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PRESENTATION

Operator

Good afternoon, and welcome to SiTime's Second Quarter 2022 Financial Results Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded today, Wednesday, August 3, 2022.

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

Brett Perry - *Shelton Group - VP*

Good afternoon, and welcome to SiTime's second quarter 2022 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 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 risk associated business, we refer you to the risk factors described in the 10-K filed on February 25, 2022, as well as the company's subsequent filings with the SEC.

Also during this call, we'll refer to certain non-GAAP financial 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 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. Please refer to the company's press release issued today for a detailed reconciliation between GAAP and non-GAAP financial results.

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

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

Good afternoon, and thank you for joining us on today's SiTime call. While the focus of today's discussion is on Q2 results and Q3 forecast, I want to begin with the transformation of SiTime as a result of the acceleration in electronic macro trends, such as High Bandwidth Communications, Cloud, eV and IoT.

Here, Precision Timing products are defined as high-performance, small size and power efficient under demanding environmental conditions such as vibration, shock and temperature, are becoming the solution of choice. While Precision Timing is used significantly in Comms-Enterprise, their use is growing in Automotive and certain Mobile-IoT-Consumer applications.

As a creator of the category of Precision Timing, SiTime plays a central role in this transformation. As we transition from our legacy non-precision timing products and design wins into this transformation, SiTime will get significantly higher ASPs, more design win stickiness and a discussion of architecture with our customers.

On Q2, SiTime had a banner Q2, we delivered record revenues of $79.4 million, non-GAAP gross margin of 66.7% and non-GAAP EPS of $1.11, all exceeding our previous guidance. This was our 11th consecutive quarter to do so. In Q2, we had the highest ASPs in the history of the company, 30% higher year-on-year and 10% higher quarter-on-quarter. This came from the role of greater precision timing products in our revenue.

While multiple segments contributed to this growth, our Comms-Enterprise business was a standout. It grew 60% over Q1 and was the segment of the highest growth rate. Multiple customers in this application, such as Network Interface Cards or NICs, datacenter servers and 5G wireless contributed to this growth, and we believe that the trend will continue in the second half. A common theme amongst these customers and applications was the use of our precision planning products to get a better system performance. As an example, one of these products, Elite, doubled in unit shipments from Q1 to Q2. And additionally, our Precision Timing opportunities have now grown to be 70% of our funnel.

Automotive was the segment with the second largest growth despite some customer pushouts due to industry-wide supply chain issues. SiTime's previous success in ADAS computers, domain controllers and cameras continued, and we have begun to see volume ramping from newer applications as well, such as driver monitoring systems and LiDAR.

As we know, the automobile is being transformed and new functionality in sensing, computing and communications are -- is continuously being added. Getting this functionality to work in the presence of vibration, shock,temperature extremes is a difficult challenge, but one that can be solved and is solved by precision timing products from SiTime. This is a natural place for SiTime to deliver value and grow, and we remain on track to deliver $100 million in annual automotive revenue in the next few years.

In May, when we increased our guidance from 35% to 50% annual growth, we did not anticipate the subsequent conditions financial downturn, supply chain disruptions and political turmoil, all of which made it difficult for our customers to see the magnitude and the speed of decline in their own business. This is evident in our Mobile-IoT-Consumer segment, that is those that place lower value on the benefits of precision timing.

Excluding our largest customer, the Mobile-IoT-Consumer segment is expected to be down by more than 30% in the second half of 2022. Considering our end customers' visibility, we are, therefore, now comfortable with our earlier guidance of 35% annual growth for 2022. In line with that, we will manage our expenses prudently in the second half of this year.

But our original thesis remains intact. We firmly believe that our longer-term top line growth will be 30% or more driven by the SAM expansion to $4 billion, the greater need for Precision Timing and fulfillment of those needs uniquely by SiTime. We also continue to see a long-term financial model of 65% gross margin and 30% net income as being intact.

We continue to invest significantly in the development of new Precision Timing products. In 2022 itself, we will sample 6 of these oscillators and clocks. These address the macro trends that I referred to that are transforming electronics, High-Bandwidth Communications, Cloud, eV and IoT. With these, we are confident in our ability to transform the electronics industry driven by greater adoption of these products.

We expect that the stellar Comms-Enterprise performance will continue into the second half, with the volume ramping up of applications like 400G / 800G optical modules and data center switches. In our last call, we talked about a clock family with 200 customers by the end of '22, and that strength continues. 60% Of the Cascade, the clock family, revenue in '22 and '23 will now come from NIC cards, 5G RRU, and backhaul. Our investment in this segment is working. In 2022, Comms Enterprise is expected to grow to over 25% of our revenue compared to 16% last year in 2021. For example, again, our Elite product is expected to grow 3x in revenue over 2021.

The value and uniqueness of SiTime products is also clearly on display at our largest customer, which is in the Mobile-IoT-Consumer segment. Our revenue here continues to grow strongly in the second half of 2022, and the design win funnel continues to grow strongly as well.

In the previous call, we have spoken about the strength of Aero Defense business. We're now engaged with the top defense contractors worldwide and our funnel continues to grow as they discover the strength of our unique Precision Timing products.

The uniqueness of these SiTime products comes from the uniqueness of SiTime technology. We've always maintained that our MEMS, analog circuits and the systems, putting it together to deliver a system solution is hard to do. In the past decade, we have not seen a credible competitor that is using similar technologies, and we don't see one on the horizon currently.

A great advantage for SiTime during the turmoil of the past 2 years has been the flexibility and the solidity of our supply chain. We've made great inroads with customers because our supply chain has been proven to be superior to that of our existing -- to that of the existing suppliers in the market today. That strength continues due to the support of TSMC, Bosch and our OSAT partners. Given that a majority of our customers are single sourced, our supply chain strength continues to be a competitive advantage for SiTime.

In conclusion, as a category creator of Precision Timing, SiTime is uniquely positioned to transform this industry. We believe that our long-term growth and market share gains will continue unabated in the future.

With that, I'll now turn it over to Art Chadwick, our CFO.

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

Great. Thanks, Rajesh, and good afternoon, everyone. Today, I'll discuss second quarter results and provide some comments on Q3 and the year. 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.

So as Rajesh mentioned, Q2 was a record revenue quarter for us. Revenue was $79.4 million, up 13% sequentially and up 78% over the same quarter last year with exceptional strength in our higher-end, higher-performance products. Sales into our mobile IoT and consumer segment, which consists of sales into mobile phones, wearable devices and consumer products, were $27.0 million or 34% of sales, down 10% sequentially, but up 24% over the same quarter last year.

Sales to our largest end customer, which are included in this segment, accounted for 14% of total sales. Sales into our Industrial, Automotive and Aerospace segment, which includes sales into automotive, industrial, medical, aerospace, military and broad-based sales were $32.2 million or 41% of sales, up 17% sequentially and up 137% year-over-year.

Sales into our Communications & Enterprise segment, which consists of wireless infrastructure, 5G, data center and networking were $20.2 million or 25% of sales, up 60% sequentially and up 120% over last year.

Non-GAAP gross margins were strong at 66.7%, up 140 basis points from Q1 and up more than 5 points over the same quarter last year. Non-GAAP operating expenses were $28.3 million, a 15% sequential increase over Q1 as we expanded our workforce and increased investment in new product development.

Expenses were $16.7 million in R&D and $11.5 million in SG&A. Non-GAAP operating margins were 31.1%. Non-GAAP net income was $25.3 million or $1.11 per share. This is up from $21.3 million or $0.94 per share in Q1 and up from $9.6 million or just $0.46 per share in the same quarter last year.

Stock-based compensation expense decreased from $15.2 million in Q1 to $12.5 million in Q2, as we adjusted stock comp expenses related to some internally granted performance RSUs. Receivables were $38.7 million with DSOs of 44 days, and inventory was $34.4 million, up from last quarter as we continued to increase wafer buffer stock.

In regard to cash flow, we generated $15.3 million in positive cash flow from operations, invested $9.6 million in equipment and assets and ended the quarter with $580 million in cash and no bank debt.

I'd now like to provide some comments on Q3 and the year. First of all, we believe our long-term strategy of developing and selling higher performance products into markets that require ever more precision timing is strongly intact. However, the current macroeconomic environment is impacting sale of some of our products and especially our lower-end products.

At the beginning of this year, we thought 2022 revenue would increase by at least 35%, which we discussed on our conference call in early February. Three months later, we were more optimistic. And in early May, we voiced our opinion that 2022 revenue could increase by at least 50%. That view is based on then current order rates and were supported by our internal forecast.

However, the current economic environment now appears somewhat less certain and order rates this summer have slowed, especially from our lower-end products. We have, therefore, modified our revenue expectations for the year and now believe 2020 -- excuse me, 2022 revenue growth will be closer to our previous 35% estimate.

As a result, sales in the second half of this year will be essentially flat with sales in the first half. However, product mix will improve significantly. We now expect sales in the second half of the year into consumer and IoT will be down 30% or more from the first half, not counting sales to our largest customer.

Sales in the broad-based industrial will also be down, but to a lesser extent. However, we expect those declines will be offset by increased sales to our largest customer, and a 30% or more increase in sales in the comms and enterprise.

For Q3, we expect sales will decline between 6% and 10% sequentially due primarily to lower consumer sales. At the midpoint, this would be approximately $73 million or 16% higher than the same quarter last year. We expect Q3 gross margins will remain strong at about 65%, plus or minus 1 point.

Q3 operating expenses would have increased due to the workforce additions in Q2. But we are aggressively managing discretionary costs to maintain Q3 OpEx at Q2 levels or approximately $28.3 million, plus or minus. Fully diluted share count will be approximately 23 million shares in Q3.

So this guidance just provided should drive a non-GAAP EPS of between $0.80 and $0.90 per share in the third quarter.

And on that note, I'd like to turn the call over to the operator, so we can begin our Q&A. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)Okay, we have Tore Svanberg.

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

Yes. First question is on your comment about order rates slowing. I think there's no surprise that consumer and IoT is slowing. I'm a little bit surprised to hear the industrial and defense category seeing some lower orders.

So can you just elaborate a little bit about what's going on there? Were there perhaps some inventories built in the first half of the year? So any color you can share that -- there would be great.

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

Tore, thanks. Yes, I think, as you said, it's not a surprise that mobile IoT consumer were down. But in the industrial, I don't think automotive, or aerospace has much changed. Aerospace and automotive continues strong. There have been some pushouts in automotive, but they were more than offset by growth from other customers.

The industrial is our sort of catch-all phrase. It's our largest group of customers. And the distinction that I want to make is that it has less to do with the end customer and has more to do with those that are using precision timing products for the purpose that they were intended or not.

So as an example, in the consumer space, our largest customer is using precision timing products for their very high-end products, and those very high-end products continue unabated as opposed to some of their competitors, where we also sell, where they have seen significant downturn.

So the similar thing happened in some industrial customers where they probably found either a pushout, which is more likely of their inventories because of higher inventories. We likely have not lost many design wins, but there have been pushouts and they have been a smaller impact because of not being able to source other components.

And that would typically be the case with industrials because they typically tend to be smaller customers, not larger customers. And they would not be in the priority list for getting other components as well.

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

Fair enough. And I know you've been working on your sales strategy and certainly getting a wider reach with customers. And I know you announced the SiTime direct online store recently. Could you elaborate a little bit on that? And when should we start to expect a contribution from that particular business model?

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

Yes. So we should be able to start expecting that starting this year. I think you'll see greater and greater traction for that for 2023 and onwards. We've just really begun this e-commerce strategy right now. It's very much in its nascent stages.

And we think that part of the task of SiTime is to grow from 14,000, 15,000 customers to about 30,000, 40,000, 50,000 customers in the coming years. And the e-commerce strategy has a lot to do with it. It's part of our broad-based strategy. It is part of expanding our customer base.

One of the things we find, Tore, is that the more we dig, the more we find. We find that some of these customers have an extreme need for these precision timing products. And typically, they are smaller customers that don't -- they have enough help in designing these. Our products make it easier for them to get the job done.

And as you know, we sell at a premium, but they're willing to pay that premium. So I fully expect that, that strategy will lead to higher than corporate gross margins and much greater stickiness because we solved a significant problem for the customer. So stay tuned for more on that as we go forward.

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

Great. Just one last one for Art. Gross margin, 65%, why wouldn't it be higher given the favorable mix for the second half of the year, especially with the mobile consumer being a much lower percentage of the business?

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

Yes, excellent question. So there is potential upside to that. But you also have to remember with the lower top line revenue, our manufacturing overhead becomes a larger percentage of sales. So that kind of counteracts that to a certain extent. And sales to our largest customer will increase in the second half over the first half, including Q3. And I don't want to go into specific margins, but that also can have some impact on our gross margins.

Operator

Next, we have Alessandra Vecchi from William Blair.

Alessandra Maria Elena Vecchi - *William Blair & Company L.L.C., Research Division - Research Analyst*

Just a follow-up on Tore's question, maybe taking it from a slightly different angle. Again, I think we all understand the weakness in mobile consumer. But can you help clarify at what point you really start -- you started to see that sort of nosedive off? Was it later in the month of June that it really started to deteriorate?

And then similarly, if my math is correct, it looks like that the Q3 consumer number is the lowest number since the first half of 2020. So how much of that is not precision timing kind of a code word for some of the supply chain wins you might have won during the COVID time frame and how we should think about the levels recovering in 2023 from here?

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

Yes. So in terms of the time frame, it is really this summer, where we've seen order rates drop rather surprisingly and substantially, kind of very end of Q2, certainly in the month of July. And I think it surprised a lot of folks, including us. But again, it's really our lower-end consumer products, and it does not impact our largest customer in that segment.

Sales to our largest customer in that segment and of course, our largest customer as a company, we expect will increase actually nicely from the first half to the second half of the year.

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

And then to add to that, I would say that what was also surprising was that while we were in touch very close communications with our top customers all across the world, many of them were not able to -- to understand the magnitude of some of this buildup, not just in the consumer, but in some of the other markets as well.

And I think that we are early in our ability to foresee that the downturn has some particular influence on Q3. So I think that, that's an important piece here to note, that we were kind of surprised by the surprise that the customers had and their inability to read.

Alessandra Maria Elena Vecchi - *William Blair & Company L.L.C., Research Division - Research Analyst*

Okay. And then as an extension of that, on the inventory dollar creep up, again makes sense given some of the maneuvers you've done in securing capacity. But given the slowdown to revenue growth in the back half, how should we think about inventory levels from here? Are you going to work them down? Are they still below target levels?

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

Yes. So I did mention that our inventory went up about $4 million in Q1 to Q2. That is a very conscious decision. I think most folks realize that the entire semiconductor industry was in very tight supply, including us. We always have enough to ship the demand that we had, but we've made a conscious and strategic decision to build some buffer stock, especially with wafers.

In case there are any disruptions in the supply chain, a lot of things can happen in the world that could impact the supply of wafers, we want to make sure we've got sufficient supply to handle any intermittent disruption. So I expect that inventory will go up more, not substantially, but it will go up more. We will increase our buffer stock between now and the end of the year.

And I think that's the right prudent thing to do. We have a lot of cash in the bank. We earn a little bit of money on it. Wafers do not go bad. So building a little more inventory, I think, is actually a very smart business move on our part because we have the ability to do that both on a cash basis and because of the relationship we have with our wafer fabs.

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

Alex, it goes back to the single source given that's such a large portion of the business, single source, it's prudent for us to secure particularly wafers and build wafer inventory, because remember that our product is programmable. So that programmability gives us a significant amount of flexibility in our supply chain.

Operator

Our next question comes from Suji Desilva from ROTH Capital.

(technical difficulty)

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

So it's harder to tell. There's everything in there. There's some medical in there, which is clearly precision timing. There's some high-end industrial in there, which is clearly precision timing. Aerospace, yes auto, yes, so all of those, it's just that, I think, that there are myriad of customers may be perhaps more based in China which had some impact in that market.

And again, we haven't lost anything because of design win losses or because for that matter of ASP losses either, even though the competitive solution is much more easily available right now than it was 3, 4 months ago. But still, we haven't lost anything there.

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

I guess that was going to be my next question, Rajesh, as you've seen, sort of, customers at the lower end, slowing orders to adjust inventories, can you give us a sense how many of those sockets are truly sole sourced by SiTime?

And you're sort of confident that when that inventory purge is complete, you'll see the orders rebound versus sockets, which may be dual sourced. And so there might be a risk that after the inventory purge, they could come back at just an overall lower level of demand given increased supply from competitors where the mix might move back to more of a dual sourcing strategy. Is there any way to try to quantify that?

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

Yes. Well, let me take a stab at some of it anyway. And that is that even when a customer has a second source, when we dig, we sometimes find that that's "more of a theoretical thing". It's really -- it takes them still 3 months to 6 months to do a qualification. Typically, that incentive is low.

What happens more is as it happened at one customer where we were on a particular design win, and it was an older design win. And they just decided that you know what, with the slowdown that they were facing, why don't we end-of-life this product? And so they just end of life it and they moved customers over to a different product that they had.

So I think when the supply chain has been hyper tight like it has been, and then when it opens up, like it is mostly opening up, customers start to look at that and say, wait a minute, what should else should I do different? As far as the socket itself, I think our single source sockets are generally pretty solid. I don't see them getting away from us based on, "Oh, I'm just going to stop somebody else for a few cents."

We don't see -- we haven't seen too much of that or in fact, I haven't personally seen any of that. I've seen more around pushouts, and I've seen certainly some in automotive and in the very high-end industrial where people have not been able to get other products to build out. And so they just -- they're just sort of sitting there and saying, "we'll just wait".

This has happened in, for example, in batteries, in electric motors. Many of these customers are relatively smaller customers in size. They're not the big multibillion-dollar companies. And so they're almost always the last ones to get all the other components as well. I don't know if that's helpful.

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

No, that's very helpful. And maybe if I could summarize just hopefully, I have the right picture. If I think about precision timing, it sounds like that's at least 60%, maybe as high as [70%] -- of the demand there has been pretty solid for the lower end. You're seeing what you think is mostly just sort of inventory adjustments leading to lower order rates, but you haven't seen significant moves perceiving at the low end, it's just a traditional inventory purge and maybe it takes a quarter, maybe it takes 2, but you're pretty confident of keeping even those low-end sockets as demand comes back post the inventory clearing.

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

Yes. And the other side of that is it gives an acceleration to our precision timing products because now they're starting to become greater and greater portion of our revenue and certainly a much greater portion of our funnel, which is exactly what we talked about a couple of years ago that this is the direction we want to go in. We're just sort of accelerating into that with the current -- with the current trend.

Thanks, Quinn. Tore, did you have another question?

Operator, are there any other questions? Operator?

Operator

No, there are no additional questions at this time.

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

Okay.

Operator

So at this time, I'm going to turn it over to the speakers for any closing remarks.

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

All right. Well, we want to thank everybody for joining us today. We apologize for the interruption in the call. We're not sure exactly what happened, but we'll go figure that out. I hope everybody has a great day. Thank you so much.

Operator

Thank you for participating in today's conference. This does conclude the program. You may disconnect now.
