Wealthpin Pro

MARCH 2023

Welcome to the March edition of Wealthpin Pro!

Spring is just around the corner, and with the new season, comes new profit opportunities.

First, let's take a look at the macro conditions of the world right now.

IS INFLATION BACK?

On March 8th, ADP released the monthly payrolls report. It showed that 242k jobs were added vs. the 205k expected. This is another hot payroll release. Remember, in January the ADP payroll report came in at 517k vs. an expected 517k.

ADP Research Institute **242,000**

This is on top of the January CPI report, which rose 0.5%, more than the expected 0.4%.

So, what does this mean?

Well, first off, it means that the Fed's attempts to crush the labor market aren't working. As a result, the central bank will probably continue to raise interest rate higher, for longer.

Fed chairman Jerome Powell said as much during his Congressional testimony this past Tuesday and Wednesday. According to Powell, in light of the recent inflation data, the Fed could institute a 50-basis point rate hike this month, instead of the 25-basis point they were planning.

Jerome Powell
FED Chairman

He also said that the terminal rate could reach 6% or higher.

Meanwhile. other economic signals, like freight rates, which just hit lows not seen since 2018, indicate that demand is cratering, which is good for inflation.

We're in a very tricky situation. There's mountains of data that could point both ways – either that inflation is falling and the Fed's work is almost done...

Or that inflation is extremely stick and the work has just begun.

But here's my view:

I still think that inflation was mainly driven by supply-side issues, not demand side. I think these issues have largely worked themselves out, and any data that we're looking at now is historic. Which means we need to wait to see what the lagging effects of previous rate hikes will be.

I'm optimistic that in a few months' time, we'll see that inflation has dropped and the economy has avoided a serious recession. However, here's the other side:

If in fact inflation IS persistent, and engrained in the economy beyond demand side imbalances, it's going to take much higher interest rates to tamp it down. Right now, the official inflation rate is 6.41%. The two-year t-bill rate is 4.1%.

As long as inflation is above the bond rate, it's going to be very hard to put the breaks on the economy. You have to slow the movement of money, which means you have to make saving more attractive than investing in inflationary assets like stocks.

So, if inflation is really baked into our system, and Powell and company want to stop it, they'll have to raise interest rates to 6.5% or higher. Which means we have a long way still to go.

Of course, if interest rate continue to rise, what effect will that have on the economy? Especially housing, which bearts the direct brunt of rate hikes. Well, let's take a look...

HOUSING CRASH? MEET THE 30-YEAR MORTGAGE BUBBLE

Lately, there's been a lot of talk about an impending housing crash. Falling new builds, rising interest rates, rising prices...in many areas across the U.S., the housing market has all but stalled. But allow me to present a second opinion. An opinion that — while not necessarily *good* — may mean that the eagerly anticipated housing crash won't come.

(At least, for another 30 years).

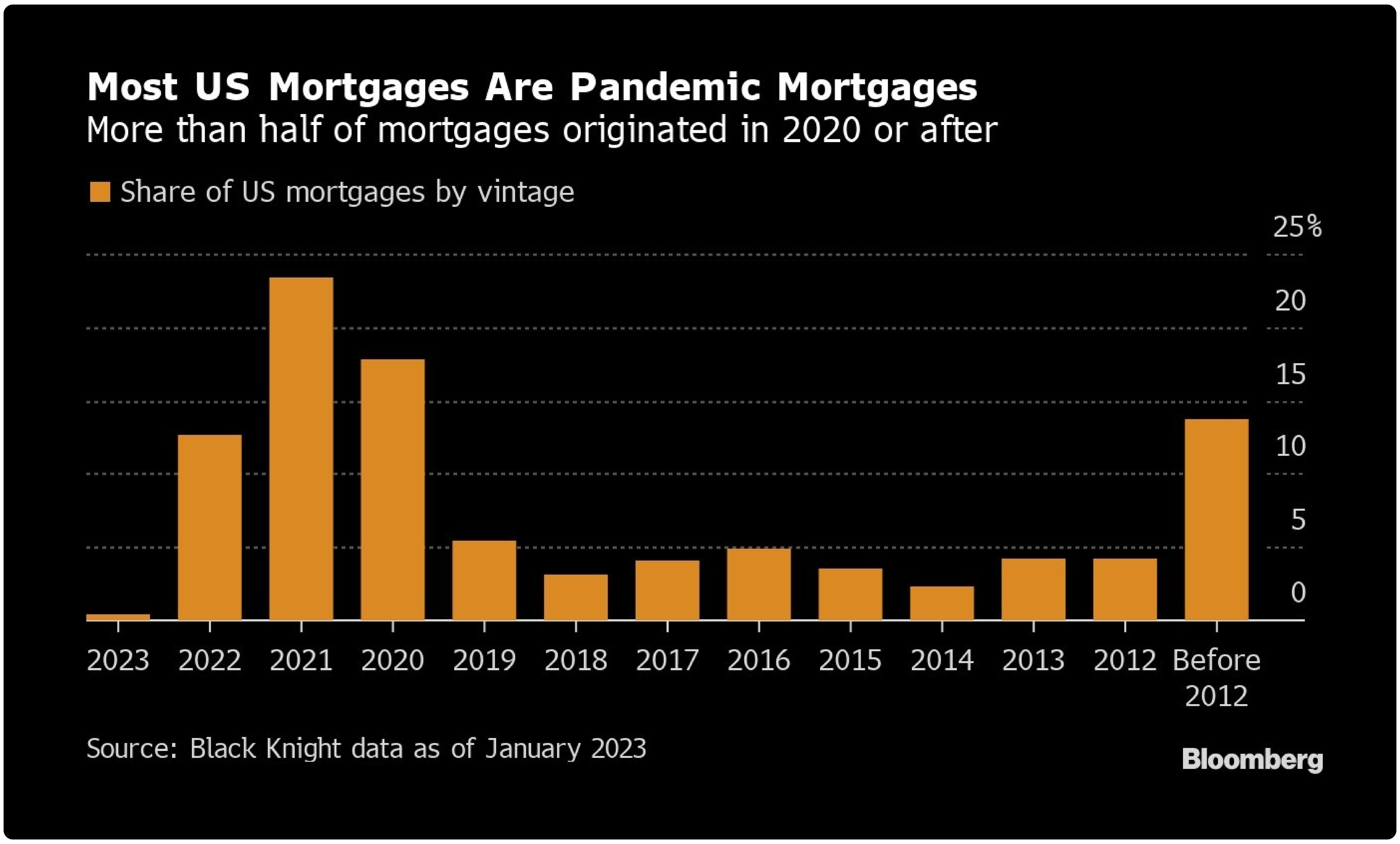
Following the '08 crash, the Federal Reserve began buying up mortgage backed securities (MBSs). These are financial products composed of a collection of mortgages that are rolled together and then can be bought and sold by banks and institutional investors.

Prior to '08, the Fed had $0 MBS's on its balance sheet. But by 2020, it owned $1.4 trillion worth of MBS. When the economy cratered during COVID, the Fed stepped in again, this time on a much more massive scale. Over the next two years, the Fed's ownership of MBS's would nearly double, to $2.7 trillion.

Why is this important?

Well, at the same time the Fed was buying all those mortgage-backed securities, Americans were taking out a record amount of mortgages.

Nearly half of all current U.S. mortgages originated in 2020 or later.



So, if you were one of the millions of Americans who bought a house during the pandemic, well, chances are that the Fed now owns your mortgage.

And those low-rates you got? Well, you can thank the Fed's purchasing activity for that.

This is a massive amount of central bank market distortion. Had it not been for the Fed, housing prices most likely would not have skyrocketed as much as they did. And now, since the Fed owns all the securities, it creates an artificial floor for home price. As long as the Fed keeps these MBS's on its balance sheet, then housing prices likely won't fall back to Earth.

At the same time, if the Fed does start to unwind its position in these MBS's, well, that would send interest rates higher, further calcifying the housing industry.

The other option the Fed has is just to wait until the mortgages get paid off. But the vast majority of the post-2020 mortgages were fixed 30-year mortgages.

Which means it will be three decades before those balances are removed and the central bank can stop having such an outsized role in American housing.

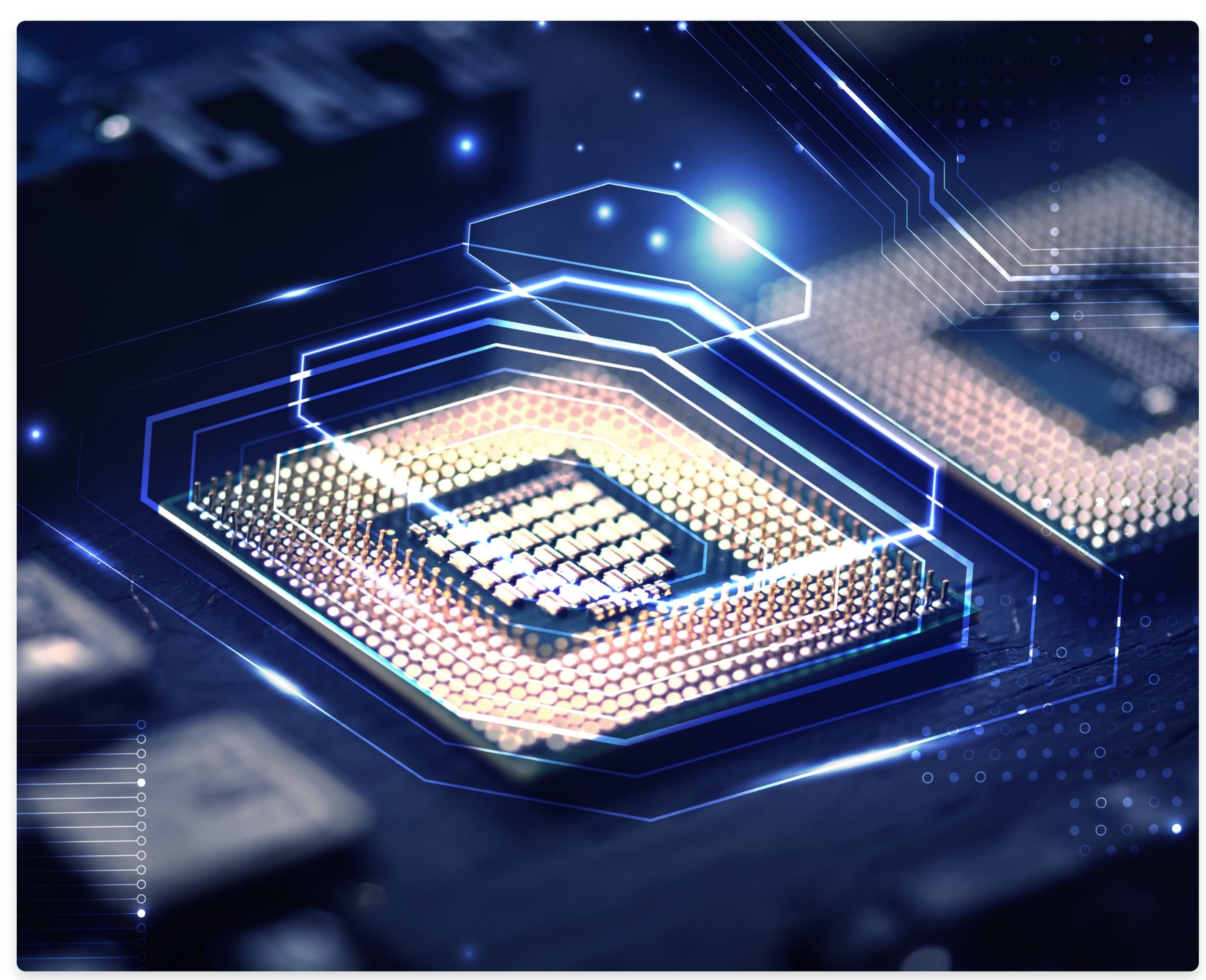
Yet another wrinkle is...

If the Fed does start to unload mortgages when interest rates are much higher than said mortgages, it will incur MASSIVE financial losses. Because the mortgages with lower interest rates are of course less valuable than higher-paying, higher interest mortgages.

The Fed is stuck between a rock and a hard spot. And this is just another example of the consequences of heavy-handed central banking. But it means that if you do believe there's a housing bubble, then buckle up, because it's here to stay for a very long time.

THE AMERICAN CHIP BONANZA

Two weeks ago, the Department of Commerce officially launched the CHIPS Act, which provides $53 billion in federal money to boost the domestic semiconductor industry. Companies like AEIS will benefit tremendously from these subsidies, as well as companies like Intel and NVIDIA.



The law itself is interesting: Companies are expected to share a portion of their profits with the government in return for the subsidies. Stock buybacks will be prohibited for companies receiving the funds. And the companies will be required to source their raw materials from other American companies if at all feasible.

This is a hard turn away from the free trade policies of years past. And it's a wild combination of private-public business interlocking in a manner that isn't usually seen in America. While some people might see this as a move that is necessary to reshore American manufacturing, others might see it as eerily reminiscent of the Chinese government's economic interventionism.

Whatever you think about the CHIPS Act, the truth is that if offers a tremendous investing opportunity. We basically have the opportunity to invest in government-picked winners (though nothing in investing is ever risk-free or set in stone).

And in an inflationary environment or even a recession, CHIPS act-adjacent companies could offer a welcome shelter and some stability away from the broader, chaotic markets.

Which brings us to our trade idea this month.

AXCELIS TECHNOLOGIES INC. (NASDAQ: ACLS)

axcelis

PRICE AT PUBLICATION: $128.83

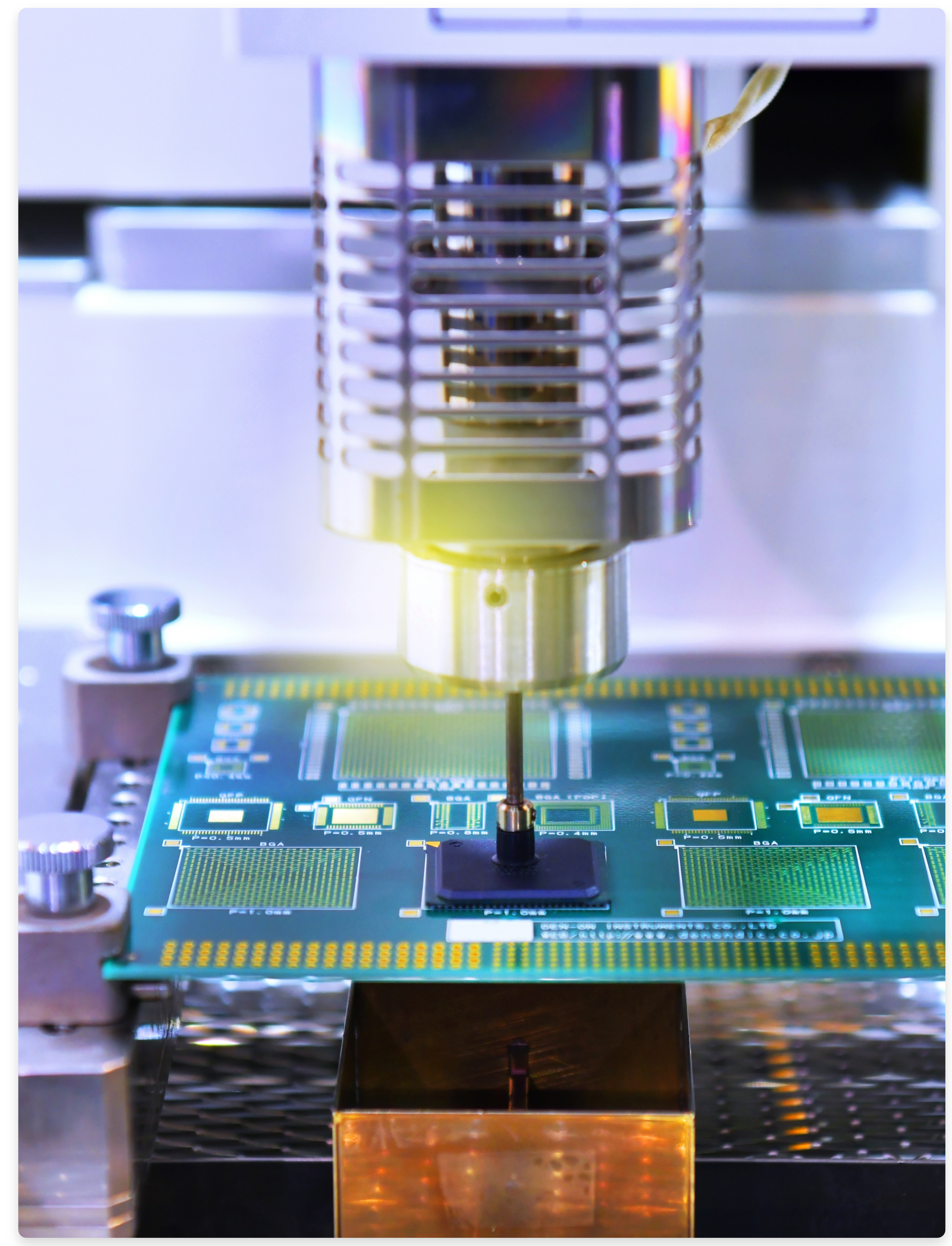
MARKET CAP AT PUBLICATION: $4.2 BILLION

SHARES OUTSTANDING: 32.71 MILLION

52-WEEK RANGE: $46.41-$132.98

THE ELEVATOR PITCH

In the midst of secular trends, it often pays better to step one ring outside the bullseye, and look for the "trend-adjacent" plays. In this case, rather than look at the main chip production companies (NVIDIA, AMD, TSMC), we're going to dive into a company that produces the machinery required to make those chips.



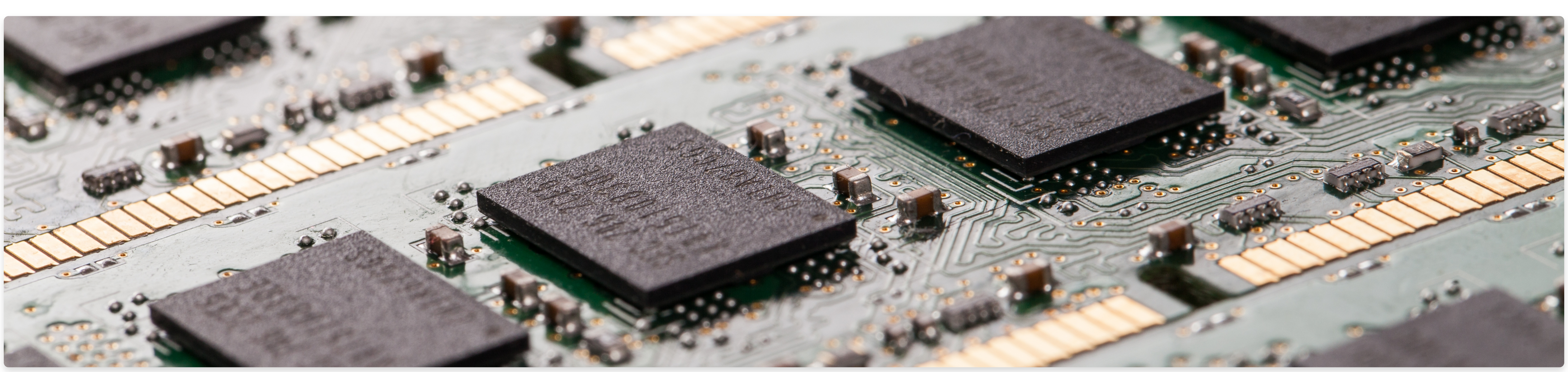
You might have heard investments like this referred to as "pick and shovels" plays. This term originated during the California gold rush, when the merchants who sold the picks and shovels often grew far richer than the gold miners who used that equipment in their quest for fortune.

So what is Axcelis' unique form of picks and shovels? It's called an ion implanter. In order to turn a thin wafer of silicon and metal into a semiconductor, you have to imbue it with certain electromagnetic properties.

An ion implanter sends charged ions into the layers of silicon on a semiconductor, altering the physical-chemical-electrical properties of the semiconductor in the process. After the implantation, the semiconductor is "activated."

It's pretty advanced science, and there's no need to delve very deeply into it. But suffice to say that without ion implantation, semiconductors wouldn't exist. And it's a very difficult process to get right.

Which is why Axcelis is such an important company.



THE FUTURE... AND AXCELIS' POSITION IN IT

Before we get into the hard numbers of Axcelis' business, let's look at the macro environment that has put Axcelis in such a strong position.

First, semiconductor demand is going to explode over the coming years. If you thought demand for tech and devices grew over the last decade, well, just wait until you see what happens in the '20s.

5G, phones, connected "Internet of Things" devices, AI, augmented/virtual reality...the number of tech devices in our world is going to proliferate substantially. And all these devices will require semiconductors.

> *In 2022, the global semiconductor market was about $573 billion. By 2029, it's expected to grow to $1.3 trillion. That's more than double the demand we have now.*

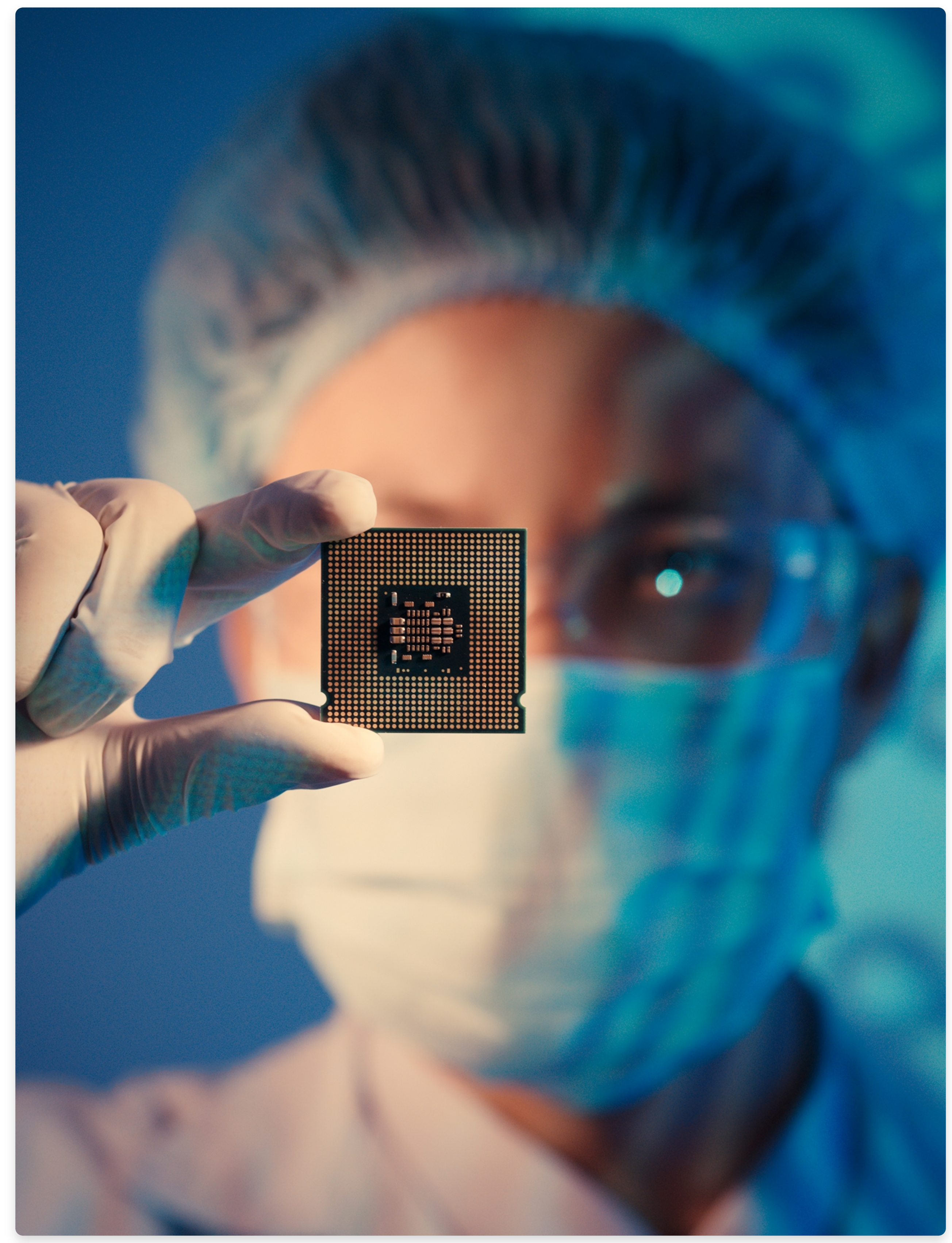
The market size of the ion implantation has grown accordingly. It's more than doubled from $1 billion in 2012 to $2.5 billion. And consensus estimates put the total market size at at least $3.2 billion by the end of the decade.

So, left to its own devices, the secular growth trends paint a rosy picture for Axcelis' business prospects.

But here's the thing:

The market isn't being left to its own devices. Like I mentioned above, the CHIPS Act is the first salvo in what will likely be a multi-decade process of reshoring America's critical supply chains. And I expect many more dollars of government subsidies to flow into the domestic semiconductor industry.

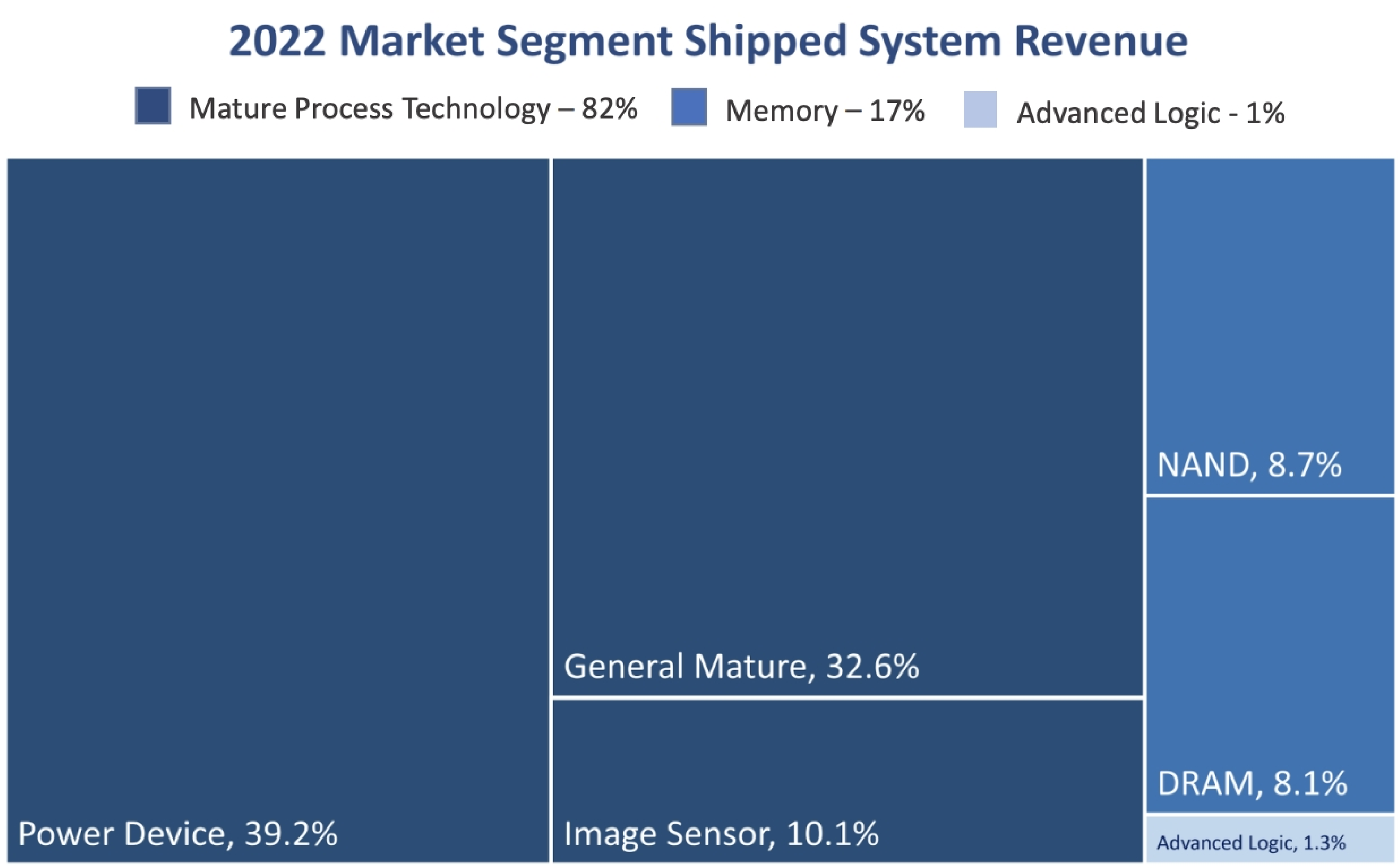
Axcelis is an American company. They're headquartered in Beverly, Massachusetts. They will no doubt receive their share of these government subsidies. And as an American company, they will continue to benefit long-term from the geopolitical realignment taking place.



Outside of Cadence Design Systems, Axcelis has few American competitors. And beyond that, they have few competitors in the Western world. Which means Europe, Latin America, and any other of America's western allies will be ripe (and let's be honest, government-controlled) markets for Axcelis to ship its products to.

THE BUSINESS

Axcelis has three main business segments:



1. POWER DEVICES

These are semiconductors that can be directly used in the circuit board to convert or control electric power. You'll find these in electric vehicles and industrial machinery.

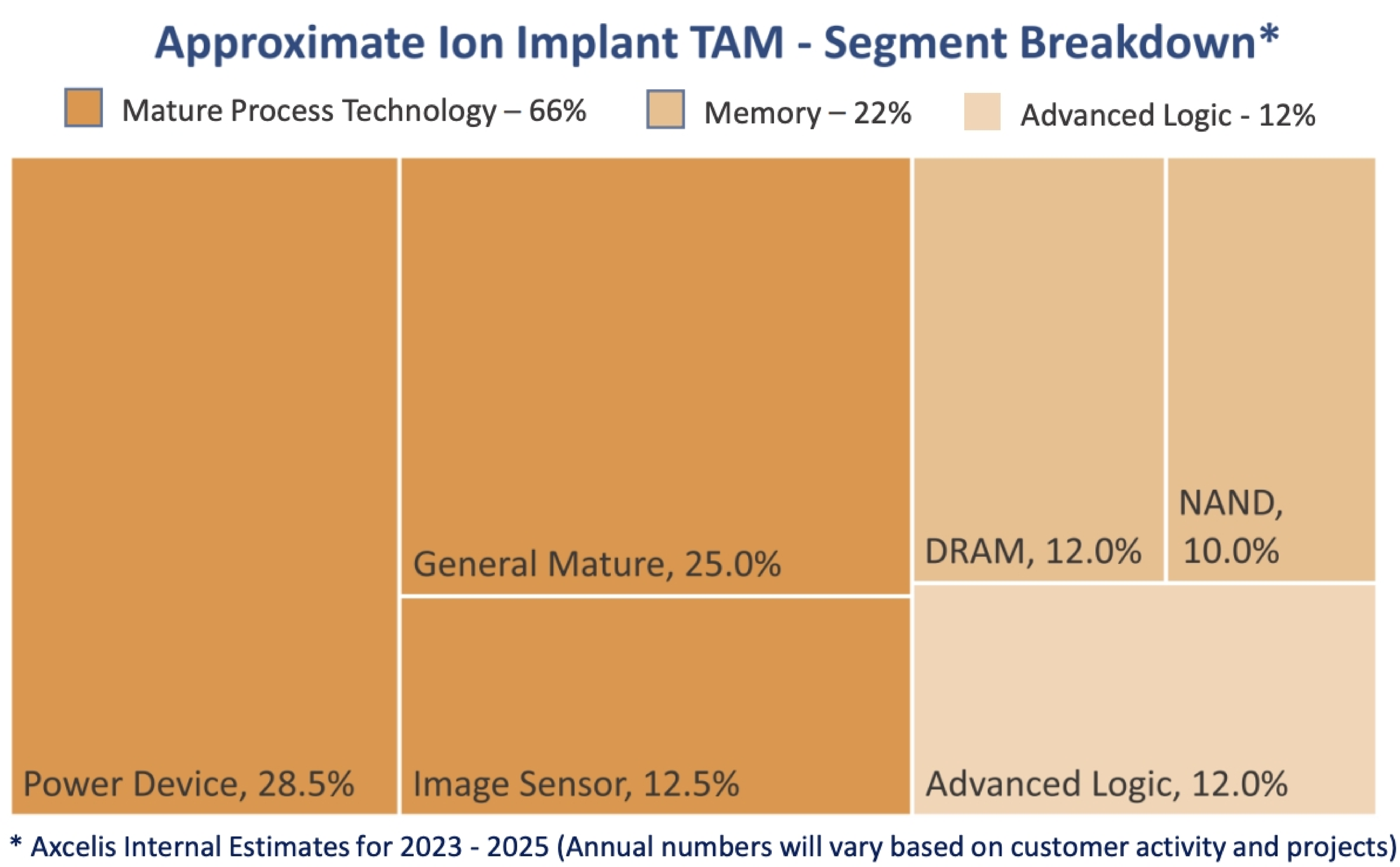
2. GENERAL MATURE

Think legacy systems or hardware in such places like our power grids, wastewater plants, etc. The chips in these need to be upgraded from time to time.

3. IMAGE SENSOR

Whether its facial recognition on our phones or self-driving cars imaging software, there's an enormous market for functional chips that can handle the thin dimension but onerous processing burden of high-fidelity computations.

However, over the next few years, Axcelis sees this distribution shifting, as ion implantation on chips for AI and advanced memory requirements take up a larger portion of their revenue.



All of these various segments, however, are largely powered by one thing:

The Purion line of implantation devices.

The Purion family is Axcelis' flagship group of products. They come in different sizes, strengths, ranges, and capabilities, but they're arguably the best ion implanters on the market.

As the demands for ion implantation grow, Axcelis will both be producing more of these Purion devices and upgrading existing ones with new capabilities.

THE FINANCIALS

Now that we have a better understanding of the business model, let's dive into Axcelis' financials, shall we? We'll be working off the latest 10-Q release, which cover through Q3 of 2022.

PART 1—FINANCIAL INFORMATION

Item 1. Financial Statements.

Axcelis Technologies, Inc.
Consolidated Statements of Operations
(In thousands, except per share amounts)
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2022	2021	2022	2021
Revenue:				
Product	$ 221,540	$ 169,151	$ 631,998	$ 435,916
Services	7,635	7,543	21,949	20,828
Total revenue	229,175	176,694	653,947	456,744
Cost of revenue:				
Product	118,992	93,201	342,387	240,223
Services	6,862	6,981	19,291	19,560
Total cost of revenue	125,854	100,182	361,678	259,783
Gross profit	103,321	76,512	292,269	196,961
Operating expenses:				
Research and development	20,563	16,707	56,267	49,015
Sales and marketing	14,573	11,415	38,567	33,979
General and administrative	14,983	11,996	41,163	33,226
Total operating expenses	50,119	40,118	135,997	116,220
Income from operations	53,202	36,394	156,272	80,741
Other (expense) income:				
Interest income	1,111	51	1,558	124
Interest expense	(1,333)	(1,269)	(4,101)	(3,572)
Other, net	(7,971)	(963)	(14,640)	(2,131)
Total other expense	(8,193)	(2,181)	(17,183)	(5,579)
Income before income taxes	45,009	34,213	139,089	75,162
Income tax provision	4,726	6,698	13,002	12,261
Net income	$ 40,283	$ 27,515	$ 126,087	$ 62,901
Net income per share:				
Basic	$ 1.22	$ 0.82	$ 3.81	$ 1.87
Diluted	$ 1.21	$ 0.81	$ 3.75	$ 1.83
Shares used in computing net income per share:				
Basic weighted average common shares	33,011	33,537	33,116	33,643

In 2022, the semiconductor companies we know and love got battered. NVIDIA, TSMC, AMD, and Intel all posted huge losses on the year and their share prices crumbled. Meanwhile, Axcelis more than doubled.

(But don't worry that you might have missed out, I believe a much higher rise could still lie in the future, which we'll get to in a moment.)

Axcelis revenues are up 44% year over year. And the gross profit margin is up over 39%.

Meanwhile, this is an extremely debt-light company. Axcelis's debt is just $58 million. It's net income per the latest 10Q was $126 million. Having this much debt-free cash is great for a company that might find itself in turbulence as the result of U.S.-Chinese geopolitical tensions.

It doesn't have to get more complicated than that. A powerhouse industry leader, flush with cash and low on debt, in a rapidly expanding industry....

Well, that's a recipe for growth if I've ever seen one.

CONCLUSION

In their latest investor presentation, Axcelis outlined a goal to hit $1.3 billion in revenue by 2024 or 2025.

Target Business Model (GAAP)

Axcelis expects financial growth through the industry downturn and to exceed $1B in revenue in 2023 and targets ~$1.3B in revenue within 2 to 3 years

Revenue	$442.6M 2018(A)	$343.0M 2019(A)	$474.6M 2020(A)	$662.4M 2021(A)	$920.0M 2022(A)	>$1B Model*	~$1.3B Model*
Gross Margin	40.6%	42.0%	41.8%	43.2%	43.7%	~44%	>45%
Total OPEX	27.0%	35.0%	29.6%	24%	20.6%	~20.5%	~19%
Operating Profit	13.5%	7.1%	12.2%	19.2%	23.1%	~23.5%	~26%
Free Cash Flow (Cash From Operations – Capex)/Total Revenue	9.5%	(7.5%)	13.2%	21.4%	22.3%	~22%	~25%

* The model is not a forecast of results but is intended to be indicative of the annual results Axcelis may achieve based on our strategic objectives

Their net income is a little above 19%.

(Which, sidenote, it 528% above the rest of the industry. Truly spectacular
So, we're assuming they maintain similar margins once they hit that $1.3 billion mark.

That means net income is $247 million.

Divide that by the shares outstanding currently and we get earnings per share of $7.55. Throw a typical stock market 30X multiple on that and you get a share price of $226.

Considering all of that, we're adding Axcelis to our model portfolio with a 12-month target price of $180.

To your wealth,
Alex Reid
Founder, Wealthpin Pro