Time to Buy the Drop in This 5G Stock

Description

The U.S.-China trade war is turning out to be a nightmare for chipmakers that rely on Chinese companies for business, and **Xilinx** (NASDAQ: XLNX) is no different. The chipmaker's fiscal 2020 second-quarter guidance failed to pass muster thanks to the overall macroeconomic uncertainty, weak data center demand, and the suspension of shipments to Huawei.

As expected, investors have decided to book profits at the first sign of trouble, and the stock is down over 13% in the past two months. But this is an opportunity in disguise for anyone looking to buy into a fast-growing tech stock at a reasonable valuation.

Huawei won't derail Xilinx's 5G growth

Xilinx management doesn't seem to be too perturbed by the ban on shipments to Huawei. That's probably because Xilinx doesn't have a single customer that produces more than 10% of its revenue, so the overall growth story still remains intact thanks to the company's diversified interests in areas such as data centers, automotive, and wireless networks.

And as it turns out, Xilinx's automotive, industrial, and wired/wireless business segments did extremely well last quarter. Revenue from the wired and wireless business segment was up 66% annually thanks to the deployment of fifth-generation (5G) wireless networks. This is a great sign for Xilinx, showing that the Huawei situation didn't throw water over the tremendous 5G traction the chipmaker has seen this year.

The reason Xilinx's 5G business didn't lose its wheels can be credited to the nature of the chips it sells. Xilinx's chips — popularly known as FPGAs (field-programmable gate arrays) — come in handy during new infrastructure deployments. The programmable chips can be bought by developers straight off the shelves and configured to perform the desired tasks. They are in strong demand among telecom companies deploying 5G networks, as FPGAs reduce their time to market.

As a result, demand for Xilinx's chips should remain strong as 5G networks are deployed across the globe, especially because the company holds the lion's share of the FPGA market.

The good news for Xilinx investors is that only 7% of the communications service providers have already deployedÂ 5G networks, according to **Gartner**. The market research firm also pointed out that 5G infrastructure spending will jump nearly 61% next year to $6.8 billion as service providers ramp up deployments. So the 5G opportunity for Xilinx is still in its nascent phase, as a huge number of communication providers have yet to join the bandwagon.

Huawei would have been a big catalyst for Xilinx because of the clout it enjoys in the Chinese telecom infrastructure space. This is probably why Xilinx has been pushing the U.S. government to ease restrictions on exports to Huawei. But even if that doesn't happen in the foreseeable future, Xilinx's 5G business has enough firepower to keep growing and boost its wired/wireless segment, which suppliesÂ 41% of its total revenue.

Xilinx has catalysts beyond 5G

Investors shouldn't forget that 5G is just one of the many drivers for Xilinx's business. The company's FPGA chips are also being deployed in other markets, such as data centers and automotive applications.

The automotive business, for example, is solidly positioned to take advantage of the proliferation of connected and self-driving cars thanks to Xilinx's numerous relationships in this space. The chipmaker's FPGAs are already being used to develop artificial intelligence (AI)-enabled self-driving computers by the likes of ZF, while Chinese car company BYD has selected Xilinx's chips to make a camera-based advanced driver-assistance system (ADAS).

Xilinx admitsÂ that the automotive business will remain soft in the near-term thanks to the trade war, but that doesn't change the long-term narrative. Demand for FPGAs in the automotive sector is estimated to increase at a compound annual growth rate of 8.5% through 2022, as per third-party estimates.

Similarly, FPGA demand in the data center space is also gaining traction as data centers accelerate their workloads. Xilinx's data center revenue was zooming thanks to the adoption of FPGAs by the likes of Microsoft, Amazon, and other cloud service providers.

Xilinx's data center business, meanwhile, might have hit a speed bump on account of the trade war and a product transition at one of its customers. According to CFO Lorenzo Flores on the company's earnings conference call:

> Revenue from the Data Center Group was below our guidance, declining 13% year-over-year and 4% quarter-over-quarter. We showed growth in multiple hyperscalers and broader accounts, but the Huawei ban did have an effect on DCG. In addition, one of our memory-related customers is going through a product transition and had an inventory-related slowdown.

Once these short-term events move out of the way, Xilinx's data center business should get back on track once again. That's because the demand for data center accelerators (including FPGAs) is expected to increase at more than 9% a year through 2025.

All of this indicates that the long-term opportunity in Xilinx is still intact.

This is why it would make sense to get into the stock after its latest pullback. It trades at a much lower valuation compared to earlier in 2019, giving investors a nice point of entry into a tech stock that can deliver long-term upside thanks to multiple catalysts.

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Date
2025/07/20
Date Created
2019/09/17
Author
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