BEHIND THE NUMBERS
Quality of Earnings Analysis

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Marvell Technology, Inc. (MRVL)
Earnings Quality Update

We are maintaining our earnings quality rating of MRVL at 2+ (Minor Concern).

For an explanation of the EQ Review Rating scale, please refer to the end of this report.

Summary

MRVL's 3Q24 non-GAAP EPS of $0.41 beat by only 1 cent. Management notes in the 10-Q that Chinese customers have big stocks of MRVL chips. On the earnings call, MRVL confirmed weakness in several end markets and even noted they expect more weakness into the next calendar year. We see several points of concern vs. guidance and sustainability.

- MRVL's stock compensation rose to 11.2% of sales vs. 9.5% in 3Q23 – that added 2.6 cents to non-GAAP EPS. It's worth noting that within that increase, gross margin was expected to have 70bp of stock compensation and instead had 111bp.

- MRVL used to add back stepped-up inventory costs after acquisitions and marking the inventory to fair value in calculating its non-GAAP gross margin. Now MRVL is adding back much larger charges for product claims to gross margin. These are legal challenges and can relate to the use of patents and technology. Unlike inventory steps-ups, they seem more likely to be cash charges. Because MRVL purchases technology licenses this also looks like an ongoing cost of doing business. This was 11.6 cents of non-GAAP EPS last quarter.

Non-GAAP adj.	3Q24	2Q24	1Q24	4Q23	3Q23	2Q23	1Q23
Product Claims	$108.0	$90.2	$39.6	$19.7			
Inv. Step-ups				$12.7	$10.4	$6.3	$9.3
GAAP Gross Margin	38.9%	38.9%	42.2%	47.5%	50.6%	51.8%	51.9%
non-GAAP	60.6%	60.3%	60.0%	63.5%	64.0%	65.0%	65.5%
EPS from add-backs	$0.116	$0.099	$0.043				

- We noted that 2Q24 was the first time we had seen MRVL report a warranty accrual which was $58.9 million. In 3Q24, the accrual dropped to $52.4 million. We don't know if that was used or reversed – but the lower amount was worth another 0.7 cents EPS.

- Variable consideration fell slightly last quarter. These are accruals for price discounts, rebates, and price protection. When the accrual rises, it reduces net sales and vice versa. Sales were higher in 3Q with this small drop in accruals. It takes about a $10 million swing to equal 1 cent in EPS – we'll call this neutral for 3Q24.

Var Con/Sales	4Q	3Q	2Q	1Q	4Q	3Q	2Q	1Q
fiscal 24		$498.3	$501.5	$426.3		$1,418.6	$1,340.9	$1,321.7
fiscal 23	$572.8	$519.3	$387.0	$349.4	$1,418.4	$1,537.3	$1,516.9	$1,446.9
fiscal 22	$258.6	$197.2	$190.5	$170.5	$1,343.0	$1,211.2	$1,075.9	$832.9

- Inventories do look improved. Using GAAP Cost of Goods Sold, finished goods actually turned down and the lower work-in-progress continued. Using non-GAAP COGS – finished goods were 58.8 days vs. 65.4 in 2Q24.

Inventory DSIs	3Q24	2Q24	1Q24	4Q23	3Q23	2Q23	1Q23
Work in Progress	60.8	70.2	79.5	92.4	87.9	88.1	86.5
Finished Goods	37.9	42.5	42.6	38.1	26.7	26.5	22.7

- Cash flow still needs to be adjusted for acquisitions and tech licenses. 3Q24 showed a big boost in free cash flow due to working capital being released:

	3Q24	2Q24	1Q24	4Q23	3Q23	2Q23	1Q23
Cash Ops	$503	$113	208	352	411	332	195
CapEx	$54	$111	100	54	43	73	37
Free Cash	$449	$1	$109	$298	$368	$259	$158
Cash Ops	$503	$113	208	352	411	332	195
CapEx	$54	$111	$100	$54	$43	$73	$37
Purchase Tech	$0	$0	$3	$2	$5	$3	$2
Acquisitions	$0	$6	$0	$9	$4	$55	$44
Tech Licenses	$32	$29	$50	$39	$32	$22	$49
Adj. Free Cash	$417	($33)	$56	$247	$327	$180	$63
Working Capital	$205	-$123	$2	-$134	-$13	-$203	-$300

Explanation of EQ Rating Scale

6- (Exceptionally Strong)- Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises

5 (Strong)- Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.

4 (Acceptable)- Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement

3 (Minor Concern)- Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.

2 (Weak) Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.

1 (Strong Concern)- Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely

In addition to the numerical rating, the EQ Review Rating also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into upcoming quarters. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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