

Consolidated Financial Forecasts Conference Call (Q&A Session) for Q2 FY2020/12 (Held May 29, 2020) Summary

<Comments from CEO Shibata>

Thank you very much for attending today.

At the Earnings call on April 27th for Q1, I mentioned that there was too much uncertainty to provide guidance as usual.

At that time, we talked about something like a launching pad, which for QoQ sales would be lower by about 6%. In addition, we said that there was the downside for production and downside for demand, and those could not be quantified.

A little over a month has passed since then, and now that we have a little over a month left in Q2, we are gaining an overall outlook, which we decided to share with you today.

As you have probably seen, as a result, we expect the revenue to decline by more than 12% sequentially. The midpoint is JPY156.5 billion. On a non-GAAP basis, the level we project for the midpoint gross margin and the operating margin are 46.5% and 14%, respectively.

Almost all of this revenue decline is from the Automotive segment. In Automotive, we produce a considerable portion of products at our own plants, so there is a slight time lag in production adjustments. This time, in terms of the midpoint of the margin that we are offering, we are seeing a slight preemption of margins.

Unlike in the past, there was the original intention to accumulate BCM stock, and the margin has been increased by about 250 bps due to the time lag that naturally happens.

Regarding these figures, production will naturally be adjusted after Q2 through the third and fourth quarters. In that context, please note that there will be figures on the opposite direction which will have a restraining effect throughout the year.

<Questioner 1>

Q: I have two questions. First of all, I'd like to ask about the operating rate for wafer-based input for April-June, and I think there is about a week of summer vacation every year towards July-September. How are operations going to be managed, including how to halt operations? First, I'd like to have guidance for July to August.

A: (Shibata) As a result of the factors I mentioned at the beginning, we intend to extend the period of shutdown for some time compared to the plant's original operating schedule. As an image, I think it would be right to assume the same kind of production adjustment as last year.

Although the timing will be different from that of the previous year, we think the range of production adjustment in the first half up to Q2 will be roughly the same as in the previous year, while there are some internal differences.

Mr. Shinkai, if you have anything to add, please.

(Shinkai) Looking at the utilization rate on an input basis, Q1 was roughly in the mid-60% range, but we expect to see a reduction of more than ten percentage points from that in Q2.

Q: Thank you very much. Second, we are about to enter June, but are you seeing any stabilization or even a rise in customer orders? Or, because of the slight time lag, do you have a fairly lowered QoQ perspective toward July-September? While it may not be just about the Automotive business, please give us your overall view and direction toward July to September.

A: We have quite a solid outlook for the fields other than Automotive. This Q2 there were some specific factors, such as temporary revenue from past EOL, so that part will be removed in the Q3. In any case, it seems that the market will move in a rather solid manner, and the backlog coverage is very extensive. In a way, the coverage will be high, so we currently don't think we have to worry about the situation for the areas other than the Automotive business.

On the other hand, honestly, it remains very difficult to make forecasts in the Automotive business, and we have to say we need a little more time to be able to express our outlook. To date, however, the best we can say today is that we can't expect the situation to hit bottom in Q2 to rise from Q3. It may remain at the bottom or become slightly weaker.

But again, please understand that it is still too early for us to talk about a direction in a true sense. At the same time, as this is the situation, we are starting to make efforts to increase predictability by taking the lead time for orders as long as possible.

Q: So compared to a month ago, when there seemed to be considerable fear of a decline towards the July to September quarter, the situation doesn't seem to have really stabilized, or you haven't let go of the prediction that there will still be a decline. Is that how you see it?

A: The answer is yes and no. You may remember, but one month ago we really didn't have an idea of Q2 figures. Therefore, the baseline figures were, naturally, quite higher than the guidance provided today.

Compared with that time, when we felt there would be a considerable drop from Q2 to the third, now that some adjustments have been made in Q2, we think that even if there is a decline, the extent of the decline from here to Q3 would be much smaller than what we had expected a month ago.

<Questioner 2>

Q: I'm sorry, I missed one point. At the beginning of the meeting, Mr. Shibata said that there might be preemptive margins in Q2, and I think he included quantitative figures. May I confirm those figures?

A: Yes, I said about 250 bps.

Q: Thank you very much. As for my second question, you mentioned the possibility of inventory adjustments from the second half of this fiscal year. I think there were phases of inventory adjustments in the last year and the year before, but as adjustments were made, there was some struggle in order to resolve the adjustments.

In the current adjustment phase, are you adopting some different approach from the previous times so the adjustments can be swiftly ended? I'd like to know if there are any initiatives that are different between the previous adjustment phase and this time.

A: I think we said last time or the time before that we made several changes in the way we worked in the last adjustment. We were talking about what we did each regarding the relationship with suppliers, our internal decision-making, and our relationship with customers.

In addition to what I mentioned earlier, we are now considering how we can further make improvements in our relationship with customers. We would like to work on this without delay.

Other than that, we don't feel the need to do anything additional for now. We don't think that we will be perceived from the outside that we are struggling to move things forward, as was the case last time.

However, let me reiterate that, although there is currently such a decline in demand, we are trying to avoid opportunity losses, particularly in the non-Auto segments. And, of course, there are considerable shades depending on the product, but when it comes to the stock of BCM, we need to be fully loaded, otherwise something like shortage in supply may happen again. This is from the perspective that we have to be prepared for adjustments in the top line.

As for the Automotive business, this time the sequential numbers are considerably lower, but if you look just at R-Car of SoC, for example, the size of decline is very small. The new generation are ramping up. These products are sent from TSMC, for better or worse, so the lead time is long.

In these areas, if we accept an increase in inventories, we anticipate changes in dynamics including a contribution to the top line. The inventory inevitably goes up or down on a quarterly basis, but I would appreciate it if you understand that this is done with awareness this time.

<Questioner 3>

Q: I would like to have some nuance by application. Compared to a month ago, I had the impression that the main decline is in the Automotive business, and the other businesses are not as affected, but is it correct to understand that major adjustments are being made only in the Auto business?

A: That's correct.

Q: Okay. My second question is about the future outlook. I recall some comments about stay-home demand or temporary demand at the previous meeting. Regarding that, do you think that they will end in Q1 and there will be moves towards inventory cutbacks together with the Auto business after Q2? I assume this might be the case for FA, or perhaps medical devices and home appliances. What do you think?

A: That is an important point that we are watching carefully, but at least in the time horizon of around Q3, we don't expect something like a major reactionary reduction will happen.

If anything, rather than healthcare products, the categories we expect big ups and downs are products like tablets and PCs, so we will keep watching this area carefully. Regarding Q2, the situation is still a little stronger than usual.

Q: Thank you. Finally, please provide an update on the former IDT products for data centers and base stations.

A: IDT and Intersil are showing similar trends, and data centers remain strong. This has not changed.

Roughly speaking, I said that there has been little change except for the Automotive business. I'm talking about Q2, but in fact, compared with our forecasts one month ago, our outlook for data centers and some

base stations have become even stronger. Therefore, the scenario has not changed at all, while the figures are trending slightly more strongly than the previous time.

Q: As a follow-up question, what do you think about the sustainability of the trend? I feel that demand for data centers exceeding expectations may continue rather than being temporary, but what do you think?

A: I largely agree. Some news reports say that certain hyperscalers may reduce CAPEX, so we are keeping a close watch, nevertheless. As of today, we have not found any negative factors in either data centers or base stations, so we are hoping that this trend will continue.

<Questioner 4>

Q: I have two questions. First, if you look at these figures, the operating margin is 14%. I recall that last time this was only about 7%, but if there was an increase, did you make any major cost reductions? This is the first question.

Regarding the next question, particularly in Europe and the United States, many car manufacturers were shut down in March. Even as almost all of them have resumed operations since around mid-April, why has the Automotive business suddenly become worse in Q2? Those two questions, please.

A: Regarding your first point, you seem to be comparing the GAAP figures with non-GAAP figures. I don't think the numbers you are seeing are apple-to-apple, so you can check it out.

Second, we don't think the automobile factories are resuming operations that smoothly. If you look at them, although some of the plants are starting up, we believe they are actually operating at a fairly low level and quite slowly.

Especially with regard to plants in Japan, the shutdown period itself was considerably later than that of European and US plants. We are currently verifying the adjustments in our demand from various perspectives, but in fact, we feel that they are fairly in line with the overall situation.

Q: I see, thank you. Then, in your case, are you mainly catering to automobiles for Japan rather than overseas markets?

A: Japan accounts for slightly less than 50%. As you may know, manufacturers also produce cars in Japan that are exported to other markets. In terms of production areas and demand areas, domestic demand is just slightly less than half, but in terms of end demand, there is probably a little less for the Japanese market. Of course, the number of automobiles sold in Japan is not so large in the world, so it's more accurate if you think that Europe, the US, and China account for very large portions.

<Questioner 5>

Q: This might go into the details, but you mentioned that R-Car and other advanced areas are relatively growing in the Automotive business. Please tell us if there are announcements like which categories are doing well and which are struggling.

A: For example, SoC is relatively strong, as I just mentioned. IGBT used in EVs are also relatively strong. Then, although it's hard to say that it's doing well, among microcomputers, those of new generations are seeing a slightly smaller decline.

Roughly speaking, you can understand that smaller declines are seen mainly for SoC and IGBT, which we are ramping up. Apart from those, the decline is in line with the decrease in automotive units.

Q: I see. Then, is it correct to understand that most of the products are falling in line with automotive units, while there are some products that are doing slightly better?

A: I think that's fine for the most part.

<Questioner 6>

Q: At the consolidated results briefing held at the end of April, you said that you will consider expanding your commitment line. What is the current situation? Please give us an update.

A: We are continuing discussions with our main banks. We would like to refrain from disclosing individual information here.

Q: Okay. I have another question. Also, at the end of April, you said you will secure cash on hand, including the liquidation of accounts receivable. What amount of money do you intend to secure, including such detailed items?

A: We are currently implementing the measures that we had planned at the end of April. I'd say the outlook has not changed significantly from there.

<Questioner 7>

Q: I have one question. If you calculate back from the guidance on non-GAAP gross profit midpoint and the non-GAAP operating margin midpoint, Q2 SG&A expenses will be approximately JPY50.9 billion, roughly on par with Q1.

I think there is a tendency for your SG&A expenses to increase in the second and fourth quarters, but it seems that this year it is almost flat QoQ. At the time of Q1 call you mentioned that you will work on cost cash management early on, so I would like to know if you can share any cost-cutting and control measures you have implemented.

A: As you pointed out, OPEX is expected to be flat QoQ. Adding some content, R&D is a single-digit increase and SG&A is a single-digit decrease, so the net change is flat. As you can see from here, we have already begun control, particularly with small items in G&A spending. I believe those efforts are reflected in QoQ movements.

[END]