



Ultra Clean Holdings (UCTT)

In our *Little Known Stocks* report, we highlight a company that may not be on the traditional radar of most investors. We probably wouldn't be adding much value if we highlighted a large-cap name that already has coverage from 50+ analysts, so this report will focus on stocks that we come across in our day-to-day research that have interesting or unique business models with very little analyst coverage. As always, this report is not a recommendation to buy or sell any specific securities, and investors should do their own research and/or work with a professional when making investment decisions. Highlighting a stock doesn't mean we are bullish or bearish on it. Our goal is simply to provide readers with facts to help them make informed decisions rather than just opinions.

“During the gold rush, most would-be miners lost money, but people who sold them picks, shovels, tents and blue-jeans made a nice profit.” – Peter Lynch

Picking winners in a growing space flooded with competition can prove to be a daunting practice. Although some investors have struck gold doing so, many more have come up empty (or even worse) in the process. However, those who stick to the less-growth-oriented, but safer equipment suppliers, tend to reap healthy rewards.

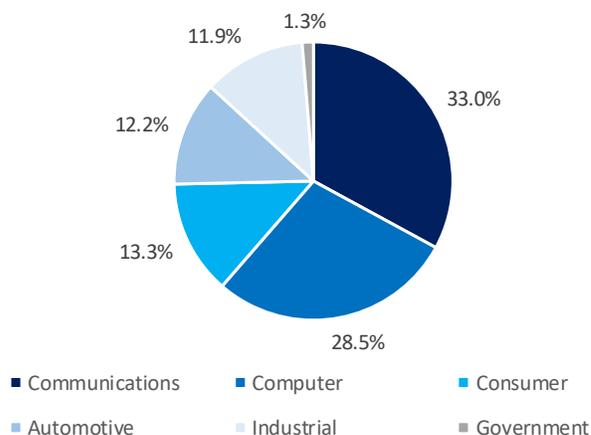
The semiconductor industry is a perfect example of this. It is no secret that semiconductors are here to stay, and one could pick from the numerous manufacturers and competitors in the sector such as **NVIDIA (NVDA)**, **Broadcom (AVGO)**, **Intel (INTC)**, **Texas Instruments (TXN)**, **Qualcomm (QCOM)**, **Marvell Technology (MRVL)**, **Advanced Micro Devices (AMD)**, or **Analog Devices (ADI)**.

Combined, these companies have a market cap of around \$2 trillion, but if you look at their stock prices, they've all seen varying degrees of success (or failure), so picking the winners among so many can be tough.

There are a variety of end markets for semiconductors, and the chips have become intertwined with our daily lives. Most of the technology we use daily involves semiconductors in one way or another. To illustrate just how reliant we are on this technology, check out [the quotes we picked out](#) from the earnings reports we covered to

see the rhetoric around the global chip shortage to understand how widely chips are used across the economy. The chart below is derived from data published by the Semiconductor Industry Association (SIA) in its [2020 State of the US Semiconductor Industry](#) report. The semiconductor industry has exposure to a variety of end markets and that exposure isn't likely to disappear any time soon.

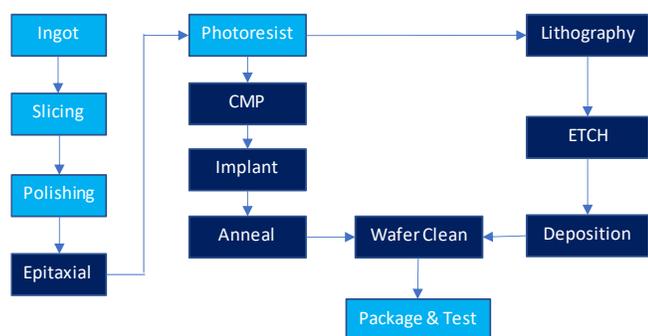
US Semiconductor End-Market Percentage of Demand



Although the industry is strong and has diversified exposure, the space is flooded with competition. In addition, there is a constant need to innovate, which significantly impacts bottom-line earnings due to high requisite levels of R&D and Capex spending. Therefore, taking a pick-and-shovels approach to the industry is an interesting alternative.



Ultra Clean Holdings (UCTT) has a market cap of under \$2.5B and is covered by only 6 analysts. UCTT, together with its subsidiaries, supplies semiconductor production equipment to manufacturers throughout the entire production process. According to the firm’s most recent 10-Q, “UCTT offers its customers an integrated outsourced solution for major subassemblies, improved design-to-delivery cycle times, design for manufacturability, prototyping and part and component manufacturing, as well as tool chamber parts cleaning and coating, and micro-contamination analytical services.” The process of creating semiconductors is divided into three stages: prep, front-end processing, and back-end processing. UCTT is involved in the prep and front-end processing phase and leaves the back-end processing (packaging and testing) to third parties.

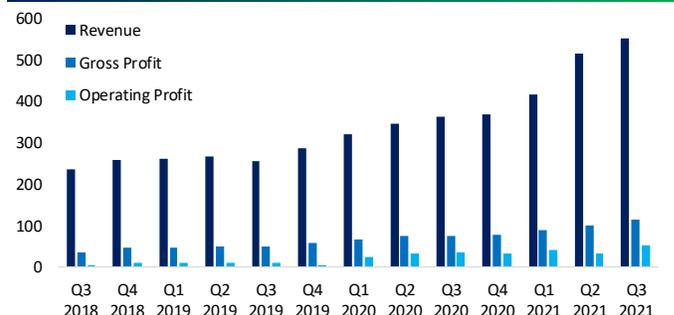


■ =UCTT Markets
■ =No Exposure

Over the last three years, UCTT has seen strong growth on both the top and bottom lines. The margins for the products segment of the business have seen substantial improvement as the company scales out. Since Q3 2019, operating margins have increased by 2.8x and have increased by over 23x since Q3 2018. In the most recent quarter, operating margins came in at 9.1%, and gross margins were 20.3%, which is only a 6-basis point increase y/y. Margins have begun to flatten out and currently are within the bound of management’s target and estimates. Based on the business model, UCTT management expects gross margins to be consistently between 18-21% when revenues range between \$1.5-2.0B. With revenues in this range, operating margins are expected to be between 9-12%. With LTM revenues of

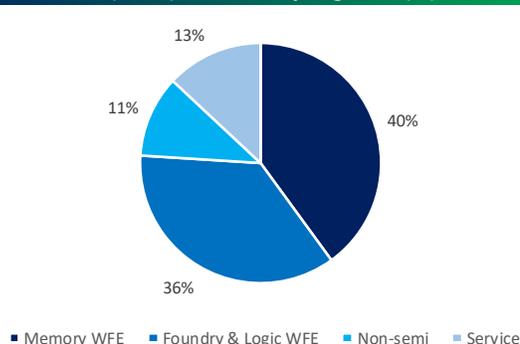
\$1.86B, UCTT is on the upper end of the revenue range. Based on management guidance, margins increase as revenues increase, and over the last twelve quarters, there has only been one quarter (Q3 2019) that saw a sequential decline in revenues. 2021 has been a particularly strong year, and Q3 revenues increased by 52.4% y/y and 117.7% on a two year basis.

Ultra Clean (UCTT) Quarterly Revenues and Profits: Last 3 Years



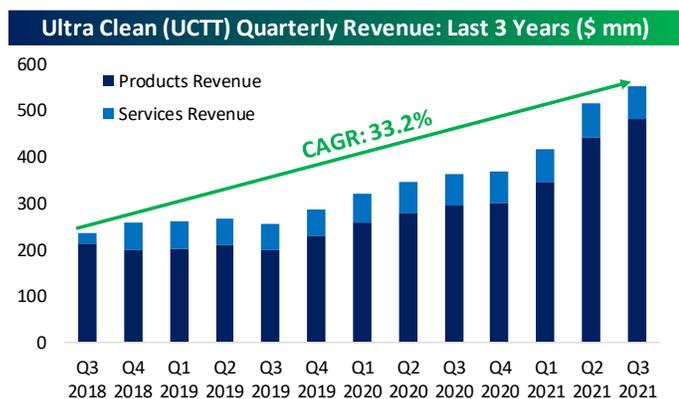
UCTT generates revenue through four segments: memory wafer fabrication equipment (WFE), foundry & logic WFE, non-semi, and service. In Q3 2021, UCTT generated the vast majority of its revenue from the two semiconductor equipment segments. Within these two segments, almost all the revenue originated from Lam Research (LRCX), and Applied Materials (AMAT), who collectively accounted for approximately 62% of total revenues. Moving forward, UCTT aims to diversify its customer base by leveraging its new device markets, such as 5G, IoT, and automotive while also increasing the penetration of LRCX and AMAT.

Ultra Clean (UCTT) Revenue by Segment (%): Q3 2021





In UCTT’s filings, revenues are broadly broken into “products” and “services”. 87% of revenues were generated from products in Q3 2021, and 13% originated through services. On a segment basis, the products segment has grown at a CAGR of 31.6%, while the services segment has grown at a CAGR of 47.1%. Gross and operating profits for both segments have increased at a higher 3-year CAGR than revenue, which illustrates the scalability of the business.



Ultra Clean (UCTT) Growth by Segment

3 Year CAGR	Products	Services
Revenue	31.6%	47.1%
Gross Profit	47.1%	52.5%
Operating Profit	139.2%	70.1%

According to the Q3 investor presentation, the total addressable market for UCTT is approximately \$590B. This combines the fabrication, original equipment manufacturing, and products division. This number seems high, especially when comparing this data to estimates published by [Verified Market Research \(VMR\)](#). VMR estimated that the semiconductor manufacturing equipment market was worth approximately \$47.28B in 2019 and is forecasted to reach \$76.85B in the year 2027, which represents a CAGR of 6.26%. In 2021, the semiconductor machinery market is expected to grow at a CAGR of 8.7%, according to [Research and Markets](#) after growing 19% in 2020, according to [Semi](#). Since the start of 2020, UCTT quarterly revenues have grown at a quarterly compounded growth rate of 8.10%, which outpaces the growth of the market. On a CAGR basis this works out to 36.57%, implying that UCTT has increased its market share over the last seven quarters.

The broader semiconductor market is expected to grow at a slightly higher CAGR (7.70%) than the semiconductor manufacturing equipment industry to reach \$778B in 2026, according to [Lucentel](#). Although overall market growth is projected to be modest, UCTT has a proven pattern of circumventing moderate market growth through penetration on a customer and market basis.

Semiconductor Manufacturing Equipment Projected Market Size (\$ bn)



Since its IPO on March 25, 2004, UCTT has returned over 600%. However, it wasn’t always sunshine and rainbows, and in October of 2016, UCTT was still trading around its IPO price. Over the next year, the stock proceeded to gain over 350%, reaching a peak of \$33.74. Following this peak, UCTT fell back down to its IPO level over the following year and a half, falling 79.3%. Since this drop, the stock has returned over 600%, and over 800% on a trough-to-peak basis. Volatility is embedded into UCTT, and the standard deviation over the last two years is 13.5 with an average price of \$33.67. The stock is currently 13.5% off of its all time highs, which it reached on April 5, 2021.

Ultra Clean (UCTT) Price History Since IPO (3/25/2004 - 11/3/2021)





On a technical basis, UCTT has recently broken above the top of a six-month downtrend channel it had been in. Traders will now look for a continued series of higher highs and higher lows, with the top of the prior downtrend channel acting as support going forward. Currently, UCTT is more than two standard deviations above its 50 DMA, which insinuates that the stock is short-term overbought. The recent move upwards comes on the back of UCTT's Q3 earnings report, in which it beat on revenue and EPS estimates while simultaneously raising guidance, thus resulting in a triple play.

Ultra Clean (\$UCTT) Historical Stock Chart

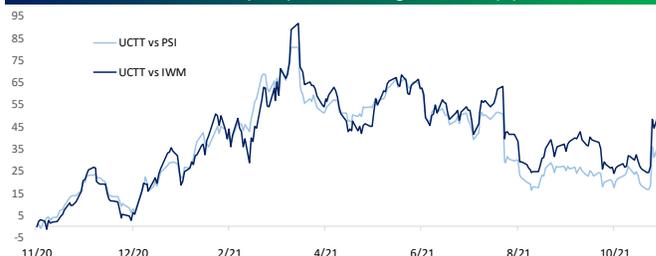
Date: 2021-06-24 O: 52.69 H: 54.10 L: 52.53 C: 54.08 Vol: 321.2K
 SMA (50) 52.74 SMA (200) 40.41 BB(close, 50, 2, sma) 59.56, 52.74, 45.92
 BB(close, 50, 1, sma) 56.15, 52.74, 49.33



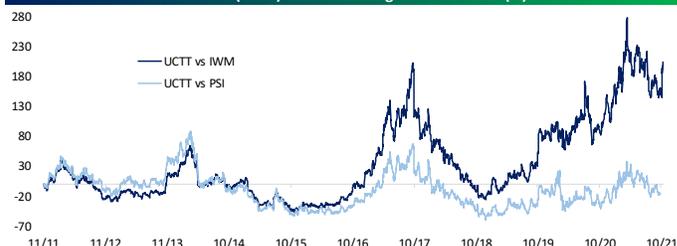
On a relative basis, UCTT has outperformed its market cap sector (small Caps) and specific industry (semiconductors) over the last year. For the broader semi's industry, we used the Invesco Dynamic Semiconductors ETF (PSI), and for the Russell 2000, we used the iShares Russell 2000 ETF (IWM). Over the last year, UCTT has outperformed PSI and IWM by 39.7 and 54.1 percentage points, respectively.

Over the last decade, UCTT has outperformed IWM by slightly over 200 percentage points but has underperformed PSI by just under 18 percentage points. The performance difference between UCTT and PSI tends to be much more muted than the differences with the broader market.

Ultra Clean (UCTT) Relative Strength: Last Year (%)



Ultra Clean (UCTT) Relative Strength: Last Decade (%)



In terms of financial health and operational efficiency, UCTT has performed worse than its competitors, with return on equity (ROE), return on assets (ROA), and return on invested capital (ROIC) all lower than the average of its competitors. Perhaps most importantly, ROIC is less than the weighted average cost of capital, which acts as a hurdle rate for ROIC. On the other hand, revenue growth on both a one and five year basis outpace that of its competitors. Although net income margin is less than half of that of its competitors, UCTT is investing in growth and expansion, which can suppress bottom-line earnings. When looking at financial health, UCTT does not have any outstanding areas of concern, as EBITDA sufficiently covers net debt and total debt is only 34% of assets.

Ultra Clean (UCTT) Financial and Operational Measures (%)

	UCTT	Comps
Return on Equity	14.85	23.06
Return on Assets	6.47	11.09
Return on Invested Capital	10.46	15.17
Weighted Average Cost of Capital	12.76	12.83
YoY Revenue Growth	52.40	41.81
Revenue 5 yr CAGR	30.52	18.61
Net Income Margin	6.69	17.00
Current Ratio	2.56	3.36
Net Debt/EBITDA	87.00	-19.00
Debt to Assets	34.09	19.28



Although UCTT seems to operate less efficiently than its competitors, its valuation reflects this. Across the board, UCTT trades at a more attractive valuation than its peer group. Based on UCTT’s revenue growth and P/S ratio, the stock appears to be relatively cheap in comparison to its competitors. Although revenue has grown at a CAGR of 30.5% over the last 5 years, investors can still buy into this company at a valuation that is only 29% higher than trailing 12-month sales. When looking at all metrics apart from the PEG, UCTT trades at valuation multiples that are about half of that of its competitors.

Ultra Clean (UCTT) Valuation Figures

	UCTT	Comps
Price to Adjusted Earnings (P/E)	22.17	49.94
Price to Earnings to Growth (PEG)	1.21	1.38
Price to Free Cash Flow (P/FCF)	14.6	40.6
Enterprise Value to EBITDA (EV/EBITDA)	9.68	20.78
Price to Sales (P/S)	1.29	7.09
Price to Book (P/B)	3.14	9.76

As is expected with stocks covered in this report, analyst coverage is minimal. According to Bloomberg, just six analysts currently cover the name, and all of them have a buy rating on the stock. The average price target is \$72.58, which is a 28.6% premium to the current level. The price target range from these six analysts is \$66 – \$77. This represents upside between 17.0% and 36.5%.

As with any investment, there are always pros and cons to consider, so below we summarize some of the more notable ones for each side.

Pros:

UCTT is a ‘pick-and-shovel’ play into the semiconductor industry, which is a ‘pick-and-shovels’ play itself, as semiconductors are a necessary component of numerous innovative developments and legacy technologies. The semiconductor industry is projected to experience strong growth in the coming years. Additionally, UCTT has experienced strong revenue growth and significantly expanded margins over the last few years. The company is committed to diversifying its customer base by improving its product offerings and increasing penetration into the industry. The total addressable market is also massive, so there are strong growth opportunities should management execute well.

Cons:

UCTT has 62% of its revenue concentrated into two customers, so there is company-specific risk involved with its customer base. On an operational basis, the WACC is currently higher than ROIC, which implies that UCTT has not been delivering the returns required by stakeholders. Certain companies within the semiconductor space also manufacture their own equipment, and should more companies do this, the addressable market would drop substantially. Penetration will be key moving forward, both on an existing customers and broader industry basis.



**Ultra
Clean
Technology™**