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Semtech Corp. (SMTC)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Semtech Corporation Conference Call to discuss the Second Quarter Fiscal Year 2023 financial results. Speakers for today's call will be Mohan Maheswaran, Semtech's President and Chief Executive Officer; and Emeka Chukwu, Semtech's Executive Vice President and Chief Financial Officer. Please note 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, Executive Vice President and Chief Financial Officer, Emeka Chukwu.

Emeka N. Chukwu

Chief Financial Officer & Executive Vice President, 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 recent 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 my prepared remarks and Mohan's 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 are included in today's press release.

In Q2 fiscal 2023, the company delivered record net revenue of $209.3 million, a sequential increase of 3.5%, and an increase of 13.1% year-over-year. While in a challenging business environment, we focused on operational execution, and were able to grow our earnings at approximately twice the rate of revenue growth and delivered non-GAAP earnings per share growth of 9% sequentially and 34% year-over-year.

Our business is seeing a continued relative strength in North America and Europe, and a bigger shift to the industrial and data center segment. This shift is aligned with our strategy to diversify our geographic and end markets. We saw significant growth in the infrastructure end market, growing 11% sequentially and 25% over the prior year, and represented 40% of net revenues. Net revenue from the industrial end market also grew nicely, up 7% percent sequentially and 44% over the prior year, and represented 40% of total net revenues.

Like many, we are seeing softness in consumer end markets, where net revenues for high-end consumer decreased 14% sequentially and 31% over the prior year, and represented 20% of total net revenues. Approximately 9% of high-end customer net revenues was attributable to mobile devices and approximately 11% was attributable to other consumer systems. Overall, Q2 shipments into Asia, North America, and Europe represented 72%, 16%, and 12%, respectively. While this represented a ship-to addresses for our distributors and customers, we estimate that approximately 35% of our shipments are consumed in China, 28% in the Americas, and 21% in Europe, and the balance over the rest of the world.

Total direct sales are stable at approximately 12% of net revenue and distribution represented approximately 88%. Our distributor POS declined during the quarter, but remained balanced with approximately 45% of POS coming from infrastructure, 31% from the industrial segment, and 24% of the total POS coming from high-end consumer end markets. Q2 bookings decreased sequentially and represented book-to-bill of less than 1. In addition to inflation, recession fears and continued supply chain challenges, the effects of COVID are still driving some of the downturn we see in China.

Q2 gross margin increased 40 basis points sequentially to 65.2%, a new quarterly record, driven by a higher mix of our growth engines. For Q3, we expect gross margin to expand to another record, reflecting the benefit of lower mix of consumer revenue. We expect this trend to continue. And in fiscal 2023, we expect our gross margins to trend higher [ph] 100 to 200 (00:05:50) basis points from favorable regional mix of our growth platforms.

Q2 operating expense increased slightly to $71.9 million, driven by new product introduction expenses. For Q3, we expect our operating expenses to decrease approximately 7% sequentially as we manage through and respond to a weaker demand environment. We will, however, continue to invest in a new product innovation to sustain our market positions and our long-term growth.

In Q2 fiscal 2023, operating profit grew 7% sequentially, approximately 2 times the rate of net revenue growth, reflecting the higher gross margin and a modest increase in operating expense. This strong operating leverage drove an expansion of operating margin to approximately 30.8%. This represents a sequential expansion of 100 basis points and 370 basis points from the same quarter last year.

In Q2, cash flow from operations was a record $77 million, up 46% from the same quarter last year. Free cash flow increased 52% year-over-year. The cash flow generation has benefited from record operating profit and our focus on the exceptional management of working capital. In Q2, we did not report [indiscernible] (00:07:22) because of our pending acquisition of Sierra Wireless. We have approximately $209 million remaining in our share repurchase authorization. Going forward, we expect to primarily use our cash to pay down the expected debt from completing the Sierra acquisition.

Q2 accounts receivable increased 7% sequentially due to higher sales and the days of sales declined slightly to 30 days. In Q2, net inventory in absolute dollar terms was up slightly sequentially and days of inventory decreased 7 days to 133 days. We expect net inventory to increase in Q3, reflecting the weaker demand environment.

In summary, we are very pleased to deliver another record financial performance in Q2. As we look ahead to a much softer second half of the year driven by macro issues, we expect to see stable gross margins and the reduction of operating expenses to help mitigate the impact of weaker demand on operating profit. We will continue to invest in product innovation to take advantage of our strong market positions and sustain our long-term growth.

Before I hand over to Mohan, I want to provide an update on the status of the proposed acquisition of Sierra Wireless. We are still on track to close the acquisition in the second half of this year. As previously announced, we have fully committed debt financing for the transaction and are currently in a syndication process to achieve an optimal debt structure and cost of capital. We are excited about the strategic opportunities that this proposed acquisition brings to us. We look forward to closing the transaction as soon as possible and getting to work delivering on our vision.

I will now hand the call over to Mohan.

Mohan R. Maheswaran

President, Chief Executive Officer & Director, Semtech Corp.

Thank you, Emeka. Good afternoon, everyone. I will now discuss our Q2 fiscal year 2023 performance by product group and provide our outlook for Q3 of fiscal year 2023. Our Q2 fiscal year 2023 net revenue was a record $209.3 million, representing a 3.5% sequential increase and a 13% year-on-year growth. We posted record non-GAAP gross margins of 65.2% and record non-GAAP earnings per diluted share of $0.87. Our Signal Integrity product group grew 19.5% annually, and achieved a fifth consecutive quarterly revenue record and represented 42% of our total revenues. Growth was driven by strength from the PON and data center markets.

In Q2, our hyperscale data center business was strong, led by growth from 100-gig optical modules. Design-ins of our Tri-Edge short reach platform for 200-gig and 400-gig PAM4 optical modules continue to gain momentum globally. Our customers are also giving us positive feedback on our long reach Tri-Edge samples, targeted at 200-gig FR4 optical modules. This will be another growth driver for us over the next few years as this new longer reach platform increases our data center SAM by over 50%. We expect strong growth from Tri-Edge over the next few years.

We recently announced our new, highly innovative CopperEdge platform targeted at short reach copper interconnects and active copper cables used in data centers. This is a new product portfolio targeted at 400-gig and 800-gig data center applications and represents a completely new SAM for Semtech. The first product in this new portfolio is a quad 112-gig PAM4 linear equalizer, offering lower power and lower latency. We are sampling this new product now and will be showcasing its performance at the European Conference on Optical Communications next month. We remain confident that our full portfolio of data center products, including

ClearEdge and Tri-Edge CDRs, FiberEdge PMDs, and CopperEdge equalizers will enable us to continue to grow our hyperscale data center business over the next several years.

In Q2, our PON business achieved a seventh consecutive record revenue quarter, driven by notable strength from our PON-X 10-gig PON platform. As global demand for higher access bandwidth grows, and new global PON deployments and use cases emerge, our comprehensive PON portfolio, together with our innovative road map, positions us extremely well in the global PON market. The PON market is growing rapidly, and we expect new PON tenders in the second half of FY 2023 to stimulate further market growth. Our PON business continues to show strength, and we remain confident this business will grow nicely over the next several years as PON deployments and PON bandwidths increased worldwide.

In Q2 of FY 2023, revenue from our wireless base station business showed solid annual growth on the strength of 5G base station deployments. We continue to win new designs for both ClearEdge and Tri-Edge in 5G base station front haul optical modules. We expect our 5G wireless base station business to continue to grow in the second half of FY 2023 and accelerate over the next few years as global 5G system deployments increase, driven by new 5G tenders in the first half of FY 2024. We also expect to see our first Tri-Edge revenues from the 5G base station market in the first half of 2024.

Despite the secular demand strength and strong design win momentum associated with our infrastructure product platforms, the macro environment is showing signs of slowing, and we continue to experience COVID related issues in China. As a result, we expect infrastructure demand to decline in the second half relative to the first half of FY 2023. We expect the Signal Integrity product group revenues to decrease slightly in Q3.

Moving on to our Protection product group. In Q2 of fiscal year 2023, net revenue from our Protection product group increased 10% over the same period last year, representing 26% of total revenues. Our consumer protection business remained soft during the quarter, as strength from our North American smartphone customers was offset by smartphone weakness from both China and Korea. North America now represents the largest region for our smartphone protection business, surpassing both Korea and China for the first time in Q2.

Our efforts to diversify our Protection business continue to be successful, and our growing revenues from the automotive, communications and industrial segments now represent approximately 42% of our total Protection business. Our high performance Protection products continue to see greater market acceptance across all industry market segments, as system designers increasingly utilize advanced process geometries and higher speed interfaces. In Q3 of fiscal year 2023, we expect our Protection revenues to decrease due to a weaker consumer market, driven by ongoing weakness from our Asian smartphone customers.

Turning to our Wireless and Sensing product group. In Q2 of fiscal year 2023, revenues from our Wireless and Sensing product group increased 8.1% over the prior year and represented 32% of our total revenues and delivered another record revenue. Our LoRa-enabled revenues achieved another record in Q2 and remain on track to grow approximately 40% this year. We continue to expect our LoRa-enabled revenues to grow at a 40% CAGR over the next five years. Strong gateway deployments have set a solid infrastructure foundation, which should enable the proliferation of ultra-low power sensor networks across numerous use cases.

Global customers are recognizing the importance of deploying ultra-low power IoT sensor networks to accelerate the digitization of their industrial assets or to mitigate against climate change impacts. Here are some recent examples of LoRa use cases. CITiLIGHT launched a new smart city lighting platform using LoRaWAN. CITiLIGHT noted that they have saved 1.29 billion kilowatt hours of energy through the implementation of smart street lighting in more than 100 cities. And this new platform will help them further accelerate their global expansion plans.

Cranberry Analytics announced new LoRa-based smart water meters, which allows for effective planning of water distribution, as well as real time monitoring, leakage analysis and mitigating water waste. WITRAC's new intelligent track and trace platform, which uses both LoRaWAN and cellular connectivity, is providing a new cold chain asset tracking and management solution. SkyLab and HeNet, which leverages Semtech's 2.4 gigahertz solution is using LoRa to optimize global maritime logistics and sea condition monitoring for passenger vessels.

We recently invested in Dryad and their Silvanet early wildfire detection and forest monitoring system based on solar powered LoRa-based mesh networking. Wildfires have become a major driver of climate change, generating up to 20% of global CO2 emissions, while costing the global economy approximately $140 billion to date. The Dryad's LoRa-based solution aims to provide an innovative monitoring system to help mitigate against wildfire damage. These are just a few examples of exciting new LoRa use cases being deployed globally today.

In Q2, the LoRa Alliance recently held their global expo, with excellent attendance and solid media coverage reaching over 3.5 million business leaders with exposure to LoRaWAN. The LoRa ecosystem continues to expand, as measured by new service providers, OEMs and system integrators joining the LoRa Alliance. And we expect the Alliance and ecosystem to continue to grow for many years to come.

Our LoRa metrics also continue to make very positive progress. The number of public LoRaWAN network operators grew to 173, up from 170 at the end of Q1. Private networks are also experiencing significant growth, as evidenced by many new use cases and applications. We expect approximately 180 public LoRaWAN operators by the end of FY 2023, and expect to have nationwide LoRaWAN coverage in 20 of the top 30 GDP countries by the end of this fiscal year.

LoRa gateway deployments continue to grow, and achieved a record 5 million gateways deployed at the end of Q2 versus 4.2 million at the end of Q1. PicoCell gateway deployments continue to increase nicely, driven by smart home and smart campus segments as Amazon Sidewalk gateway deployments increased 23%, and Helium gateway deployments increase 18% sequentially this quarter. Both Sidewalk and Helium [ph] Network (00:20:02) should drive an acceleration in end device deployments over the next several years as the smart home and campus segments increasingly adopt low power sensor networks.

In addition, our macro gateway deployments increased 8% sequentially, demonstrating the continued deployment of LoRa for wide area network use cases. We expect LoRa gateway deployments to achieve approximately 5.5 million by the end of FY 2023. The cumulative number of LoRa end nodes deployed increased to 270 million at the end of Q2 from 256 million at the end of Q1. We expect this number to exceed 300 million cumulative end nodes by the end of FY 2023. With continued network expansion globally, we expect end node deployments to accelerate rapidly over the next three to five years.

Our LoRa pipeline continues to be strong, ending the quarter at approximately $1.1 billion. We anticipate that on average, 40% to 50% of the opportunities currently in the pipeline will convert to real deployments over a 24-month timeline. We continue to see growth in sustainability and smarter planet initiatives in areas like smart utilities, smart logistics, asset tracking, industrial IoT, smart home, and smart cities, where innovative solution providers are using LoRa to monitor, measure and manage resources more efficiently. Opportunities continue to drive geographical diversification in our LoRa revenues, as we continue to see our LoRa momentum accelerate in the Americas and Europe. Over 82% of our LoRa opportunity funnel is currently from regions outside of China.

In Q2, revenue from our proximity sensing platforms declined due to Asia smartphone softness and some ongoing pandemic related challenges in China. While we are seeing proximity sensor design wins in both smartphones and the consumer wearable market, we are expecting a weaker second half demand environment for our consumer related products, including proximity sensors.

For Q3 of fiscal year 2023, we expect net revenues from our Wireless and Sensing product group to be down due to macroeconomic softness and a weaker consumer market. The Semtech innovation engine continues to deliver new and disruptive technologies to our customers across several end markets. And in Q2, we released 14 new products and achieved 3,200 new design wins.

This quarter, we entered into a definitive agreement to acquire Sierra Wireless. This transformative acquisition will bring together the ultra-low power, long range, and network flexibility benefits of LoRa technology, together with the low latency, high bandwidth and global network coverage benefits of cellular technology. The combination of optimizing LoRa and cellular technology is a highly strategic decision to position Semtech as the leader in the fast growing, ultra-low power IoT market.

We aim to bring solution simplification through a disruptive shift to cloud IoT services platform that helps our customers accelerate their digital transition to the Internet of Everything. The acquisition will approximately double the scale of Semtech to be non-GAAP earnings accretive immediately, and expand our IoT addressable market to almost $10 billion by 2027. We expect the transaction to close in the second half of FY 2023.

Looking forward to the third quarter of fiscal year 2023, we are seeing the effects of a softening macro environment, ongoing COVID-related issues in China and a very weak consumer market. We also continue to have pockets of supply chain challenges in specific areas. As a result, we are currently estimating our Q3 revenues to be between $170 million and $180 million. To attain the midpoint of our guidance range or approximately $175 million, we needed [ph] terms orders (00:24:26) of approximately 6% at the beginning of Q3. We expect our Q3 non-GAAP earnings to be between $0.60 and $0.66 per diluted share.

I will now hand the call back to the operator. Emeka and I are happy to answer any of your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first 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. I wanted to ask a question about your gross margin comment on fiscal 2023. It sounds like you're expecting some upside driven by mix. And I'm just wondering, what's driving that change? I do suspect that maybe the Protection business and especially the smartphone part of the Protection business is probably going to continue to decline. But if you can elaborate a little bit more on what's driving that higher gross margin outlook for fiscal 2023? Thank you.

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

A

Hi, Tore. This is Emeka here. So, our gross margin story has definitely been a highlight because it's been pretty stable. It's coming almost exactly as we anticipated. I think if you remember in the past, we've always talked about the growth drivers that we have for the company. We've talked about LoRa being – having gross margins above the corporate average. Even our PON business, especially our 10-gig PON-X platform has a pretty good gross margins.

The data center business has good gross margins. The wireless base station, good gross margins. And then like you mentioned, within Protection, we continue to see the industrial and automotive revenues being a higher mix of the Protection revenue and that gross margin is pretty good. So, as we go into the October quarter here and with this expectation of continued weakness in the consumer sector, we think that actually would be accretive to our gross margin.

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

Q

Very good. And as a follow-up, I know you're expecting all three product segments to be down sequentially, but are there any of those that are perhaps going to be up sequentially? I'm thinking maybe LoRa, maybe PON or is this at this point basically all products down sequentially?

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

A

So, I think, Tore, all the product groups as a whole will be down probably sequentially. I think some of them – some of the subgroups may be flat to slightly up on an annual basis. And I think you mentioned PON is being one of them. I think data center is possibly another one. With the industrial segment, there are some areas there that are a little bit less weak than others, I would say.

The biggest challenge we have is probably China. China is – that's a fairly broad market opportunity for us, obviously. And our revenues are 35% consumed in China. So there is certainly softness across all of our segments there. But I would say in order of kind of magnitude, it's consumer, China consumer and then the other segments.

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

Q

Great. Just one last question. As we think about this sort of correction here, care to comment on the timing? I know there's a lot of different dynamics, right, supply, there's shutdowns, there's also sell-through softening. So, any sort of guess as to how long this correction will persist, if you have any comment? Thanks.

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

A

Yeah. What we've seen throughout Q2, bookings have been softening, I think, and so consumption was softening. So that's what we anticipate for Q3, softening – consumption appears to be weaker. Q4 typically is a weaker quarter for us and certainly, consumer normally is down. A lot depends on how weak Q4 is, I think. But our expectation is, as we go into next year that a lot of the inventory will start to bleed off in the kind of second half this year. So we should start to see strengthening next – early next year.

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

Q

Very helpful. Thank you.

Operator: Our next 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 for taking the question. I wanted to follow up on the comments that Tore had or the inquiry that Tore had. And just really understand more about what the company has been seeing. So, Mohan, as you look at guidance that's down, I think, at 16.5% quarter-on-quarter. How much of that is order weakness that you've seen quarter-to-date versus a desire to try and get in front of the macro trends that you talked about?

When I look back at your commentary on Signal Integrity, it sounds like that business is holding up pretty well. And then within Wireless and Sensing, LoRa is very strong. So I'm just trying to reconcile some of the strength you've seen very recently and the numbers that were reported with the magnitude of decrease that we're looking for in the fiscal third quarter. I'm just hoping you can provide some segment or subsegment color on what the bigger drivers are there?

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

A

Yeah. So the – for sure, I would say consumer in Asia is definitely very weak and that's probably the weakest area. And then I would name within Asia, obviously, the smartphone business in Korea and in China is extremely weak. I think those are well-known kind of things out there. On the rest of the consumer space, I would say that North America is a little bit stronger, but starting to also show softness, I would say.

And then if we take out – go [ph] out of sight (00:30:56) consumer, the industrial and infrastructure segments in the first half have been very strong. I think what we saw in Q2 is starting to see softness in the bookings there as well. Even though we have fairly good backlog, I think the booking softness and then the consumption weakness is starting to obviously demonstrate that the end demand is now starting to go back into balance. Maybe the supply-demand equilibrium is now going the other way a little bit, which is normal in our cyclical industry, as you know. So, within infrastructure and industrial, I would say, infrastructure and industrial North America and Europe are relatively strong, and China and Asia are relatively weak.

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

Q

Got it. And then a clarification on the comments regarding the fourth quarter, which I think we all know is typically a seasonally weaker quarter, in part because of what happens with inventory and consumer markets. But can you or Emeka refresh our memories on what typical seasonality would be? And if we have an inventory correction, how you think about the magnitude of that relative to seasonality?

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

A

Craig, so, I think typically we've seen softness probably in the range of 5% to 10% in the fourth quarter. It depends on a lot of things. In the consumer space, the consumer inventory rebalancing is also very well known. However, the potential upside to that could be what happens in the infrastructure space, right? There are – as you know, when things really go soft in China, there's always talk about stimulating the economy by infrastructure spending.

And so, we'll have to – we've heard news about that, but we don't know when that's going to happen. We have to keep an eye. If that happens and the tenders go out and the orders are placed, that could be an uplift for the fourth quarter. But at this point, we are not banking on that. So, we'll just have to see if there's a whole lot of puts and takes. But overall, we typically see about a 5% to 10% softness – decline in the fourth quarter.

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

Q

Yeah, which seems like you might be getting in front of that with the down 16% in the third quarter, but we'll see. If I could just follow up with a clarification on your prepared remarks. Emeka, you mentioned that you expect the deal to close this fiscal second half and also that you had committed debt financing. Can you provide any color on the rate you'd expect for that committed debt financing?

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

A

We're looking at different structures. Term loan As, going after the commercial banks, going after the [ph] convert markets (00:33:43), we're looking at different things. And hopefully, by the time that we're done here, we should probably see cost of capital in the 5% to 5.5% range.

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

Q

Got it. Thanks for the color, guys.

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

Rick Schafer
Analyst, Oppenheimer & Co., Inc.

Q

Thanks, guys. Maybe just to start with a quick clarification question. Maybe I missed it. I know bookings dropped, I think, over 20% last quarter, the prior call. So maybe I missed it, but how much are bookings down heading into 3Q?

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

Bookings are down significantly, Rick, and continue to be weak in Q3. So as we mentioned, the book-to-bill was less than 1. We continue to see fairly soft bookings in Q3, and that's part of the challenge for us. So as we look at – even though backlog is still fairly – relatively strong, so the [ph] turns (00:34:50) number we require in Q3 is relatively low number for us versus historical, bookings rate is still soft. And a lot of that is China. A lot of that is consumer. But, yeah, the reality is I think all segments are starting to weaken a little bit.

Rick Schafer
Analyst, Oppenheimer & Co., Inc.
Q

Okay. Thanks for that clarification. So my first question is really just on data center. It sounded like you kind of called that out in answer to an earlier question as being relatively strong, up potentially here in the third quarter, if I heard that correctly. You guys obviously have a large income position there. So I'm curious how much of that business for you guys is sort of cloud versus enterprise, like what that roughly split might look like? And is there any anything to call out there within that? So is enterprise maybe a little softer, cloud a little better? Is there any kind of any color that you could provide with what you're seeing there?

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

I would say hyperscale cloud is where the strength is, Rick. We're anticipating the second half to be weaker than the first half. But really, in the scheme of things, probably up from last year. So, relatively strong. We've got a lot of new stuff going on there as well. So a lot of new products and a lot of new areas of opportunity. But in general, I think that even infrastructure market, unless as Emeka pointed out that, we get a new stimulus package in China that might kick in or something like that, one is expecting that to maybe be Q4 or early next year before we start to see it really going up again.

Rick Schafer
Analyst, Oppenheimer & Co., Inc.
Q

[ph] Have patience (00:36:34). If I could, I'll just ask one on Tri-Edge and appreciate the update there. I was just curious if we could get any more color on – like an update on the number of trials you have ongoing or number of wins like what the revenue funnel might look like, something like that. And then I know you mentioned the long reach Tri-Edge increases SAM about 50%. I was just curious if you could level set us on what that SAM – what that existing SAM is?

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

Yes. So Tri-Edge for us is doing extremely well, I would say, across not only data center but also the base station market, 5G base station front haul market. And now we have – now we're starting to bring out our newer products. So we have short reach Tri-Edge, which is doing well, expecting very good growth from that business next year. It will grow nicely this year, but also next year, I think we'll continue to see the acceleration of Tri-Edge revenues there. And then, the longer reach products are sampling now. So, that's kind of at a high level an additional $100 million SAM for us, really. And then, the base station market adds additional SAM for our Tri-Edge platform. And I mentioned the CopperEdge we announced as well, which also gives us more SAM in the data center market. So, total SAM for data center, we look at maybe $1 billion SAM in FY 2027, kind of the way we look at it. And our goal is to get 30% to 40% share in that space.

Rick Schafer
Analyst, Oppenheimer & Co., Inc.

Q

That's great color. Thanks a lot, Mohan. Appreciate it.

Operator: Our next question comes from the line of Tristan Gerra with Baird. Please proceed with your question.

Tristan Gerra
Analyst, Robert W. Baird & Co., Inc.

Q

Hi. Good afternoon. So, you've made it very clear that consumer spending is very weak in China. How do I [ph] disassociate (00:38:31) that from, perhaps, lingering impact of the COVID-related shutdown in the April and May timeframe? Is that really a factor in the weakness because there's still some bottlenecks in the supply chain, or is it basically a flowing supply chain, but it's purely consumer weakness at this point?

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

A

Well, I think there's different elements, Tristan. First of all, I think the China consumer consumption in terms of China, end demand is weak. Also China as a economy is weakening. And that is a challenge for China smartphone manufacturers, I think. Then, we have the issue of COVID, shutdowns and lockdowns, and all of that sort of thing, which doesn't help. I don't know if I can quantify what percentage is related to that but it doesn't help for sure. And then I think there's other consumer pockets of weakness elsewhere.

So, I think we're seeing that because we see – obviously, we have fairly broad penetration of the smartphone market with the Korean smartphone and North America and China. And China is definitely very weak, and I would say Korea is relatively weak as well. North America not so bad. And then if you take other kind of outside the smartphone space and look at other elements of consumer, they are also relatively weak across the board.

Tristan Gerra
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. And then back to an earlier question. Given your guidance for the quarter, by how much do you think you're under-shipping real end demand? And if you could talk about how much inventory deleveraging is happening in Asia? I'm assuming that your guidance doesn't reflect really what the end demand is going to be in terms of sequential changes.

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

A

Well, we are – part of the thing we do is we look at consumption, Tristan. So we look at how much is being consumed. And when we see that trending downwards, then that concerns us, right? So we start to look at that being an early indicator of softness. And certainly, over the last quarter, it's been weakening. So you have a consumption weakness, you have bookings weakness, and therefore, one expects demand weakness. Also, if you – there are pockets of relative strength, as I mentioned. I would say North America and Europe industrial and infrastructure seem to be relatively strong compared to consumer, but even those areas are also showing signs of some softness.

Tristan Gerra
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Thank you.

Operator: Now 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. Hey, Mohan. I wanted to get into your weakness for the guidance. Let's say, hypothetically, let's assume you're about $40 million off. It's just easier for us to understand from the aspect of end markets such as industrial, consumer and infrastructure rather than your product groups. So if I asked you hypothetically to break down, call it $40 million weakness into the end markets, my assumption is that consumer would be the biggest part. But would you just humor us and kind of give us an idea of how much of that $40 million weakness is coming from consumer and how much coming from an industrial versus infrastructure. And then I've got a follow-up.

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

A

Yeah. So, Harsh, I think as you can imagine from the questions that we've answered before, if you had to rank order those, I'll probably say that of course consumer is leading that. And then there's probably a little bit of industrial, a little bit and then [indiscernible] (00:42:44) side. But I think most of it, the bulk of it, is coming out of the customer space.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Okay. So when I look at – so my follow-up is, when I look at your latest quarter, I think handset and consumer is only 20% of sales. So is the bottom just falling [ph] out of that (00:43:02) business? Is it fair to assume that business is down like 50%, 60% or am I way off here in my assumption?

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

A

The consumer space is down significantly. I don't know that I can give you the percentages like you're trying to get. But if you look at – remember that our consumer business is made up of proximity sensors, products going into the smartphone space. And that is down significantly. The Protection consumer business as well, we are expecting it to be down in the next quarter as well, so. And then if you look at the other segments, a little bit on the infrastructure side and a little bit on the industrial side, so definitely the bulk of that is coming from the consumer space.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Okay. Can I ask just one more follow-up? Emeka or Mohan, I know that you guys do business, so you have historically been very strong in data center in China historically. And also maybe to some degree, I can say that's true for industrial. Let's say we put aside the weakness in China as something specific to COVID for now that let's just say we assume that it gets fixed down the line next year. Would you say that that's accounting for the bulk of your weakness in those two areas? And that I think you mentioned US is holding up relatively well. Is that a fair way to look at it?

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

A

Yeah. I think that's probably correct, Harsh, that China is definitely both on the infrastructure side, elements of the infrastructure side are pushed out. Of course, as Emeka pointed out, that could come back in Q4 quite strong depending on investments going in that area. But that – for sure, in Q3, that is part of it. I would say the industrial – China industrial is also part of it and consumer is, obviously, the bulk of it. But we're seeing pockets of weakness elsewhere as well. Other regions are starting to get softer. But I would say China is by far the bulk of it.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Appreciate the color, guys. Thank you so much. I'll get back in line.

Operator: [Operator Instructions] Our next question comes from the line of Christopher Rolland with Susquehanna International Group. Please proceed with your question.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

Hey, guys. Thanks for the question. So, it's around proximity sensing. You guys called it out in your prepared remarks. I thought that this was a much smaller product for you guys after the Huawei issues. Perhaps you can level set us for what it was in Q3. And the reason I'm asking is, I think I'm down maybe $15 million to $20 million sequential for the Wireless and Sensing segment, and I'm trying to figure out how much of that is proximity, how much of that is LoRa, and how much of that is other? Emeka, maybe you can help us just with some broad strokes to kind of figure that out. Thanks.

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

A

So, the proximity sensing is a number of different companies, Chris. I think Samsung is a big piece of that as well as China. So, those two are contributing definitely to weakness. There is some excess inventory out there as well. So, some of that demand was very strong, around kind of COVID timeframe, and then kind of came down. So, I would say the big piece of it is the proximity sensing.

And then, if you look at industrial and LoRa, obviously, we're starting to see weakness in the second half on – from China. Again, China still contributes probably 50% of the revenues for our LoRa-enabled business. So, there is definitely some weakness there as well. Some of that's COVID related, and I think maybe we'll get stronger towards the end of the year. But for now, that's also weak.

And then we have some weakness in, as I mentioned on my prepared remarks, on some of the gateway deployments. Obviously, that's lumpy anyway. Infrastructure tends to be a little bit lumpy. As you know, Helium has definitely weakened as well. So there's some elements there. So within Wireless and Sensing, I would say it's proximity sensing, and then both Korea and China, and then some of the LoRa from China and in Helium gateways.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

Great. Okay. Thank you for that. And then my second question is on LoRa. Can you remind us what an ASP is for a LoRa node? And congratulations on all the growing content you have at Amazon, for example. Should we assume kind of the same ASP for that node in sidewalk considering it's such a big volume or is it more considerably discounted? Thanks.

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

A

Well, you have to separate the gateway deployments. So what goes into an Echo, for example, versus what goes into the end nodes. The end nodes are the sensors that connect to them. So typically we use a reference point of about $1 for an end node kind of ASP, could be higher, could be $2 to $3 or could be lower depending on volume and what type of – which device it is. But that's where the opportunity is for LoRa and that's what we're hoping to see now over the next three to five years.

We have a lot of gateways out there and now it's all about connecting end devices. But that's where I think that we're going to see the world is going to need LoRa, as we've talked about several times that the value of the lower power sensing and the connectivity that brings together a complete IoT and sensing network is really the value of LoRa. So to us, that's the real opportunity. But to answer your question, yeah, we typically think of an end node in the $1 to $2 range.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

And I guess just a follow-up there, should we think about the content for, like, an Echo – the gateway content in an Echo, how should we think about that when compared to the content for – I would assume it's a more robust gateway for, like, a Helium hotspot or something like that. How do we broadly think about the content differences in magnitude?

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

A

Think about a macro gateway as typically being $10 to $20 of chip content. A PicoCell gateway, typically $5 to $10, something in that range. And obviously, we're not going to speak about specific customer partnerships we have, but in some of our strategic partners we may do – have lower ASP in order to try to proliferate the networks.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

Great. Thanks, guys.

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. Actually, my question was just answered. I appreciate the opportunity again. Thank you.

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

Scott W. Searle
Analyst, ROTH Capital Partners LLC

Q

Hey, good afternoon. Thanks for taking my questions. Mohan, maybe just to follow-up on some of the earlier questions. Certainly, consumer smartphone is a big area of the weakness that's going on right now in China and globally. But I'm not sure if I heard a level of inventory – channel inventory that you think is out there with the distributors or at the customers themselves. I just want to clarify kind of how much of this is inventory channel absorption versus demand? And are you losing share from a design perspective because when you look from a macro standpoint, the market being down 5% to 10% or so in terms of units this year and clearly, you're going through – it looks like a bigger trough [ph] in there (00:51:35)? So, just trying to figure out that aspect.

And also on the LoRa front, I'm not sure if you gave an indication of what that looks like sequentially? Will it be sequentially up in the current quarter because it sounds like you're still looking for that 40% growth in fiscal 2023?

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

Well, let me start with that one, Scott. So, I think, in the first half of the year, LoRa has grown versus last year, I think it's over 70%. So, obviously, we couldn't expect that rate to continue. So, for the year, we're still projecting 40% growth for LoRa. But in the second half, it'll be weaker than that. I think part of that is China weakness and then part of that, as I mentioned, is the Helium, a little bit of weakness there as well. So, that's what the expectation is for LoRa.

We don't believe we're losing share in any of our businesses or any segment. We actually – if anything, I think we're actually gaining share in some areas. I think the weakness we see today, you mentioned channel inventory is really tied to consumption. So, if consumption comes down, obviously your channel inventory increases because it's not moving from the channel. And then so that's what I'm saying as we see that weakness, we have to bring down our expectations. And so, once that consumption increases again, that will give us a more positive feeling about guiding more aggressively. So, I think, yeah, that's the way we look at it.

And if you look at the details behind that, a lot of it is consumer, a lot of it is China. Some of it, as I mentioned, is tied to still China lockdowns and things like that. So I think those will come back. But even the other segments like infrastructure and industrial now is starting to show some signs of weakness. Definitely, the bookings are not as strong as one – as we've seen over the last few years.

Scott W. Searle
Analyst, ROTH Capital Partners LLC
Q

Okay. Very helpful. And, if I could, just from a follow-up perspective, in terms of Sierra Wireless, I'm wondering what you're seeing from your customer base in terms of cross-platform interest like LoRa and cellular kind of being built into the same solution and what the general feedback is and interest level that you're getting from the customers in the early going here? Thanks.

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

Yeah. The Sierra Wireless acquisition has always been a very strategic one, but very tactical in the sense that because customers is – are the ones that really drove the thinking behind it for many reasons. One is the kind of global connectivity aspect of it that just immediately you have the ability to connect LoRa sensors and networks to already established global cellular networks that are out there. So, that provides network coverage for all IoT use cases. So, that's a – that's definitely a plus point for customers.

You have end-to-end IoT capabilities, so Semtech can go out there and talk about how to connect a sensor to the network, to the cloud, and that's going to be very, very positive for many customers we're already talking to because they see the ability to reduce energy, reduce costs to get global connectivity, and be able to connect their industrial assets to the Internet. So, that's definitely a positive.

And then, I think the cloud is kind of the silver lining on this is going to be very, very exciting but, obviously, Sierra's cloud platform is already established. They already have it out there and us bringing our LoRa cloud capability and connecting the two and providing that total solution to customers is enabling them to really think about new use cases and new ideas of bringing ultra-low power, long range LoRa together with low latency, high bandwidth capabilities of cellular.

And if you think about the use cases, there's just so many, mobile asset tracking, cold chain, fleet management, public safety, security, smart city, smart utilities, industrial IoT. All of these use cases will – and applications will use ultra-low power sensing with cellular connectivity maybe on the backhaul side. So, I think, we just can't wait really to get into the integration, get the deal closed and then integrate the two companies, and really start to provide a total solution offering to our customers. It's going to be pretty exciting.

Scott W. Searle
Analyst, ROTH Capital Partners LLC

Q

Great. Thanks.

Operator: And we have reached the end of the question-and-answer session. I will now turn the call back over to the management for closing remarks.

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

Thank you. In closing, we were very pleased with our record Q2 results. We have demonstrated a commitment to excellence and innovation, and have delivered excellent financial performance despite many headwinds over the last few years. While we are facing some short-term macroeconomic challenges, Semtech is a very resilient company, and I am confident that we will successfully manage through the current headwinds we face.

With that, we appreciate your continued support of Semtech and look forward to updating you all next quarter. Thank you.

Operator: And this concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation.