יועצי השקעות ישראל

Israel Investment Advisors

Intel Acquires Mobileye

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March 31, 2017

On March 13th Intel announced the largest ever acquisition of an Israeli technology company. The $15.3 billion deal for Mobileye leapfrogs Intel into a leading position in the race toward self-driving cars. Mobileye uses a single camera mounted on a windshield to capture visual information along the road in a similar fashion to a human eye. The data is processed using sophisticated algorithms embedded onto a computer chip. By using commonly available cameras, Mobileye's system is cost effective for many automobile buyers.

Mobileye is already a leading supplier to the automotive industry for camera-based "Advanced Driver Assistance Systems" (ADAS). ADAS provide safety features to avoid collisions through alerts or safeguards that take control of the vehicle in certain situations. Mobileye and other automobile industry participants believe current ADAS products lay the groundwork for fully autonomous vehicles in the future. Bain & Co. estimates the market for self-driving car technologies will be $25 billion by 2025, and Intel believes the broader market for "vehicle systems, data and services" could reach $70 billion by 2030.

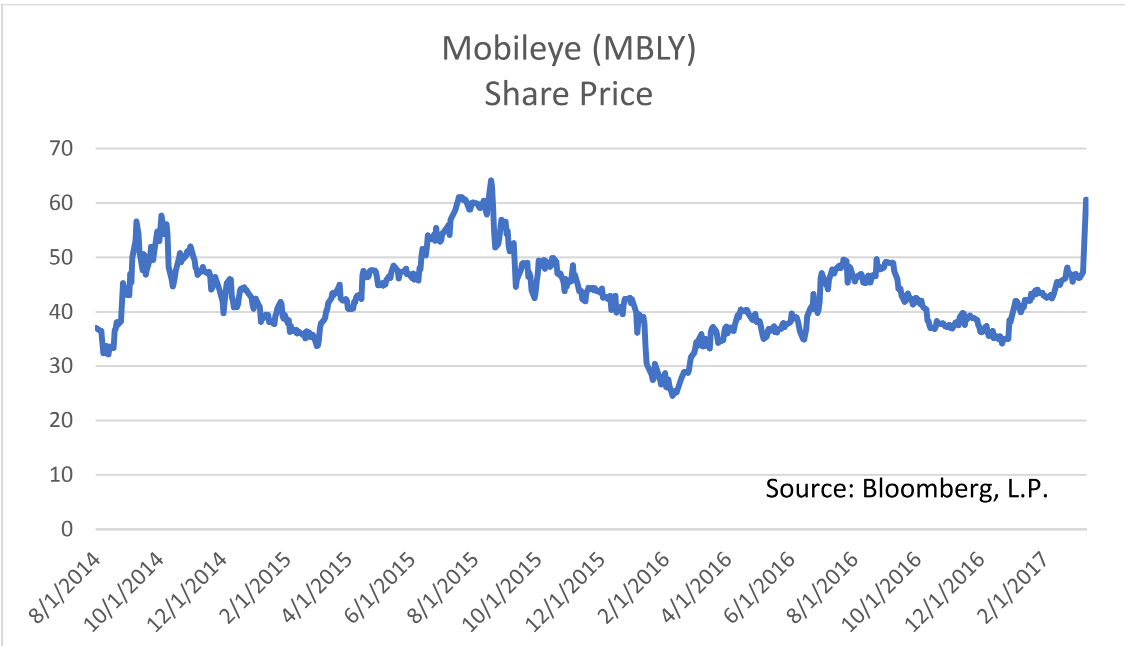
Mobileye is an Exciting Business, but a Richly Valued Stock

Even though the market for camera-based automobile safety technologies is in its infancy, Mobileye is already a very profitable business with strong growth. Mobileye's revenues last year were $358 million with net income of $108 million. Revenues in 2016 were 48.7% higher than the $241 million generated in 2015, and profits soared by 58%. Analysts estimate Mobileye's revenues will hit $500 million in 2017 and $729 million in 2018. They expect earnings to triple over the next two years.

Although Mobileye priced its IPO after the stock market closed on July 31, 2014 for $25 per share, the opening trade on August 1st was for $36.41. At first glance Mobileye's brief tenure as a public company looks quite profitable for shareholders. Based on Intel's all-cash offer of $63.54 per share, those lucky enough to own shares at the IPO price will gain 154% over 3 years when the deal closes this autumn. An investor who purchased the shares on the first day of trading for $37 will return 71.7%.

Figure 1 puts Mobileye's share price history into a little different perspective. Despite the company's phenomenal growth, significant profitability and astounding long-term prospects, its shares were not clear winners prior to Intel's acquisition. Even at Intel's acquisition price, the three-year trend is mixed. Figure 2 helps us understand why.

Figure 1



On December 31, 2014 Mobileye's stock closed the year at $40.56 per share. Mobileye lost money on an accounting basis, but still produced positive operating cash flow. The market value of the company was 78 times higher than its cash flow. Imagine a small business where the owner pockets $100,000 per year in cash. Now imagine a chump comes along and pays the owner $7.8 million to buy it.

One year later Mobileye's stock still only sold for $42.28, and a year after that – December 31, 2016 – its share price fell to $38.12. By this time, Mobileye stock sold for 83 times earnings (its P/E multiple) and 51.9 times cash flow (P/CF). The day prior to Intel's announcement, Mobileye stock closed at $47 per share.

During most of its tenure as a publicly traded company, Mobileye's exciting growth story was fully reflected in its very high market valuation. Despite our own excitement and astonishment that an Israeli company is a world leader in autonomous driving, we nonetheless maintained discipline regarding our investment strategy. Figure 2 compares Mobileye's valuation statistics with the averages for Israel's leading stock index – the Tel-Aviv Stock Exchange 125 Index (TA-125).

During the time period displayed, Mobileye's P/E averaged 105 and its P/CF 76, while the TA-100's averaged 17 and 9 respectively. The arithmetic of a boring, slow-growth company selling for a P/CF of 9 implies an annual investment return of 11%. The Israeli stock market contains quite a few interesting growth companies selling at modest valuations.

Figure 2

	Mobileye, NV			Tel-Aviv 125 Index	
Year End	**P/E**	**P/CF**		**P/E**	**P/CF**
2014	Loss	78.0		20.4	15.7
2015	145.5	91.1		16.4	7.1
2016	83.0	51.9		18.2	6.8
Current	135.3	82.7		18.8	7.0
2017E	58.3	NA		11.8	NA

Intel May be Betting the Entire Company on Israeli Innovation

Not only did Intel announce the acquisition of Mobileye, but they will also relocate their entire automotive technology division to Israel led by Mobileye's CEO Amnon Shashua. The automobile business is one of the most globalized, capital-intensive and large-scale industries. Israel is a small country of 8 million people without any local automobile production. The Israeli government imposes a 95% sales tax on each car sold. At first blush Israel looks like a highly inhospitable environment for an automotive supplier.

Intel began operations in Israel in 1974 and currently employs 10,000 Israelis. Several of its best-selling processors were designed and manufactured in Israel. With Personal Computer (PC) sales dimming and computer chips for autonomous vehicles promising to be a very large market, Intel may be betting the company's future on Israel.

Mobileye is exciting, but we only buy shares if the price is right. Risks abound in Mobileye's business. Alternative technologies such as Radar or Lidar (using microwaves or lasers to acquire vehicle information) once seemed superior to Mobileye's camera based system, but they are quite expensive. Perhaps innovation will drive their cost lower. Self-driving cars might hit other technological, regulatory or consumer roadblocks that delay deployment. Long delays can impair valuations of high-flying stocks just as much as unexpected competition or product failures.

Israel is a hotbed of exciting start-ups and promising growth stories. As professional stock market investors, it is our job to feel the excitement without letting it unduly influence our decisions. Often a company with modest growth selling at a fair price will deliver superior returns at lower risk when compared to an exciting, but highly valued growth story. We love Mobileye's story, but we did not - and would not - invest in their stock.