



NVIDIA | MELLANOX

NVIDIA TO DOUBLE DOWN IN the DATACENTER BUSINESS.

– by Michael Isaev



Following a bloody bidding war with Intel (NasdaqGS:INTC), Microchip Technology (NasdaqGS:MCHP), Xilinx (NasdaqGS:XLNX) and Marvell Technology (NasdaqGS:MRVL), on March 11th 2019, NVIDIA (NasdaqGS:NVDA) (an American technology company, which designs graphics processing units and system on a chip units) reached a definitive agreement to acquire Mellanox Technologies (NasdaqGS:MLNX), a leading supplier of end to end Ethernet and InfiniBand smart interconnect solutions and services, for \$7.34 billion. On June 23rd, 99.5% of Mellanox shareholders voted in favor of NVIDIA's offer.

The acquisition will marry two of the world's leading companies in High Performance Computing (HPC). Together, NVIDIA's computing platform and Mellanox's interconnects power over 250 of the world's TOP500 supercomputers and have as customers every major cloud service provider and computer maker. With Mellanox, NVIDIA will optimize datacenter-scale workloads across the entire computing, networking and storage stack to achieve higher performance, greater utilization and lower operating cost for customers.

Although the deal was announced several months ago, volatility and uncertain market conditions during the summer time have saved the arbitrage opportunity until now. With a cash offer price of \$125 per share and Mellanox's current price of \$110.28, the merger spread is \$14.72, translating into an enticing return of 13.35%. Since the deal announcement, the raw spread has been as wide as 16%-plus and as

tight as 3.4%. The deal is expected to close by the end of the year, which implies a 54.13% annualized return.

Let's try to understand why the spread is not decreasing over time and keeps the deal uncertain. U.S – China acrimonious trade relations is the main part of the answer. The Chinese Ministry of Commerce (“Mofcom”) is taking an interest in a large number of deals. A great example of how Chinese regulatory approval has been affecting M&A activities is the deal between Qualcomm and NXP, which ended with Qualcomm not getting Mofcom's approval and consequently the deal collapsed. If China plans to use NVIDIA Mellanox deal as leverage in trade negotiations with the U.S., we can anticipate not a full rejection, but ongoing delays, which would ultimately decrease the annualized return. This decreases the probability of closing and makes this arbitrage opportunity somewhat risky.

During the earnings call on August 16th NVIDIA stated: “... regarding our pending acquisition of Mellanox, we have received regulatory approval in the U.S. and are engaged with regulators in Europe and China. The approval process is progressing as expected, and we continue to work toward closing the deal by the end of this calendar year...” So, NVIDIA management still expects this deal to close by the end of the year. On September 4th, China's State Administration for Market Regulation has started a formal review, which may take 180 days, of the NVIDIA-Mellanox merger. Based on this probe, the closing date could slip to the end of February next year and decrease the annualized return to 32.92%, which is still an attractive arbitrage.

In the past couple of weeks, there has been some positive movement from China's State Administration for Market Regulation (“SAMR”), exemplified by the recent approval of the acquisition of photonic component maker Finisar by II-VI. This could release the tension around many U.S.-China deals, including NVIDIA-Mellanox.

All things considered, this transaction offers an enticing return due to the good chances of the deal closing despite the doubts that the market still displays. Therefore, in our view this is an arbitrage opportunity that is worth pursuing by going long Mellanox.

Michael Isaev is quantitative analyst at Bardi Co. LLC, an investment bank based in Los Angeles, CA. He is part of Bardi Capital Management where he specializes in M&A arbitrage. Michael is a graduate of University of California Los Angeles Extension where he earned a certificate in finance.

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