# Teradyne's Market Niche Spurs Purchase for CUSP

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Teradyne Inc. (TER) is a leading U.S. manufacturer of semiconductor test and automation equipment. Semiconductor manufacturers and/or buyers need to test their semiconductor efficacy before they can sell them in a computer system to the end user. Teradyne's equipment determines the flaw rate of the computer chips being tested and predicts how they will operate in a full-fledged computer system rather than just as a standalone piece. The increasing reliance on semiconductors and electronics globally has led to immense top and bottom line growth for Teradyne over the past two years. The company is poised to capitalize on continued semiconductor demand in the foreseeable future. The firm also has a growing industrial automation segment, which designs robots that assist in manufacturing and product preparation across multiple industries. These efforts have been boosted by recent labor shortages. The firm is aiming to expand market share for semiconductor test equipment and their nascent industrial robotics division. Minimizing the flaw-rates of semiconductors is going to be increasingly important as more cars, medical equipment and machinery are dependent on electronics, highlighting Teradyne's importance across multiple industries.

The semiconductor test division is the largest revenue stream for Teradyne and makes up roughly 71% of the firm's total revenues. The next largest revenue stream is its systems test devices division. This revenue segment is similar to the semiconductor test division but has broader applications to electronic instruments rather than just semiconductors. This segment makes up about 13% of total revenue. The third largest revenue stream for Teradyne is its industrial automation unit, which comprises 10% of total revenue. This division of the company produces collaborative robots, also called "cobots", designed for dangerous, dirty or repetitive tasks across multiple industries. The firm has seen over 30% revenue growth in its cobots division in the last two years, and the firm's management team is expecting accelerated growth as the labor force declines and dangerous and dirty jobs become more expensive to employ.

The CUSP management's decision to buy Teradyne is based on a multifaceted thesis: an increasing need for semiconductor test equipment across multiple industries, a quickly growing robotics and automation division, strong cash flows and profitability margins and a dramatic market selloff on the firm's latest earnings. We believe this provides a timely buying opportunity.

The firm has a track record of increasing profitability at impressive levels given its line of work is machinery and hardware. They have a three-year average net profit margin of 24.35%, with a last year net profit margin of 27.57%. The increase in net profit margin is partnered with a 76% increase in revenue over the last four years, which has contributed to a much larger bottom line. Additionally, the firm has generated free cash flow in excess of operating needs, which should start boosting shareholder value. Teradyne has more than a 10% increase in dividend payments over the last five years, and the management team recently announced an aggressive share buyback program committed to repurchasing up to $750 million worth of stock in 2022.

Moreover, there has been a steady increase in cash reserves over the past few years, creating expectations of value-add acquisitions in the company's future.

Teradyne has attractive valuation multiples that make us confident in the timing of our purchase. At the time of purchase, it had a 27.29 price-to-earnings ratio, which is in line with its competitors. More importantly to us, however, was the EV/EBITDA multiple of 18.99, which makes the company seem fairly-to-undervalued compared to similar companies. After the company's most recent earnings call (pertaining to the company's 12/31/21 yearend), management stated it expects sales to decrease for the first half of 2022. This drop in sales is due in part to how well the company performed in 2021. Management expects sales growth to pick back up in the second half of 2022. After the earnings call there was a major selloff dropping the share price nearly 25% on the day. We believe this selloff was a bit of an overreaction and presents an opportunity for long-term investors, like us, to buy the stock at a price that's below its intrinsic value.

Teradyne's growing importance across multiple industries and its steadily growing revenue segments are what caught the attention of the CUSP managers originally. After further investigation, its impressive profitability and cash flow growth partnered with the recent market selloff gives us confidence that the company is a strategic value purchase.