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PRESENTATION

Operator

Good afternoon and welcome to the SiTime Second Quarter 2020 Financial Results Conference Call. (Operator Instructions) As a reminder, this conference is being recorded today, Wednesday, August 5, 2020.

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

Leanne K. Sievers - *Shelton Group - President*

Good afternoon and welcome to SiTime's Second Quarter 2020 Financial Results Conference Call. On the 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 is 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 these statements to actual results or to changes in the company's expectations.

For more detailed information on risks associated with our business, we refer you to the risk factors described in our 10-K filing, which we filed with the SEC on March 2, 2020.

Also during this call, we will 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 for or 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. Please refer to the press release issued today for a detailed reconciliation between our GAAP and non-GAAP financial results.

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

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

Hi there. Good to have you all here today, and thank you, Leanne. I hope that you and your families are safe and healthy.

SiTime has continued to work productively from home, as evidenced by our second quarter results, which at $21.5 million were up 36% over the same quarter last year. Normally, we don't quantify our design wins and don't plan to do so going forward, but I wanted to share with you some remarkable progress and design wins in the second quarter this year.

We had more than 300 across the entire product portfolio, including 50 in Elite and Emerald products. On the product front, we continue to innovate and introduced 2 new products, the 9501, the differential oscillator, and Cascade, which is our first clocking product.

As discussed on the last quarter's call, we thought our business would be impacted by the pandemic, but the impact that transpired was less than we expected. Communications and enterprise markets were up 20% sequentially, while industrial, auto and aerospace were up 10%. The one segment that was down was mobile IoT and consumer, which was down 14%, but was still less down than we had expected. And Art Chadwick will provide more details in his financial overview in a few minutes.

I want to talk about our increased focus on the communications, enterprise and data center markets as part of our future growth story for a number of reasons: one, our technology is well suited to these markets, where we can solve difficult timing problems; two, the higher-margin profile associated with these markets aligns well to our target gross margin; and three, these markets have longer product life cycles, which deliver higher revenue predictability. Once we are designed into these end products, customers are less inclined to change suppliers.

As part of this thrust into communications, we introduced 2 new products: the SiT9501 for optical modules and data center; and our first clock IC, the Cascade platform. Well, the SiT9501 is a differential MEMS oscillator and is based on our third-generation MEMS technology. It offers 70 femtoseconds of jitter in half the space of existing products. This enables customers to integrate more features, deliver higher performance and reduce development times. Particularly, in outdoor deployment, this device also offers outstanding resilience to environmental stressors, such as vibration, high temperature and shock.

In addition to the 100-gig and 800-gig optical modules in data centers, the 9501 is well suited for switches, routers, edge servers, graphic cards, storage controllers, and positions us, therefore, to capture meaningful share of market in these applications.

We're also bringing outstanding value through our next product, our Cascade, which is our first clock chip, which is a MEMS clock system on a chip. Now this platform, this Cascade platform, can be configured into 5 different products, 2 clock generators, 1 jitter cleaner and 2 network synchronizers, all through configurable, programmable setup on one platform. All of these offer unsurpassed environmental resilience and end-to-end integration.

For example, we are 10x more robust and reliable than quartz-based solutions due to the inherent robustness of our MEMS and analog. We believe that this higher resiliency and reliability is needed for the next-generation of comms and enterprise hardware. The integration of the MEMS resonator, the oscillator and clock IC, all 3 of which are in this MEMS clock system on a chip, eliminates the potential problems that are typically associated with using other kinds of clocks, which use external quartz devices and have noise issues, impedance mismatches, unreliable start-up and activity dips.

Since SiTime is the only producer of high-performance MEMS resonators, oscillators and clocks, we are in a unique position to solve difficult timing problems, and thereby delivering value to our customers. In doing so, we continue to strengthen our role as a trusted timing advisor to our customers, and we believe that this also brings incremental revenue opportunities with the oscillator products.

Overall, SiTime is well positioned to gain increasing market share and revenue growth in the years to come. We expect strong growth in the second half of this year across all our segments.

With that, I'd like to turn the call over to Art to discuss our second quarter financial results and give you the third quarter outlook. Art?

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

Great. Thanks, Rajesh, and good afternoon, everyone. So we're very pleased to be holding our third financial results conference call as a public company. During my review today, I'll discuss Q2 2020 financial results and will provide guidance for the third quarter.

I'm going to 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, which exclude stock-based compensation and related payroll tax expense.

Going into the quarter, we knew our business would be impacted by the pandemic, especially our mobile IoT and consumer business. Business was impacted but not as much as feared. Revenue for the quarter was $21.5 million, down 1% from Q1 but up 36% over the same quarter a year ago. To provide some color on end markets, I'll report sales by market group, as I have in the past.

The first is "Mobile IoT and Consumer", which consists primarily of sales into mobile phones, wearable devices and consumer products. This was the segment most impacted by the global slowdown. Going into the quarter, we expected sales might be down as much as 20% to 30% sequentially due to the pandemic. Sales were down but not that much. Sales in Q2 were $10.2 million or 47% of total sales, down 14% sequentially and down 6% from the same quarter last year.

The second is "Industrial, Auto and Aerospace", which goes into industrial, automotive, aerospace, military application and includes broad-based sales. This segment was strong during the quarter, as expected. Sales were $6.1 million or 28% of sales, up 10% sequentially and up 70% over the same quarter a year ago.

The third is "Comms and Enterprise", which consists of wireless infrastructure, including 5G, data center and networking. This was our highest growth segment this quarter, with particular strength in data center. Sales in Q2 were $5.2 million or 24% of sales, up 20% sequentially and up 121% over the same quarter last year.

We had just one end customer in Q2 where sales exceeded 10%, and sales to that customer were 26% of sales.

Non-GAAP gross margins for the quarter were 46.8%, up 70 basis points from Q1. Non-GAAP operating expenses were $11.9 million, essentially flat with Q1, comprised of $6.3 million in R&D and $5.7 million in SG&A expense. The non-GAAP operating loss was $1.9 million, essentially flat with Q1.

Net interest and other expense was $0.3 million. This generated a non-GAAP net loss of $2.2 million or $0.14 per share on a fully diluted basis. Stock-based compensation expense and related payroll taxes were $3.4 million. Accounts receivable were $13.0 million, down from $15.8 million in Q1, with DSOs at 58 days. Inventory was $14.8 million, up just slightly from $14.2 million in Q1.

We generated $3.6 million in cash from operations and used $3.2 million for the purchase of assets and taxes paid on RSU grants.

Our big financial event during the quarter was our follow-on stock offering. In June, we sold 1,525,000 shares of stock at $32 per share, netting $45.8 million after fees and expenses. In addition, MegaChips sold 2.5 million shares of SiTime stock, putting those shares into the public float, and this has increased our daily trading volume and liquidity of our stock. MegaChips' sale reduced their ownership percentage from approximately 66% to just 45% now.

In addition, we paid down $15 million of debt, reducing our debt from $50 million at the end of March to $35 million at the end of June. In Q3, we plan to reduce debt even more and may pay it off entirely. We ended the quarter with $102.5 million in cash and equivalents.

I'd now like to provide some guidance for the third quarter of 2020. We believe the COVID pandemic will continue to have some impact on our business this quarter. But even with that headwind, we are expecting strong sequential revenue growth. We expect revenue will be up 30% to 35%

sequentially, which would put Q3 revenue at between $28 million and $29 million driven in large part by strong demand in our mobile IoT and consumer business.

In addition, we believe there is a very good chance we may have additional revenue this quarter from a phone design win. We believe such a win would be for just 1 SKU and shipments would not begin until later in the quarter. However, any such revenue would be upside to the guidance I just provided.

In regards to gross margins, we have a number of initiatives within the company to expand gross margins, and they are starting to pay off. We expect gross margins in Q3 will increase to approximately 50%, plus or minus 1 point. So at that midpoint, there would be gross margins 3 points higher than they were in Q2.

We're also aggressively managing operating expenses. Operating expenses will increase but at a significantly lower rate than top line growth. Non-GAAP operating expenses are expected to increase between 2% and 4% sequentially, which at that midpoint would be approximately $12.3 million. Net interest expense will decrease from Q2 to less than $150,000 as we pay down debt.

Share count has increased as a result of our recent stock offering. The basic share count in Q3 will be approximately 16.8 million shares. In addition, the dilutive effect of employee RSUs will add approximately 2 million additional shares, taking the total Q3 share count used for non-GAAP EPS calculation to approximately 18.8 million shares.

Stock-based compensation expense in Q3 will be approximately $4.5 million, up from Q2 due to the higher stock price, some new higher employee stock grants and the establishment of an executive performance stock bonus plan. We expect non-GAAP EPS will go from a loss in Q2 to a profit in Q3. Based on the guidance just given, we expect Q3 non-GAAP EPS will be between $0.08 and $0.12 per share.

Though the COVID pandemic still poses certain challenges to how we run our business and to many of our customers, we believe we are well positioned for the second half of this year and beyond. We have an exceptional workforce that is performing extremely well while sheltered at home. We have differentiated products that address large and growing markets. We have a number of new products in the pipeline, an enviable list of Tier 1 customers and a strong balance sheet.

And with that, I'd like to turn the call back to the operator for questions and answers. Thank you very much.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from the line of Blayne Curtis with Barclays.

Blayne Peter Curtis - *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

Yes. Great results. Maybe a near-term one, then a long-term one. Just in the near term, can you just talk about the rebound in IoT consumer mobile? I know there was some uncertainty with COVID, and you said it's coming back. But I also see the gross margins kind of coming up. So I'm just trying to understand the big move, with the mix going to those lower-margin parts. Is it a function of just sheer volumes driving the margin better? Or are you seeing a better mix within segments?

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

So I mean all of that is good news, Blayne, right? Gross margins are improving for a whole variety of reasons. We've talked about some of these in the past. We've been raising some prices. The mix, obviously, in Q2 was very favorable for us and that we hope will continue. You're right, the consumer margins are generally somewhat lower than the corporate averages. But even within our consumer space, our gross margins are expected to improve going forward. Again, the mix within those products, cost reductions that are taking place, we're taking more sales direct, and that cuts out the middleman. So all the things that we've talked about to improve gross margins are happening, taking place.

The higher volume also helps, but it's really all of those things combined. So yes, even with a higher expected mobile IoT and consumer mix next quarter, we're still expecting gross margins to improve more than 3 points, give or take, from Q2 to Q3.

Blayne Peter Curtis - *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

And then just longer term, you mentioned the first clock product, and that's a -- you primarily sold oscillators to date. I'm just kind of curious with this. I think you said it could be 5 SKUs. When you look at that TAM for clocks, I kind of equate that to how much of that TAM you can address. And I think you're going to -- I think it's going to be more of a next year event. But I'm just kind of curious to just get your perspective as to where you are in clocks and kind of what that addressable TAM is.

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

Correct. Right. Yes, you're absolutely right. The revenue is out in the future. It's almost de minimis amount this year, but next year, it starts to ramp up. Nothing substantial, but it's over the coming years that it's really going to make an impact.

As far as the -- as we have said before that the total market for clocks is about $1 billion, growing to about $1.2 billion, $1.3 billion in the next 5 years. We continue to look at the communications market as the best place for these clocks. And so I would say that with this particular product, with the Cascade product, we are going for about a TAM of around $20 million to $30 million, so nothing particularly large.

But what it is notable for is the fact that we -- as we said, we are going to be -- during our IPO, we said that we are going to be a full-level systems player in the timing market, and we're going to be focusing on every aspect of timing. So in a sense, it's fulfilling our promise to our investors that we will be in clocking. And I think it -- what it does is it changes the kind of conversation that we can have. Right now, when we go in with a high-end product and oscillators, like an Elite or Emerald, we are able to bring in the Cascade as a part of a system solution.

As we go forward and as we introduce more products next year and the year after, we'll be able to also reverse the products to the process where we lead with the clocking products, and we'll be able to bring the oscillators in, into those customers. So we think it's a highly strategic move. And a few years from now, we think that revenue of this -- for this product could be very high indeed. And we think it's a very promising market.

Operator

And your next question comes from the line of Tore Svanberg with Stifel.

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

Yes. First question on the phone design win. I know you only guide one quarter out, but it sounds like this is going to be sort of a late quarter event. So should we infer that, that would be material enough to perhaps growth again sequentially in the December quarter?

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

So -- yes. So we had to thread the needle on this one, right, because we've obviously been working towards getting such a design win as an expansion of our business. But we've also said that we don't want to bake it into anybody's numbers until we've shipped enough production parts, that we're confident that is real and sustained. And as of today, August 5, we're not at that point, but we do believe that there's a very good chance that we will have that design win. It will be for, we believe, just 1 SKU. Shipments would begin later this quarter. And we're not including it in our guidance, as I mentioned. So this would be incrementally positive to our guidance in Q3. And of course, we haven't given any guidance for Q4 yet.

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

Okay. That's fair. And Rajesh, on the clock product, or Cascade, first of all, I assume this is fabbed with your main foundry partner. And then should we assume the profitability of this platform to be quite a bit higher than your corporate average, just given the amount of content you can get from a clock product like that?

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

Yes. So we generally don't comment on where our products are fabbed, so I won't comment on that. But basically, what I'll say is that it is in-line with our corporate guidelines for -- or particularly going forward. We view this first product as a more of a strategic foot-in-the-water product so that we can start the conversation going with key customers. We have a lot more of these coming, of different versions and different architectures coming. So we just wanted to get connected to our customers and start to get design wins, which we have. Yes.

Operator

And your next question comes from the line of Chris Caso with Raymond James.

Christopher Caso - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Yes. Just another question on the phone win. And -- but just maybe you can clarify why you chose not to put it in guidance. Is that still some question of whether or not you've actually secured the socket? Or perhaps that's a question of how much revenue comes in within the quarter. Because I guess we know that in some cases in the second half, the timing of some of these launches have been affected by COVID, and I suppose that would affect how much revenue comes in the September quarter as compared to the December quarter.

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

Yes. So Chris, very thorough question, but my answer is going to be very similar to how I answered it a minute ago. We -- until we start shipping production parts to at least a certain level, where we're comfortable that the design win is solid and will continue, we've chosen not to include it in our numbers, and that's where we are today. So 3 months from now, when we report Q3, we may have more to say about that. But as of today, I think it's very good news that we believe there's a very good possibility, in fact, a probability that this will happen. But until we start shipping production parts, we're not going to count it yet.

Christopher Caso - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Got it. Okay. That's clear. The follow-up question is just -- regard to the other segments and what you see through the second half in general. And perhaps you could separate out some of the COVID effects of some of the other markets against some of the design win effects. And you suggested that you're expecting strong growth across all segments as you go through the second half. Maybe you could just give some color of what you're thinking for those other segments.

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

Yes. So obviously, the -- go ahead, Rajesh.

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

Go ahead.

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

So obviously, the most significant growth from Q2 to Q3 will be mobile IOT. We pretty much have the bookings, so we know what that looks like. And in Q4, we would expect that segment to strengthen even more just because it's the holiday season, and historically, Q4 would be stronger than that.

Our other segments, we've got a number of design wins that continue to ramp. And in the second half of the year, we would expect sales for those segments to be higher than they are in the first quarter. I think there will be an impact because of pandemic. We know a few of our customers that are delaying some of their rollouts as a result of the pandemic. But we have factored that into our guidance with the numbers that we provided for Q3.

Operator

And your next question comes from the line of Suji Desilva with ROTH Capital.

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

Congratulations on the progress here and momentum. So in the third quarter time frame, just the non-consumer mobile segment, the industrial and communications, is -- do you expect communications to continue to lead the growth here with the ramp-up of additional programs? Is that the way to think about the percent growth leadership?

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

So for Q3, again, I mentioned we've got a couple of specific customers that are slowing some their programs down in Q3 because of the pandemic. And again, I have factored that into the overall guidance. But I think that the growth rate, the sequential growth rate in Q3 in those segments will likely be less than they were going from Q1 to Q2. But I also expect -- again, without going into guidance for Q4, I expect those to grow very nicely from Q3 to Q4, the segments outside of the mobile IOT, so both industrial and the comms space. Again, I'm basing that comment on specific knowledge of specific customers and where they are with different programs. So I think the growth rates for those 2 segments slow down from Q2 to Q3, but I think they accelerate again from Q3 to Q4.

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

Okay, That's helpful. And I also have a quick follow-up question here on the smartphone win. Can you say if that's a customer that's new to SiTime or an existing customer?

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

Yes. We're not going to say. It's a phone design win, so that's how we're going to have to leave it, Suji

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

Fair enough, Art. Congrats again on the progress.

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

Great. Thanks a lot, Suji.

Operator

And your next question comes from the line of Quinn Bolton with Needham & Company.

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

Congratulations on the results. So I'll try one here (inaudible) there -- could you talk about -- is there something -- value that you guys brought that competitors couldn't bring that allowed you to win that socket? Is this, say, perhaps, a millimeter wave where your solutions performed better than competitive alternatives? Or just any -- what do you think technically allows you to secure that socket?

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

Yes. I mean broadly speaking, we have 2 categories, reasons for people choosing us. One is the performance area, and in performance, we put in things like size and quality, reliability, power into that mix. The other portion of it, which we think is having a bigger impact over time now is the supply chain value. So as you know, we are always -- SiTime is always a fabless company. And our competitors in the quartz world are, in fact, have to build factories, have to build fabs, and it's either feast or famine for them. I think that -- portion of the fact that in today's business, in today's COVID, there are a few companies in the crystal world that have had significant issues with production, either shutting down plants or basically not being able to open plants and so on, that has, we think, put in constraint in the world supply. And it comes and goes, so it's not quantifiable yet by us, but the supply constraint comes and goes.

So I think through an abundance of caution, some of our customers are using us significantly for supply chain reasons and just putting us into the mix, and that's why the -- getting a smaller SKU rather than getting the whole phone is part of the reason why I attribute this to. So we always get it because of performance reasons. There's always a performance reason to buy from SiTime. But in this case, the supply chain is having a greater impact than previously.

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

Got it. And then for you, Art, could you just -- I missed it, but could you reiterate the gross margin guidance for the third quarter?

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

Yes. So gross margins are improving very nicely from Q2 to Q3. I guided them in Q3 to be at 50 percentage points, plus or minus 1 point. So at 50%, that would be a little over a 3-point improvement from Q2.

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

Got it. Okay. And then, Art, it sounds like -- I know you're not giving guidance for the December quarter, but I think in answering to Q&A, you said all 3 segments look like they will grow again in the December quarter. It sounds like the gross margin trajectory should continue to increase into the fourth quarter, unless there's some real significant mix shift. But comms enterprise and industrial auto and the reaccelerate in Q4, that doesn't sound like mix becomes an issue. So should we be thinking that gross margin continues to trend higher into the fourth quarter?

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

Yes. Without getting too far ahead of ourselves, I think we're setting ourselves up for good gross margin expansion over time. I think going from Q3 to Q4, it will at least be at Q3 levels and likely a little bit higher.

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

And Blayne, I just -- and Blayne, I just wanted to say one thing that on the Cascade TAM, I looked at it a little carefully, and it's $50 million just for the communications portion of it.

Operator

And your last question comes from the line of Alessandra Vecchi with William Blair.

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

Congratulations on the excellent results. Just on the Endura platform, which I believe was launched in Q4, I was wondering if you could sort of update us on design win traction there for the -- with aerospace and defense, and potentially if that's been pushed out a little bit as well due to COVID.

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

Actually, we see no stopping in the design win activity. In fact, in some cases, it's been very strong, and that's why I made a point of sharing the numbers of 300 total design wins, including 50 in Elite and Emerald. Some of the Elite and Emerald were in the Endura line. So I think we have a very strong broad-based demand for Endura-grade products, and there's been no push-outs in that market. In fact, as I said, we're gaining even more traction as we go and as it becomes apparent of the value of the products that we bring.

Operator

There are no further questions at this time. I'll now turn it back over to Art Chadwick for any closing remarks.

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

Great. I just want to thank all of you for spending the time listening to our call. We really appreciate it. We hope everyone has a great rest of the afternoon. Thank you very much.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating, and you may now disconnect.

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

Thank you.