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Q1 2023 SiTime Corp Earnings Call

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PRESENTATION

Operator

Good afternoon, and welcome to SiTime's First Quarter 2023 Financial Results Conference Call. At this time, all participants are in a listen-only mode. At the conclusion of today's conference call, instructions will be given for a question-and-answer session. As a reminder, this conference is being recorded today, Wednesday, May 3, 2023. I would now like to turn the call over to Brett Perry with Shelton Group Investor Relations. Brett, please go ahead.

Brett Perry *Shelton Group - VP*

Thank you. Good afternoon, and welcome to SiTime's First Quarter 2023 Financial Results Conference Call. On today's call from SiTime are Rajesh Vashist, Chief Executive Officer; and Art Chadwick, Chief Financial Officer.

Before we begin, I'd like to point out that during the course of this call, the company may make forward-looking statements regarding expected future results, including financial position, strategy and plans, future operations, the timing market, and other areas of discussion. It's not possible for the company's management to predict all risks, nor can the company assess the impact of all factors on its business or the extent to which any factors or combination of factors may cause actual results to differ materially from those contained in any forward-looking statements. In light of these risks, uncertainties, and assumptions, the forward-looking events discussed during this call may not occur, and actual results may differ materially and adversely from those anticipated or implied.

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Also, during this call we refer to certain non-GAAP measures, which we consider to be an important measure of company performance. These non-GAAP financial measures are provided in addition to and not as a substitute for nor superior to measures of financial performance prepared in accordance with U.S. GAAP. The only difference between GAAP and non-GAAP results is stock-based compensation expense and related payroll taxes.

Kindly note, non-GAAP measures for the first quarter of 2023 only exclude stock-based compensation, whereas non-GAAP measures for all periods prior to the first quarter of 2023 also exclude stock-based compensation expense-related payroll taxes. Please refer to the company's press release issued today for a detailed reconciliation between the GAAP and non-GAAP financial results.

With that, it's now my pleasure to turn the call over to SiTime's CEO. Rajesh, please go ahead.

Rajesh Vashist *SiTime Corporation - Chairman, President & CEO*

Thank you. Good afternoon. First, I'd like to welcome new as well as existing investors to SiTime's Q1 2023 Earnings Call. For those of you who are new to this, SiTime is the leader in a dynamic new semiconductor category called "precision timing." In electronics, timing is ubiquitous and ensures reliable functioning. SiTime created precision timing to service the needs of applications like automated driving, datacenter, 5G, and IoT. We are early in our growth as we transform the $10 billion timing market. And, SiTime has shipped 3 billion

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precision timing chips to 15,000 customers in 300 applications.

We delivered Q1 results in line with our guidance. Revenue for the quarter was $38.3 million. Non-GAAP gross margins was 61.8%, and non-GAAP EPS was $0.09 per share.

Previously, we had expected Q2 revenue to be equal to or modestly higher than Q1. We now expect Q2 revenue will be lower than Q1. However, the previous guidance for lower first half '23 and higher second half '23 remains intact. This revenue drop in previously forecasted demand is in 3 areas: datacenter, automotive, and broad-based. We believe that the slowdown in macroeconomic conditions has had an impact on all of these 3 areas.

Cloud service providers have reduced their CapEx spending, which has reduced demand for networking and storage equipment. In automotive, Chinese eV makers appear to have significantly reduced their 2023 forecast. Our broad-based segment, which represents 300 diverse applications and 15,000 customers, has also exhibited lower demand. While inventory continues to decline, because of lower demand it has not declined at the rate that we previously expected.

We now forecast that customer and channel inventories will return to a normal level by the end of 2023. Second-half revenue will be higher because of higher demand, though likely not of the magnitude that we previously believed.

We continue to forecast an acceleration in '24 and '25 based on 4 key indicators: SAM expansion from new products, design wins, continued single-source business, and expanding ASPs or average selling prices. These indicators continue to be healthy, and I'll now spend a few minutes talking about them.

In 2020, our SAM was $1 billion, and we are now on track to grow it to $2.5 billion by the end of 2023. As the only company focused on all aspects of precision timing, our strategy is to bring to market compelling products that offer significant benefits, solve tough problems, and make us trusted advisers. Our increasing product portfolio gives us a bigger timing footprint in the customers' systems. As an example, in the past few months, we introduced 2 new products in the Automotive and Aerospace-Defense markets.

We continued our momentum in design wins. The number of design wins in the first quarter of 2023 grew 35% quarter-on-quarter and in every market segment.

Another source of continued strength is our sole source business, which reflects the value of SiTime products. 80% of Q1 2023 revenue was sole-sourced, and 85% of Q1 designs in 2023 were sole-sourced.

Average selling prices, or ASPs, reflect SiTime's value to the customer. Despite lower revenues and better availability from quartz competitors, our ASPs have remained stable.

Now I'd like to give some color on 2024. We expect 2024 to be a solid recovery year. We're expecting the business that was already in production to get back to levels closer to real demand once customer and channel inventory is consumed by the end of 2023. Additionally, our continued design win momentum will translate to new revenue in 2024.

For example, in Communications-Enterprise, we forecast that 65% of 2024 revenue opportunities are already in production right now. From '22 to '27, AI is expected to drive significant growth in high-speed Ethernet, and we are well positioned here.

The situation is similar in Aerospace-Defense. We forecast that 60% of our expected 2024 revenue will come from opportunities in production today. Here, 10 applications drive our revenue, and we are shipping to 7 out of the top 8 U.S. defense contractors, where we have an average of 50 design wins per customer.

In Automotive, we forecast that 70% of our expected 2024 revenue in this segment will come from opportunities that are already in the early stages of production, primarily in ADAS, which is automated driving assistance systems. In this segment, we are engaged with all U.S.-based pure-play electric vehicle customers that are shipping in volume. In China, we're engaged with most major eV manufacturers

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and their OEMs.

In conclusion, design wins continue to grow, as does our SAM. Our connection with customers is strong, as evidenced by stable ASPs and sole-source business, as well as the fact that we did not lose any meaningful business to our competitors. As inventories are consumed and demand returns, we expect to be in a great position to take advantage and resume growth. We continue to remain very confident in SiTime's future success. Thank you.

Arthur D. Chadwick ***SiTime Corporation - Executive VP & CFO***

Thanks, Rajesh, and good afternoon, everyone. This is Arthur Chadwick. Today, I'll discuss the first quarter 2023 results and then provide some guidance on the second quarter. I'll focus my discussion on non-GAAP financial results and refer you to today's press release for a detailed description of our GAAP results as well as the reconciliation of GAAP to non-GAAP results.

Revenue in the first quarter was $38.3 million, down 37% sequentially. 2/3 of that decline was caused by much lower sales to our historically largest customer as they work through excess inventory. Most of the rest of the decline was due to lower sales to our Comms and Enterprise customers as they, too, work through inventory. Sales into our Mobile, IoT, and Consumer segments were $8.8 million or 23% of sales, down from $24.7 million in Q4 due primarily to lower sales to our historically largest customer, where sales were $1.2 million, down from $15.5 million in Q4. Excluding sales to that historically largest customer, sales into this segment were $7.6 million or 20% of sales.

Sales into our Industrial, Automotive, and Aerospace segment were $18.7 million or 49% of sales, down from $20.3 million in Q4. Sales into our Comms and Enterprise segment were $10.9 million or 28% of sales, down from 15.8% in Q4.

Q1 non-GAAP gross margins were 61.8%, down slightly from Q4 due primarily to the lower revenue. Q1 non-GAAP operating expenses were $27.3 million, down slightly from Q4, as we managed certain discretionary and other expenses. Expenses were $16.4 million in R&D and $10.9 million in SG&A. Our non-GAAP operating loss was $3.6 million. Interest income was $5.6 million from interest earned on short-term T-bill investments. Non-GAAP net income was $2 million or $0.09 per share.

Accounts receivable were $21.5 million with DSOs of 50 days, down from $41.2 million and DSOs of 61 days in Q4. Inventory at the end of the quarter was $60 million, up from $57.7 million last quarter, as we continue to make strategic wafer purchases.

During the quarter, we generated $7.5 million in cash from operations. We invested $2.3 million in capital purchases and ended the quarter with $576 million in cash, cash equivalents, and short-term investments.

I'd now like to provide some financial guidance for the second quarter of 2023.

As Rajesh mentioned, the macro environment remains challenging. Demand has continued to soften in a number of markets and, most recently, in the data center. In addition, channel inventory, which is inventory at both distributors and at our customers' contract manufacturers, is historically high, and customers are not consuming that inventory as quickly as expected. Inventory levels will likely remain high well into the second half of this year, and this is having a significant impact on current revenue. As a result, we now believe the revenue cycle will be deeper and more prolonged than we had previously thought. We thought Q1 would be the low quarter for the year, but it now looks like Q2 will likely be the low quarter.

Revenue in the second quarter is now expected to be between $25 million and $28 million, down from Q1 due primarily to lower sales into Comms and Enterprise and auto markets as those customers continue to work through inventory. Sales to our historically largest customer will also continue to be well below their consumption rate, though likely higher than in Q1.

Gross margins are expected to be between 56% and 58%, down from Q1 due to the lower sales as well as to a change in mix. Operating expenses are expected to be between $27.5 million and $28 million. Interest income should be at least $6 million. The share count will be approximately 22 million shares.

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As a result, we expect Q2 non-GAAP net income will be a loss of between $0.25 and $0.35 per share.

Though it's not clear when end demand will pick up, we do believe that once our customers work through excess inventory, sales will improve. Though visibility is not great, we believe sales in Q3 will be higher than in Q2, and Q4 should be nicely higher than that as sales to our historically largest customer and others should be back to a more normalized level.

I'd like to conclude my remarks by saying that even though we are going through a very tough cycle, we firmly believe that our long-term growth story is intact. We continue to aggressively invest in our process and product development. We have unique and superior technology that addresses large and growing markets. Design win and quote activity continues to be strong, and that, coupled with new product introductions and an expanding SAM, should lead to continued long-term growth. And on that note, I'd like to hand the call back to the operator for questions and answers. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)Â And our first question will come from Tore Svanberg of Stifel, Nicolaus & Company.

Tore Egil Svanberg ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD***

Yes. My first question is if you have a more general feel for the real rate of consumption. Because I mean, obviously, $27.5 million at the midpoint is clearly impacted by the inventory digestion. And I mean you had a peak of almost $80 million, now you are at $27.5 million. So do you have any sense for what the real rate of consumption is just so we kind of know what the revenues will be once the inventory has been digested?

Arthur D. Chadwick ***SiTime Corporation - Executive VP & CFO***

So Tore, that's a great question, of course. It is not easy to quantify it, but I will put this out there. We look at how much inventory there is in the channel, again, both at the distributors and now the inventory that's being held at the subcontract manufacturers. And by our analysis, we think there's about $30 million worth of inventory out there at the end of Q1, above and beyond what we would consider to be normal levels. So what that means for the year, assuming that, that inventory gets worked down by the end of the year, and we do believe that it should. It means that we'll probably under ship by somewhere around $30 million this year. So that's the way we look at it in terms of the inventory that's in the channel and what that's doing to our current revenue.

Tore Egil Svanberg ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD***

And a question on inventories. So they've been up the last 2 quarters, so $60 million last quarter. Perhaps you could help us feel comfortable with that number in light of the revenue decline, whether comments on shelf life or, I mean, you didn't mention strategic inventory, right? So anything you can share with us to feel comfortable with that $60 million?

Arthur D. Chadwick ***SiTime Corporation - Executive VP & CFO***

Yes. So if you think back a year plus ago, with all of the supply constraints, it was difficult to build up any buffer stock in wafers. And our MEMS wafers, for example, can take 6 to 9 months lead time. So it was kind of hand-to-mouth for a long time. those shortages have eased, and we made the conscious decision to build a quite sufficient wafer buffer stock. So our wafers come from Bosch for our MEMS wafers, and they come from TSMC for our CMOS analog wafers. And almost all of the increase that we've had in inventory over the last few quarters is wafer stock. Wafers do not go bad. So these wafers could sit there for many years if necessary. I think we'll consume it well before that. But to answer your question, they do not go bad.

It's also important for us to have sufficient inventory for our customers. A number of our customers, as we mentioned last year, 80% of our sales were sole-sourced. So these are large customers that rely on us. and it gives them quite a bit of comfort. In fact, they've asked us to provide that kind of comfort to them. To have that kind of buffer, we could go quite an extended time with supply constraints in the market and still be able to support those customers. So this was a very conscious decision to buy those wafers. They will not go bad. We lose a little bit of interest because it does absorb some of our cash. But as I mentioned, we've got a very strong cash balance, $576 million. So we have made the decision that this was the right strategic thing for us to do.

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Operator

And our next question will come from Suji Desilva of Roth Capital.

Suji Desilva ***ROTH MKM Partners, LLC, Research Division - MD & Senior Research Analyst***

So can you just help us understand what the quarter looked like from a linearity perspective into April? Was it a sharp fall-off? Was it just a kind of a lower recovery than you expected? Just to the shape of that would be helpful.

Arthur D. Chadwick ***SiTime Corporation - Executive VP & CFO***

Yes. I wouldn't say that it had a step function decline. It's been slow for a while now for the last few months across a few of our markets, as Rajesh talked about, as I talked about in our script.

Rajesh Vashist ***SiTime Corporation - Chairman, President & CEO***

Yes, I think I would add that, Suji, that bookings have been disappointingly low all through this past quarter, perhaps not in January. But starting in around the middle of February onwards, they have been generally low and weak and not very healthy. And so we've been looking at this for a while. And what we conclude, of course, is that given that we have not lost any business to competitors, given that we have not lost any design wins, given that our customers are forecasting bigger numbers, we think that those should recover when their business recovers. In the meanwhile, a couple of specific businesses, I called out the Chinese electric vehicle car companies in this, they declined, they put out information that they've declined quite significantly in data centers. We have seen that in other semiconductor companies that supply to that market as well, that sort of weakness.

One of the interesting things is we see other semiconductor companies that ship to what I'll call legacy cars like internal combustion cars, those companies seem to be doing okay in the automotive space. But given that we are heavily focused on new business on electric vehicles on ADAS systems, which are more emerging, we are not seeing that because, of course, we don't have a big legacy business in automotive.

Arthur D. Chadwick ***SiTime Corporation - Executive VP & CFO***

And Suji, I'll just add a few comments. Last year, clearly, our customers overbought. So there was too much inventory out there. In the meantime, demand has softened. We've talked about that over the last couple of quarters, but it continues. And I look at, say, our top 5 customers, for example, our top 5 customers last year, they're sitting here and saying, "Look, I have enough inventory, my demand is less than I thought. I just don't need to buy anything right now." And that's what we're seeing in Q2. Our top 5 customers are buying very, very little, at least compared to what they were buying, and that's driving to a decline in sales in Q2. As Rajesh mentioned, our design win activity is stronger than ever. It is up nicely, Q1 over Q4. Our quote activity is very strong. The long-term markets that we're addressing, we feel very confident that they will continue to grow. Our new product introductions are on track. So longer term, we're as confident as ever. But short term, our customers are basically shaking their heads and saying, "I just don't need any product right now." And that's what we need to work through.

Suji Desilva ***ROTH MKM Partners, LLC, Research Division - MD & Senior Research Analyst***

My second question is on the gross margin, the drop here. What are the drivers here? And what are the factors that get it back above 60%? Just give us some color.

Arthur D. Chadwick ***SiTime Corporation - Executive VP & CFO***

Yes. No, great question. So in Q2, I guided the gross margins, non-GAAP gross margins of between 56% and 58%. So that's down from our 61.8 in Q1. Two factors that are driving that, and I mentioned it briefly. One is just top-line revenue. We've got -- we've talked about this many times, kind of a fixed manufacturing overhead. It's really a cost of our ops group, some depreciation on back-end equipment that we own at our OSAT, and some other cost of sales. That number is relatively fixed. So, when revenue goes down, that becomes a larger percentage of sales, and that drives down blended margins. And that probably accounts for about half of the drop between Q1 and my guide for Q2. The other half has to do with the mix. As I mentioned, much of the decline in revenue from Q1 to Q2 is in comms and enterprise, and auto. And those are high-margin products for us.

So that becomes a lesser percentage of our revenue, and then our consumer IoT will be a slightly higher percentage of our revenue. So

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that mix moves against us in terms of gross margins. And let me add to that. Going forward, as revenue continues to increase, and that's what we expect will happen, I mentioned we think Q3 will be better than Q2. Q4 should be better than Q3. And we think 2024 should be nicely better than 2023 in total, that manufacturing overhead absorption will improve. That will pick up a number of points. I think the mix will also improve.

Our whole strategy since the IPO is to develop products that are addressing these higher-performance markets. And that drove a very nice gross margin expansion from our IPO through last year. Because of the inventory situation that we talked about, comms and enterprise sales are down substantially right now, but that should come back. And when that comes back, the mix should get back to where it was and improve even beyond. So, at this point, I think we exit this year, gross margins probably closer to 60% just because of the revenue. I think by 2024, we should, at some point, during 2024 be able to get back to our gross margins in the mid-60s. That's how we see it right now.

Operator

And our next question will come from Quinn Bolton of Needham & Company.

Nathaniel Quinn Bolton ***Needham & Company, LLC, Research Division - Senior Analyst***

I wanted to come back to your comment about the $30 million of inventory and probably taking through year-end to work that down. I guess I'm trying to come back to this, what's the right level of consumption? And if I just take $30 million and spread it over 3 quarters, you're under-shipped by $10 million a quarter. It kind of feels like you're telling us that end consumption might be only something like $40 million a quarter. That seems a lot lower than I think what we might have discussed a quarter or 2 where I think you were thinking, and consumption might have been closer to 60% to 65%. So, can you give us any better sense? I mean is $40 million the right number now to be thinking about consumption?

Arthur D. Chadwick ***SiTime Corporation - Executive VP & CFO***

Yes. So, I don't want to give a -- it's difficult to give a hard number on that. Clearly, there is softness in some of the markets that we're addressing. Data center is the more recent one, a lot of changes. They're pulling back on CapEx. That impacts high-performance servers. It impacts optical switches, and a whole variety of things. So, my point is demand is down. We think that it will come back. I think this is a classic cycle, and it is hitting us hard. I think that's obvious. But it's difficult to put a hard number on your question.

Nathaniel Quinn Bolton ***Needham & Company, LLC, Research Division - Senior Analyst***

Okay. Fair enough. And then I know you guys have talked about a CAGR or longer-term CAGR in sort of the 30%, 35% level, you're going to have a very weak '23 as you under-ship consumption. Do you think you come back, and are you looking at a 2024 that's sort of in line with that 30%, 35% long-term CAGR? Or do you think that as you snap back to consumption, you have an opportunity to potentially grow faster than that, just given how weak '23 is? I know you're not guiding out a year, but I just wonder if you might be able to try to provide us with a framework because it feels like the numbers are still moving around a fair amount this late into the inventory cycle.

Arthur D. Chadwick ***SiTime Corporation - Executive VP & CFO***

Yes. Well, first of all, we've been surprised by this cycle. This is becoming deeper and longer than we had expected. So there has been some surprise there. To answer your question, longer, longer term, we still think that the 30% CAGR is very reasonable. And we base that on the number of new products that we've recently introduced, that we're going to introduce, what that does to our SAM expansion, we do this market segment by market segment. We spent a lot of time on this in the company. So longer term, I think that 30% growth rate is defensible. It hasn't happened yet, but I think it's a very reasonable number. It could be higher than that, it could be lower than that, but I think that's a good baseline.

For next year, I think 2 things will happen. One, we get back to shipping at our customers' consumption level. So, with whatever we end up shipping this year, I think we're going to under-ship probably somewhere around $30 million less than the consumption based on the fact that we believe there's about $30 million in inventory above and beyond what would be normal. So that would get us to a baseline, and then what's the growth rate in 2024? I would like to think it's 30%, but people are also talking about maybe there's going to be a recession, things are slowing down. So, I don't know if that's going to happen or not. I think it might make better sense to have a slightly more conservative expectation on revenue growth, something less than 30%, only because we don't know. But my point is we've come up

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with a baseline by adding back the under shipment this year, and then folks can assume on a growth rate from that base to a revenue number for 2024. And I think that's how we look at it. And I think that's the right way to look at it.

Rajesh Vashist ***SiTime Corporation - Chairman, President & CEO***

To add to that, Quinn, I would reiterate the element of disappointment that we see in the bookings because of demand. And we look at the usual things, design win-loss, single source going to multisource declining prices, and so on, and we don't see the issues there. We see the issues in declining demand, and I think it's mirrored in macroeconomic conditions, perhaps and certainly in a couple of the key markets, which are important to us. And so, we definitely cite the disappointment. On the other hand, everything that I mentioned in those 4 things, new products, therefore new SAM, new design wins, a 35% increase, single-source business undiminished, and expanding ASPs. Those are still visible to us in the new business that we are finding in our funnel and taking it all the way through into design wins.

Operator

(Operator Instructions)Â And we have a follow-up question from Tore Svanberg of Stifel, Nicolaus & Company.

Tore Egil Svanberg ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD***

I had a follow-up question on your largest customer. Obviously, it is very low this quarter, as you had projected. But it did sound like you expect that customer to be up sequentially in the June quarter. So, is it safe to say that the bulk of sort of their inventory overhang is now played out? I mean, I do recognize that June quarter probably is still some lingering effect there, but it does directionally feel like the bulk of that overhang is now behind you?

Arthur D. Chadwick ***SiTime Corporation - Executive VP & CFO***

Yes. I would not say it's played out yet, it is playing out. As I mentioned, they only purchased $1.2 million in Q1. That was down from $15.5 million in Q4. So clearly, they burned through inventory in Q1. I do expect that sales to them will be up some in Q2, not a lot, could be a few million dollars, give or take. I think that improved substantially in Q3. And as I mentioned in my comments, I think by Q4, they'll be back to what we would consider to be a normalized run rate. Look, the good news there is we are still in all the products that we were designed into that has not changed. They are -- essentially their subcontract manufacturers severely overbought over the last few quarters, and we have to get through that. So it's going to come back, but it's going to take a couple of quarters to get back to kind of a full normalized run rate.

Tore Egil Svanberg ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD***

Very good. And my last question, trying to think about some of the longer-term trends out there. I know Rajesh, you introduced a new range of high-precision timing devices for in-car connectivity. Just hoping you could elaborate a little bit on that, especially when we can start to see more material revenue contribution from that product family?

Rajesh Vashist ***SiTime Corporation - Chairman, President & CEO***

Yes. I think what we are seeing is that these products take about 9 months for design wins and then another year to roll out in fruition. So, continuing into one of the reasons I gave some of the metrics on how we see 2024 for example, in automotive, 70% of the revenue from automotive is already shipping today. In other words, that is a level of insight or outlook we have on it. So, we don't expect that kind of product to have a significant impact on the revenue because it's a lot of the stuff that's already in design win. And not even design win, that's actually mass production, which is one step well out of design wins. So, I think it's safe to say that when we put out a new product announcement, it's generally about 1.5 years away from high-volume production, low-volume production, another matter, but high-volume production probably 1.5 years.

Operator

And I'm showing no further questions. I would now like to turn the call back to management for closing remarks.

Arthur D. Chadwick ***SiTime Corporation - Executive VP & CFO***

All right. Thank you, operator. Well, we want to thank everybody for joining us on the call today. We hope you have a great afternoon, and thank you very much.

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Rajesh Vashist ***SiTime Corporation - Chairman, President & CEO***

Thank you. Bye-bye.

Operator

And this concludes today's conference. Thank you for your participation. You may now disconnect.

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