Third Quarter 2020

Conference Call (Held October 29, 2020) Question & Answer Summary

---

<Questioner 1>

Q: First, let me know what the actual utilization rate is. I believe that the utilization of the front-end, that you mentioned in page nine, takes into account the capacity that will not be used in the future, so please let me know how much can be done on an actual basis to increase production on its own.

In conjunction with this, please tell us whether you are properly securing the capacity of the foundries. I've heard that old geometry such as 8 inches is quite tight, so I'm wondering if it won't be a hindrance to future growth. This is the first point.

A: Regarding your first question, especially the one regarding page nine, the unused capacity is not deducted here, so please understand that this figure shows how much utilization is physically capable.

Regarding the securing of the foundry capacity, we are doing our best to not make it an obstacle. 8 inches and 12 inches are very tight, as you can see. In our case, the impact of the microcontrollers, SoC, and vehicle load is significant for 12 inches. As for the 8-inches, the impact on analogs is large, particularly in PMIC.

So far, we have established very good strategic relationships with each foundry. Although tight, we are constantly doing allocations and so-called pull-ins to keep up with the demands of our customers. From me, that's all.

Q: How much room do you think you have for your own capacity?

A: Please see the slides on page nine. In terms of aggregates, it means that we can still make about twice as much as we do now.

Q: Is there an actual basis? I think that a 6-inch line cannot be used for microcontrollers, et cetera. For example, if I look at microcontrollers, how much room do I have?

A: With actual basis, do you mean for each product?

Q: That's right. I'm afraid your company can't afford the capacity of 12 inches or 8 inches, though there would be some room for 6 inches. What do you think?

A: There is indeed. As you can see on this slides, 12 inches are represented by purple lines. 8 inches are yellow lines, each of them have similar utilization rates. It is by no means a number we can brag about, but there is capacity.

Q: Second, I would like to ask about the industry's outlook for the future. Of course, I think there was demand for “Work-from-Home” or “Stay Home” this year. Are you operating now with the expectation that such things will slow down after October-December? Or is there less concern about slowdowns as there are new waves for next year? The channel inventory has been rising slightly, so what do you think about the situation for the next six months or so?

A: Thank you for your question. I'm afraid I'll talk about the inventory one more time, including partial repetitions.

It is not that the channel inventory has increased. There are quite a few clear reasons for the increase. About one third of them came from the so-called booking numbers issue, so it's only remaining two thirds related to content increase. One third of that fraction, as I said earlier, is due to increased lead times for orders from customers and channels. It will take some time for the channel inventory level to settle. That is now appearing here.

So it may go as it is, it may go down a little, it may go up a little. I want to spend a little more time watching it.

Most of the remaining third was due to preparations to meet the customer's need to keep very tight supplies, primarily for data centers, in the channel with leeway. This will be settled soon.

Therefore, the channel inventory is as shown above, which is the overall picture.

In the first half of your question, you asked about work-from-home. I feel that this surprisingly this trend may continue.

With the unexpected rise of 5G smartphones, for example, the demand for PMICs as a whole is growing explosively.

Demand for compute is also in a situation where there is a fairly continuous demand for education and enterprises, rather than individuals buying it up all at once. Of course, I don't think this will continue to be stable forever, but I think there is a possibility that it will continue to calm down for a fairly long time.

Data centers and base stations aren't low right now. It's not a situation that is growing sequentially, but now it's a little calm. However, I expect this situation to continue for a while and to rise again next year. Probably, for data centers it will start from 2Q, and for the base station it will start from the second half. At that time, even if the demand for handhelds, PCs, Chromebooks, et cetera, settled down, I feel that overall, it will go towards a positive direction.

So, I'm afraid it's a little longer, but so far it's in a pretty good cycle, and while the waves of different applications are somewhat offsetting each other, I'm seeing the picture of increasing incremental on the net.

I'm sorry, but that's all for a long time.

<Questioner 2>

Q: First, for Automotive. At the briefing session on the financial results for 2Q, you mentioned that channel inventory adjustments which would take about half a year. What percentage of inventory adjustments did you complete in 3Q?

I think that all the effects will probably disappear in 4Q, but can you tell me how much of the sell-through gap will remain at QoQ?

A: As I mentioned earlier, in sell-through, I think that the inventory adjustment in the channel has been completed because demand is recovering very rapidly now compared to the time of 2Q.

Rather than that, as mentioned earlier, we are now feeling a bit more tight, so rather than adjusting our inventory, I think we have transitioned to a phase in which we need to load a little more things if possible, just like for some of the data centers.

Q: Second, I would like to ask about the outlook for the Industry business. This time, toward 4Q, I think there was a slight decrease in QoQ. Of these, I think there are three subcategories: Factory, Infrastructure, and IoT. Could you tell us what kind of developments you are looking ahead with QoQ?

A: For factories, you can imagine a slight decrease. As for the market, there is nothing especially bad, nor especially good. As for our sense, on the client side, I feel that we are taking relatively cautious order-placement actions, assuming COVID-19 second wave, et cetera, which is now spreading in Europe.

So, in sell-through terms, there will be a slight and sequential brake. In terms of our sales, I feel that it is going to be a slight decrease.

In terms of Infrastructure, sell-through remains strong both for sequential and compared to last year. In terms of our sales, there are some parts that are already on the channel upon request. We expect our Infrastructure sales to fall a bit sequentially, but on a sell-through basis, I think they continue to grow steadily.

Regarding the IoT category, which is related to the so-called Work from Home, we have put air conditioners here. There is a lot of seasonality here, so it goes up and down, so I'm assuming that it will go down as it is for this sequential.

Though smartphones as a whole might be good, the launch of our smartphone model/wireless power charger can offset the large decrease from some air conditioners, and thus the IoT category little bit decrease. On the other hand, although it is not as strong as infrastructure in terms of end demand, I think that growth will continue both sequentially and YoY.

So, in sell-through terms, infrastructure and IoT remain strong. Industrial is adjusted slightly. On a sell-in basis, we assume a slight overall decline, partly due to the inventory adjustments in the channel just described. This is all.

Q: The third point. I would like you to have an image of the utilization rate of 4Q. At the same time, the year 2021 is approaching, but with regard to the image we have now, I would like to know if you can suggest how much utilization we can achieve at the peak time of operations next year. Thank you very much.

A: First of all, the utilization rate for 4Q is expected to increase by nearly 10 percentage points from this point. As a result, we expect collection to increase somewhat.

In the overall production volume of 2021, many of the growth drivers are actually foundries that are pre-processed. At least as far as we can see now, we assume that the 1Q of next year will also have a flat production trend as in the second half of 2020.

<Questioner 3>

Q: I want to ask three questions. They are mainly about how you will proceed in 2021.

First of all, I think that it is said that your company will reduce costs by about JPY40 billion in the medium-term plan. Please let us know if there are any factors that could fluctuate in terms of cost in 2021, such as controllable R&D or synergistic effects.

The second is market share. I want to know whether it will go up or down for automotive and industrial infrastructure in 2021, and if so, what factors could change. I would like to hear from you.

Third, how long will QoQ sales continue to increase? I know it is difficult to say anything because the premise of sell-through is very difficult, but at least at the end of September, the inventory of sales channels also decreased in total at QoQ, and your company's inventory also decreased. So, from here, it will probably be going up next October-December. Do you want to continue from January to March and April to June? Will it be in a steady state from January to March? I'm happy with your best guess, please let me know.

A: (Shibata) First of all, Shinkai will respond to the first point, and the second point relating to automotives can be answered by Maoka and Kataoka. The third point is very difficult, but I would like to talk a little bit. We will start with Shinkai.

(Shinkai) It is the cost reduction situation. First, comparing the finish in 2020 with 2019, we found that the fixed cost was about JPY40 billion, or about 10% in the fixed cost. It consists of factors such as the effect of early retirement in the middle of 2019, reduction of depreciation cost, and further integration with IDT. Thus, we expect to reduce fixed costs for 2020.

The most obvious thing we are seeing in 2021 is a reduction in depreciation costs, which are expected to be just under JPY10 billion for YoY, including all R&D and COGS.

For other fixed costs, R&D will continue to be used while maintaining an appropriate level as a percentage of sales. SG&A are expected to be flat in terms of ratio. These are the costs for 2021.

(Maoka) I would like to talk about market share movements and automobiles. I think that the changes we are seeing this year will continue as they are next year. Now, platforms for new products have been launched, particularly for SoC products. In this regard, expansion is continuing.

The market share and the number of units will also expand. Since this product has a relatively high unit price, it will be expanded on a monetary basis as well as unit basis.

With the exception of SoC, new platforms for microcontrollers are steadily launching. I think it will be necessary to continue to secure capacity and support it. Also, some new analog platforms will be launched.

With regard to power devices, there has been a shift from a relatively legacy product to a new product with a higher unit price. As this continues, we believe that the share and amount of money will increase by unit price more than the actual number base.

(Kataoka) A little supplement. There is a mix of applications, but as Maoka said earlier, new platforms such as ADAS and IVI will be launched. So I think the market share will grow steadily.

Conventional vehicle control, on the other hand, has a variety of applications such as powertrains, bodies, and chassis. However, because a fairly large platform will be launched, particularly in chassis systems, its market share will grow.

The body does not have a slight steady-state slight increase. In this sense, when it comes to total control, the share of conventional control is almost unchanged.

Therefore, when viewed from a total perspective, I think it will increase as a share. That's all from me.

(Shibata) Shares outside of Automotive are quite difficult, because it's a fairly distributed market. You can say that they are organized by product. I think analog is on a relatively good trajectory. Not only data centers but also smart power stages and power management systems are quite competitive, and design-in is advancing, so I think this is strong.

Other analog systems and RFs are also robust, and DDR5 such as memory interfaces and timing will probably be launched in the second half of next year. However, our contents are expected to increase accordingly. DDR5 will be up in the second half of next year, so I still don't know how big it will appear in the numbers, but I think it will be a positive trend.

On the other hand, we have been calling it digital SoCs so far, but recently we changed it to MPU.

Until now, MPU has been operating in a customer-focused and application-specific way, centered around ASIC. I think it's difficult to call it a share. This will not change that much next year, so I think it's difficult to say that.

I think that more standard MPU products will be able to be introduced little by little from year after next onward, so if this happens, I have an expectation that discussions on share and discussions on share gains could be made positive.

As for microcontrollers, ARM-based market launches began near the end of last year. Right now, we are still in the phase of focusing on design-in, so we don't know what the sales will be next year, but we like to take a share. I don't think the contribution of new products is that big yet. From next year to year after next, ARM-based microcontrollers and low-pin counts will be growing. Especially around 2022, the RISC-V that was announced last time will gradually become a reality, so I'm still not sure how much we can discuss regarding shares next year.

Then, your third question was about how long the sequential growth will last. Well, I think it would be nice if it continues. In the scene that is currently visible, I think that this 4Q and next year’s 1Q will continue to be fairly smooth.

Especially considering next year's 1Q, I'm still not sure. A fire that broke out in Kyushu the other day or a fire that broke out in Taiwan yesterday could have a slight impact on the entire supply chain, affecting demand on the customer side. I feel that it is too early to judge what kind of influence it will have.

That is why if nothing is done, if it goes smoothly, we will be able to achieve a good curve around next year's 1Q.

<Questioner 4>

Q: Regarding our own fabs, I think we have already announced that we will shut down two 6-inch fabs. The input base goes up by 10%, which is about 60% in a busy situation. Is the 8-inch fab going to shut down in the future? This is the first question.

The second is about the new platform of SoC for automobiles. I think I had a lot of design in 2016 and 2017. As for confirmation, is the camera SoC now up and running? Let me check how much the sales composition ratio in SoC has increased. that's all.

A: (Shibata) The first point will be answered by me, and the second will be answered by Kataoka of the Automotive Department.

Of course, management will continue forever, so there is plenty of potential for the future. We do not anticipate a shutdown like this at the moment in the near future. At this point, the 8-inch is expected to be used continuously and strategically.

So, shall we go on with Mr. Kataoka about the SoC?

(Kataoka) In 2016 and 2017, there was a major D-in, and honestly, it is true that the launch of SoC's large platform has been delayed to date.

There are many reasons for this, but ADAS's platform in particular entails that customers must collect the data and create software over a very long period of time on a public road, so it is true that the launch has been delayed a long time.

But progress is slowly happening. From next year onwards, OEM platforms will be launched through our customers. I can't mention any specific numbers, though.

Also, what is called the 3rd generation of our R-Car has entered the IVI platform, and that has been growing rapidly from this year. To be honest, we are now showing rapid growth that cannot keep up with demand. I think that will remain fairly strong next year.

As a result of this COVID-19, we are now focusing particularly on customers, comfort, and peace of mind. In this sense, IVI and ADAS will continue to grow very much. This is all.

<Questioner 5>

Q: The first question is about the outlook for 4Q. You mentioned the situation for each segment in a little more detail earlier, but in making this forecast, for example, how do you come to these assumptions? For example, in the case of cars, do you calculate your outlook based on orders and potential cancellations?

Please tell me what you think happens when these numbers swing up or down.

The second point is the adjustment of GAAP and Non-GAAP. This time, I think there is a difference of about JPY19 billion in 3Q. It was about JPY13 billion in 2Q. Looking at the contents, I think that the number of stock-based compensation is increasing, but should we think about this in the direction of increasing in the future? Please tell us the direction, as it appears to be a little more in 3Q.

A: The first point is the 4Q sales forecast. I made it as usual. We look at the response-based backlog to see how well that backlog covers our sales outlook.

Therefore, from the perspective of ups and downs, I think that if we naturally catch up on supply, we could overshoot. We are referring only to the reply-based backlog, it could be higher for 4Q when the orders are piled up.

Regarding the second point, GAAP and Non-GAAP adjustments, as you pointed out, we are making stock-based compensation adjustments in 3Q. We introduced the voluntary stock option program in the context of responding to the new norm based on COVID-19 when the financial results for 1Q were announced. This is the cost of the voluntary stock options.

Accordingly, we were using it on a one-time basis in 3Q, and we do not currently anticipate that it will occur on a recurring basis.

The run rate of stock-based compensation is roughly adjusted at JPY3 billion for the quarter for GAAP and Non-GAAP.

<Questioner 6>

Q: What is the gap between the sell-out of your product today and the recovery in automobile production for the time being for the automobile market? Is it consistent or a bit too early? Certainly, the recovery is a little early in 3Q, so I remember that there were comments at the time of the interview stating that it was too early. I would like to ask you just this one point about how you feel at the moment.

A: It is indeed early, so we are catching up while adjusting delivery and capacity.

It looks like sellout is now running a little stronger.

Q: So do you mean you haven't caught up yet? Is production still not catching up with demands?

A: That's right. In terms of this quarter, I still have two months, so we will be working on a daily basis. It does not mean that something unusual is happening.

Q: So nothing will change at the moment despite the situation of coronavirus in Europe and the US?

A: The surface may not be fully visible yet. At present, the orders we are seeing is still strong. In the future, if this enters the OEM's production plan and reflects it in Tier1's production plan and subsequent orders, there is a possibility that the surface will become visible.

[END]