE*



**NEWCAP PARTNERS INC.**  
PRIVATE INVESTMENT BANKERS

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## THE THESIS

- Investors are focused primarily on the large-cap public companies in the semiconductor capital equipment industry.
- This focus on the large-cap public companies has led to a divergence in the valuations of the large-cap companies relative to their small-cap cousins.
- This divergence leads us to conclude that there will be more merger and acquisition transactions in the semiconductor capital equipment industry in the coming months.

## THE BACKGROUND

The disparity in relative valuations between large-cap public companies in the semiconductor capital equipment industry and their small-cap cousins has become more pronounced over the past eight months. While the financial press reports that the stock market continues to hit new highs, a more detailed analysis of the ongoing rally in equities reveals that the breadth has actually been quite narrow. This is also the case with companies in the semiconductor capital equipment sector.

The bull market in public equities has generated a tremendous amount of wealth over the last few years. Indeed, according to the Federal Reserve, the market value of equity holdings owned by U.S. households and non-profit organizations (including their holdings of equities owned by pension and mutual funds) increased from \$7.2 trillion at the end of 1996 to almost \$10.8 trillion at the end of 1998, an increase of 50%. This growing wealth must be reinvested, and investors are constantly on the lookout for new investment opportunities. It is difficult for investors to put this new wealth to work without having an impact on the market.

## THE REASONS

We believe there are three major factors that have influenced investors and their behavior in purchasing large-cap equities over smaller cap equities in general, and in the semiconductor capital equipment industry in particular. These factors are:

- *Larger absolute dollar investments*: Investors today are investing larger amounts of money in public equities. Investors have limited bandwidth in terms of following companies in their portfolios. As a result, they are making larger absolute dollar investments in individual companies.
- *Liquidity*: Liquidity is the ability to move into or out of a stock quickly and without significant impact on its market price. Investors with more absolute dollars to invest need to invest in large-cap companies where moving millions of dollars in or out will go unnoticed.
- *Government regulation*: Investors who acquire a beneficial ownership of 5% or more of a publicly traded company must report that position to the SEC pursuant to Section 13 (g) of the 1934 Act. Investors prefer to stay under that threshold rather than be burdened by this requirement. Thus, if one wants to invest \$5 million, the company must have a market cap of at least \$100 million; to invest \$10 million, it must have a market cap of at least \$200 million, and so on.

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These factors have led to a focus on large-cap companies, particularly in the semiconductor capital equipment sector.

## THE DATA

As investors have focused on those companies that meet the criteria of having adequate size and liquidity, we have observed a change in the relative valuations in large-cap versus small-cap companies in the semiconductor capital equipment industry, particularly over the past several months.

We analyzed 47 companies in the industry in order to validate our observations. Included in our analysis are global public semiconductor equipment, materials and related services companies which derive 50 percent of total revenues from the semiconductor, semiconductor-related or flat panel display markets and have a market capitalization of \$50 million or more as of December 31, 1998. The companies we analyzed are listed in Appendix A. Data used in our analysis was collected from Market Guide, annual reports, quarterly reports and SEC filings. For the purposes of consistency, a cut-off date of May 25, 1999 was established. The selected companies were separated into two groups:

- Large-Cap – Companies with a market capitalization of \$250 million and above
- Small-Cap – Companies with a market capitalization of under \$250 million

We looked at the relative valuations of both groups of companies and found that those in the small-cap group had relative values lower than the large-cap group.

We determined relative valuations of the companies by measuring their market cap with respect to:

- Revenues
- Net income
- EBIT
- Book value

The results of our analysis are summarized below:

	Small-Cap			Large-Cap		
	N	Revenues	Book Value	N	EBIT	Net Income
Small-Cap	20	1.43	1.55	4	10.05	14.83
Large-Cap	27	3.36	3.80	14	62.79	81.88

## CONCLUSION: THE URGE TO MERGE

The higher relative valuations of large-cap public semiconductor capital equipment companies lead us to the conclusion that there will be more mergers and acquisitions in this sector over the coming months. More specifically we see:

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- Large-cap public companies acquiring the small-cap companies in an effort to arbitrage the relative valuation differentials.
  - Two or more small-cap companies, seeking higher relative valuations, merging to become a large-cap company.
  - Private companies, which typically carry relative valuations below even the small-cap public companies, becoming attractive acquisition candidates to both small, and in particular, large-cap semiconductor capital equipment companies.

While opportunities exist to arbitrage the differing relative values, we believe that there will still need to be strong strategic underpinnings associated with these mergers and acquisitions. These strategic underpinnings could include:

- Product line expansion/diversification
- Sales organization leverage
- Manufacturing integration
- Administrative savings

Also pointing to more transactions in the near future is the pending death of pooling of interests accounting for acquisitions in 2000. In pooling of interests accounting, acquirers do not record goodwill (the difference between the purchase price and book value). Goodwill, which is created when using purchase rather than pooling accounting, decreases future reported earnings as it is amortized.

If you would like to discuss our conclusions and how they fit with your company's situation, please feel free to contact any of the individuals listed on the back of this report.

## **HIGHLIGHTS OF CURRENT MERGER ACTIVITY**

- Asyst Technologies, Inc. announced that it has completed its acquisition of Progressive System Technologies, Inc. The acquisition, originally announced on April 19, 1999, was accounted for as a pooling of interests and is valued at approximately \$11 million. – *June 3, 1999.*
- ATMI, Inc. today announced it acquired Delatech Incorporated on May 31st. ATMI issued 2.3475 million common shares in exchange for all Delatech shares in this pooling of interests deal. – *June 1, 1999.*
- SpeedFam International, Inc. and Integrated Process Equipment Corp. jointly announced today that the shareholders and stockholders of each company, respectively, have approved the merger agreement between the companies. Under the terms of the merger agreement announced on Nov. 19, 1998, each outstanding share of IPEC common stock is being exchanged for 0.71 shares of SpeedFam common stock. – *April 6, 1999.*
- Applied Science and Technology, Inc. (ASTeX) reported it has completed the acquisition of Klee Corporation in exchange for 310,604 shares of ASTeX common stock. The acquisition will be accounted for as a pooling of interests business combination. – *April 5, 1999.*

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## APPENDIX A

### Semiconductor Capital Equipment Companies

Name	Symbol
ADE Corporation	ADEX
Advanced Energy Industries	AEIS
Aetrium	ATRM
Align-Rite International, Inc.	MASK
Amkor Technology, Inc.	AMKR
Applied Materials	AMAT
Applied Science & Technology	ASTX
Asyst Technologies	ASYT
ATMI, Inc.	ATMI
Brooks Automation	BRKS
Cerprobe	CRPB
CFM Technologies	CFMT
Cognex Corporation	CGNX
Coherent, Inc.	COHR
Cohu, Inc.	COHU
Credence Systems	CMOS
Cymer, Inc.	CYMI
DuPont Photomasks	DPMI
Electro Scientific Industries	ESIO
Electroglas Incorporated	EGLS
Emcore	EMKR
Etec Systems, Inc.	ETEC
FSI International	FSII
Gasonics International	GSNX
Helix	HELX
Integrated Measurement Systems	IMSC
Keithley Instruments	KEI
KLA-Tencor	KLAC
Kulicke and Soffa	KLIC
Lam Research	LRCX
LTX Corporation	LTXX
Mattson Technology	MTSN
MEMC Electronic Materials	WFR
Micrion Incorporated	MICN
Nanometrics	NANO
Novellus Systems	NVLS
Photronics	PLAB
PRI Automation	PRIA
Robotic Vision Systems	ROBV
Semitool	SMTL
Silicon Valley Group	SVGI
SpeedFam-IPEC, Inc.	SFAM
Teradyne	TER
Ultratech Stepper	UTEK
Veeco Instruments Incorporated	VECO
Watkins-Johnson	WJ
Zygo Corp	ZIGO



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NewCap Partners, founded in 1987, is a private investment banking firm located in Los Angeles, California, (USA) which focuses on serving the corporate finance needs of emerging companies. NewCap Partners is a “broker-dealer” registered with the U.S. Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD).

NewCap Partners provides specialized strategic merger, acquisition and divestiture services to buyers and sellers. NewCap Partners privately places debt and equity securities for its clients to finance expansion, acquisitions, buyouts, recapitalizations and reorganizations. NewCap Partners also specializes in business transactions in the Greater China Region. NewCap Partners is staffed by a team of senior, experienced, professional investment bankers. For additional information on NewCap Partners visit our website at [www.newcap.com](http://www.newcap.com) or contact any of the individuals listed below.

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