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SITM.OQ - Q2 2023 SiTime Corp Earnings Call

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## PRESENTATION

**Operator**

Good afternoon, and welcome to SiTime's Second Quarter 2023 Financial Results Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded today, Wednesday, August 2, 2023.

I would now like to turn the call over to Brett Perry of Shelton Group Investor Relations. Brett, please go ahead.

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**Brett Perry** - *Shelton Group - VP*

Thank you, Chris. Good afternoon, and welcome to SiTime's second quarter 2023 financial results conference call. On today's call from SiTime are Rajesh Vashist, CEO; and Art Chadwick, CFO.

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 factor 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 could differ materially and adversely from those anticipated or implied.

Neither the company nor any person assumes responsibility for the accuracy and completeness of the forward-looking statements. The company undertakes no obligation to publicly update forward-looking statements for any reason after the date of this call to conform the statements to actual results or to changes in the company's expectations. For more detailed information on risks associated with the business, we refer you to the risk factors described in the 10-K filed on February 27, 2023, as well as the company's subsequent filings with the SEC.

Also during the call, we'll refer to certain non-GAAP measures, which are considered to be an important measure of company's 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 reported GAAP and non-GAAP results is stock-based compensation expense. Please refer to the company's press release issued today for a detailed reconciliation of GAAP and non-GAAP financial results.

With that, I'd now like to turn the call over to Rajesh. Please go ahead.

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

Thank you, Brett. Good afternoon. I'd like to welcome you as well as existing investors to SiTime's Q2 2023 earnings call.

Q2 was in line with our guidance. Revenue for the quarter was $27.7 million. Non-GAAP gross margins were 58.2% and non-GAAP net loss was $0.22 per share. As forecasted, we see a turnaround in our business, so we expect Q3 revenue to be higher than Q2.

For those of you that are not familiar with SiTime, we are the leader in a dynamic new semiconductor category called "precision timing." In electronics, timing is ubiquitous and ensures reliable functioning. SiTime created the category of precision timing to serve the needs of applications like automated driving, data center, 5G and AI. We're early in our growth as we transform the $10 billion timing market. SiTime has shipped 3 billion precision timing chips to 15,000 customers in 300 applications.

In past calls, we noted the negative impact of higher-than-normal inventories at a customers' contract manufacturers or CMs on our revenue. For the past few quarters, these inventories have continued to decline. Though the decline is at a slightly slower rate than previously anticipated, we have factored this into our guidance for now. So, looking towards Q4, we expect the quarter-over-quarter growth trend over Q3 to continue.

Previously, we forecasted that our revenue should accelerate in 2024 and beyond based on four factors. These are SAM expansion from additional products, single source business, design win momentum and expanding ASPs, or average selling prices. The fact that these trends continued into Q2 2023 is a good indicator of the fundamental health of our business, even though Q2 2023 was our lowest revenue quarter in recent history. More on these trends now.

First, we continue to grow our SAM from $1 billion in 2020 to $2.5 billion by the end of this year. Our product strategy is consistent. We solve our customers' toughest timing problems by delivering compelling precision timing products, which are defined as products that deliver high performance in tough conditions. Much of the SAM growth is our focus areas of Enterprise and Communications, Automotive and Aerospace/Defense, which gives us a bigger footprint at focus customers. In Q2, we introduced a compelling new product, the SiT162X, that we believe enables greater safety in automotive applications such as ADAS automated driving.

As you may know, the incumbent timing technology, quartz, is provided by around 40 companies worldwide. Customers have a pattern of typically buying from multiple servers as they've been previously been impacted by variable levels of quality, reliability, performance and delivery in these quartz-based timing products. One can imagine that sole source positions are uncommon in the quartz timing business, and that is, in fact, the case.

In contrast, SiTime is focused on building a timing business that is largely sole-source because we make timing easy and our customers value that. A useful metric is that 83% of our Q2 revenue is sole-sourced, which is an increase from 79% in Q1 2023.

On the third factor, on number of design wins, our momentum continues from previous quarters. In Q2, we set a record for the total number of design wins closed in any quarter, which grew by 55% from the same quarter a year ago. In addition, the number of design wins in each of these end markets, Communications-Enterprise, Industrial-Automotive-Aerospace, and Mobile-IoT-Cconsumer also grew by more than 50% from a year ago.

Our ASP depends on our end market mix and product mix. In Q2 2023, ASP declined from Q1 due to a higher business from Mobile-IoT-Consumer and a decline in Comms-Enterprise revenue. An insight is that despite the normal supply in the market today, our Q2 2023 ASP was higher than Q1 2022, which you may recall was at the height of an industry-wide shortage. We believe that the higher ASP products that we introduced since Q1 '22 and the increase in business from Aerospace-Defense contributed to this.

Our strategies of SAM expansion with higher ASP products and focus on end markets where customers recognize a value are playing out well, and we expect our ASPs to remain stable for the rest of the year.

SiTime has maintained that ongoing macro trends driving the electronics industry, automated driving, electric vehicles, cloudification, Internet of Things and AI depend upon precision timing. Most have seen the recent developments on the increasing role of AI.

We believe that AI processors from chip companies and the top cloud service providers are prime users of our timing solutions that deliver low jitter and high stability. We've been working with these key players who are leading the charge in AI and expect to benefit from the AI macro trend for many years to come.

In conclusion, our SAM and design wins continue to grow. Our sole source business is a strong indicator of a strong connection with customers and the value we deliver to them. As inventory is consumed and demand returns, we expect to be in a great position to take advantage and resume growth. We remain very confident in SiTime's future success.

And I'll now turn it over to Art.

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

Great. Thanks, Rajesh, and good afternoon, everyone. Today, I'll discuss second quarter 2023 results and then provide some guidance for the third 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 a reconciliation of GAAP to non-GAAP results.

Revenue in the second quarter was $27.7 million, down 28% from Q1. Sales were down in most of our major markets as customers worked through excess inventory. Inventory in the channel is still high. And though it continues to be consumed by our customers, it will likely take some customers much of the rest of the year to get back to more normal inventory levels.

Sales into our Mobile, IoT and Consumer segment were $10.4 million or 38% of sales. That's up from $8.8 million in Q1 due to higher sales to our largest customer. Sales to that customer were $4.6 million, up from $1.2 million in Q1. Excluding sales to our largest customer, sales into this segment were $5.8 million or 21% of sales.

Sales into our Industrial, Automotive and Aerospace segment were $12.4 million or 44% of sales. That's down from $18.7 million in Q1. Sales into our Comms and Enterprise segment were $4.9 million or 18% of sales, down from $10.9 million in Q1.

Second quarter non-GAAP gross margins were 58.2%, down from 61.8% in Q1 due to the lower overall sales level and to changes in product mix towards more Mobile/IoT and less Comms and Enterprise sales. Second quarter non-GAAP operating expenses were $27.4 million, essentially flat with Q1. Expenses were $16.6 million in R&D and $10.8 million in SG&A. The second quarter non-GAAP operating loss was $11.2 million.

Interest and other income was $6.5 million, up from $5.7 million in Q1 due to higher earned interest on our T-bill investments. The second quarter non-GAAP net loss was $4.8 million or $0.22 per share. Accounts receivable were $15.8 million with DSOs of 51 days as compared to $21.5 million and DSOs of 50 days in Q1.

Inventory at the end of the quarter was $64.3 million, up from $60 million last quarter as we continued to make strategic wafer purchases.

During the quarter, we generated $3 million in cash from operations, invested $3.9 million in capital purchases and ended the quarter with $574.7 million in cash, cash equivalents and short-term investments.

I'd now like to provide some financial guidance for the third quarter of 2023. To begin with, we are now confident that Q2 will be the low quarter for the year, given that we are now seeing a rebound in our business. We expect sales in the third quarter will be up approximately 25% from Q2, with growth coming from higher sales to our largest customer as well as higher sales into Comms and Enterprise.

Though the higher revenue will help gross margins, this will likely be offset by a change in product mix towards a higher percentage of mobile IoT sales. We, therefore, expect third quarter gross margins will be relatively flat with Q2.

We continue to manage expenses closely and plan to reduce third quarter non-GAAP operating expenses to between $26 million and $27 million. Interest income should be at least $6.3 million. Share count will be approximately 22 million shares. And as a result, we expect third quarter non-GAAP net income will be approximately breakeven. Though we are not giving specific guidance for the fourth quarter, we do expect sales will be up sequentially from Q3.

As I mentioned before, we are seeing a rebound in our business and believe that our recent downward trends are reversing. 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 activity continues to be strong, and that, coupled with new product introductions and expanding SAM, should lead to renewed long-term growth.

And on that note, I'd like to hand the call back to the operator for Q&A. Thank you, everyone.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question will come from Tore Svanberg of Stifel.

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

Congratulations on the turnaround here. As it relates to Q3, I think your largest customer, I mean, that's seasonal. So I think that makes sense. But I think you also said Communications and Enterprise will be up sequentially. Could you just elaborate a little bit on some of the subsegments there? Because obviously the data points in some of those markets remain pretty mixed. And I also assume that's where AI is embedded. So, any further color you can give us there, that would be great.

C-Art:

Sure, Tore. So, to begin with, Comms and Enterprise was down pretty substantially from Q1, as I mentioned in my commentary. Our largest customers in that segment, again, have built up too much inventory. And so, order rates from those customers were down substantially in Q2, and that's why revenue decreased from Q1 to Q2 as much as it did. They are starting to work through that inventory. So, we're seeing something of a rebound there from Q2 to Q3. It's across both data center and our communications markets, so it's hard for me to be more specific than that. When we report our numbers at the end of Q3, We could probably give a little more detail. But it's primarily due to the fact that our customers are going to start getting back to more normalized purchase levels.

A:

Great. And that's my follow-up question for Rajesh. Rajesh, the sort of 55%, I think, is the word you -- the number you used for increase in design wins year-over-year. How should we think about that in relation to that 30% long-term growth rate that you have, and then, especially when we consider that now 83% of your revenue is proprietary. Just hoping if you could just put some more framework around that.

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

Yes. So, I think that 55% gives us a lot of comfort that the guidance that we have given for long-term growth of 30% is a good guidance. It's solid, particularly since a lot of that is happening in the Comms, Enterprise, Automotive, Aerospace, Defense areas, the ones that we really want to, although we continue to get strong design wins across the board in Consumer, in Internet of Things as well as Industrial.

As far as -- what is the second question was around...

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

Yes, the 83%, that's now a proprietary revenue.

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

Yes, the 83%. So, remember that the 83% is, I wanted to make a case for that it is holding steady or even marginally growing from 79% to 83%. So, the point that I wanted to make was that a question we get asked quite a bit is, what happens "when things get to normal." Did you just enjoy a brief flurry in '21 and early '22 of shortage? And my point that I'm making is not -- it doesn't have to do with shortage, it has to do with the specificity of the product, the fact that we make it easy to design in, the fact that we have easy to get information and data on our products. And then, of course, that they are truly precision timing, in other words, high performance under tough environmental conditions. So that's the point I wanted to make that we continue to show that we are quite different from the existing technology as witnessed by the fact that multisource versus single-sourced.

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

That's great perspective. Congrats again.

**Operator**

Our next question will come from Suji Desilva of ROTH Capital.

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

Maybe can you talk about the linearity in Q2 in July? It sounds like it's steadily improving. Just wanted to get the color there and really the factors that give you confidence, and 4Q, you'll increase again. Are the customer forecasts stabilizing at lease levels? Is that one of the things that's changed from 3 months ago?

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

Yes. Well, to go back to our commentary, we've certainly seen a turn -- a positive turn. As I mentioned, we view Q2 to absolutely be the low quarter for the year. Order rates have been up nicely as we started the third quarter. We are very comfortable with our third quarter guidance being up 25% or so from Q2. And if those trends continue, then that will also help us later in the year. But the other thing that will help us also is the fact that our customers continue to work through this inventory that we've talked about. And as more of that gets consumed, we'll get back to more normalized shipment rates. So we're very comfortable with our Q3 guidance, and we're also very comfortable that Q4 will be up from Q3.

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

Great. And then, also just on the gross margins here. It sounds like mix is the primary driver, but what's the correlation of the pricing because I don't think have tailwinds there, particularly as the mix continues to improve. Is that something that can kind of override the mix? Or is that something that is kind of steady gross margin across the product?

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

Yes. So for Q2, as I mentioned, higher revenue improves gross margin because of our manufacturing overhead absorption. But going from Q2 to Q3, there will be a higher mix of mobile IoT and consumer sales, primarily driven by our largest customer. And that has generally gross margins that are somewhat less than our corporate averages. So that will offset the benefit of the higher sales.

So, the guidance for Q3 of relatively flat gross margins, I think that's solid. Longer term, what we've always talked about and what I still firmly believe will happen is that all of our new products that we have introduced over the past 1 to 2 years that we plan on introducing this year are generally much higher performance products. They're going into higher performance markets. We get higher ASPs and generally higher gross margins. So, as these new products become a larger and larger percentage of our overall sales, that is a general driver of higher gross margins going forward. And I believe that, that will -- that trend will continue. So that is positive for gross margins in the longer term.

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**Operator**

Our next question will come from Quinn Bolton of Needham & Company LLC.

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

Congratulations on seeing the turn in the business. I guess, a few questions. One, Art, you mentioned the sort of mix shift to mobile, IoT, consumer driven by your largest customer in the third quarter. Do you expect that customer to get back to sort of more normalized run rates in the third quarter? Or is there still some inventory being consumed at that customer so that you might see sequential growth again in the December quarter as that customer comes back to more normal purchases?

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

Sure. So they are clearly making progress and working through their inventory. As we've reported before, our shipments to them were only $1.2 million back in Q1, and they were $4.6 million in Q2. This is well below a normalized run rate. We will be getting closer to our normalized run rate in Q3, and I believe we'll probably get there by Q4. And so that would argue that sales to that customer, and this is consistent with our internal forecast, would increase from Q3 to Q4.

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

Perfect. And then, last quarter, Art, you mentioned sort of an estimate that there might be about $30 million worth of inventory that was still out in the channel that needed to be burned off. Obviously, it looks like you've continued to make progress, but I think in the prepared script, you talked about maybe that inventory taking a little bit longer to burn. Do you think you made progress on that $30 million? Do you have any update? Is that down closer to $20 million at this point? Or any thoughts on how much inventory might be out there that still needs to get consumed in the back half of the year?

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

Yes. Clearly, our customers are making progress. What makes it a little challenging is, it's different for every customer. As I mentioned, some of our customers, it will likely take the rest of this year for them to work through their excess inventory. Other customers will work through it before them. So, I don't want to put a hard number on how much it was worked down through the quarter. We are very confident that it is. We have internal analyses and what we think that number is. But that's not a number I want to put out there right now.

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

Understood. If I can sneak one more in. Last quarter, you talked about some softness still in the China EV market. I think some of the others that have reported this earnings season, maybe starting to see a little bit better trend in the China EV market. I think SiTime's got some pretty good exposure there. Are you guys seeing any turn in the China EV side of the business?

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

Well, we certainly see more design win activity in that business. We see some shortages popping up that we did some heroics to satisfy some customers. So that's always a good indication because that hasn't happened for 2, 3 quarters. But it isn't a full on big trend yet, Quinn. And -- but I will take it as a little bit of a positive. There's other murkiness around general growth in China from the headlines, we probably see the same headlines you do. I don't have any inside information. But that's what makes me a bit cautious. So, the micro news is good, call it, the macro is a little less clear.

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**Operator**

Our next question will come from the line of Chris Caso of Wolfe Research.

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**Christopher Caso** - *Wolfe Research, LLC - MD*

With respect to some of the inventory that's built on your customers over the last year, can you give us some sense of how much inventory you think the customers may have built last year? I know said a different way, perhaps how much do you think you may perhaps overship the market last year, and therefore, we have to undership this year in order to normalize that?

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

Yes. Great question, Chris. So we have talked about some of this on our past calls. Clearly, our customers over-ordered last year. I think, coming out of the pandemic and the shortages when there was supply and not just with us, I think this also applies to other companies out there. Most of our customers ended up ordering more than they ended up needing last year. We put that number at somewhere around $40 million. So, it's hard to get an exact number because we'd have to know exactly what our customers use rate was versus exactly what they bought and their timing differences. So, it's a little bit of a squishy number, but I think it's in that ballpark. We've done internal analyses and that's kind of what we come up with. So that would mean we overshipped to demand by about $40 million. If we were to work through all of the excess inventory, if our customers work through all the excess inventory this year, then we'd be under-shipping by that similar amount this year.

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**Christopher Caso** - *Wolfe Research, LLC - MD*

All right. That's helpful. And perhaps you could talk about what's happened with the traditional timing market as well. I think perhaps 1 of the fears is that with product being plentiful there, that some of the customers that you may have signed up over the last 2 years when product was tight, would switch over. Perhaps there would be adverse pricing in the conventional market, which might spill over to your way. I know that you've had some confidence in that in the past, but I wonder if you can give us an update on that.

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

Yes. We've always maintained that SiTime is not in a market share game. We've always maintained that SiTime's products are unique because we created the precision timing category, which is not the case with our competitors, our 40 quartz-based competitors, in this situation. So therefore, what it means is that pricing normally doesn't come into the equation very much, particularly in existing design wins. In other words, existing design wins do not disappear if somebody shows up with a lower price. We have evidence of that because we have tried this out ourselves to see if we can take away market share by taking down price aggressively, and it's never worked. So, I think that it just doesn't work for anybody because once design wins are made, then they remain stable until they ship.

What we -- I specifically made a point of sharing the fact that our ASPs have continued as demonstrated by the numbers I shared, regardless of whether it is a tight supply or whether it's a more normalized, which is what is current supply. So, the fact that we could still keep on growing versus Q1 '22 in price is a testimony to 2 things, 1 our mix shift, which is -- continues to occur and will continue to occur going forward. And the second is the value proposition that gets our customers to value our products and remain in single source significantly. We mentioned 80%, 83%, and that's what helps us. So, I think it's a fundamental -- I think we are waiting for the world to start to understand more clearly how differentiated SiTime is from all other players in this market.

We're also unique in the fact that we are uniquely focused only on timing, whereas most of these other people are either not focused on timing or if they focus on timing, they're focused on only some specific parts of it, not on all parts of it, which would be oscillators, clocks and resonators.

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**Operator**

(Operator Instructions) Our next question will come from Douglas McLaughlin of Fabricated Knowledge.

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**Doug O'Laughlin**

I just wanted a question about even with some meaningful sequential revenue growth into the back half and some growth next year, you've raised operating costs significantly, and it doesn't look like you're going to be quite at the 2021 level of EBIT. Is that the right way to think about that business as you continue to reinvest in the long run? And then, I have a follow-up after.

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

Yes, Doug. So, to answer your question on operating expenses, yes, we grew operating expenses over the last few years, but we've held them absolutely flat for the last 4 quarters or so. And we're actually ratcheting them down a little bit more in the back half of this year. I mentioned that our guide for Q3 is operating expenses of between $26 million and $27 million. That's slightly less than where we were in Q2. So, we are managing that very closely. But we've invested a lot in the team at SiTime, right? Most of our expenses are invested in people. And even though our revenue has declined because of this whole inventory issue out there in the last couple of quarters, we did not think that it made sense for us to make radical changes to our spending patterns. So, we're going to hold them flattish, squeeze them down just a little bit.

Going forward, we'll increase expenses only when our top line revenue grows sufficiently. So, to answer your question, yes, they've increased over the last few years, but we're holding the line on it, and we're going to continue to hold the line on our OpEx right now.

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**Doug O'Laughlin**

My follow-up question is mostly about the design win timing. Each quarter, you talk about how record new levels of design wins. Is there any kind of visibility when a design win hits production? Because that's like in theory, as 2024-2025 come along, you have the single-source deals, so it's just you guys, these design wins should move to revenue. Any kind of timing on when this cliff of new design wins will roll through? Or is it just -- this could be many, many years and we don't really have any kind of visibility?

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

No, I think you got it right, Doug. It's '24-'25. There are some that are particularly in aerospace or defense that are further out or actually even in automotive, there's some that are out in '26. But '24, '23, '26 with the peak being in '25 is probably a good way to think about it. The other way to think about it is that, as you know, we service multiple markets. And the longest design win cycles are probably in automotive, although that's not a given, if it's an infotainment or it's in some of the EV companies that move very fast, the new companies that we all know about that are not the traditional relatively slow-moving companies.

On the other hand, incumbent companies in automotive move a little bit slower. So that's one thing. The second is that in the Consumer side, we may find -- or Industrial, we may find a design win paying off in revenue within a few quarters, maybe as little as 6, sometimes 6 to 9 quarters, we've seen that happen as well. So, it's hard to get much more specific on that other than to say we're building for the future for a highly diversified, differentiated product line, which will start paying off in '24 -- particularly second half of '24 and '25 and '26. So, we're pretty focused on going in that direction.

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**Doug O'Laughlin**

Perfect. Can I sneak 1 in real quick? I think you guys had Comms sequential growth a little bit. Which end market -- are you willing to comment on where you think the inventory is better or worse by the end markets that you guys talk about? Or is that not a disclosure you want to do?

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

Yes. I think that's more detail than we can go into right now.

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**Operator**

Thank you. I am seeing no further questions in the queue. I would now like to turn the conference back to Art Chadwick for closing remarks.

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

All right. Well, I just want to say thank you to everybody that listened to the call. We appreciate your interest in SiTime, and hope everybody has a great day. Thank you.

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

Thank you very much.

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**Operator**

This concludes today's conference call. Thank you all for participating. You may now disconnect, and have a pleasant day.

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