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Semtech Corp. (SMTC)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Semtech Corporation Conference Call to discuss the First Quarter Fiscal Year 2024 Financial Results. Speakers for today's call will be Mohan Maheswaran, Semtech's President and Chief Executive Officer; and Emeka Chukwu, who's Semtech's Executive Vice President and Chief Financial Officer.

Please note that this conference is being recorded. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation.

I will now turn the call over to Semtech's Vice President of Investor Relations, Anojja Shah.

Anojja Shah
Vice President-Investor Relations, Semtech Corp.

Thank you, operator. A press release announcing our unaudited results was issued after the market closed today and is available on our website at semtech.com.

Today's call will include forward-looking statements that include risks and uncertainties that could cause actual results to differ materially from the results anticipated in these statements. For a more detailed discussion of these uncertainties, please review the Safe Harbor statement included in today's press release and in the other Risk Factors section of our most recent periodic reports filed with the Securities and Exchange Commission. As a reminder, comments made on today's call are current as of today only, and Semtech undertakes no obligation to update the information from this call should facts or circumstances change.

During this call, all references made to financial results in our prepared remarks will refer to non-GAAP financial measures unless otherwise noted. A discussion of why the management team considers such non-GAAP financial measures useful, along with detailed reconciliations of such non-GAAP measures to the most comparable GAAP financial measures, is included in today's press release.

And with that, I'll turn it over to our Chief Financial Officer, Emeka Chukwu. Emeka?

Emeka N. Chukwu

Executive Vice President & Chief Financial Officer, Semtech Corp.

Thank you, Anojja. Good afternoon, everyone. Before I begin, I trust you all saw the news that the board has completed its search for our new CEO. We are pleased to welcome Paul Pickle to Semtech. Mohan will comment further. But we are all excited about Paul's impressive mix of semiconductor and IoT experience and look forward to his arrival later this month. And I also want to congratulate Mohan on his retirement. Mohan has led Semtech very successfully for the past 17 years and we have all enjoyed working with him. Like the many Semtech employees, we wish you well on your next adventure.

Turning to Q1 fiscal 2024, the company delivered net sales of $236.5 million, above the midpoint of our guidance and an increase of 41% sequentially and 17% year-over-year. These numbers include a $136 million of revenue from our acquisition of Sierra Wireless. Our non-GAAP gross margin of 48.5% was in line with our guidance, and our earnings per share of $0.02 was above our guidance. In Q1, shipments into North America, China, Europe, and the rest of Asia represented 31%, 24%, 15% and 30% respectively. The addition of Sierra Wireless has increased our geographic mix towards North America and Europe. Total direct sales represented approximately 39% of net revenue and distribution represented remaining 61%.

Turning to our end markets, as we mentioned last quarter, we expect to see macroeconomic challenges affect our business in the first half of fiscal 2024, which we did see in Q1. Net revenues from the high-end consumer market decreased 38% sequentially and 55% versus the prior year. High-end consumer represented 9% of total net revenues. Net revenue from the industrial end market increased 130% sequentially and 125% over the prior year due to the inclusion of Sierra Wireless. The industrial end markets represented 75% of total net revenues. And finally, the infrastructure end market declined 30% sequentially and 49% over the prior year and represented 16% of total net revenues.

In terms of POS, we saw the majority of POS, 60%, come in from the industrial end market due to the addition of Sierra. The infrastructure and consumer end markets were balanced with 21% and 19% respectively. Q1 bookings grew 1% sequentially, driven by strength in our Advanced Protection and Sensing business unit.

Q1 non-GAAP gross margin was 48.5%, in line with the midpoint of our guidance. For Q2, we expect gross margin to stay roughly flat. For the remainder of fiscal 2024, we expect our gross margins to trend higher through the year, as material cost synergies are achieved and revenues in our higher-margin Semtech organic businesses increase. These benefits would be slightly offset by lower absorption, as we work to reduce our internal inventory levels. We are still expecting a 100- to 150-basis-point improvement in gross margin by Q4 of this year.

In Q1, operating expenses were $93 million, $6 million below the midpoint of guidance, due to our strict management of discretionary spending. For Q2, we expect further reductions to our operating expense, down another 2% sequentially and expect to see continued declines throughout the remainder of the year as we execute on our integration plans and operate to optimize for financial performance.

In Q1 of fiscal 2024, non-GAAP operating margin was 9.3%, significantly better than expected, driven by actions we took to preserve operating profit. In Q1, cash flow from operations was a $90 million use of cash, impacted by the fiscal year 2023 annual bonus payout and the payment of acquisition-related expenses. We expect our cash flow to recover in the second half of the year as acquisition-related expenses taper off and demand improves, allowing us to improve profitability as current inventory levels are reduced.

Our gross debt at the end of Q1 was $1.4 billion or approximately 4.3 times leverage on a net basis. We expected to see an increase in net leverage in the first half of the year as we navigate this softer demand environment. We announced today that we negotiated another amendment to our credit agreement to get further relaxation through our leverage on interest expense coverage ratio covenants. Given our current projections for revenue and earnings, we now expect to have adequate cushion through fiscal 2025. The Q1 weighted average cash interest expense was approximately 5.65%. And as we have said before, the main priority for free cash flow will be to pay down our debt.

In summary, Q1 performance was better than expected, but still impacted by macroeconomic headwinds. Looking ahead, we continue to make progress on our integration of Sierra Wireless. Our synergies are ahead of plan, and as a result, we still expect the Sierra acquisition to be accretive to earnings in fiscal year 2024. We are getting good customer feedback on our cellular and LoRa integration plans. Overall, we are seeing higher design wins, and with the steps that we're taking to improve our financial performance, we believe that our business will thrive as demand improves and channel inventory gets back to normal levels.

I would now hand the call over to Mohan.

Mohan R. Maheswaran

President, Chief Executive Officer & Director, Semtech Corp.

Thank you, Emeka. Good afternoon, everyone. Thank you for joining today.

On May 30, we announced that Paul Pickle would join as new President and Chief Executive Officer to Semtech. I will ensure a smooth transition with Paul and support him and the board as needed for the next 16 months. Thank you all for your support and interest in Semtech over my tenure as CEO over the last 17 years. I've enjoyed working with you all and I'm counting on you to continue to support Semtech through the next phase of growth. Today marks my last earnings call as Semtech's President and Chief Executive Officer.

Onto our Q1 fiscal year 2024 performance by product group as well as the outlook for Q2 of fiscal year 2024. In Q1, our quarterly net revenue increased 41% sequentially and achieved a new record of $236.5 million, slightly above the midpoint of our guidance. We also posted non-GAAP earnings per share of $0.02, driven by lower OpEx, as synergies were ahead of expectations. Both net revenue and EPS were better than guidance. While inventories remain high, Q1 bookings for the organic Semtech business were up sequentially, increasing our confidence that the organic Semtech business has stabilized, albeit at much lower levels.

In Q1, our Signal Integrity Product Group revenue was down 32% sequentially and represented 18% of total revenues. As expected, all our infrastructure businesses were very weak in Q1. Our China PON and base station businesses were especially weak in Q1 as overall demand softened and inventories remained high. Our hyperscale data center business was also weak in Q1, but we are expecting this business to rebound modestly in Q2 as inventories reduce. We are anticipating a strong second half performance from our data center business driven by our North American design wins.

AI is driving significant demand at hyperscalers, and our SIP portfolio is primed to take advantage of the upcoming data center buildouts. Our Tri-Edge, FiberEdge and CopperEdge platforms deliver lower power and lower latency advantages over DSP solutions, which are key requirements for future AI data centers. We are growing our data center footprint with North American partners, and we are already well positioned in China, where we believe that data center buildouts will regain momentum in the next 12 months.

In Q1, we announced the industry's first 200-gig per channel FiberEdge type TIAs, which are generating positive interest and design wins with Tier 1 customers in North America. In addition, our CopperEdge platform is in the early stages of penetrating the 100-gig and 200-gig per channel active copper cable segment in North America, which we believe has tremendous potential in the data center market.

We remain confident that our full portfolio of data center platforms, including ClearEdge and Tri-Edge CDRs, FiberEdge PMDs and CopperEdge redrivers will enable us to rapidly grow our hyperscale data center business over the next several years. While our PON business saw a sequential decline in Q1, we believe excess inventories are starting to reduce. Increasingly, we are seeing service providers outside of China starting to deploy PON systems, which is a very encouraging sign for our future PON business.

Our PON portfolio has recently been expanded with the industry's first 50 gig PON OLT chipset, which already has design wins at Tier 1 European customers. We believe our 2.5 gig, 10 gig, 25 gig and 50 gig PON PMD portfolio offers customers the broadest and highest performance PON PMD portfolio in the industry, and we expect our PON business to return to growth in the second half.

Revenue from our wireless base station business was also down in Q1 on both a sequential and year-over-year basis, as the macro economic slowdown in China has impacted demand for both 4G and 5G base stations. However, new tenders recently issued in China should drive meaningful growth in this segment in the second half of FY 2024 and in FY 2025. In Q2 of FY 2024, we expect continued reduction of customer and channel inventories across our infrastructure businesses, and we expect a modest improvement in revenues from China, as our China demand begins to recover. As a result, we expect our Signal Integrity Product Group revenues to increase sequentially in Q2.

Moving on to our Advanced Protection and Sensing Product Group. Q1 net revenue from our Advanced Protection and Sensing Product Group decreased 25% sequentially and represents 15% of total revenues. The drop was driven by lower demand from the consumer segment, as we are faced with high inventories in both the China and Korean smartphone markets. We expect inventory digestion to continue for several quarters. However, we continue to achieve solid design wins on new smartphones with our leading USB-C protection platform across all Tier 1 global smartphone customers.

In Q1, we announced the expansion of our PerSe product portfolio with the release of a new SAR sensor for 5G mobile devices. Semtech's PerSe technology senses human proximity and enables smartphones to implement RF power control. New SAR regulations in China starting in FY 2025 are beginning to be a catalyst for new proximity sensing growth with bookings and POS up significantly from Q4. We expect this to increase as adoption of our SAR sensors continues in the second half of FY 2024. On the broader market for our protection products, we are seeing strong demand from the automotive segment as adoption of our high-performance system protection portfolio is accelerating. Specifically, we are seeing increasing adoption of Ethernet, USB-C and antenna protection from the automotive segment.

In Q1, for the first time in our history, our broader protection business exceeded our consumer protection business and represented approximately 55% of the total protection business. In Q2, we expect our Advanced

Protection and Sensing business to see revenues grow sequentially. Turning to our IoT business. As a reminder, our new IoT business has two sub-businesses. The first is the IoT Systems Product Group, which is made up of Semtech's LoRa business, the Sierra Wireless module business, and the Sierra Wireless router business.

The second product group is the IoT Connected Services Group, which includes Sierra's managed connectivity business and Semtech's LoRa Cloud services business. In Q1, total IoT revenues increased 170% sequentially to approximately $159 million or 67% of total revenues. While our LoRa-enabled revenues were down in the quarter, driven by the lower demand for Helium gateway chips, our LoRa and POS volume grew – our LoRa end-node POS volume grew 29% sequentially, with strong growth in Europe, Japan and China. This is a strong indication that our strategy is working.

We expect future LoRa end-node deployments to continue to increase as the demand for low-power sensor networks incorporating edge AI routers becomes mainstream in the IoT world over the next few years. The adoption of LoRa continues to grow across many IoT use cases globally, especially in North America and Europe. Some of the recent exciting announcements this quarter included Sustainable Hrvest deployed LoRa-enabled sensors and LoRaWAN-based gateways across its Durian fruit farms in Malaysia to improve farming practices, lower operational costs and increased crop yields. Durian is a challenging crop that needs 24/7 maintenance for high yield, and LoRa-enabled sensors give farmers real-time data for the health of their farms every step of the growth cycle.

Bechtle, a large European -based IT system solution provider, announced that they have joined the LoRa ecosystem and will incorporate LoRaWAN into their strategic portfolio targeted at the retail, manufacturing, logistics, healthcare and public infrastructure segments. Lacuna Space, the direct to satellite LoRaWAN company, launched its latest satellite on SpaceX, raising its number of satellites to seven to bring low-cost connectivity to the most remote parts of the world.

In Q1, we launched a new multi-band LoRa transceiver for use in IoT endpoints, enabling a single low power device to be used anywhere in the world. The highly integrated LoRa Connect platform provides LoRaWAN connectivity for terrestrial low power wide area networks, as well as supports LoRa 2.4 gigahertz for global connectivity and S-band for direct connection to satellites. This new multi-band LoRa radio is perfect for global logistics and asset management use cases.

And in Q1, the LoRa Alliance launched a new LoRaWAN Accredited Professional program to support the IoT industry's need for skilled LoRaWAN engineers and developers. New LoRa opportunities continue to emerge across multiple end markets, including smart utilities, smart logistics, and asset management and connected spaces. While our LoRa-enabled businesses is expected to decline this year due to the negative impact of our Helium gateway business and a weak China, we are expecting LoRa end-node deployments to continue to increase globally, and we expect our LoRa-enabled business to return to strong growth in FY 2025.

In Q1, the Sierra Wireless IoT module business increased 31% sequentially as demand for IoT LPWAN connectivity solutions increased. Interest in Sierra routers – Sierra's routers in the public safety and industrial IoT segments continues to increase. Specifically, we are seeing increased adoption of our routers for utility monitoring, EV charging, and precision agriculture. In addition, we are pleased with the strong growth of our IoT Connected Services business, which grew 10.3% annually. As we grow our managed connectivity subscriber base, we see a massive opportunity to deliver value-added IoT services to our customers. We are investing in both our IoT managed connectivity platform and our future IoT Cloud services platform.

As we start to marry our LoRa ecosystem strategy together with our IoT, module, router, and services strategies, we expect to deliver a uniquely differentiated and highly attractive IoT portfolio to the low power IoT industry over the next few years. In Q2, we expect our IoT business to decline sequentially as we continue to face high channel inventories and relatively weak demand across all our IoT hardware businesses. In Q1, Semtech's overall design win volume was up 32% sequentially and our module design win value was up 50% sequentially. Both of these metrics bode well for a strong FY 2025.

Now let me discuss the outlook for the company for the second quarter of fiscal year 2024. As a result of our lower revenues and our increased leverage, we are taking actions to ensure our operating profits remain at acceptable levels. These actions are on top of our planned synergies. In addition, the Semtech board continues to carry out a detailed portfolio review and will discuss its findings and any actions with the new CEO who will be joining Semtech approximately June 30. We are currently estimating Q2 net revenues to be between $233 million and $243 million. Retaining the midpoint of our guidance range, or approximately $238 million, we needed turns orders of 39% at the beginning of Q2. We expect our Q2 non-GAAP earnings to be between minus $0.02 per share and plus $0.06 per diluted share.

I will now hand the call back to the operator, and Emeka and I will be happy to answer any questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, at this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of Craig Ellis with B. Riley. Please proceed with your question.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

Yeah. Thanks very much for taking the questions. Mohan, I was hoping you could just start by providing a little bit more color on some of the things you're seeing out in the end markets that you serve. One, can you comment on what you've seen with order activity quarter to date? What are the pluses and what are the weaknesses? And in areas where, per the press release, you're seeing signs of stability, where do you and the people in the sales team feel more confident that things have stabilized, where things still relatively weaker or richer in inventory?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah, Craig. So, I think the – obviously, the consumer business now in China particularly is starting to show some signs of life. Of course, it's come down in its very low levels. So, that's not a surprise. It was going to turn around at some point and we're starting to see improved orders from the consumer business, a little bit improvement in the China business, particularly in consumer. And so, that's, I would say, probably the primary area. I would say we're also seeing continued improvement in the automotive industrial area. That one is not being so bad. So, I think in general, those are the two kind of strong areas.

I would think the – I would say the other areas in general are still relatively weak. Bookings are still relatively weak. But remember, there's a lot of inventory out there. So, we're expecting it's really looking at POS and the digestion of that inventory, that's the key thing. And there are some positive signs there, as I mentioned, in the infrastructure side and the data center side specifically. And I think I would say also in the broader kind of protection business.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

Got it. That's helpful. And then, Emeka, I wanted to follow up. So, a quarter ago, we were pacing very well on cost savings and I think you raised the cost savings target from $40 million to $50 million. Now, we've had better operating expense in the quarter. It's better than what I expect in the guide. So, how should we look at that prior $50 million expense reduction targets and the potential for that to move up either now or with time?

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

Yeah. So, Craig, we're definitely doing very well on the synergies front. The numbers that we're seeing is a little bit above the $50 million that we had upsized the last quarter. I'm not ready at this point to quantify that, but it is coming in nicely above that number. We've also – definitely, like I said in my prepared remarks, we are definitely watching every penny of OpEx at this point. Our discretionary spending is something that we are keeping very close eyes on. The traveling expenses, some of other discretionary supplemental compensation, we're keeping an eye on all of that.

So, we are definitely very pleased with what we have seen in the first quarter in terms of our abilities to manage operating expenses and given where the business is right now. Like Mohan said in his prepared remarks, we're looking at other things and hopefully we'll continue to do a good job on that.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

That's good. And then, if I could just sneak in one more. You mentioned that you had achieved some incremental covenant flexibility. Can you just talk more specifically to that point? And was there any incremental cost to interest rates on the debt you have out, or was that achieved with some other means? Thanks so much, guys.

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

Yeah. So, definitely on the covenant side, obviously, just given the outlook for the business, other macroeconomic issues that we're seeing, the fact that our inventory in the channel continues to remain stubbornly high, we sort of anticipated that the covenants might be challenged in the second half of the year. So, we took proactive steps to get back to our banking group to work with them.

So, yes, there was incremental cost. It cost us probably about 50 basis points in terms of amendment fees. And because the leverage is anticipated to be higher, the interest rates associated with those are going to be a little bit higher than what we originally had communicated and the original agreement that we had out there. But having said that, I think our expectation is that with all the synergies, the fact that we're running ahead on synergies, also looking at things continuously getting better in terms of demand in the second half of the year, we continue to believe that the acquisition is going to be accretive to our earnings in fiscal year 2024.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

Thanks, Emeka. Thanks, Mohan.

Operator: Our next question comes from the line of Scott Searle with ROTH Capital. Please proceed with your question.

Scott W. Searle
Analyst, ROTH MKM

Q

Hey, good afternoon. Thanks for taking my questions. Nice job in the quarter, and Mohan, I want to wish you all the best again in your future endeavors. It's been a pleasure working with you in the past couple of years.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Thank you, Scott.

Scott W. Searle
Analyst, ROTH MKM

Q

Hey, maybe just to follow up on Craig's question on the covenants front. Emeka, I just want to clarify a couple of things. Sounds like there were some small penalties. There's an increase in the interest rate. But I want to make sure in terms of the guidance that you gave for the second quarter, that is included, right? That interest expense is already included in there. And then, going forward in terms of further reductions in the OpEx structure and/or evaluation of the portfolio and potential asset sales, that is not being mandated by the bank, that is in fact just part of your general pruning of operations and optimizing things going forward. Is that correct?

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

Yeah. So, the second one, I'll just take that. Yes, that is just is what every good business would do in a time like this. And we already have that set in motion. It was not something that was mandated by the banks. And with regards to the interest expense, yes, our guidance has factored in the new agreements. I think in Q1, the weighted cash interest rate was about 5.65%. In Q2, we're anticipating that based on our guidance to probably be about 6.1%.

Scott W. Searle
Analyst, ROTH MKM

Q

Great. Very helpful. Thank you. And if I could just – in two of the end markets, first, in terms of IoT modules, it sounds like you're still working through some inventory issues there. Mohan, I'm not sure if I heard your comments looking into the second half of this year, but you're expecting some relief in the inventory work, which at that point in time sounds like design activity remains very high. So we're getting back on a path to normalcy.

And then just to clarify your comments around data center, there's a tremendous amount of interest in activity as it relates to AI and what that's doing to the demands of the data center. Do you get that – given the new products that you have, given those demand dynamics, by the end of this fiscal year, entering fiscal year 2025, do you start to get back or start to approach the levels that you had seen two or three quarters ago? Thanks so much.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah, Scott. So, let me start with the – on the IoT side. I think Semtech's IoT business, we saw softness in China. We saw softness, in general, probably a little bit earlier. The Sierra business now has seen some weakness and continues to see some weakness particularly in our modules and the router side and the hardware side. So little bit – some of that is North America and Europe catching up with the softness in Asia. And I think we're going to see that in Q2 and maybe Q3. But after that, I think we'll start to see a little bit more positive momentum. And this is speaking about kind of the traditional Sierra modules that they've been selling.

Obviously, there's a lot of design and activity around the new approach that we're taking now with modules and how we're thinking about things and that could generate some interesting opportunities, I think, going forward. With regard to data center, I think, yeah, our expectation is that, obviously, Q2 – Q1 was very weak, Q2 will be stronger, and we're expecting the second half to be stronger than the first half. Could we get back to the levels of the first half of last year? I think we need to see some of our design wins that we've got going on. We have good momentum in North America as we've stated, and we have some new opportunities with CopperEdge, as I mentioned in the prepared remarks, that probably more FY 2025 kind of drivers. But we're hoping to see some of that in the back end of this year.

Scott W. Searle
Analyst, ROTH MKM

Q

Great. Thanks so much and best of luck going forward.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Thank you.

Operator: Our next question comes from the line of Harsh Kumar with Piper Sandler. Please proceed with your question.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Yeah. Mohan, I want to also wish you best of luck with your retirement. Enjoyed working with you all these years. I just had a couple of questions. The first one, generally speaking, kind of, if I had to pin you down and say, how many quarters of inventory do you think there is on an aggregate basis for Semtech plus Sierra Wireless combined? Would you be able to tell us, is it a quarter or two quarters? And are you losing any design wins or is it just – the slowdown is just purely a function of the fact that there is excess inventory in the channel?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah, I'm not aware of any design wins we've lost, Harsh. I think most of it is just inventory buildup. And, you know, it's difficult to say, when you look at inventory, you obviously have to look at consumption in parallel with inventory, right, because, you know, as consumption increases then inventory comes down and you can – you start to see the opportunity and that's kind of what we are seeing. So in consumer as an example of that, where I think most of the inventory is, we are starting to see a few positive signs there. As I mentioned on the China, consumer is starting to look a little bit more positive.

So – and as you know, if consumer comes back quickly, that can absorb that inventory very quickly. So I think in the other areas like infrastructure, I think the same commentary applies to the PON business where we have some inventory and base station business where we have some inventory that those can be quite – absorbed quite quickly depending on if tenders come out there and demand picks up in China, for example. I think where we're currently seeing demand, I would say data center is the strongest in the infrastructure areas. And I would say on the industrial side, it's probably still the automotive area and then the consumer area. And the consumer area has been extremely weak for a long time. So that's not a surprise, right?

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Yeah. Yeah. No, totally. And then, Mohan, I had a follow up, but I'll ask a two-part question, if you don't mind. On LoRa side, is Helium all completely played out? And do you think it's bottomed out in your guidance at this point in time? And what would make it come back? So the – is it the funnel or are you seeing still pretty good design activity here? And then secondly, if I was to make a statement, this is part two of the question that, that I think your – maybe your business is about bottomed out in the last quarter that, that happened. What would you say, would you agree with that statement in general based on all the commentary, or would you say that maybe there's some color required there?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

No. Actually, I think the Semtech organic business is definitely – Q1 was probably the bottom. I don't think it'll – we'll see any further decline from that. And that's clearly why we're guiding Q2 slightly up. And part of that is the improvement in the Semtech organic business and that kind of narrative is the same on the LoRa side. Yeah, we – the Helium was kind of an opportunistic business, came, has now gone away and so it's, yes, clearly in the guidance that it's not in there. Could it come back? We're not banking on Helium coming back. I don't think that was ever the strategy for LoRa. And we're banking on low power IoT sensors growing.

And as I mentioned, more end nodes are growing. We're still seeing a lot of demand for LoRa across the globe. We're seeing a lot of use cases being deployed. All the dashboard metrics that I've been giving out for years and years now I think are still doing well. Obviously, China is weak at the moment. And because of what's happened with Helium, the metrics don't look as good. But I think one of the things to remember anyway was part of the strategy is we integrate Sierra. We're looking at a very different playing field now, the opportunity to go and attack a much larger space and with a broader portfolio. So I think that's the way you should think about it. But, yeah, to answer your question, I think it's pretty much built into the guidance any weakness from Helium.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Appreciate it, Mohan, and best of luck. Thank you.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Thank you.

Operator: Our next question comes from the line of Tore Svanberg with Stifel. Please proceed with your question.

Tore Egil Svanberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yes. Thank you. Congratulations on your retirement, Mohan. It's been great working with you these last 17 years.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Thank you.

Tore Egil Svanberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Let me start with a comment on working capital, and you guys did a really good job there. Inventory days now back down to 159, DSOs 56. As we think about this new combined entity, where would – what would those metrics ideally be? I know, Emeka, you mentioned that you still expect to lower internal inventories somewhat, but where do you think eventually the business will land on DSOs and inventory days?

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

So, Tore, as we continue to get very familiar with the new Sierra business, my expectation would be that the inventory days will continue to come down, both in terms of Sierra's inventory and Semtech organic inventory. Right? Probably I wouldn't be surprised to see those days of inventory probably get down to the 120s or something like that by the end of the year given the plans that we have. So we just have to see how it plays out. Of course, demand is going to be a key factor in that equation. With regards to receivables, Sierra typically has a longer payment terms for their customers than the Semtech organic business, that are 59 days. It's not that bad, but I think I would expect to see that come down. I would like to see that maybe come down to 50 or 55 days.

Tore Egil Svanberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. That's great perspective. And Mohan, you talked about expectation for growth resuming in data center second half of the year. I mean, I think that's – that makes sense given all the dynamics there. But you also mentioned you expect base station to actually grow in the second half. Any data points that gives you that conviction?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Just new tenders in China, Tore, that we know about. We don't know exactly how that's going to affect our business yet, but we know that's happening. And whenever you hear, obviously in the base station business and the PON business, it's all about service providers and all about tenders, and it's all about how many systems are going to be deployed. And so when you see tenders going out and you see quantities of – unit volume quantities, then it just becomes a question of how the share is allocated. We're pretty much, as you know, in most of these 5G systems in China where we are and 4G systems, we have very good relationships and very good penetration, and the same on the PON side. So I think our expectation is that if those come to fruition and then obviously that's always a question in terms of timing, then the second half will be stronger. If not FY 2025 is going to be very strong.

Tore Egil Svanberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Thank you. I'll go back in line.

Operator: Our next question comes from the line of Quinn Bolton with Needham. Please proceed with your question.

Quinn Bolton
Analyst, Needham & Co. LLC

Q

Hey, Mohan, I will echo my congratulations and great working with you. Wanted to start just on a follow-up on Tore's question on the base station business. I think in the past you guys have said you get much higher content in sort of the 3 to 6 gigahertz bands rather than the 700 megahertz band. Just wondering if these tenders going out in China are in those higher frequency bands where you might have greater dollar content in those base stations?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah, I believe so, Quinn. So, I don't know exactly the detail, but I believe they are.

Quinn Bolton
Analyst, Needham & Co. LLC

Q

Perfect. And then on the turns percentage, I may have missed what turns was in fiscal Q1, but 39% I think is back up towards the higher end of certainly recent ranges. With visibility still being pretty low, how comfortable are you with turns up near 40% for the second quarter?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah, I think actually this is kind of closer to our historical level. So, actually if you go back pre-COVID, I mean, we were turning 40%, 50%. As you know, consumer business, that's kind of normal. So, this is kind of getting back to normal levels, I think. So we're quite comfortable. Obviously, we have a mechanism. We look at backlog. We look at what's on the books. We look at channel inventory. And we have to make some adjustments there depending on what we expect to happen to POS and the consumption levels. But that's driving the turns number. But we are quite comfortable, yeah.

Quinn Bolton
Analyst, Needham & Co. LLC

Q

Great. Then lastly, quick one for Emeka. Just on the OpEx reductions, it looks like they're coming in nicely ahead of plan. How much of that is in the near-term, just lower variable comp or lower selling expense? So you mentioned watching travel expenses pretty closely that as the business recovers may come back versus cuts that are more permanent, whether it's head count reductions or just you're streamlining R&D expenses and those expenses don't necessarily come back as the business recovers?

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

I think it's roughly equal, Quinn, in terms of us seeing higher levels of synergies and then some of the other opportunities that I spoke to I saw, but I think even if anything is going to come back, we're not expecting them to come back in this current fiscal year. We are definitely managing this on a very tight basis for the rest of the year.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

I think the other point on that, Quinn, as you know, is if you go back and look at our history, lot of the variable comp is driven by our ability to generate profitability. So, it's dictated by the revenue, right, and the growth in the revenue. So, a lot of those expenses won't come back if the revenue doesn't come back.

Quinn Bolton
Analyst, Needham & Co. LLC

Q

Got it. Okay. Thank you.

Operator: [Operator Instructions] Our next question comes from the line of Matt Ramsay with Cowen. Please proceed with your question.

Matthew D. Ramsay
Analyst, Cowen & Co. LLC

Q

Yes. Thank you very much, guys. Appreciate you taking the questions. I guess, the first one that I wanted to get to, and obviously there are some with the new CEO coming in and the board doing different evaluations of things, I wanted to ask sort of a nuts and bolts question. Just with the non-IoT businesses, so the Signal Integrity and the Protection and Sensing segments, what's the operational overlap between those two business segments from a R&D perspective, from a go-to-market and sales perspective, from a FAE perspective? I'm just trying to understand there's obviously synergies and things, but how independent are those businesses or how integral do they need to be, to be run together? Just general big picture thing. Thanks.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah. So, Matt, I think if you go back and look at Semtech's history, we've always had businesses that are largely discrete businesses that stand alone. That's what analog companies do. It's a portfolio of different analog businesses. And each of these analog businesses, we largely don't do the whole system. I mean, we are doing analog functions. So, Advanced Protection has advanced sensing functions, advanced protection functions. In our SIP business, we do CDRs and PMDs, but we don't do some of that digital functionality. So, that's the way we run it.

But they are very different independent businesses. They don't really have a lot in common with each other. But we target attractive markets. And as most high-performance analog companies do, you look for opportunities to continue to expand in those businesses. And that's what we've done with our Integrity Product business, which used to be the old Gennum business that we acquired. That's what we've done with our protection business for many years now. And even the IoT business for Semtech, the organic Semtech business, was largely just radio business, low-power radio business with LoRa. We had some other functions, analog functions around it.

The difference now, of course, is with the acquisition of Sierra, we have brought in a module and router and a software and services business. But as those of you who have kind of kept in, aware of what we were doing with LoRa, as we expanded from our radios, from our LoRa end node radios into gateway radios and connected to systems and networks, we started to look at cloud services as an opportunity. And part of the rationale, of course, with the Sierra business was to try to accelerate that and bring in a sensing and service business and really build on the edge capabilities that we have.

And so, those are slightly different than kind of the chip business approach that we have. But I think it can really take Semtech to a whole new level, and that's why we did the acquisition. But to answer your question, the Protection business and the Signal Integrity Product business and the IC business of IoT are very different businesses.

Matthew D. Ramsay
Analyst, Cowen & Co. LLC
Q

Thank you for that. Appreciate the perspective. I guess, as my follow-up question in the IoT business largely came from Sierra, there were obviously cloud infrastructure pieces or connected services business that were affiliated with the old LoRa business and also with the big IoT franchise that came in from Sierra. Is the intention to integrate those cloud platforms into one and how has that evaluation started and is it progressing well? I guess, what kind of overlap is there and opportunity to sort of put those two cloud platforms together? Thanks.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.
A

Yeah. So, when you look at the Sierra software services business, it's really a managed connectivity business. It's managed network business. It's really managed network services with some elements of services around the managed connectivity. With Semtech, it's all about the end nodes and managing those end nodes and thinking about sensors. And so, marrying the two together, we're essentially saying we're building a higher-value platform for our customers. So a customer that wants to build a fiber network, for example, and manage its sensors on that network and have managed connectivity and understand where the security holes are and understand the provisioning of those sensors on the network and understand the location of the sensors on the network and the health of the sensors, I mean, that's really the kind of end game I think for us.

And I think we really have a very nice platform to do that now, the Sierra AirVantage platform, a software platform that they have, which they've had for many years, combined with our cloud, Lora Cloud platform. And, obviously, that's what to do on the integration side. But really once we've done that, I think it's going to be a very unique and very differentiated platform.

Matthew D. Ramsay
Analyst, Cowen & Co. LLC
Q

All right. Thank you very much, guys. Appreciate it.

Operator: We have a follow-up question from the line of Tore Svanberg with Stifel. Please proceed with your question.

Tore Egil Svanberg
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Yeah, thank you. Just two quick follow-ups. The turn is 39%. That was at the beginning of the quarter. How would that number be now as you're almost halfway through the quarter?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.
A

Yeah. We don't normally give that answer, sorry. I hadn't given that number, we normally talk about the turns at the beginning of the quarter. I would just tell you that we're confident that we will make our guidance, right?

Tore Egil Svanberg
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Got it. But I mean, it's safe to say that the world is back to turns, right, because obviously industry had not a lot of turns in the last two years. So we're sort of back to that, right?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.
A

Yeah. I think – so, remember, during COVID, I mean, the turns went to zero, right? So, we basically had [indiscernible] (00:49:35) backlog. And that was an unrealistic situation. And so now we're getting closer. I don't think we're quite there yet. But we're getting closer to the pre-COVID levels where we were routinely turning 45% a quarter, right.

Tore Egil Svanberg
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Got it. And the 67% that's now IoT, what percentage of that is services at this point?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.
A

Let's see. Do you have that number, Emeka?

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.
A

No, I don't have that number. Sorry, but I can get it to you.

Tore Egil Svanberg
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Okay. No, that's fine. We can follow-up. Thank you.

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.
A

Yeah. Okay.

Operator: Our next question comes from the line of Rick Schafer with Oppenheimer. Please proceed with your question.

Wei Mok
Analyst, Oppenheimer & Co., Inc.
Q

Hi. Yeah. This is Wei Mok on the line for Rick. Wanted to wish you the best in your retirement. It's been a pleasure working with you. For my first question, in your prepared remarks, you guys mentioned bookings increased 1% quarter-over-quarter from the organic Semtech and more particularly from Advanced Protection & Sensing segment. I was wondering if you could parse that out a little bit further. Are you seeing more of the strength from the protection business or more from the proximity sensing side?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.
A

We're seeing both actually. It's – the consumer business in general has been really soft over the last few quarters, as you know, particularly in China. And I would say that we're starting to see improvements in both the consumer business, consumer protection business and the consumer sensing business. But I would say on the proximity sensing business, a lot of it's now, as I mentioned in China the new regulations for FY 2025 starting calendar year

2024 are driving design – more design wins. So I would say that the consumer protection business is what's driving the current demand increase.

Wei Mok
Analyst, Oppenheimer & Co., Inc.

Q

Got it. Great, thanks. As for my follow-up, particularly within protection, it looks like the broad market side reached 55% of your protection business of that mix. But given the higher growth of this segment, do you expect this mix to shape out for the rest of the year compared to the consumer side?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

No, I expect consumer to come back actually and be a larger percentage again. I think what it demonstrates is the value of having that diversity and the fact that we have momentum in the broader protection business bodes really well for the future, because that's the business that I think will go on for the next 10 years, growing as we start to just get broader industrial penetration.

The consumer business, of course, is very volatile, right? It goes up and it goes down. Currently it's very down, which is why our protection – industrial business has got a larger percentage. But I do think that once that protection businesses, and we've got good design wins, so once the demand comes back, I think that will come back quite quickly and be a larger percentage.

Wei Mok
Analyst, Oppenheimer & Co., Inc.

Q

Great. Thank you.

Operator: We have a follow-up question from the line of Craig Ellis with B. Riley. Please proceed with your question.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

Yeah. Thanks for taking the follow-up. And since I missed it in the initial round, Mohan, congratulations, great pleasure working with you and good luck in your next phase.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Thanks.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

I wanted to follow up on a couple of longer-term things. One, I think China is implementing proximity sensing standards that go into effect in January of 2024. As the team works with smartphone companies around designs for early next year, what are you seeing in terms of content and proximity sensing win rates versus where you might have been in other generations of phones, et cetera? Is this looking like something that could be a meaningful, incremental driver? Does it just support the run rate of the business as you have it?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah. So first of all, it's something that we've been working towards and hoping for, for quite a few years now. It's been actually, probably two years late than we had liked. But it's finally coming to fruition. And the main reason for that and the reason why it's valuable for us is it means that most of the smartphone manufacturers that are selling to China will now include proximity sensing or SAR functionality in their phones.

As you know, with Samsungs and some of the companies that we have partnered with and have penetration with, they have multiple phones and some of their phones that don't have proximity sensing and they ship into China. But now that will change. So we are starting to see that momentum already in China and outside China. So that's good. So it's more design win, of course, we don't have to see the momentum from a revenue standpoint, but I expect to see that net by 2025 for sure.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

That's helpful. And then, from time to time we talk about Amazon Sidewalk initiative, and I know it's something that the companies worked on. Just any color on how you feel like the team is progressing with Amazon and prospects for that to monetize as we go through the year?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah. So, on the Sidewalk side, Craig.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

Yeah.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah. So, I think it's early. But I think obviously the smart home world in IoT is really just beginning I think in many ways. And I think, Amazon's vision and with their Sidewalk initiative is something that we've always supported and feel like – feel very good about. And I think as we start to see some of the use cases and applications that are there are out there, we're excited about it. Now we're excited about it from a smart home standpoint regardless of Amazon Sidewalk. So I think it's going to continue. We're going to continue to see LoRa kind of become a mainstream technology in the smart home connected spaces area. Obviously, we are really hopeful that the Sidewalk also has tremendous success. They already have a lot of gateways out there in the ecosystems and now it's about end devices and so haven't got any kind of major update. But I think that we're still very positive about it.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

Got it. Thank you very much, Mohan.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Thank you.

Operator: There are no further questions in the queue. I'd like to hand the call back to management for closing remarks.

Mohan R. Maheswaran

President, Chief Executive Officer & Director, Semtech Corp.

Thank you. Before we close, I want to share that we delivered our inaugural ESG report this quarter, showcasing the many ways our low-power products are having a significant impact on society, as the world adopts technology to monitor and manage our scarce natural resources. You can find this report on our website.

In closing, our global teams are executing well in a challenging economic environment. I know I'm leaving the company in excellent hands with the arrival of Paul Pickle as the next Semtech President and CEO. Thank you all again for the many years of support.

Emeka N. Chukwu

Executive Vice President & Chief Financial Officer, Semtech Corp.

Thank you.

Operator: Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time and have a wonderful day.