

Analyst Call Regarding the Temporary Shutdown of Renesas Factories

(March 8, 2019)

Q&A

(Shibata CFO)

I would like to explain our plans behind the temporary factory shutdown.

A large reason for implementation comes from reflecting upon last year. It has been nearly 6 years since I came to Renesas, and the company's nature is its ease and ability to respond to increases in demands and customers' requirements with agility and autonomy. On the other hand, when it comes to a downturn, there is a trend to end up running behind, and while we tried different ways last year, there was no impact. From the second half, we changed our ways and were able to control our inventory towards the end of the year. To reflect on these actions, we are implementing a temporary factory shutdown.

The visibility into the second half of this year is limited. As mentioned at the earnings release, our internal figures are not entirely pessimistic. However, the outlook is still unclear. It is possible it will improve or worsen. Taking into consideration of the company's nature, it is easier to operate by creating a base from a low outlook and responding to demand as and when they come. This allows us to perform well financially without affecting our customers. Therefore, we will continue our style to give a low forecast for our production plan, and if demand increases later, to produce more. However, the utilization rate is currently low, and to ignore this fact and continue operation is also an issue. To contain fixed costs, the ideas we had which not only included a top down but a bottom up approach, was to temporarily shutdown our factories.

As included in the statement released on our website yesterday, nothing has been decided. There have always been long vacations in May and August, and the idea is that if we were to shutdown factory operation for a prolonged period, these months would be the most appropriate. We are trying to clarify what needs to be done by explaining our thoughts to our customers. There are some reports that say, "the market is collapsing and therefore Renesas is reducing production by 10%", and although the current situation makes it difficult to make forecasts, it is certainly not the case that the outlook is tough, and we are in a hurry to control production. This implementation is to follow our flexible operating style which allows us to cope when demand suddenly increases by forecasting low demands.

Q) Is there a change in the outlook for demand? On the news reports, it gives the cooldown in the Chinese market as a reason, but has there been any changes in demand since Chinese New Year?

A) We track demand forecasts by combining the end and channel figures into our system. There, we do not see any major changes. However, the macro index for January does not look good. There seems to be a movement where February's demands are moving back into March, though we are not seeing these movements in our figures. While we do not expect the current figures to remain the same, there is no guarantee that the figures will improve or worsen, either. Therefore, from the figures we can see now, we will assume a low demand as a base and create a production plan. This does not mean there were any changes to the demand outlook.

Q) At the February earnings call, you stated that your “in-house inventory was more or less adjusted to a healthy level by the end of the year”. What are your thoughts on your inventory now? Are there any changes to your direction of reducing inventory while demand outlook seems to be weakening?

A) Nothing in particular. Although there will be changes in volumes due to technicalities, on average, we think the inventory level is optimal. At the channel, however, there are slight excesses in non-Auto products. The question is, how long will it take for the piled up non-Auto inventory at the channel to be adjusted, but it depends on the certainty of the end demand.

Q) Please tell me about utilization rates and costs. Utilization in Q4 was around 55% and the Q1 outlook was +10%pts. If you were to shutdown the factory for a month each in Q2 and Q3, will the utilization for the months where the factory will be operating be running at full capacity? Looking at this at the same perspective as your annual revenue outlook, is there a difference in costs for running the factories at a lower utilization rate through the year and temporarily shutting it down? It sounds like you can receive some kind of subsidy if you shut down the factories?

A) Although we do have figures internally, we cannot disclose them. We are expecting a cost reduction of a lower double digit oku-yen. If we were to temporarily shutdown the factories, for the period outside the shutdown, the utilization will likely be fairly high. Though the 12 inch line will weaken, the 6 inch and 8 inch line utilization should increase.

Q) Will utilization return to 80-90% in Q4?

A) Nothing can be said. It depends on the demand.

Q) The operation to migrate from zero to a high utilization rate is innovative. Why do other companies not do, or cannot do this, while Renesas can? Please explain along

with the risks.

A) We are not unconcerned about the technical implications of shutting down all factory operations and restarting again. Everybody would like to avoid risks as much as possible. As a company, we are good at increasing production to meet customers' requirements. However, we have always been hesitant to put the brake on production when inventory is building up. This time, we are attempting an operating style where we press down on the accelerator and the brakes at the same time.

Q) There are reports that say your production in 2019 will decrease by 10%.

A) The said 10% decrease could have been a calculation based on the fact that out of the 12 months, we will shut down our factories for a total of 2 months. However, this calculation does not reflect the increase in utilization for the months where the factories are not being shut down. Renesas does not give a forecast for the full year, as it is difficult to make a prediction. We are preparing to respond in an agile manner, and therefore we are not currently forecasting a 10% reduction.

Q) Your share price fell significantly following the news reports. Is your communication with the market inefficient? What will you improve or change in terms of communication going forward?

A) This issue gives me a headache. As for the market, we are consistent with our messages and try to minimize any surprises. However, it is not ideal for information to be published almost as a scoop outside of the market. Although it is common within Japanese companies, it is an ongoing problem to improve information control. If the contents were accurate, it wouldn't have been a problem, but it is not ideal for the information to be misleading. It's not easy to set a plan to accomplish targets to be completed by a certain time, but we are aware of the issue and we would like to appropriately tackle it.

Q) You mentioned earlier that the cost reduction had an impact of a "lower double digit oku-yen", but is that the total of implementing the factory shutdown in both May and August?

A) Yes.

Q) Regarding the shutdown, are there any changes to the outsourced portion of production?

A) No.

Q) It's innovative that you can stop production for a month but by operating at a high utilization for the remaining 2 months you can still meet customers' demands. However, doesn't this mean your production capacity is excessive? Have you considered reduction your production capacity through measures such as factory closures?

A) Although there is no general answer to this question, an example from a competitor would be TI, whose operation means factory utilization rates are low and have some allowance in their production capacity, and still take businesses that give them high margins. Ideally, we will have operating leverage that doesn't impact our profits if there were small changes to our fabs' utilization rates, and for questions regarding our fabs are not raised in the first place. It took TI 15 years to achieve this, and we cannot spend such a long time like they did, but if demand was to slump for a long period with certainty, a revision in the production capacity as a whole would become necessary. However, for the business we do, the outlook is not bad in the mid- to long-term. There may be ups and downs in shares within Automotive, Industrial and IoT, but demand will increase in the mid- to long-term. We cannot just idly increase utilization. We would like to consider this calmly. For new products designed, we assume to utilize outsourcing. If the demand does not increase in the mid- to long-term, our fabs' loading will certainly decrease. If that were to happen, we will adjust our production capacity in a timely manner.

Q) TI has a market share of 90% and a gross margin of over 80% in some areas, and pricing strategy is also important. What ingenuity does Renesas need?

A) We are thinking about a lot. Although there are limits, for current products, we increased prices and prevented price reductions. What products we will compete against which competitors will be a definitive factor in pricing control. Therefore, we have always stated our need for analog products. TI are not gaining high margins without sticking to a specific product group. We need to build a portfolio that allows us to gain high margins. The company we are acquiring is small and therefore outsource their production, but it may be possible to produce some of their products in our lines.

Q) This shutdown is to prevent inventory buildup, but does this mean you are consciously making the decision to control inventory despite the occurrence of opportunity loss? You may have already started talking to your customers, but do they understand? Will you be halting delivery to customers during the factory shutdown, or will you be delivering in a timely manner?

A) We will not be stopping the delivery to our customers. It will either be delivered from

existing inventory or produced ahead of the shutdown. We have began communicating with our customers and suppliers, and as it is happening right now, individual details are being decided. It's an issue if inventory builds up, but if we control inventory, there are chances of opportunity loss. We can only try and maintain a balance. We will not be forgiven if we try and avoid opportunity loss over inventory control and lead to another inventory build up like last year. We must absolutely control inventory, and also aim for zero opportunity loss as much as possible.

Q) What triggered the decision to “halt production”? You said you want to maximize profitability, could you not foresee any impact to your share price? I feel like there were other ways to make this announcement, especially since it's hasn't been a month since the earnings release.

A) This measure is implemented from a demand perspective and a cost perspective. The former is to control the outlook for volatility of demand, while the latter is to control inventory and fixed costs. The outlook for demand has not changed in terms of figures. However, the January figures are not good, and we decided we wanted to avoid operating with an optimistic plan when the macro environment is bad. As movements in the beginning of the year becomes clear, we listed our priorities and came to a solid decision on operation despite large volatilities. We formulated the annual budget and began operation without deciding on a goal for how to tightly manage costs and inventories. As time went by, we devised and put into action a plan on how to meet the goals, but it did take some time. It's not rare for us to think while we move, and this has always been our operation method. Therefore, the measures were implemented at this timing.

Q) Will you implement the supply time volatility onto the suppliers? What is your view on the cost reduction impact in the long term?

A) Some supply will be stocked up, but some will continuously be delivered to us. For the latter, the delivery will be halted while we halt production. Unlike some raw materials, it's not like we will lose negotiation power because supply is tight, and suppliers have strong price negotiating power. We do not think this measure will give the suppliers' price negotiation power any impact and that we will not be able to negotiate further price reductions/ We have been taking these into consideration from the beginning of the year, and it was not a decision we could have made without taking time.

Q) There were some reports that customers were switching vendors to different sources and therefore your market share was falling. Has this resulted in any

changes to your situation?

A) It's simply not our business structure for shares to drop by half over a month following the earnings release. It does not make any impact on our current outlook. We still don't know how long into the future the impact from the Kumamoto earthquake will affect our market share, so we must consider how to allocate resources to growth areas and maintaining or increasing shares as a result. This is not to optimistically say "everything is fine, the shares are returning", but to consider our options and take the necessary actions.

Q) Last year's BB ratio was below 1, but you plan to increase shares as a separate issue to the factory shutdown?

A) Yes.

(Shibata CFO)

Regarding communications, we will continue our efforts not to give any surprises to the market.