

Nova Measuring Instruments Ltd.

BUY

(NVMI - \$27.25 - intra-day)

Price Target: \$30

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Strong Results And Solid Guidance Given Macro Backdrop; Maintaining BUY Rating And \$30 PT

We have the following takeaways from Nova's earnings report:

- **Guidance Relatively Solid** – While the midpoints of revenue and EPS guidance fell slightly short of consensus estimates, we look for investors to quickly overlook this given the general softness in the semi cap equipment space.
- **Near-Term Gross Margin Headwinds But Improvement Next Year** – Q2 gross margin was 56.0%, down from 56.5% in Q1, and is expected to decline to 54% in Q3. The expected softness is due to unfavorable mix, higher sales of new products, lower volume, and facility costs. However, we believe margins should begin to improve beyond Q3.
- **What To Do With The Stock** – Although 2019 is still set to be a transition year, we are encouraged the Company is seeing improving demand in advanced logic in the foundry market. We believe this commentary should give investors confidence a meaningful rebound in growth is still set for 2020. We are maintaining our BUY rating and \$30 price target (14.5x '20 pro forma EPS plus cash/share).

HIGHLIGHTS

- **Q2 Results Beat Estimates** – Nova reported revenue of \$51.1M (LSCM: \$49.0M/consensus: \$49.9M) and pro forma EPS of \$0.32 (LSCM: \$0.26/consensus: \$0.27). The Company had guided for revenue to be in the range of \$45-\$53M and for pro forma EPS of \$0.17-\$0.35.

	Q2	LSCM	Consensus	Company
	Reported	Estimates	Estimates	Guidance
Revenue (M)	\$51.1	\$49.0	\$49.9	\$45 - \$53
Pro Forma EPS	\$0.32	\$0.26	\$0.27	\$0.17 - \$0.35

- **Q3 Guidance** – Nova guided for Q3 revenue to be in the range of \$46-\$54M (LSCM: \$55.7M/consensus: \$53.0M) and for pro forma EPS of \$0.20-\$0.34 (LSCM: \$0.36/consensus: \$0.31).

	Q3	New LSCM	Previous LSCM	Consensus
	Guidance	Estimates	Estimates	Estimates
Revenue (M)	\$46 - \$54	\$50.0	\$55.7	\$53.0
Pro Forma EPS	\$0.20 - \$0.34	\$0.27	\$0.36	\$0.31

Changes	Previous	Current
Rating:	--	BUY
Price Target:	--	\$30
FY19E Rev. (M):	\$222.8	\$210.9
FY20E Rev. (M):	\$262.7	\$240.3
FY19E Adj. EPS:	\$1.45	\$1.24
FY20E Adj. EPS:	\$1.91	\$1.62

Profile

Price (intra-day):	\$27.25
Shares Out. (M):	28.6
Market Cap. (M):	\$779
Enterprise Value (M):	\$601
Avg. Daily Vol. (M):	0.1
Insiders Own:	1%
Short Int. (M) / % of Float:	0.2 / 1%
Book Val. / Sh.:	\$10.43
Net Cash / Sh.:	\$6.38
Div. / Yield:	NA / NA

Rev. (M)	2018A	2019E	2020E
Mar	\$62.6	\$56.7A	--
Jun	\$61.9	\$51.1A	--
Sep	\$63.6	\$50.0	--
Dec	\$63.1	\$53.1	--
FY	\$251.1	\$210.9	\$240.3
Y/Y Growth	13.1%	-16.0%	14.0%
AEBITDA (M)	\$75.1	\$47.4	\$62.3

Adj. EPS	2018A	2019E	2020E
Mar	\$0.54	\$0.37A	--
Jun	\$0.46	\$0.32A	--
Sep	\$0.52	\$0.27	--
Dec	\$0.59	\$0.29	--
FY	\$2.11	\$1.24	\$1.62

Valuation	2018A	2019E	2020E
EV/S	2.4x	2.8x	2.5x
EV/EBITDA	8.0x	12.7x	9.6x
P/E	12.9x	22.0x	16.8x

Management

CEO	Eitan Oppenheim
CFO	Dror David

Company Description

Nova Measuring Instruments designs, manufactures, and sells optical and x-ray metrology systems that help manufacturers improve quality, productivity, and yields within the semiconductor manufacturing process.

- **Product Segment** – Product revenue was \$37.4M (73% of rev), down 15% q/q from \$44.1M (78% of rev) in Q1, and down 18% y/y. The Company had four 10% customers. Foundry revenue was around \$13M (35% of product rev), down 41% q/q from \$22M (50% of product rev) in Q1, and down 43% y/y. The Company noted it is seeing improving demand for 7nm and 5nm from its large foundry customer. Memory revenue was approximately \$24M (65% of product rev), up 10% q/q from \$22M (50% of product rev) in Q1, and up 6% y/y.
- **Service Segment** – Service revenue was \$13.7M (27% of rev), up 9% q/q from \$12.6M (22% of rev) in Q1, but down 15% y/y.
- **Margins** – Q2 gross margin was 56.0%, down from 56.5% in Q1, but in-line with guidance of 56%. We had been modeling for 55.9%. The Company guided for Q3 gross margin to be 54% compared to our previous estimate of 56.1%. The softer outlook is due to unfavorable mix, higher sales of new products, lower volume, and facility costs. The Company's long-term gross margin target continues to be 56%-59%. Operating margin was 18.3%, down from 19.7% in Q1, but above our 15.7% estimate.
- **Balance Sheet** – The Company exited Q2 with a cash and investment position of \$177.7M and no debt, translating to cash per share of \$6.38. This compares to cash per share of \$6.85 exiting Q1. The Company reported a book value per share of \$10.43.

ESTIMATE CHANGES

We are adjusting our Q3 estimates to reflect the Company's guidance and are now modeling for revenue of \$50.0M (previously: \$55.7M) and for pro forma EPS of \$0.27 (previously: \$0.36).

For 2019, we are now modeling for revenue of \$210.9M (previously: \$222.8M) and for pro forma EPS of \$1.24 (previously: \$1.45).

For 2020, we are now modeling for revenue of \$240.3M (previously: \$262.7M) and for pro forma EPS of \$1.62 (previously: \$1.91).

INVESTMENT THESIS & VALUATION

We think Nova Measuring Instruments remains an overlooked, underfollowed company positioned to benefit from the growing unit volume and rising complexity of the semiconductor market. Nova has outlined a goal of reaching \$300M in annual revenue organically. While management has not designated a date to achieve this, we believe the Company is well-positioned to hit this goal as it will benefit from the overall growth of the semiconductor market and the increasing complexity of the manufacturing process within this space

VALUATION

Our \$30 price target is based on a P/E multiple of approximately 14.5x using our 2020 pro forma EPS estimate of \$1.62 plus the Company's cash per share of \$6.38.

RISKS

We believe an investment in Nova Measuring Instruments involves the following risks.

- **Competition** – The Company faces a high level of competition from numerous other technology companies, some of which have both much larger scale and

resources than it. The ability of the Company to keep pace with the technical innovations of the industry is imperative for it to win designs and be successful.

- **Business Can Be Lumpy** – Given the spending habits by its customers, orders can sometimes be lumpy. This lumpiness may cause increased volatility in the Company’s quarterly results.
- **Cyclical** – The Company’s results can see significant volatility due to the cyclical nature of the overall semiconductor capital equipment industry. This could lead to the Company’s results seeing meaningful swings quarter to quarter.
- **International Revenue** – The Company derives a significant portion of its revenue from outside the U.S. In 2018, approximately 92% of its revenue came from outside the Americas. This could potentially create additional risk for the Company.
- **End Market Growth** – The Company’s future growth prospects are contingent on the continued growth of the semiconductor market. If the worldwide semiconductor market slows or declines, the Company’s results will be negatively impacted.
- **Domiciled In A Foreign Country** – The Company is headquartered in Israel which exposes it to potential additional risks that a U.S.-domiciled company may not face. These risks include political, economic, and legal risks associated with operating in Israel. In addition, the Company may be impacted by its personnel being obligated to perform military service.

FINANCIAL MODEL

Jaeson Schmidt

Lake Street Capital Markets, LLC

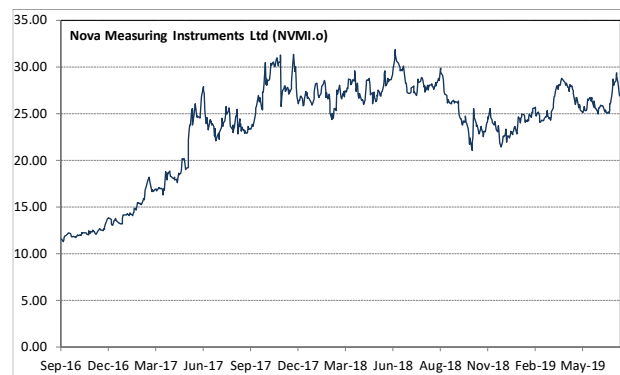
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Nova Measuring Instruments

	2016	2017	2018				2019E				2020E		
			1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			
<i>(in 000s, except per share data)</i>													
Products Revenue	122,439	174,343	50,185	45,784	48,953	48,376	193,298	44,061	37,401	36,000	38,500	155,962	179,600
Service Revenue	41,464	47,649	12,418	16,104	14,618	14,696	57,836	12,596	13,719	14,000	14,600	54,915	60,700
Total Revenues	163,903	221,992	62,603	61,888	63,571	63,072	251,134	56,657	51,120	50,000	53,100	210,877	240,300
Total Cost of Revenue	73,299	90,167	26,075	25,982	25,821	27,093	104,971	24,627	22,517	23,020	24,177	94,341	106,499
Total Gross Profit - Pro Forma	90,604	131,825	36,528	35,906	37,750	35,979	146,163	32,030	28,603	26,980	28,923	116,536	133,801
Research & Development	34,015	37,901	10,886	11,463	11,402	9,990	43,741	12,584	11,654	12,000	12,100	48,338	49,200
Sales & Marketing	19,852	23,129	6,012	7,183	6,731	7,041	26,967	7,146	6,641	6,900	6,950	27,637	28,800
General & Administrative	6,527	7,636	2,126	1,992	1,960	1,995	8,073	2,522	2,384	2,400	2,450	9,756	9,950
Total Operating Expenses - Pro Forma	60,394	68,666	19,024	20,638	20,093	19,026	78,781	20,872	19,259	19,800	20,000	79,931	82,350
Operating Profit (Loss) - Pro Forma	30,210	63,159	17,504	15,268	17,657	16,953	67,382	11,158	9,344	7,180	8,923	36,605	51,451
Adjusted EBITDA	37,026	69,338	19,072	17,234	19,657	19,103	75,066	13,858	12,114	9,780	11,684	47,436	62,265
Financing Income	1,216	2,276	448	486	872	1,178	2,984	994	1,150	1,000	1,000	4,144	4,000
Pre-Tax Income (Loss)	31,426	65,435	17,952	15,754	18,529	18,131	70,366	12,152	10,494	8,180	9,923	40,749	55,451
Income Tax Expense (Benefit)	1,105	10,031	2,522	2,411	3,449	1,217	9,599	1,703	1,487	409	1,488	5,087	8,318
GAAP Net Income (Loss)	9,644	46,459	14,080	11,833	13,310	15,152	54,375	7,756	6,468	5,221	6,334	25,779	38,333
GAAP EPS	\$0.35	\$1.63	\$0.49	\$0.41	\$0.46	\$0.53	\$1.89	\$0.27	\$0.23	\$0.18	\$0.22	\$0.90	\$1.32
Pro Forma Net Income (Loss)	30,321	55,404	15,430	13,343	15,080	16,914	60,767	10,449	9,007	7,771	8,434	35,661	47,133
Pro Forma EPS	\$1.10	\$1.94	\$0.54	\$0.46	\$0.52	\$0.59	\$2.11	\$0.37	\$0.32	\$0.27	\$0.29	\$1.24	\$1.62
Diluted Shares Outstanding	27,503	28,524	28,739	28,766	28,777	28,655	28,765	28,580	28,564	28,700	28,800	28,661	29,050
Margin Analysis													
Products Revenue	74.7%	78.5%	80.2%	74.0%	77.0%	76.7%	77.0%	77.8%	73.2%	72.0%	72.5%	74.0%	74.7%
Services Revenue	25.3%	21.5%	19.8%	26.0%	23.0%	23.3%	23.0%	22.2%	26.8%	28.0%	27.5%	26.0%	25.3%
Total Cost of Revenue	44.7%	40.6%	41.7%	42.0%	40.6%	43.0%	41.8%	43.5%	44.0%	46.0%	45.5%	44.7%	44.3%
Total Gross Margin	55.3%	59.4%	58.3%	58.0%	59.4%	57.0%	58.2%	56.5%	56.0%	54.0%	54.5%	55.3%	55.7%
Research & Development	20.8%	17.1%	17.4%	18.5%	17.9%	15.8%	17.4%	22.2%	22.8%	24.0%	22.8%	22.9%	20.5%
Sales & Marketing	12.1%	10.4%	9.6%	11.6%	10.6%	11.2%	10.7%	12.6%	13.0%	13.8%	13.1%	13.1%	12.0%
General & Administrative	4.0%	3.4%	3.4%	3.2%	3.1%	3.2%	3.2%	4.5%	4.7%	4.8%	4.6%	4.6%	4.1%
Total Operating Expenses	36.8%	30.9%	30.4%	33.3%	31.6%	30.2%	31.4%	36.8%	37.7%	39.6%	37.7%	37.9%	34.3%
Operating Margin	18.4%	28.5%	28.0%	24.7%	27.8%	26.9%	26.8%	19.7%	18.3%	14.4%	16.8%	17.4%	21.4%
Adjusted EBITDA Margin	22.6%	31.2%	30.5%	27.8%	30.9%	30.3%	29.9%	24.5%	23.7%	19.6%	22.0%	22.5%	25.9%
Tax Rate	3.5%	15.3%	14.0%	15.3%	18.6%	6.7%	13.6%	14.0%	14.2%	5.0%	15.0%	12.5%	15.0%
Net Margin - Pro Forma	18.5%	25.0%	24.6%	21.6%	23.7%	26.8%	24.2%	18.4%	17.6%	15.5%	15.9%	16.9%	19.6%
Growth Analysis (Q/Q)													
Products Revenue			12.1%	-8.8%	6.9%	-1.2%		-8.9%	-15.1%	-3.7%	6.9%		
Services Revenue			-1.6%	29.7%	-9.2%	0.5%		-14.3%	8.9%	2.0%	4.3%		
Total Revenue			9.1%	-1.1%	2.7%	-0.8%		-10.2%	-9.8%	-2.2%	6.2%		
Growth Analysis (Y/Y)													
Products Revenue	10.1%	42.4%	15.3%	1.8%	19.1%	8.1%	10.9%	-12.2%	-18.3%	-26.5%	-20.4%	-19.3%	15.2%
Services Revenue	11.1%	14.9%	13.8%	44.1%	13.0%	16.4%	21.4%	1.4%	-14.8%	-4.2%	-0.7%	-5.1%	10.5%
Total Revenue	10.4%	35.4%	15.0%	10.3%	17.6%	9.9%	13.1%	-9.5%	-17.4%	-21.3%	-15.8%	-16.0%	14.0%
Key Balance Sheet Metrics													
Cash & Short-Term Investments			\$160,666	\$167,661	\$169,567	\$175,828		\$191,457	\$177,726				
Debt			0	0	0	0		0	0				
Net Cash			\$160,666	\$167,661	\$169,567	\$175,828		\$191,457	\$177,726				
Shareholder Equity			241,661	254,570	269,262	280,740		290,009	290,608				
Book Value/Share			\$8.66	\$9.10	\$9.60	\$10.02		\$10.38	\$10.43				
Net Cash/Share			\$5.76	\$5.99	\$6.05	\$6.27		\$6.85	\$6.38				

IMPORTANT DISCLOSURES



Source: Thomson Eikon

Initiate: March 26, 2018 – Rating: BUY - Price Target: \$33
 August 1, 2018 – Rating: BUY - Price Target: \$31
 November 1, 2018 – Rating: BUY - Price Target: \$30
 February 13, 2019 – Rating: BUY - Price Target: \$28
 May 1, 2019 – Rating: BUY - Price Target: \$30

RATINGS DEFINITION

BUY rated stocks are expected to generate greater than 10% returns during the next 12 months. **HOLD** rated stocks are expected to generate returns of 0% to 10% during the next 12 months. **SELL** rated stocks are expected to generate negative returns over the next 12 months and generally do not have a price target.

Information on our valuation methodology and risks can be found in the “Investment Thesis & Valuation” and “Risks” sections above.

RATINGS DISTRIBUTION

(as of June 3, 2019)

Rating	All Covered Investment Banking Companies (%)	Clients (%)
BUY	86.5%	17.8%
HOLD	13.5%	0.0%
SELL	0.0%	0.0%

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