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Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Semtech Corporation Conference Call to discuss the Third 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 that this conference is being recorded. And 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. Thank you. You may begin.

Anojja Shah

Vice President-Investor Relations, Semtech Corp.

Thank you, John. 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 risks and 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 are 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

Chief Financial Officer & Executive Vice President, Semtech Corp.

Thank you, Anojja. Good afternoon, everyone. In Q3 fiscal 2023, in line with our guidance, Semtech delivered Q3 net revenue of $177.6 million, a sequential decrease of 15% and a year-over-year decrease of 9%. We faced a challenging macroeconomic environment and see sustained softness in the consumer market and overall weakness in China. But we are beginning to see signs of stability and several bright spots.

Our focus on regional revenue diversification is showing signs of success. We see accelerated adoption in North America and Europe for Tri-Edge, for LoRa, and our broad-based industrial and automotive Protection business due to our targeted growth efforts with end customers.

Overall, Q3 shipments into Asia, North America and Europe represented 71%, 15%, and 14%, respectively. While this represented ship-to addresses for our distributors and customers, we estimated 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.

Looking at our end markets, our infrastructure end markets grew 5% over the prior year, but declined 17% sequentially and represented 39% of total net revenues. Net revenue from the industrial end market also grew 7% year-over-year, but declined 13% sequentially and represented 41% of total net revenues.

As I previously mentioned, we continue to see softness in consumer end markets where net revenues for high-end consumer decreased 43% over the prior year and 15% sequentially, and represented 20% of total net revenues. Approximately 10% of high-end consumer net revenues was attributable to mobile devices, and approximately 10% was attributable to other consumer systems.

Our sales channel remains consistent, with distribution representing approximately 83% of shipments and direct 17% of shipments. Our distributor POS declined during the quarter, but remained balanced, with approximately 38% of POS coming from infrastructure, 33% from the industrial segment, and 29% coming from high end consumer end markets. So far in Q4, we see signs that our POS is stabilizing and no longer declining.

The Q3 bookings decreased sequentially and represented book-to-bill of less than 1. Bookings were generally weaker across all regions and end markets. And just as in POS, we are beginning to see stability in bookings over the past month.

Our gross margin remains resilient. In Q3, gross margin increased 30 basis points sequentially to 65.5%. This is the new quarterly record, driven mostly by a lower mix of consumer revenue. For Q4, we are projecting a small decline of gross margin to 64.5% at the midpoint, driven by lower absorption due to the softer overall demand environment. We expect gross margins to hover at current levels plus or minus 100 basis points until demand recovers.

Q3 operating expenses decreased approximately 5% sequentially to $68 million, as we took steps to respond to softening demand. For Q4, while maintaining our investments in new products, we will take additional measures to reduce operating expenses by approximately 10% sequentially in response to the weaker demand environment.

Managing our cash flow is our focus in these challenging times. In Q3, cash flow from operations was unusually low at $18 million or 10% of revenue, reflecting elevated use of working capital, as accounts receivable increased due to timing of shipments and as we continued to pay for prior period, long lead time materials.

We expect our cash flow from operations to rebound in Q4 to normal seasonal levels. Cash, cash equivalents and marketable securities increased approximately $256 million to $618 million. The increase is primarily due to the $319.5 million in convertible notes we issued to help fund the proposed Sierra Wireless acquisition, slightly offset by a $23 million payments on our existing line of credit. The convertible notes resulted in net cash proceeds of approximately $280 million after expenses, sell-off warrants, and the cost of convertible notes hedge transactions we entered into in conjunction with the issuance of the notes. These convertible notes carry an interest rate of 1.625% and will mature on November 1, 2027. The conversion price of the notes, including the hedge transactions, is $51.15, and on a non-GAAP basis, there would be no dilution below this price.

In Q3, we did not repurchased any stock 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 Wireless acquisition. In Q3, accounts receivable increased 13% sequentially due to the timing of shipments and days of sales increased nine days to 39 days.

In Q3, net inventory in absolute dollar terms was up slightly sequentially and days of inventory increased 27 days sequentially to 150 days, as we continued to receive previously committed long lead time materials despite the decline in demand. We expect net inventory to be flat to slightly down in Q4, reflecting the weaker demand environment.

As we look forward to the pending acquisition of Sierra Wireless, we remain excited about the growth potential of the two companies when combined. Sierra's reported revenue is consistent with our expectation. When complete, the transaction is expected to be immediately accretive to Semtech's non-GAAP EPS.

In summary, our business continues to be adversely impacted by the broad slowdown in China and a sustained weakness in the consumer market. Maintaining our financial health is paramount during these uncertain times. We have the management team that have experience managing through industrial downturns, and I'm confident that the proactive actions taken, our focus on new products, design wins, working capital management, and geographic diversification will strengthen Semtech and prepare us well for the recovery.

I will now hand the call over to Mohan to share more details on the business.

Mohan R. Maheswaran

President, Chief Executive Officer & Director, Semtech Corp.

Thank you, Emeka. Good afternoon, everyone. Let me begin by providing a brief update on our proposed acquisition of Sierra Wireless. I will then share details of our Q3 fiscal year 2023 performance by product group and then provide details on our outlook for Q4.

With regard to our acquisition of Sierra Wireless, as previously announced, we received a second request from the U.S. Department of Justice. We are cooperating fully with the DOJ and providing them with their requested documents. In parallel, together with Sierra, we have made significant headway with integration planning and are prepared to close immediately when approval is accomplished.

We continue to be extremely excited by the transformation we can drive in the entire IoT industry by bringing together the ultra-low power, long range sensor benefits of LoRa technology, together with the low latency, high bandwidth network benefits of cellular technology. Our goal is to enable IoT deployment simplification through end-to-end connectivity and deliver a cloud-to-chip IoT services platform that will accelerate our customers' digital transition to the Internet of Everything.

We continue to receive very positive feedback from our customers as they start to recognize the disruptive potential of the combination of the two companies. Combination of optimizing LoRa and cellular technology is a highly strategic opportunity that will position Semtech as the clear leader in the fast-growing, ultra-low power IoT market.

Now turning to our Q3 performance, our Q3 net revenue was $177.6 million, slightly above the midpoint of our guidance range. We posted record non-GAAP gross margins of 65.5% and non-GAAP earnings per diluted share of $0.65. Despite the challenging macro environment, we continue to execute well, have solid new product releases, and new design and momentum, and are very excited by our future growth prospects across all our target market segments.

Let me begin with our Signal Integrity product group. Revenue was up 2% from Q3 of fiscal year 2022 and represented 44% of total revenues. As expected, the weak economic environment in China is impacting infrastructure demand negatively. Our Hyperscale Data Center business slowed in Q3 following a strong first half performance.

Despite the softer demand, our FiberEdge revenues doubled over the previous quarter, as we increased our PMD penetration in the 400-gig active optical cable segment. In addition to solid FiberEdge momentum, our Tri-Edge platform continues to make excellent design and progress in global data centers, predominantly in North America.

We are pleased to report Tri-Edge has been selected by a major North American Hyperscale Data Center Provider in a new, high volume, multi-year program to enable low power up, low latency, and low cost interconnects within their data centers. We expect to be in production on this project in the second half of this fiscal year 2024.

The benefits of Tri-Edge align well with the long-term goals of hyperscalers, focused on lowering the power and cost of their interconnects within their data centers. Tri-Edge and CopperEdge are starting to gain traction in advanced data centers in North America that are focused on leading-edge artificial intelligence or high-speed computing applications with both low cost and low latency are critical requirements.

In addition to our current FiberEdge and Tri-Edge momentum, we continue to invest in new higher performance solutions that will enable further system-level innovation within the hyperscale data center market. We recently demonstrated our first 200-gig per channel PAM4 FiberEdge platform. This innovative PMD platform will be used in 800-gigabit and 1.6-terabyte optical modules deployed by hyperscalers.

We also recently introduced our ultra-low power 50-gig per channel Tri-Edge solution for both ultra-low power 200-gig and 400-gig optical modules. In addition, we are starting to see great interest in our new CopperEdge re-driver platform, targeted at 100-gig per channel copper interconnects. We expect to announce more significant CopperEdge, Tri-Edge and FiberEdge design wins throughout FY 2024. We remain confident that our full portfolio of data center platforms, including ClearEdge and Tri-Edge CDRs, FiberEdge PMDs, and CopperEdge re-drivers will enable us to continue to rapidly grow up our hyperscale data center business nicely over the next several years.

In Q3, our PON business also declined sequentially due to weakening demand in China, what was up approximately 36% on an annual basis and is on track to deliver another record year. We continue to see relative strength in 10-gig PON OLTs and ONUs while gigabit PON demand is weakening. While most of our PON revenues today are from China, we are starting to see increasing deployments of 10-gig PON outside China. In addition, we are actively engaged with leading PON system providers globally who are focused on higher bandwidth PON deployments.

We expect global PON deployments to continue to accelerate as demand for higher access bandwidth is expected to increase in the future. While weakness in China is a major headwind at this time, we remain confident this business will grow nicely over the next several years as other regions deploy PON solutions and as our China business recovers.

Revenue from our wireless base station business was down in Q3, both on a sequential and year-over-year basis. This was mostly driven by economic weakness in China, which negatively impacted 4G and 5G deployments. However, our 5G revenues grew 75% on an annual basis as European customers start to expand their 5G footprint.

In Q3, we announced the production release of our Tri-Edge 5G base station platform targeted at 50-gigabit per second PAM4 Front Haul links. This Tri-Edge platform is a bi-directional, analog PAM4 CRD with an integrated differential driver, offering ultra-low latency and low power and enables the use of low cost 25-gigabit per second optics to operate at 50-gigabit per second.

We already have numerous 5G base station design-ins with both our ClearEdge and Tri-Edge platforms, and expect continued adoption throughout FY 2024 and initial production revenues in the second half of FY 2024. While overall macroeconomic conditions continue to delay the rollout of 5G infrastructure, we are seeing more global deployments driven by European 5G vendors, which will provide more geographical balance in this business.

As a result of demand weakness and excess inventory in China, we expect the infrastructure market to remain weak and expect our Signal Integrity Products Group revenues to decline in Q4. However, we still anticipate that our Signal Integrity Products Group will deliver record annual revenues for FY 2023.

Moving on to our Protection Products Group. In Q3, our Protection revenues were down 27% sequentially and represented 22% of total revenues. Extreme softness from the high-end consumer market negatively impacted our business. Lower revenues from our Asian smartphone customers and broad consumer weakness offset record revenues from our North American smartphone customers. We believe we are very well-positioned in the consumer protection market with a strong USB-C Protection portfolio, which is expected to be the high-speed interface of choice across most future consumer segments.

Our broader Industrial Protection business, which represents a wide range of end markets across all regions, showed resilience in the Americas and Europe markets. We are seeing continued positive traction in the automotive segment as our Ethernet shield, display shield and antenna shield products are all gaining momentum as our customers integrate more advanced lithography technologies with high-speed interfaces into their vehicles. Our Protection Shield Solutions also have solid design win momentum at several of the top global EV makers, which is the fastest growing sub-segment of the automotive market.

We recently announced our new HotSwitch platform for industrial and communications applications. This truly innovative system protection platform provides [ph] new (00:21:57) protection features that will safeguard systems, prolonging the lifespan of electronic devices and reducing electronic waste. As the overall macro environment improves, we remain well-positioned to grow in the broader protection market with a well-rounded protection portfolio for high-speed interfaces such as 10-gig Ethernet, USB Type-C, touch displays and antennas, and expect our broader Industrial Protection business to deliver record revenues in FY 2023. While we are starting to see demand levels stabilize due to high consumer inventory levels, we expect the Protection business to further decline in the fourth quarter.

Turning to our Wireless and Sensing Products Group. In Q3, revenues from our Wireless and Sensing Products Group declined 3% from the same quarter a year ago and represent the 34% of our total revenues. Our LoRa-enabled revenues grew 36% annually, driven by growth from the Smart Building, Industrial IoT and Smart City segments.

LoRa revenues increased nicely in North America and Europe, but remained weak in China due to ongoing COVID lockdowns and general economic softness in the regions. LoRa continues to be utilized across a broad range of exciting use cases and we are seeing increasing global adoption of LoRa due to its ultra-low power, long range and low cost connectivity. Here are a few exciting announcements from this past quarter.

Exeger is integrating LoRa Edge with their unique solar cell technology for indoor and outdoor asset tracking and global supply chain logistics. Combining Semtech's LoRa Edge asset management platform with Exeger's Powerfoyle solar cell technology significantly extends the battery life of asset tracking and environmental sensing devices.

CWD introduced a new module combining LoRa and Bluetooth to bring the LoRaWAN capabilities to hazardous work environments such as oil rigs, mines and construction sites where employees' safety is the first priority. These easy-to-deploy IoT modules enable the tracking and monitoring of employees safety.

Intent Technologies announced its LoRa-enabled smart property solution, which enables improvements in the operating performance of the building, is being adopted by Nexity, a leading real estate service provider, to optimize performance, improve quality of service, and reduce the carbon footprint in residential and commercial properties. Their platform has already achieved a 10% savings in overall building operational costs.

Kiwi Technology introduced a new fully autonomous LoRaWAN-enabled network control unit for gas metering. This new comprehensive NCU will enable multiple remote meter reads per day and allows customers access to their real-time and historical gas consumption trends to identify cost savings and discover waste reduction opportunities. The NCU also anticipates and remotely shuts off gas in potentially dangerous situations. Kiwi Technology expects these meters to remain fully autonomous for 10 years.

This week at Amazon's re:Invent Conference, we announced that Amazon Web Services is integrating our LoRa Cloud geolocation capabilities into their AWS IoT Core platform and launching a new service to simplify asset tracking solutions using AWS. Customer adoption is already beginning and we will expect – and we expect this will enable the broad expansion of our LoRa Cloud geolocation services and our LoRa Edge silicon platform in the future.

LoRa's global adoption continues to make very positive progress and our metrics dashboard indicates solid momentum. These metrics include the number of public LoRaWAN network operators grew to 178, up from 173 at the end of Q2. In addition to public networks, private networks are also experiencing significant growth, as evidenced by many new use cases and applications.

We expect approximately 180 public LoRaWAN network operators by the end of FY 2023. There were 5.6 million LoRa Gateways deployed at the end of Q3, ahead of our FY 2023 target of 5.5 million. This was driven by growth in Amazon Sidewalk gateway deployments, which were up 14% sequentially and up 120% annually and private network gateway deployments, which increased 13% sequentially and 45% on an annual basis.

Macro gateway deployments also increased 10% sequentially and 33% on an annual basis. We expect these global gateway deployments to drive an acceleration in end device attach rates over the next several years as numerous new use cases increasingly adopt low power sensor networks. The cumulative number of LoRa end nodes deployed increased 15% sequentially to 280 million at the end of Q3. We expect this number to exceed 300 million cumulative end nodes by the end of FY 2023.

With the increased interest in adopting digital technologies to monitor and preserve our natural resources and to help mitigate climate-related issues, we expect end node deployments to accelerate rapidly over the next three to five years. Excluding China, we expect our FY 2023 LoRa-enabled end nodes to increase on an annual basis by approximately 60%, confirming the increasing attach rate of LoRa end devices to installed gateways globally.

Our LoRa opportunity pipeline at the end of Q3 was 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. Over 82% of our LoRa opportunity funnel is currently from regions outside of China.

In Q4, we expect our Wireless and Sensing business to decline as weakness in China and a weak consumer business negatively impact both our LoRa and proximity sensing business. However, driven by record LoRa-enabled revenues, which we will expect – which we expect will grow approximately 39% in FY 2023, we anticipate our Wireless and Sensing business to deliver another record revenue year in FY 2023, despite very weak consumer revenues. In Q3, we released 12 new products and achieved 2,189 new design wins, positioning us very well for future growth as macro trends improve.

Looking forward to the fourth quarter of fiscal year 2023, we see continued demand challenges in China resulting in weaker than normal seasonality. However, we are starting to see signs of stability in both demand and POS, including from China. As a result, we expect our Q4 net revenues to be between $145 million and $155 million. To attain the midpoint of our guidance range or approximately $150 million, we needed turn orders of approximately 27% at the beginning of Q4. We expect our Q4 non-GAAP earnings to be between $0.44 and $0.52 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, sir. We will now 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. The first question is on your turns number there for the January quarter. So, I think last quarter, I think you expected 0% turn, obviously now quite a bit higher. Does that mean Mohan that kind of like the supply and demand is back in balance because I think historically you turn about 20%, 30% on any given quarter? And as a follow-up to that, what gives you the confidence that you can actually achieve the 27% turns?

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

A

Yeah. I think that is correct, Tore. It's supply lead times are starting to normalize and get back to what they kind of historically have been. There are also – there's also inventory in place, so meeting short lead time orders is not going to be as difficult as it has been in the past. I think also with the POS stabilizing and the general feeling that consumer, for example, has been extremely weak for a long period of time and starting to see some improvement in bookings there gives us that confidence. And as you point out, yeah, historically, we've turned 30%, 40% a quarter fairly frequently.

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

Q

Very good. And as a follow-up to Emeka, Emeka when you talk about OpEx next quarter, you mentioned a 10% number. So is that total OpEx down 10% sequentially? And would this sort of be the new run rate going forward for as we model the rest of the year?

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

A

Yeah. It is 10% down sequentially. As you know, Tore, maybe when we start the – a new fiscal year, there are additional expenses that will come out, right, higher taxes and things like that. So, the operating expenses I would expect that going forward it's probably going to be a little bit up in the first quarter and the first half of next year. But I think the run rate is going to be significantly down from what it was for fiscal year 2023. As a matter of fact, I would probably expect the quarterly run rate to be about $63 million, $64 million a quarter.

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

Q

Very good. Just one last housekeeping one. You mentioned 82% of the LoRa funnel is outside of China, which means 18% in the funnel is China. What would that be currently as far as revenue is concerned?

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

A

Revenues are closer to 45% to 50% of total revenues up from China, Tore. Obviously, I think in the last quarter, it's probably a little bit lower than that. But I think it's still – most of the – a lot of the revenues up in China. The funnel obviously takes time to transition into revenue, but the important point there is that we are seeing a lot of success outside China.

Now, China also is still doing very well and LoRa is growing in China. And I think it will continue to grow in China. But there are other regions, particularly North America has taken a while to catch up. But I think now if the funnel – if we execute on the funnel transition to revenue, then we'll start to see a little bit more balanced geographical business for LoRa.

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

Q

Very good. Helpful. Thank you.

Operator: And our next question comes from the line of Richard Schafer with Oppenheimer. Please proceed with your question.

Wei Mok
Analyst, Oppenheimer & Co., Inc.

Q

Hi. This is Wei Mok on the line for Rick. Thanks for letting me ask a question. So in regards to your agreement to license LoRa Cloud to AWS, I was wondering how this affects your end node forecast and the long-term 40% CAGR, is this already embedded in – can we see in accelerated growth in your 40% CAGR? Thanks.

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

A

Well, yeah, it's kind of embedded in the 40% CAGR, I think, because it drives a lot of end use connectivity. The whole goal here is to use AWS' channel and market power and presence to go out and drive more end node connectivity and more assets that need to be tracked and managed and we feel pretty good about the combined companies' efforts here and the thinking here and the platform. But certainly, that's the expectation. Obviously, it will drive – in addition to LoRa Edge end devices, it will drive Cloud services revenues for us and that's significant.

Wei Mok
Analyst, Oppenheimer & Co., Inc.

Q

Great. Thank you. My second question is on LoRa spectrum. Is there any way you can help parse out how big LoRa is for the unlicensed sub-gigahertz spectrum? And how does this compare to the 2.4-gigahertz variety? Thanks.

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

A

Majority of the revenues are sub-gig. The 2.4-gig is relatively new. So I would say, yeah, 90% and above is probably sub-gigahertz at the moment. Yeah.

Wei Mok
Analyst, Oppenheimer & Co., Inc.

Q

Thank you.

Operator: And 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 and Emeka. I've got a couple. Mohan, I'm looking at your commentary. You talked about – both you and Emeka talked about signs of demand stabilization. But when I sort of square that against your commentary, I kind of concur that both industrial and infrastructure are down. So my question is, if you're seeing signs of stabilization, where are you seeing them? And do you think this is happening because of some of the new products that you guys are launching, like Tri-Edge getting some traction and CopperEdge getting some traction? Or are you seeing sort of broadband – or sort of broad-based, sort of pickup in demand which suggests that maybe you're on your way up from here?

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

A

Yeah. I think, obviously, Harsh, we guided down for Q4 and any bookings, POS demand stabilization is really going to impact the first half of next year, right? So, as we start to look at it, I would say that the stabilization is more on the existing business, the existing business in China, looks like it's going to recover in the – starting to recover in the first half. The existing consumer business, which has been down most of the good part of the year, looks like it's starting to bottom out here. So, hopefully Q1, maybe Q2, we'll start to see a pickup there.

Now, you add on top of that some of the new growth engines that – and design wins I talk about, we're starting to feel pretty good about certainly the second half of next year from a growth standpoint. But the – to answer your question, the comment on the stabilization is more on the existing revenues today.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Understood. And then you talked about a couple of growth rates for LoRa. So, I just want to understand, you talked about – Mohan, I think you said, all in, all out, you'd end up with about a 39% growth rate for LoRa for this year, which I think is pretty respectable, given your exposure to China and what's really happening in China. And then, you talked about a number ex-China of 60% that I didn't catch. Maybe you could clarify that. And then, how are you thinking about – the real question is how are you thinking for growth for next year?

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

A

Yeah. So, the 39% is our estimate for this year's growth, that's correct, for LoRa-enabled business. The 60% now refers to end nodes, and I simply commented on the fact that if you extract China, if you take out China where the growth has been a little bit slower, end nodes would have grown 60%. So, end nodes are growing 60% in North America and Europe. And actually, it's about 17% to 20%, including China. So, it's still pretty good. But I think it just shows that the acceleration in other regions is quite good.

And next year, a lot is going to depend on the second half. I mean, we – obviously, China is – continues to be weak. And – but we have some very good things going on like the Amazon announcement we just made. We think Sidewalk and some of that is – some of those areas are starting to get some momentum. We have a few headwinds. I mean, really, what happened in the last couple of years with the Helium gateways is going to get us – give us a little bit of a headwind for growth next year. But still, we haven't given up. We think next year should still be a reasonably good growth. It won't be close to the 40% CAGR, but I think if we can get some momentum on some of these other use cases, I think we'll still see good growth.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Mohan, very helpful. And if you don't mind, I'll ask another one and I promise I'll get off the line after this. I had a question on the deal. You've got a second request, so that changes the timing of the deal. I guess, my question is, where do you think the timing of the deal will lie? And then, for Emeka, $319-odd million raised, do you think that's enough to close the deal? And then, were you looking at converts the entire time or were you looking at straight debt? And then given the interest rates, you sort of pivoted to convert? And if these are converts, would you have an intent to buy these bonds back so they actually don't convert and dilute?

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

A

So, let me start with the timing, Harsh, which is obviously out of our control to some extent. I can tell you what we're hoping, which is that towards the end of the year and early next year, we will be closed and we're ready to close and we're ready to move to the integration. We're very well prepared for that. We're excited about doing it. And so far, there's no indications that that timeline shouldn't be achievable.

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

A

And so, Harsh, with regards to your question, we do have the financing that we need to close the transaction. We have a combination of our line of credit from our commercial banking partners. We have a term loan A from our commercial banking partners and then we do have this convertible debt in addition to our internal cash. So, the financing is pretty much in place for the acquisition.

In terms of what we were looking at, we were looking at all the options. We're looking at everything and we were trying to – we had to make the decisions that we thought was best in terms of the cost of capital and things like that. With regards to being able to retire the debt, we just have to see how things are – how things play along here. So – but we do have a lot of options on what we can do with regards to the convertible debt, but I will make those decisions at the right time.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Appreciate it, guys. Thank you.

Operator: And our next question comes from the line of Trevor Janoskie with Needham. Please proceed with your question.

Trevor Douglas Janoskie
Analyst, Needham & Co. LLC

Q

Yeah. Hi. This is Trevor on for Quinn Bolton. Thanks for letting me ask a question here. So, given your comments on demand stabilization, does this mean you – we will see fiscal 4Q and fiscal 1Q 2024 as the possible revenue troughs with the step-up in the second half of 2024? Thank you.

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

A

That is the hope from what we see today. We certainly see the second half as being sequentially up from the first half. If you look at FY 2023, we had a very strong first half, looks like it's going to be relatively weak second half. But as you see from our comments that we expect FY 2023 to be a record year for us.

So, when you look at it as a total, it looks like a pretty good year. Now going into next year, we know the first half is going to be relatively weak. The question is how strong is the second half going to be if it comes back and how it comes back. And the main drivers of the weakness have been China around consumer. There's some inventory buildup, I think, from the very strong first half. So, as those bleed through, and China comes back and consumer starts to strengthen a little bit, we could hopefully see a stronger second half next year.

Trevor Douglas Janoskie
Analyst, Needham & Co. LLC

Q

Awesome. Thank you. And you spoke about relative resilience in North America and the EU and broad industrial. Do you expect this resilience to continue moving forward? And is automotive playing a big role in this as well?

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

A

Well, automotive is one of the stronger segments today, for sure, and we expect it to continue to be. I would say the other industrial markets in North America and Europe are holding up relatively well. It's all relative. Consumer has been extremely weak, particularly Asian consumer business. I guess it's well documented that China consumer, and Samsung, as an example, have been very weak. And I would say that the broader consumer market and computing market, PCs, laptops, tablets is also very weak. And then China itself is definitely going through some challenges economically and through – still through COVID issues. And so, demand is weak. I don't anticipate those will remain. But for sure at the moment, North America and Europe are stronger regions.

Trevor Douglas Janoskie
Analyst, Needham & Co. LLC

Q

All right. Thank you.

Operator: And our next question comes from the line of Craig Ellis with B. Riley Securities. Please proceed with your question.

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

Q

Yeah. Thanks for taking the question and appreciate all the transparency on what you're seeing in the markets and with the different product groups, guys. Mohan, I wanted to start just digging a bit deeper into China to understand what you're seeing there. You were early in flagging the weakness that started in China back in August. And in interpreting your comments, I'm trying to discern if the signs of stability that you may be seeing in consumer really related to Lunar New Year builds and therefore more of something that might be near term oriented versus something that might be related to product cycles that would be beyond that. So, can you just go a little bit deeper into what's actually happening in China and the confidence that you have in consumer and elsewhere that we're near bottom there?

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

A

Yeah. I think I would say the key thing to remember, Craig, is that it's come down significantly, right? So, consumer and China across the board has come down quite significantly in Q3, comes down again in Q4, so we guide down in Q4. And so, the indications are that Q1 will start to stabilize and we're seeing demand stabilization, so demand has started to level off. We're also seeing POS starting to improve and also bookings. So, I would say it's fairly broad. I wouldn't say it's one specific thing, but just remember that it's off a very low base, right? So, the hope is now we'll start to see, I think, inventory consumed. I think that's the key. So, POS increasing and some of the – even our customers' inventory is starting to flow through over the next two quarters, and then we'll start to see kind of more of a real demand-supply environment, I think, in the Q2-Q3 timeframe hopefully.

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

That's helpful. And then the second question is more about intermediate term question. As you look out over the course of calendar 2023, really fiscal 2024 for the company, what businesses in the portfolio do you have confidence that can grow year-on-year? We clearly have a challenging start given where we exit fiscal 2023. But as you look ahead, it seems like LoRa would be set up for good growth. You talked about some real momentum in Tri-Edge. What are the businesses that you think are going to be year-on-year growers next year?

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

Yeah. So, I do think, for us, the data center business has a good chance of being a very strong grower next year, obviously second half-driven, but we mentioned the significant wins actually we have in both Tri-Edge and FiberEdge in my script. And if you look at that second half, that can certainly drive growth in data center.

On the Wireless side, it's been fairly muted. So, I think the question there is just – is really more of a macro kind of comment on 5G base station deployments and some of the 4G stuff coming back. Again, China is a key player in that, but that could certainly grow again. It's been very weak this fiscal year. So next year could be a strong grower. PON has had – will have a record year in FY 2023 for us. So not sure we'll see the same level of growth. So, it will grow, but probably it will be a smaller – a lower grower, low growth rate versus the other segments.

And then, the consumer is the big question, because I think it's had such a poor fiscal year 2023 that one has to believe that that has a good chance to come back in FY 2024, and that includes our Protection business and our proximity sensing business in Asia, particularly and Korea. And then, of course, LoRa, as I mentioned, if you take out the Helium challenge that we have, the business should grow.

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

And, Craig, I also think our broad-based industrial and automotive protection, which is a record – which is expected to have a record this year, should also grow next year. That is the anticipation.

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

Great. And then my last question is for you, Emeka, and it's just a follow up to comments made three months ago around the capital cost, really the debt interest cost for the [ph] square deal (00:50:00). I think three months ago, you were thinking 5% to 5.5% would be a reasonable blended interest cost. Is that still the expectation or is it changed?

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

I think it's kind of moved slightly because of all the increase in the rates at this point. Depending on where the rates are at the time we close the transaction, I'll probably expect it to be between 5.5% and 6%.

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

Okay. So pretty close, but a little bit higher. Got it. Thanks, guys.

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

Right.

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

Thank you.

Operator: And our next question comes from the line of Christopher Rolland with Susquehanna. Please proceed with your question.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP
Q

Hey, guys. Thanks for the question. Either of you guys, perhaps you can illustrate the weakness we're seeing in China. Perhaps you can illustrate it for us. I think for the full year, you're expecting 34% of end consumption to be in China. I guess the first question is what's a more normalized number? And then where do you think this trough in Q4? Are we talking like 20%? Is it less from that? How sort of deep is this? I guess that's my first question.

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

So, with regards to the consumption by region, it is an estimate, right? We currently have it sized at 35% and it is still at that range. Maybe we'll just have to see how the POS and everything continues by the end of the year. But Chris, my gut feel at this time is that it is probably going to be at that level or maybe slightly lower, but I can't really give you a number at this point.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP
Q

Okay. Maybe you can talk about, I think you mentioned inventories in China, I don't know if that was for a specific product or not, but can you talk about that where you think inventories are? I know you've talked about demand weakness, but inventories, is that coming into play here as well? And the reason I mention that is April, I think in the April quarter for you guys can go either way up or down if there is some inventory being chewed through here, do you think that would indicate perhaps some positive sequential into April?

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

Yeah. I think so. I have to look at it by product group. For sure, in our infrastructure business, and I'm just referring to China now, we had a very, very strong first half across all of our businesses, and I think particularly PON. PON has perhaps a little bit more inventory than the other segments and that's reflected in a weaker Q4 expectation, I think.

So, yeah, I would say China, it's infrastructure data center and PON mostly, little bit of 4G wireless I think there. And then on the consumer side, again, that's – both for Protection and Proximity Sensing. Again, we had pretty strong previous fiscal year and I think what we are seeing is that consumer has been fairly soft for the whole year, but particularly, I would say, in China and Korea. So, those are the two main areas.

On the LoRa front, obviously, there's some excess inventories from the Helium drop-off there, but I think that will eventually be utilized. The Helium gateway chips are the same chips that can be used for other gateway. So, I'm not so concerned there. It's just more of a macro softness kind of thing for China. So, we'll see how that plays out.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

Thanks so much, Mohan.

Operator: Okay. And at this time, I'm not seeing any further questions. I'd like to turn the floor back over to management for any closing remarks.

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

In closing, our global teams are executing well in a challenging economic environment while we are facing more macroeconomic challenges in Q4. Semtech is a very resilient company and I am confident that with the solid progress of our exciting growth engines and the diversified nature of our business, we will successfully manage through the headwinds we currently face and deliver yet another record year in FY 2023.

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

Operator: This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation and have a great day.