Second Quarter Ended June 30, 2019
– Financial Results Announcement (August 6, 2019) –
Q&A for Briefing Session

Q. There are 4.7 points difference between the Q2 Non-GAAP Operating Margin results and the guidance. Can you explain the difference?
A. (CFO/Shinkai) For the difference in Operating Margin QoQ, the biggest factor was the change in OPEX. OPEX changes are around 5 billion yen. Around 20% of this is due to positive measures, such as reductions of nonessential and nonurgent costs, or by realizing early cultivation of IDT cost synergies. The rest are gaps caused by reviewing nonessential and nonurgent R&D costs, or its partial cancellation.

Q. Within the 4.7 points, 1.3 points come from costs, while the rest of the 3.4 points can be split between the 20% and the 80% you mentioned?
A. (CFO/Shinkai) That would be right.

Q. In terms of the Q3 sales revenue forecast, can you explain the portions for Automotive and Industrial?
A. (CEO/Shibata) For Automotive as a whole, the Japanese yen has appreciated and is making a negative impact. Excluding the forex effect, Automotive shows a slight increase of about a low-single digit. Non-Automotive excluding IDT is slightly down, almost flat. IDT faced a mixture of special factors this quarter and are forecasting a QoQ decrease of about 10%. As for the end market demand outlook that we have, Automotive looks to be almost flat QoQ. Therefore, if the end market is flat and the company revenues are looking to grow just a little, there may be some channel inventory buildup, such as BCM (Business Continuity Management) inventory. As for non-Automotive, excluding the forex effect, we may be able to expect a low-single digit or even a mid-single digit increase in the end market.

Q. In Automotive, there are views that gasoline engine related sales growth will decline while EV and hybrid related sales will increase. How do you analyze your revenue being flat QoQ if you were to separate Automotive into control and infotainment?
A. (CEO/Shibata) Infotainment includes SoCs, which means there is a long lead time. As we have mentioned before, the movement here is bumpy and therefore is hard to

predict. The QoQ outlook is that control will grow more than infotainment. As for xEV, the main growth will be from power trains, at a similar level to Automotive control.
(EVP/Yamamoto) For the mid- to long-term trend, the growth in gasoline engine is a little slow, as you said, and EV will grow at a higher pace. With the uncertainty in the economy, OEMs are delaying their projects including the launch timings for new models, but it would be just as we've stated in the short term.

Q. What is the main driver for the slight QoQ growth in Industrial?
A. (CEO/Shibata) It is hard to say as there are contrasting factors, but we feel some of the so-called hard-core FA related products are hitting the bottom.

Q. In regard to the factory shutdown, you said it will happen again in August, but would this be similar to the May shutdown or more of a production adjustment? Which factories are being shut down?
A. (CEO/Shibata) It is within production adjustments. There are contrasting factors, but this is not a limited measure for some factories. We will adjust production in front-end and back-end factories.

Q. Due to the US-China trade friction, the Japanese yen has appreciated, but what do you see from this situation and what impacts are you expecting?
A. (CEO/Shibata) It is very bothersome. As we have previously shared our two issues within our internal structure, the operating leverage is too high and there is a large impact on profit and loss from factory utilization, and the impact of the forex sensitivity is also high, so we are trying to take measures to shift the cost basis more towards other currencies rather than the US dollar and the Japanese yen. However, a large portion of the new revenue acquired is US dollar based and the forex sensitivity is on the rise. The Japanese yen appreciating has been an issue for us and is actually becoming a bigger issue.

Q. Would there be an impact if growth in Korea declined due to the trade restrictions imposed on Korea by the Japanese government? How do you see the impacts going forward?
A. (CEO/Shibata) The measure undertaken is to make export procedures a little stricter and while there may not be a direct impact, the two possible issues would be how our Korean customers may change the priority of its Japanese suppliers, and whether if our Korean customers slow down as a result. This is an issue that cannot be ignored, and we

would like you to understand that this is one uncertain factor that results from the macroeconomic environment.

Q. There doesn't appear to be a huge change in operation direction after the CEO change, but after Shibata-san becoming CEO, what will be changed and what would you like to change?

A. (CEO/Shibata) As a disclaimer, we are still in the process of making the company mid-term plan, so we would like you to wait for the details. For my current opinion at this moment, I would like to further separate Automotive and others. There are many differences such as the structure of the industry, design cycles, advancement of technology and trends, so there are some impossibilities if we treat all industries as the same. The segment disclosure is one step in this direction and if we are able to explain the businesses with this in mind, we will be able to show you the new mid-term plan which separates Automotive and others quite differently. To give more details, in terms of what must be done, I don't imagine a lot to be changed. If anything, it should be kept the same. On the other hand, the time span in order to achieve this, how to execute this and the priority will depend on the changes in the economic environment, so must be adjusted as needed. With all these in mind, we will be able to present the new mid-term plan with Automotive and others separated with quite different flavors.

Q. What do you see for the July – September utilization rate? The Gross Margin in April – June exceeded forecasts by 1.3 points due to fixed costs, but how does it affect the Gross Margin in July – September?

A. (CFO/Shinkai) Q3 utilization rates are forecasted to increase about 10% points from the graph shown on page 10 of the presentation material. In regard to the impact in Gross Margin, the fixed cost reduction which exceeded forecasts in Q2 is fairly temporary, and the QoQ increase for Q3 Gross Margin is mainly due to the increase in profits due to a QoQ increase in production.

Q. If Gross Margin is almost flat despite utilization rates increasing by 10% points, there must be some other kind of reductions to substitute the increase in utilization rates. How should we think about this?

A. (CFO/Shinkai) The QoQ Gross Margin improvements in Q2, which exceeded forecasts, are partially from temporary factors like cost reduction, and this will not continue. Please understand that the Gross Margin will increase from a low level of wafer input across Q3.

(CEO/Shibata) To add, when we say utilization rate will increase by 10% points, we mean wafer input base. The figures that affect the earnings are output base, and there is a time lag. The actual factory operation will increase by around 10% points, but the utilization rate at the time of the products completing will not drastically change, so please understand those to be separate.

Q. I heard that the former CEO became under review of the Nomination Committee because there were some loss in Automotive market shares according to third-party data, but what plans do you have for regaining those shares? In addition, in 2016-17, the trend for Automotive D-in was extremely encouraging, but can you tell us what has been the trend for this year and last year?

A. (EVP/Yamamoto) There are several reasons why Automotive market shares may be lost on a revenue basis. For example, if you look into our history, the combination of market shares from electronics companies which were former parent companies for Renesas resulted in market shares to be 100% for Renesas within some companies. From a Tier 1 perspective, there are high risks in terms of supply chain, if one company dominates and in order to bring other companies to the mix, Renesas' market shares have been decreased structurally. In addition, after the Tohoku earthquake in 2011, overseas Tier 1s were afraid to be solely reliant on Renesas, and therefore market shares were adjusted slightly. Furthermore, we did have high market shares in MCUs, but some Japanese OEMs began to struggle, changing the strengths Tier 1s had. We were not able to catch up with these changes, resulting in a decrease in market shares as a mid-term trend. It's difficult to regain market shares quickly once they are lost on a revenue basis, but as it has been pointed out, there were large amounts of D-in in 2016-17, which helped us avoid further market share losses, and will be a large factor for us to maintain and regain shares going forward. As the Automotive Solution Business Unit, we would like to continue our D-in efforts. On the other hand, if we were to try to take every single D-in opportunities, the resource management will become increasingly difficult and it may lead to inability to develop products effectively if we take on too many opportunities, so we would like to have a structure that will allow us to select opportunities that match our resources and to increase resources and opportunities. Recently, compared to 2016-17, the D-in amount was decreasing, but we believe 2018 was a time for preparation for further D-in efforts and we are accelerating efforts in 2019, so we should be able to give you more insight at the Q3 earnings.

Q. In terms of inventory, the channel inventory still seems a little excessive, but when will this be resolved and what is the direction going forward?

A. (CFO/Shinkai) In terms of channel inventory, as it has been mentioned before, Automotive inventory may increase going forward due to BCM demands. On the other hand, non-Automotive inventory depends on the end market situation, but we believe it may be flat or a slight increase.

(CEO/Shibata) This means that adjustments will take a little more time. We would like to reduce non-Automotive inventory within the year.

Q. What impacts are there from the fourth additional tariffs between the US and China? Can you tell us what risks you see?

A. (CEO/Shibata) This is hard to predict. There are no immediate signs of a large slowdown, but there will surely be impacts on OEMs who produce in China and sell in America. We need to understand this more, but we must carefully determine the risks. On the other hand, we have incorporated any risks we can foresee in company-wide operations and are careful in trying not to let anything surprise us even if the worst happens. This includes the production adjustments in factories, and though it resulted in creating some confusion, there has been no change in the operation policy. Even if there are impacts from the fourth additional tariffs, we are currently incorporating large risks from the Japanese Korean relationship in planning our internal action plan, but the end result may be that these risk buffers may balance out.

Q. In regard to the current earnings and the forecast for IDT, until now YoY seemed to be increasing, but Q2 results showed a 2% increase, and without the forex effects it will almost be flat. What was the background to the slowdown in growth? In addition, in Q3, it appears that there will be around 10% decrease in Q3, and YoY would be a decrease of around 15%. What is the reason of sales decreasing in Q3?

A. (CEO/Shibata) One factor is caused by mobile handsets and base stations. High-end handsets are struggling, and IDT's wireless power charge, mainly used for high-end devices, are slowing down. This is purely market related and have no geopolitical impact. On the other hand, for base stations, about half of the slowdown is caused by market slowdowns, but there are moves to pass or wait and see for 4G investments, and to move quickly onto 5G investments. In the end, IDT do both 4G and 5G so there should be some positive impact coming to 5G, but at the moment there are slowdowns in 4G which is maintaining a negative impact. In addition, some larger users for datacenters are behind on return on inventory compared to other hyperscalers. Q2 should be the bottom, with little recovery in Q3, and should start to pick up in Q4. In total, as we have been saying, it is true that it is no longer the case that IDT are very good at selecting their customers and are continuing to grow as they are not receiving an impact of the weakening market, and although we need to carefully determine the situation across Q4, the general forecast is that this is likely to be a tough year.

Q. As you explained in the previous earnings call, how much cost saving measures are being taken in the second half? Tell us the impacts of the early retirement program undertaken in Q2 and the amount of cost saving measures being taken in the second half.

A. (CFO/Shinkai) There are 2 cost saving measures, and one is the early retirement program as you mentioned undertaken at the end of Q2, and the impact should be felt in Q3 and Q4. The overall impact to the Operating Profit across 2019 is estimated to be high-single digit billion yen. The other measure is the cost synergy realization planned at the time of the IDT acquisition, and part of it has already been included in Q2, but we are well on our way to the initial annual cost saving target of 80 million USD. From these measures, we believe the cost saving potential for Q3 and Q4 would be significant.

Q. How much of the 80 million USD can you see will be shown by Q4?

A. (CFO/Shinkai) The annual target of 80 million USD is the run rate for 2020, and some of this will be realized within 2019.

Q. One of your major customer Denso submitted a Large Shareholding Report and appear to be buying Renesas shares recently, but do you have any comments? Are you asking them to buy your shares?

A. (CEO/Shibata) We have not made any such requests from our side. In addition, we have no information to share with you regarding this at this time.

Q. In the Q3 forecast, Operating Margin is said to increase by 2.3 points compared to Q2. This is possibly due to the headcount reduction, but what other analysis can be made?

A. (CFO/Shinkai) Although this is a repetition from an earlier question, the 2.3 points are the results of the Early Retirement Program and the cost saving effects from IDT synergy.

Q. In terms of Capex going forward, it appears in the appendix of the presentation material to increase again in Q3 despite reducing it in Q1 and Q2. What is the reason for this? What are your plans for R&D?

A. (CEO/Shibata) We control Capex to about 5% of revenue, and as it is stated on page 21 of the presentation material, it has been controlled to remain at relatively low levels for the past 2 years. It may appear that Capex is increasing over Q1, Q2 and Q3, but the increase in Q3 includes investments to increase production. As for R&D, totaled with SG&A, we are controlling it to be within 30% of Revenue, and we plan to continue this policy.

Q. With the change in CEO, will the direction for new product development change? In addition, with the temporary production shutdown, the utilization rate remains at low levels, but does this mean there is too much production capacity and there needs to be a reorganization going forward? What are your thoughts?

A. (CEO/Shibata) R&D is important, and as we mentioned when we talked about Automotive shares, we were focusing too much on Digital products in Automotive. Digital products contents will not grow. On the other hand, Analog product contents will increase, so we would like to change the balance slightly, in terms of the development process and how the money is spent. However, we do not plan to take our feet of the accelerator for future developments. From that perspective, we would like you to look at Automotive in a longer time span, and we believe it needs to be explained separately. As for the utilization rates in factories, as shown in the Capex plans, to put simply, we invested too much between 2016 and 2017. It would cause a misunderstanding to say some of the equipment are dormant, but there are vacancies and we must do something about it. I do think this is a serious issue. However, there are many factories and each factory produce different products and have different utilization, so to summarize all factories when having this discussion is not ideal. We need to consider what is being produced and what will be produced at each factory going forward, and therefore what measures need to be taken; we do not plan to take too much time in considering this, but we must consider them carefully.

Q. In recent years, you were in a phase of making profits by controlling Capex and R&D, but when will you step on the accelerator? Would that timing be illustrated in the mid-term plan you'll present to us within the year?

A. (CEO/Shibata) If you look at the figures, you will be able to see that we have been doing a lot of Capex over the years. Especially between 2016-17, we have invested about 20% of sales, so you can say we definitely pushed our feet down on the accelerator. As for R&D, as we need to control the overall profit and loss, the overall amount is lumpy, but even with the percentage, even during recent challenging times in terms of revenue, we have not reduced our R&D expenditure. You can see in the materials that R&D percentage against revenue is increasing. It would not be ideal from a financial standpoint to continue increasing R&D costs, but within the figures presented, we would like to change the balance or to maximize efficiency and increase the amount spent in a particular product or area.