

First Quarter Ended March 31, 2019
–Financial Results Announcement (May 14, 2019) –
Q&A for Briefing Session

Q: Within the outlook for Q2, what are IDT’s figures, and what are the outlooks for Automotive and Industrial sales?

A: Although we will not disclose IDT’s standalone figures, for Renesas standalone figures prior to the consolidation with IDT, we expect an increase of around 9% QoQ. For Automotive, that will be an increase of around 10%, and Non-Automotive would be about 100 basis points lower than the expected growth for Automotive.

Q: If Q2 Renesas standalone sales revenue was to grow at around 9% QoQ, revenue would come to around 165.0 billion yen, but YoY would be around negative high-teen per cent. Can you explain this decrease in terms of inventory adjustments and impacts from the end market?

A: Within the decrease, just under half is owing to decreased demand, while just over half would be impacts from inventory adjustments.

Q: There will still be some impact from inventory adjustments in Q2, but what is the outlook beyond Q3?

A: At this stage, we believe inventory issues would be largely resolved beyond Q3. If anything, we forecast distributors may have to slightly increase their channel inventories. Although we do not have such an optimistic view for some of the hardcore factory automation (FA) related products, we believe channel inventory levels for other segments have been adjusted to an optimum level, even needing to increase slightly.

Q: Do you see air conditioner inventory to be going through similar changes?

A: Currently, yes. However, when it comes to air conditioners, we are all carefully monitoring the situation. At the moment, there are no issues as channel inventory levels are decreasing. Our main customers’ inventory and production levels are also steady and has already become slightly tight. However, air conditioner inventory in China as a whole is still at a high level. If there are excess in the macro environment, even if our customers are steady, we may feel some impact. We believe we must monitor the situation carefully, even though it looks as though it appears to be maintaining a steadiness.

Q: In terms of your mid-term plan, you stated that there are increasing uncertainties in the macro environment and therefore you had to postpone the announcement from the first half of this year, but what is your understanding of the macro environment? When are you planning to make an announcement?

A: There are no further details about the increasing uncertainties in the macro environment, but with the recent additional US tariff for China and the countermeasures put in place by China, it is difficult to foresee how much impact will come at what point. When all these issues have settled down, and when we can have a more composed view on the future is the best time to announce an update. As to when may be difficult to say, especially as many of you may have predicted the U.S. – China trade friction to move in the complete opposite direction than it has. We believe we would like to have a discussion within the year when we have a better outlook.

Q: In regard to the factory production shutdown, the May shutdown was much shorter than expected, and the factories were shut down for 30-40% of the originally planned period. You initially planned to shutdown around the Golden Week holidays, but what are your current factory shutdown plans?

A: For some factories, we decided that there will be no shutdown whatsoever. As for other factories that will be temporarily shut down production, the period of shutdown will be shorter than initially expected.

Q: Which of the fabs will not be shut down, in inches?

A: It's not purely in inches, but products such as power discrete, there were some room for adjustment in our in-house inventory, so within the 6-inch lines and 8-inch lines, we are reducing production mainly for power discrete. On the other hand, for microcontrollers, production levels will be maintained and will operate to slightly increase utilization from the current level.

Q: As a result of order backlogs increasing significantly in Q1, the outlook is that the August factory shutdown will be shorter than expected and there are some differences in scale for the May factory shutdown. What kind of applications' backlogs were seen in Q1?

A: It's not all new backlogs that came in Q1, but we also do not have the impression that FA related products are growing so strongly. In other areas, there aren't many differences in scale, and we believe orders are growing. Especially for Automotive, as explained earlier, the channel inventory adjustment was completed earlier than other segments and, as we mention every now and again, we have changed our operation style to fit our strengths and weaknesses, which is to hit the brakes first, and then hit the accelerator later on. As for channel inventory, we are now able to increase channel inventory levels for Automotive. Regardless of the end market, we would like to operate the Automotive segment with a little more confidence.

Q: With the increase of channel inventory for Automotive, what level of sales do you expect in 2H? When will you state the cost saving effects and scale of the restructuring currently taking place?

A: We can only give our guidance on a quarterly basis, but in terms of 2H, at the moment we see sales to increase in Q3 compared to Q2, and in Q4 compared to Q3. As for the restructuring, we think the impacts can be seen in Q2, and the result of the restructuring will be one of the main differences between GAAP and Non-GAAP figures.

Q: In regard to the factory production shutdown, on page 10 of your presentation material, you explained that Q2 utilization rates will slightly decrease, but to what level? How much cost savings did you make with the shutdown?

A: As mentioned earlier, we decreased the shutdown period compared to the original plan, so the cost saving from this measure was limited to around single-digit oku-yen. As for Q2 utilization rates, it is difficult to give specific numbers at this stage, but it is looking to be a decrease of just under 10 percentage points compared to Q1. However, we will update our production input plan towards the end of May, and at the moment it appears that we may increase the input slightly; therefore the percentage points of decrease could well be smaller.

Q: Q1 utilization rate is just below 70%, but does that mean Q2 utilization rate will be 50-60%?

A: It would be something around there, yes.

Q: In terms of orders, is it right to conclude that Automotive and FA related products' orders grew in Q1 compared to Q4?

A: Yes.

Q: You were planning a headcount reduction, but what are the costs like? When will you announce them?

A: I mentioned this as "restructuring" earlier, but we should be able to give a figure at the Q2 earnings conference call.

Q: Are there any other measures related to “restructuring” other than the plan to decrease headcount in Japan?

A: We are always implementing restructuring measures. We have already included restructuring-related expenses except the headcount reduction into the financial results for Q1 and Q2. However, these impacts were limited, and we anticipate that most of the restructuring expense in Q2 will be from the headcount reduction.

Q: The factory shutdown for the April – June period will be reduced to 30-40% of the originally planned period, so the shutdown would last around 10 days. The August shutdown is expected to be even shorter than that, and the cost savings have decreased to a single-digit oku-yen scale. It appears that by shutting down the factories completely, there is an increased risk of the start-up costs to increase, but despite this, what is behind your decision to go ahead with the shutdown?

A: With the start-up in mind, we planned to shutdown the factories in May and August. Given the long vacation for Golden Week and summer vacation, we had originally planned to organize a production adjustment and maintenance in these period in our annual plan, and if we were to conduct additional shutdowns, we decided that May and August would be appropriate as we will not have to repeat the shutdown and start-up process. In regard to the shutdown period for April-June decreasing to 30-40% of the original plan, if you had understood this as us increasing frequent, short shutdowns, that means we have not explained sufficiently; we’d like you to understand that we are operating with the idea not to have frequent, short shutdowns but with a slightly extended the original shutdown period from our annual plan.

Q: For IDT’s January – March quarter, their sales revenue was around 27.0 billion yen and was almost flat QoQ. While the semiconductor industry is going through adjustments, IDT’s results seem to be in good shape. What is the background of IDT outperforming the industry?

A: Their selectiveness for their applications and customers are functioning very well. If they were a company with 10 times as much revenue, this type of growth area focus would be difficult, but the fact that their annual revenue is around 100.0 billion yen has worked well along their execution of application and customer focus.

Q: Is IDT having any channel inventory issues?

A: Not at all. They have a very tight operation for their channel inventory as well as their in-house inventory. From the perspective of cash conversion, it would be good for us to reach a similar level of operation as IDT.

Q: The IDT acquisition has been completed, but when will the purchase price allocation (PPA) be completed, and when will you announce them?

A: We are not able to confirm this at the moment, but we expect it should take about six months. It will take some time to allocate goodwill and intangible assets, but the market valuation for the assets acquired through the acquisition will come up in Q2. At the moment, the market valuation for IDT’s inventory has been recorded at an inflated amount of 13.0 billion yen, but this will impact Q2 results; it will be recorded as sales but without resulting in gross margin. If this was Non-GAAP basis, if all 13.0 billion yen of inventory was sold, it would become gross margin or operating margin, but under GAAP basis, sales revenue will be zero. The temporary impact of the market valuation of the IDT’s inventory will be added as the Non-GAAP items in Q2 and these items will be inflated with the one-time costs of restructuring and acquisition related costs.

Q: In regard to factory shutdown, the original measure was to meet short-term changes in the market, but it seems that objective has disappeared. It also does not look as if the market

environment has changed for the better. What changed in order for you to reduce the shutdown period to 30-40% of the originally planned period, which was a one-month shut down?

A: It is not entirely true to say the measure was to meet short-term changes in the market. It was more like we were considering an operation where we were looking at a fairly conservative place at the bottom of the range and hit the brakes first, and if there were improvements, we were going to hit the accelerator, as this is the operation style we are good at. As a result, we are releasing the brakes and slowly pushing down on the accelerator. It is not as if demand is significantly increasing and therefore we are becoming increasingly confident, but the initial expectation of demand we had where we thought it would decrease by quite a lot in the range, through passing of time and looking at the order backlog buildup, it turned out that we may not need to have such a conservative outlook. We increased the lowest range of the demand outlook, but it doesn't mean we increased the range. We do not plan to make a confident statement that demand will improve significantly in 2H, but compared to the earnings conference call in February, we are able to talk you in a calmer, surer manner.

Q: There are reports that you will be reorganizing your distributors (“tokuyakutens”). What strategies do you have?

A: Although there were news reports that we will reorganize our sales channel, what we can decide and control is limited. We can only give you our idea behind this as a general view, but we are increasing our analog portfolio as the market environment changes, and in the digital segment, the role that software play is increasing. From that perspective, the demand for customer support for the entire board including analog and software-centric support in the digital segment is increasingly high. To realize this, it is our strategy to divide the support responsibility not only with our distributors (tokuyakutens) but with our other sales channels and ourselves, but the investment is becoming larger. Unless we create a system that allows us to continue these investments, it is not ideal for our distributors and ourselves. We would like to continue increasing our investments here and support our customers generously and we believe it is the best to be able to do this on a global scale.

Q: When you announce your updated mid-term plan, what will you include in it?

A: As we feel the macro environment changes are too large, so it is difficult to give an outlook for three months or six months ahead, but we would like to update our mid-term plan flexibly to meet the market situation, especially as the environmental changes are fairly large. If we set the current mid-term plan as the golden rule, instead of making additions to them, we would like to reflect the market and the fact that IDT has joined and make a candid update.

Q: The outlook for Q2 states that Non-GAAP gross margin will improve to 43.5%, but IDT's gross margin is over 60%, so this can mostly be explained by IDT's consolidation. Would low gross margin for Renesas standalone continue? There are impacts from the utilization, but the level is different from 2017 and 2018. The production level is different from then, but what other effects are impacting the gross margin to decrease aside from the utilization level?

A: IDT's consolidation does explain the improvement in gross margin, but without the consolidation of IDT, from Q1 to Q2, there are improvements of around 100 basis points as well. The level is lower compared to past levels and it is true that a large reason is due to factory utilization rates. The other side to this is that we conducted large scale CAPEX in 2016 and 2017, and therefore the factory capacity increased, leading to a lower utilization rate. From an accounting perspective, that is contributing negatively as an extra depreciation cost.

Q: This is not directly related to the earnings, but third parties such as Gartner and Strategy Analytics have released share data and it states Renesas' shares in 2018 have fallen. Your 40nm microcontrollers should be increasing in volume, but why are your shares decreasing despite this?

A: It is true that our shares are falling, and this could be due to a number of angles. In terms of

products, in areas we target such as IoT, Connected and ADAS, sensors and motors are widely used, and therefore the demand for analog products are increasing. However, our portfolio of analog products is insufficient compared to our competitors. Product development takes time and that can't be helped, but the fact is that we are not able to incorporate the high growth products' opportunities. As a second reason, we have not been able to incorporate significantly growth areas in Automotive such as EV and ADAS. If you look at this from another angle, the business volume outside these areas are large, and therefore if you look at the business as a whole, our growth rate is inferior compared to our competitors. A third reason is relevant to some power and microcontroller products, but when we announced the mid-term plan in 2016, we began improving our product mix and gross margin mainly in the Automotive business. As a result, we have partially stopped producing low profitability products and partially transferred low profitability products to a next generation. We did expect sales to decrease temporarily from these measures, and it is actually happening now. Our shares could be decreasing due to all these three reasons mixed together. Especially for the product and profitability side, depending on the products, improvements take time. In addition, with our current products which make up a large portion of our business, with the environment changing rapidly, we are changing our operation style to meet these changes as flexibly as possible, and in order not to reduce shares further, would like to continue into 2H.

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