

Third Quarter Ended September 31, 2018
-Financial Results Announcement (October 31, 2018) - Main Q&A for Briefing Session

Q: I would like you to explain the inventory situation, wafer input amount, utilization rate in the presentation material and how the inventory adjustment situation has improved.

A: As we call it “inventory adjustment”, we assume that inventory will decrease. In our case, however, a long lead time is required for manufacturing, and as an indicator for the future, we included wafer input figures on page 31 of the presentation material this time. It usually takes three months from input to finished products. Depending on the foundry, it will take 4 months or longer to become finished products. However, after August, you can confirm that we narrowed down the wafer input further than the conventional input pace. It is assumed that this effect will appear clearly after Q4, and as a result, by the end of the fiscal year, inventory will be tightly controlled. In the inventory figures on page 30, the results of hitting the brakes for a while are appearing little by little. With regard to our own inventory, although it is a little if excluding accounting factors, it is heading for a decrease in comparison with the end of June. As it is difficult to cover all the channels regarding channel inventory, we show pictures only for exclusive sales distributors (Tokuyakuten), but you can also confirm that there is a big decrease in that from the end of June to September. There has been a track record of inventory not decreasing as quickly, but you can confirm that we are controlling production considerably into Q4 or the end of the fiscal year.

Q: I thought that inventory adjustment had started from Q1 and Q2, but looking at wafer input amount on page 31, it does not seem like you have started inventory adjustment at the time. What did you mean by "stepping on the brakes" at that time?

A: I have talked about the fact that inventory level was too high or we produced too much from last year. However, I recognize I have stated the fact that we put a full-fledged brake on inventory adjustment in the Q1 earnings call in May. Compared to the input figure in March 2018, I think that you can confirm that the figure in May fell to a certain level. Therefore, I commented that we were beginning adjustment at that time. Looking back, however, it is undeniable that it was inadequate, as it turned out to be. We were gradually reducing input from March to July 2018. I think that in Q2 it became clear that it cannot catch up with the adjustment. So we started controlling the production in Q3 based on a different way than before. That is strongly reflected in the August figures.

Q: What is the situation of sales in Q4 in Automotive, Industrial and Broad-based respectively? What is the growth rate?

A: Automotive sales are expected to be positive QoQ and industrial/others are almost flat. For the breakdown of the Automotive sales, SoC sales for infotainment has been bumpy for a long time. Due to their long manufacturing lead times, our sales will move too much or short against end demands. Although it seems that SoCs for automotive infotainment grew from Q3 to Q4, other Automotive control sales were on par with the market, and we expect a relatively constant high-single digit growth. In terms of “Industrial” in a broad sense, we anticipate that it is nearly flat, but we anticipate QoQ reduction in applications like FA. Air conditioners mainly in China and white goods are also expected to reduce QoQ. On the other hand, we anticipate that applications centered on office automation will grow significantly, and when combined in total, it is almost flat in Industrial and others.

Q: There is concern about a decrease in demand due to the trade friction between the US and China. Is there a negative movement on trade friction?

A: We do not have the impression that the demand is decreasing from Chinese local customers and Japanese customers due to the influence of the US-China trade friction. However, as for the whole impression, we see that the demand is being postponed by entering the wait-and-see mode. Meanwhile, as the diversification of customers are progressing in our company's sales portfolio, we see the impact of the trade friction to be currently minor.

Q: Regarding the consolidated earnings forecast for the current fiscal year, it is lower than the previous year's results. Please tell us about the factors of the decrease in net income in particular.

A: I recognize that inflation of orders and demands occurred last year due to reaction to the earthquake and tight supplies. In reaction to that, the top line will fall, and the margin will be squeezed this term. In addition to that, as a result of capital investment being maintained at the high level last year and in the year before, depreciation costs have greatly increased compared to last year from this term. Due to these two factors, the margin is being pressured by the decreasing top line, increasing depreciation costs and manufacturing costs.

Q: I think that the influence of the trade friction between the US and China on the business performance is minor, but how do you deal with it in the future?

A: I think that it is an option to aim for regional diversification. Just as I said in the previous earnings call, I would like to take a more essential approach without being deprived of the surface and short-term things. As a Japanese company, we have friendly relationships with Chinese companies and American companies, so in order to be a necessary partner for either side, we regard it as an opportunity to communicate with customers by making more proactive proposals.

Q: Regarding inventory information in page 30 of the presentation material, how will the inventory move from the end of September to the end of December when divided into Renesas own inventory, foundry inventory and sales channel inventory?

A: We expect reductions in all.

Q: I feel that the whole semiconductor market is starting inventory adjustments. Even with competitors' earnings announcements, I hear that customers are increasing inventories from the end of June to the end of September. When do you think inventory adjustments will be over as a whole supply chain?

A: I think that we can finish the adjustment of our own inventory by the end of December. Regarding channel inventory, we expect adjustments will be postponed to next year in areas other than Automotive. We anticipate that channel inventories will be adjusted over Q1 or the first half of next year. Regarding the slowdown of the market as a whole, I think that the trend in our company has changed ahead of competitors thanks to the extremely tight situation of last year and the year before. As a picture seen from our company, we do not have a prospect of major changes in channel inventory and end demands in the future. I believe that the changes we were aware of ahead of time could be confirmed throughout the industry with a little time lag.

Q: The amount of inventories was about 141.5 billion yen at the end of September. How much do you see the level is lowered by the end of December?

A: I would like to refrain from commenting the exact figure, but it is supposed to reduce around 20 billion yen or so.

Q: At the time of announcing the mid-term plan in November 2016, there was an explanation that a LTV of over 500 billion yen was accumulated for the new design-ins for Automotive. What is the update for the current situation? When we decomposed the TESLA model 3, we saw the integrated solution of MCUs and I think there are beliefs that the number of MCUs will not increase. I would like to confirm how you see the move in the current Automotive business at this stage.

A: Nothing has drastically changed from the previous state. Regarding the integrated solution of MCUs, such discussions have been made for a while as you point out. Customers divide the automotive functions into several domains, and organize the architecture in a hierarchical manner by bundling the divided domains. Under these circumstances, the number of business talks for our SoC towards a place where computing power is required is increasing, and part of the business talks are very large-scale. Regarding the point that MCUs' volume may be reduced in the future, I think that we will see a move toward the integration in the long term, but we don't have business talks whose MCUs' volume will be considerably reduced, but looking at the time axis of the next few years, I think that these changes will not be materialized yet, so we will take appropriate measures during that time. Even if MCU volume decreases, we will continue to grow by increasing market share or ASP.

Q: With regard to Q4 sales forecasts, are there movements different from actual demand due to channel inventory adjustment? Please let us know if there are any visible movements in the Industrial business after 2019.

A: For the Automotive business, sales for SoC and some products are bumpy quarterly, but the impact of inventory adjustment is negligible if combined. Although it varies quarterly centering on SoC, if you view it in a half-year period, the movement of our company may be linked with the market. On the other hand, for Industrial, in a broad sense, especially in the case of MCUs for white goods, we think considerable adjustments of the channel inventory are required. Perhaps our sales will be considerably smaller than the actual demand due to inventory adjustments until Q1 next year. As for the demand of the entire market, the demand for white goods is getting soft compared to last year. Demands for the factory automation cannot be said to be slow as a whole, as the contents are patchy. It is no longer a strong situation across the industry like it has been a while ago; there may be further market softening.

Q: Regarding the utilization rate and gross margin, the forecast for gross margin for Q4 is 40%, which is lower by 3 points QoQ. Will the utilization rate be lowered further after October? Or do you have any other factors affecting the low gross margin?

A: The major factor that the gross margin is declining is production adjustments. In addition to that, we expect the cost will be increased as it is the end of the year. As you can see for the production adjustments and utilization rates on page 31 of the presentation material, we reduced wafer input from August in Q3, and we expect to continue the same level as August-September's input in Q4. On the other hand, if we mention the quarterly production recovery, since there was a large input effect remaining until the end of July, the utilization rate in Q4 will be lowered QoQ and the production recovery will be decreased as well. As a result, the gross margin will shrink in Q4.

Q: With regard to the IDT acquisition, since the stock price has fallen sharply in the semiconductor market as a whole, some says that it should be canceled even if paying the penalty. If there is a possibility to cancel the acquisition in the future, what would be the conditions to trigger it at that time? Is canceling the acquisition possible because the market has deteriorated?

A: Since we do not expect such events at this stage, we refrain from commenting on that. By the way, IDT announced Q2 (Q3 for our company) financial results yesterday. I would like you to see it, but even though the stock market has been adjusted considerably, the fact remains that IDT is doing well.

Q: You said that the increase in expenses such as R&D and SG&A is expected at the end of the fiscal year as shown in page 22 of the presentation material. However, the margin forecasts always exceeds the guidance every quarter every year. In this Q4's margin decline factor of 4.7 billion yen, how much cost item is already visible?

A: We know our guidance is said to be too conservative in the market, so we tried changing the stance slightly from Q4. The cost of Q4 we have included this time is aggressive compared to the past until Q3. I cannot deny the possibility of being blurred above and below. However, we are forecasting for less expenses to avoid situations like the past whereby costs continuously downturned the guidance, resulting in profit outperforming the guidance.

Q: Regarding the wafer input, if inventory level would be normalized after FY19, will you input wafers at the normal level as well? Is it possible to raise wafer input from August and September levels?

A: As a trend, we expect to return wafer input after Q1. Regarding inventory levels, once we complete the optimization of surplus inventory, it is better to manage with less inventory as much as possible, so we will continue to lower the target. Although there are some ups and downs from this point of view, I will assume that the factory utilization rates will rise from Q1 if I see the targeted inventory amount.

Q: For the general-purpose products business, what is the difference between the performance of Q 3 when divided into general-purpose MCUs and general-purpose analogs?

A: With regard to analog products, former Intersil products are highly versatile, while former Renesas products are relatively application-specific products. In regard to former Intersil products, Q3 is actually a record quarter and it is growing greatly. In regard to former Renesas products, we have accumulated individual factors, and as a result sales were greatly reduced QoQ. Although sales for former Renesas analog products were decreased by more than twice as much as the downward range of MCUs, on the other hand, sales of former Intersil analog products increased largely and on the whole, it was muted.

Q: Do you see any change in this situation in Q4?

A: We expect the sales to be flat in Q4 as we forecast former Renesas analog products to bottom out.

Q: I think the situation of general-purpose analog products has changed with the earnings announcements of TI or Maxim. How about Renesas' analog business?

A: So-called general-purpose analog products are expected to be down QoQ. In the above, I said “flat” for former Renesas analog products. I think that general-purpose analog products as a whole will go down. It seems that our viewpoint is not much different from our competitors.

Q: Why do you see the sales in Q4 remain flat while the market is falling and you are promoting inventory adjustments in Industrial and Broad-based businesses?

A: We expect decreases in sales of FA and white goods. On the other hand, we anticipate increases in sales of office automation, and if we look at it in total we say it will be flat.

Q: Since Q4 sales forecast includes intentional inventory adjustments, will Q1 sales return to being in-line with actual demand? In that case, should we look at about 190 billion yen as a target level?

A: We anticipate channel inventory adjustments will continue, especially for non-automotive applications. Therefore, I do not think that it will return to the level of actual demand. The guidance of Q1 will be discussed at the Q4 earnings call, but at the moment it feels like it will be a smaller number compared to what we see now.

Q: As for the inventory situation posted in the presentation material, Renesas' own inventories, foundry inventories and channel inventories seems to go down considerably toward the end of December. Since I heard that Renesas was making arrangements early as you are the sole vender for some orders for FY19, I cannot understand why inventories for foundry should decrease. I think that these orders were for automotive 40-nm MCUs, but will stocks other than that be reduced?

A: As you can see the table on page 31 of the presentation material, we anticipate that inventory will decrease as a result by narrowing down purchasing amounts from foundries. The point you talked was a story at the beginning of this year, and at the time, the automotive MCUs centered on the products procured from the foundry were expected to increase considerably in the latter half of the next fiscal year. I do not know that it really will, but from the trauma of the tight supply of the past two years, if it turns out that way, there is a strong desire by all means to avoid a situation where there is lack of inventory. As a result, we were too careful about narrowing down purchases from next year. We anticipate that the product group corresponding to this will also be steadily rising in the medium and long term, but in fact, if we anticipate the level of this term, currently the amount is actually a bit more than expected. There is an action to lower it to the appropriate level once, and as a result we are anticipating a decrease in inventory through the end of the fiscal year. Therefore, although it is not unnecessary in the medium to long term, it was judged that it is better to reduce once from the viewpoint of the balance sheet.

Q: Is it correct to assume that this order will ramp up from the second half of next year?

A: It is a bit behind the original number, but it is surely ramping up. That has not been changed.