Corrected Transcript

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Semtech Corp. (SMTC)

Q2 2024 Earnings Call

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Craig A. Ellis
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Analyst, Craig-Hallum Capital Group LLC

Harsh V. Kumar
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Tore Egil Svanberg
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Scott W. Searle
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Christopher Rolland
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MANAGEMENT DISCUSSION SECTION

Operator: Greeting and welcome to the Semtech Corporation Conference Call to discuss the Second Quarter Fiscal Year 2024 Financial Results. Speakers for today's call will be Paul Pickle, 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. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation.

I would now like to turn the call over to Semtech's Executive Vice President and Chief Financial Officer, Emeka Chukwu.

Emeka N. Chukwu

Executive Vice President & Chief Financial Officer, Semtech Corp.

Thank you, operator. A press release announcing our unaudited results was issued after the market close 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 other than net sales would 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.

Turning to Q2 fiscal 2024. The company delivered net sales of $238.4 million, in line with the midpoint of our guidance, and an increase of 1% sequentially and 14% year-over-year. Gross margin of 49.6% and earnings per share of $0.11 was above the high end of our guidance range. In Q2, shipments into North America, China, Europe and the rest of the world represented 24%, 29%, 14% and 33% respectively. The addition of Sierra Wireless has increased our geographic mix towards North America and Europe. Total direct sales represented approximately 36% of net revenue and distribution represented the remaining 64%.

In Q2, gross margin was 49.6%, above the guidance range, driven by some onetime benefits. For Q3, we expect gross margin to decrease approximately 160 basis points sequentially at the midpoint of our guidance, as the favorable impact of the higher mix of IC components revenue is offset by the onetime benefits in Q2 and lower absorption. Due to the softer demand environment and the subsequent lower absorption, we expect our gross margins for the rest of the year to remain around current levels.

In Q2, operating expenses was $86 million, 6% below the midpoint of guidance, due to focus on cost reduction actions in addition to synergies. We except these cost reduction actions and incremental synergies to drive Q3 operating expense lower to between $81 million and $85 million.

In Q2, cash flow from operations was a $12 million use of cash, impacted by demand softness and interest expense on our debt. Our cash flow from operations will remain a challenge in Q3 due to a softer demand environment. Our gross debt at the end of Q2 was $1.4 billion or approximately 5.3 times leverage on a net basis. We expect our leverage levels to increase for the remainder of the year as we navigate this softer demand environment.

We expect to be in compliance with the financial covenants included in our debt agreements. The Q2 weighted average cash interest rate was approximately 6.37%. In summary, our financial performance continued to be impacted by macroeconomic headwinds. Meanwhile, we are taking focused actions to realign our operations to enable us not only to manage the current headwinds, but also to position us for strong earnings growth when the demand environment improves.

I will now hand the call over to Paul.

Paul H. Pickle

President, Chief Executive Officer & Director, Semtech Corp.

Thank you, Emeka. While our net sales for the second quarter met expectations, I'm proud to note that our cost saving measures enabled us to surpass estimates on both the gross margin and EPS fronts. Yet as we navigate today's economic climate, our Q3 outlook remains cautiously reserved, reflecting elevated channel and customer inventories stemming from previously optimistic projections. We're intensifying our focus on cost control and operational enhancements in response.

I see component sales after an initial dip this fiscal year is now showing stability with the 16% sequential growth in net sales. Further improvement is anticipated for the rest of the year and into the next due to customer design engagements being primed to boost consumption in the upcoming quarters, particularly in the infrastructure and consumer end markets.

Our IoT Systems Product Group witnessed an 11% sequential decline, bringing the total to $119 million on a pro forma basis. While we have experienced a decline in demand for both module and router products, modules revenue is presenting a particular challenge in the current quarter. However, we are seeing silver linings in the broadband module business horizon, with legislative discussions putting our low-cost APAC competitors under the spotlight. This presents us with an unexpected opportunity to expand our market share. In-quarter pipeline engagements have significantly increased as a result, and we're gearing up to seize this window to our advantage.

Despite a minor drop in wireless radio-enabled component sales, LoRa end-node sales increased slightly. LoRa's potential for private networks, especially where power, reach and mobility are crucial, remain significant. While LoRa may not be a cellular infrastructure substitute, its unmatched value proposition for specialized private networks remains undebated. We're envisioning a more inclusive strategy to harness this vast potential, especially at the outer fringes of the IoT realm.

Q2 IoT Connected Services remained relatively consistent at $24 million. A 20% year-over-year growth was achieved from smart and enhanced carrier connectivity. Given the relatively low attachment rates for our cloud services platform, we will be focusing on enhancing hardware revenue with a high-margin software sales and a renewed focus for our IoT-managed connectivity and cloud platforms.

The Signal Integrity Products Group grew 12% sequentially in Q2 quarter to $46 million. Cloud hyperscale data center revenue was significantly up sequentially in the quarter, benefiting from the momentum in AI-driven applications. Product sales were driven by strong 100-gig, 200-gig, 400-gig data center and broadcast revenues. Tri-Edge and FiberEdge applications, all improved sequentially with a large US hyperscaler placing initial orders for a 400-gig active optical cable application. These gains were offset by weaker 10-gig China PON and wireless infrastructure revenue. Channel inventories remain high amidst improving, although cyclically weak end market demand. China infrastructure demand, although stable, remains muted. Our product portfolio in PON is well positioned and is poised to benefit when this market rebounds in the upcoming quarters.

The Advanced Sensing and Protection Products Group grew 35% sequentially, primarily driven by anticipated production of new design and security and smartphone applications. We are especially well-positioned with new protection circuitry for North American smartphone vendor. Proximity sensing or our PerSe product was also up in the quarter ahead of anticipated regulations in China for specific absorption ratio limits starting in fiscal year 2025. PerSe is still in the early innings of the design cycle, but the penetration and early ramp is encouraging. We continue to make progress in diversifying our end markets for the Advanced Sensing and Protection Products Group, with approximately half of product revenue coming from industrial, telecom and automotive applications.

For Q3 2024, we project net sales between $190 million and $210 million. Non-GAAP earnings for Q2 (sic) [Q3] are expected to range between minus $0.09 and plus $0.22 per diluted share.

We're steadfast in our commitment to the synergy plan presented to investors earlier this year and aim to fulfill it ahead of schedule. Post my induction, I launched a robust cost-reduction initiative which, along with other measures, has decreased our OpEx run rate by about $100 million compared to last year's combined entity pro forma. Further refinements are on the horizon.

During my short tenure at Semtech, I've been immensely impressed by our team's dedication and talent. Our unique state-of-the-art products create a competitive barrier, setting us apart. After extensive discussions with team members, I'm optimistic about navigating current market challenges. The tech industry is seeing fluctuations due to pandemic-driven demand, but the need for electronic advancements remains robust. At Semtech, our vision is clear: enable a smarter, more connected planet. Our focus for the upcoming months will be to execute this vision.

I'll now turn it over to the operator for Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Thank you. Our first question comes from Craig Ellis with B. Riley Securities. Please proceed with your question.

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

Hello, Craig.

Operator: Oh, I'm sorry.

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.
A

I think we have to take everybody off mute.

Operator: One moment. Thank you. Our first question is from Quinn Bolton with Needham & Company. Please proceed with your question.

Quinn Bolton
Analyst, Needham & Co. LLC
Q

Hey, guys. Thanks for taking my question. Paul, welcome to Semtech. I guess, first question, obviously guidance coming in I think much below expectations on a revenue basis. The semiconductor business has already been hit pretty hard by the combination of weak demand and market inventory. Paul, Emeka, can you give us some sense for the October guide at $200 million, is the semiconductor business flat, down or up, and where do you see the Sierra Wireless contribution coming in, in the October quarter? It looks like it's got to be well below $100 million if the semiconductor business, as I think you indicated in the script, might be flat to trending higher in the back half of the fiscal year?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.
A

Yeah. Thank you for the question, Quinn. I think for the most part, we've definitely seen a bottoming out of semiconductors that happened fairly early in the cycle. And of late, I think we've seen a little bit of pullback in hardware. Routers is off in terms of end-market demand. And when I say end-market demand, I'm really looking at POS numbers, so it's off slightly. But modules has substantially pulled back. The mix between those routers tends to be heavy channel dependent. Those inventories are not too terribly out of whack given the POS pullback, but modules is largely a direct business and we've seen at least some indicator from our direct customers that they are sitting on some substantial inventories over the next several quarters.

So, I've seen the hardware business pull back. Semiconductors, conversely, is doing fairly well, skipping along the bottom. Perhaps we're beyond the dead cat bounce that one looks forward to resume a kind of normal rate. And then I'd say for the most part, going forward, we'd expect continued improvement in the high-margin semiconductor business versus the hardware.

Quinn Bolton
Analyst, Needham & Co. LLC

Q

Great. Thanks for that color. And then a follow-up question. Paul, you'd referenced sort of having already reduced the OpEx run rate with synergies and other actions by $100 million. You guided OpEx in Q3 to a level of $81 million to $85 million. Is that the right baseline to think and model going forward? Do you think you can bring non-GAAP OpEx even lower? And how long will you hold OpEx at kind of that baseline level before you start to increase OpEx?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

So, the way – it's a good question. I wouldn't necessarily look at the current quarter as a baseline. We're going to have some ebbs and flows in that number in terms of R&D projects. There was pullback on R&D projects in the previous quarters. Those are coming in to fruition now, which kind of, if you read between the lines there, it says our baseline is perhaps a little bit better than what we're currently showing.

In terms of how good can it be? I think the way I kind of look at it and the way the team is looking at is to say, all right, everybody kind of bloated expense during the COVID cycle. So if we go back, you know, imagine a run rate business that was pre-COVID, look at those OpEx levels, so where the company used to be at, we should be able to easily get back there. So I think that there's – without giving an absolute number, there's improvements to be made. The first tranche is, I don't want to say easy, because it's always difficult to make those changes. The decision-making is perhaps a little bit easier. The second tranche needs to be a bit more thoughtful going forward. And so, I need to spend some more time discovering the workings of the organization and how it can be optimized and expect there to be continual improvement on a go-forward basis. But I do believe that there's more efficiency for this company to garner.

Quinn Bolton
Analyst, Needham & Co. LLC

Q

Great. Thank you. I'll get back in queue.

Operator: Thank you. 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

Thanks for taking the question and trying again. Paul, welcome to the call. I wanted to start, Paul, with an intermediate-term question for you since this is your first call. Can you just take a step back and look out over the next 6 to 12 months and just frame up what your priorities are as you come into the role and start to interact with the Street and look at the initial phase of optimizations you can make with the Semtech business?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

That is a great question. I think when you come into a company, you'd like to be afforded the opportunity to learn and really go through a proper discovery purpose or process. And I think, the current state of the economy, this current state of the company has necessitated a, hey, we're going to have to walk and chew gum at the same time, coming in and enacting some cuts. I will say, my priorities are a little bit split, and I believe that it's really kind of a twofold approach. It needs to be done in parallel, where we kind of look at how can we structure the company for its most efficient profitability model, given the current, you know, makings, projects, products, and then the various go-to-markets, along with assessing what we're really good at, the beachheads in technology that we have and putting together a good strategic plan for a long-term vision and long-term operating model.

I think we're making nice progress. I'm making nice progress along those fronts. I would say of late, it seems like I spent a good portion of my day on the tyranny of the urgent, an affectionate term, but still we have a good team here. As soon as we identify something, I'm able to delegate and continue to kind of think a little bit longer term. So, short-term, get us back to final – financial health, and on the intermediate, construct a plan for long-term operating model envision that that works and will drive shareholder value.

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

Q

That's really helpful. Thank you. And then, I'll follow up with Emeka on a couple of clarifications. So, Emeka, can you just help us understand how we compare the prior $50 million Sierra-related synergies target with the $100 million in expense reduction that Paul just mentioned? And then, with respect to the gross margin color, what are the biggest changes that have occurred from where we were expecting 100 to 150 basis points of expansion through the year to flattish from here? Thank you.

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

A

Hi, Craig. I think – so with regards to the synergies, I think the last time I gave a number for the synergies, I said it was about $50 million that we were expecting. I think we're doing a little bit better than that now. I don't have an exact number, but we're doing a little bit better than that. And then, in addition to some of the other actions that Paul has already taken within the company, that is how we're getting to a $100 million reduction from a pro forma number.

With regards to gross margin, it's actually very simple. We are seeing the benefit of the mix – of a higher mix of the IC component revenues that is good for gross margin. However, when the guidance was initially discussed, Craig, the expectations was that the revenue levels would be much higher and we'll be able to improve the utilization of our manufacturing businesses and stuff like that. So, right now we have a lot of fixed manufacturing overhead that we're not able to absorb. And that is the primary reason for coming off of the previously, you know, expectation that was set for about 100 to 150 basis points in gross margin improvement.

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

Q

That's helpful. If I could just sneak one more in for Paul. Paul, you commented in your prepared remarks about the strength in Signal Integrity, and it looked like it was within data center. Can you just talk about the visibility you have to that strength and what some of the specific program drivers are for that? Thanks, guys.

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

So, we've got quite a bit of visibility there. I will say though, it's a bit more difficult to plan for those particular customers, because when they're ready to go, they turn on a dime. And it's also the kind of thing that we don't have a ton of channel inventory that's out there waiting to be consumed either. So, we're cognizant of it. It's very much a hands-on process where we're running proof of concepts, understanding that the programs are coming, and staging them, getting ready for when the orders drop down, in terms of planning that in a particular quarter is a bit more difficult. So, I think we have a good sense that it's going to becoming a bit more of a relevant figure for us over the next several quarters, but exactly which quarter, it's a little bit more difficult for me to determine.

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

Thanks, guys.

Operator: Thank you. Our next question comes from Anthony Stoss with Craig-Hallum. Please proceed with your question.

Anthony Joseph Stoss
Analyst, Craig-Hallum Capital Group LLC Q

Thanks. Hey, Paul. Just to put a finer point on what Quinn was asking on OpEx. So if there was some, I guess, one-time things that elevated the OpEx, should we think about OpEx coming down a couple million dollars each quarter sequentially? And at what point do you think your goal of getting to $100 million costs taken out in total will be done, in which quarter? And I have a couple of follow-ups.

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp. A

So I don't think I said a couple – $100 million (sic) [million dollars], but I think on a run-rate basis, we're $100 million off. I think we can improve that. I won't put a number on it at this juncture. In terms of the rate of fall off, I think don't expect it to be significant windfall chunks that happen, but we'll be looking to execute as quickly as possible. And I'll say, through Q1, is the current plan to have most of those operational efficiencies in place. After that, it would be continual improvement that we would look to enact. So, trying to give you a little bit of a timeline, I'll avoid putting an exact number on it until I have a good feel for what that budgeting exercise is.

Anthony Joseph Stoss
Analyst, Craig-Hallum Capital Group LLC Q

Got it. And then, at what point are you going to reach a determination what assets you may want to keep either from Sierra or Semtech? Are you getting closer to that?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp. A

I think, if I look at – first of all, right now, every asset that's a positive contribution is an asset to keep at this juncture, unless I can hit certain clearance ratios associated with those assets. And that really kind of comes down to the short-term exercise. If you ask me long-term, do I need certain assets? I've already made a determination what is strategic in my mind and critical for our future. Other than that, we don't need certain assets in order to get that job done for the long-term vision of where we'd like to go. I'd like to spend a little bit more time on that plan. But I have a good sense of which assets I can divest, and it just comes down to whether or not I can reach those clearance ratios. Having said that, I really don't think this is a conducive environment to doing a deal or running a process. So, my goal and my determination at this point is to get the company to a point where we are not forced to do a divestiture, but we can do that if it strategically makes sense.

Anthony Joseph Stoss
Analyst, Craig-Hallum Capital Group LLC

Q

[indiscernible] (00:25:15)

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

I think of it more as a long-term principle pay-down.

Anthony Joseph Stoss
Analyst, Craig-Hallum Capital Group LLC

Q

Got it. And last question, just your comments related to the FCC coming out last week highlighting the Chinese module makers, and you said your pipeline is increasing. This has been discussed from the Commerce Department and other agencies for almost two years. What's giving you confidence now that they actually might do something?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah, we saw a significant boost in the pipeline. And I think it's to the point where, you know, I'll quote one customer. They don't believe that it's necessarily an issue or risk, but they just don't feel like they can fight the politics anymore. So, if we kind of look at it from that standpoint, I think if I can offer better quality, better security maybe at slight premium to the cost that they're currently paying for a low-cost APAC counterpart, I don't know why somebody wouldn't come my way, because we're certainly going to solve that problem. We also have the ability to put in place TAA-compliant modules if that becomes a requirement as well. So, it really kind of comes down to, from an infrastructure or critical industrial applications, we will be the guy to beat and we're going to make sure that we're the guys to beat.

Anthony Joseph Stoss
Analyst, Craig-Hallum Capital Group LLC

Q

All right. Thanks, Paul.

Operator: Thank you. Our next question comes from Harsh Kumar with Piper Sandler. Please proceed with your question.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Hi. Thank you. Paul, congratulations on your first earnings here at Semtech.

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

Thank you, Harsh.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Paul, what you've got here is you've got two companies, couple of different product lines. And as an analyst, I'm trying to understand what is Semtech, what is Sierra Wireless? And I was wondering if just from sake of simplicity, if you would be willing to give us how much is core Semtech revenues and how much is core Sierra Wireless revenues? And within Sierra Wireless, if you don't mind breaking out routers versus modules? Because you called out, I think you said the routers were off slightly and modules were down quite a bit. So I was wondering if you could help us level set some parts and pieces so we can be better at modeling.

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah. And so if we look, my commentary was on modules versus router was in the current quarter, so I'm kind of projecting a little bit, really kind of talking about the guidance here. You've got routers. I'm going to give you some rough percentages. So, don't expect this to reconcile to the dollar. But essentially, you've got $300 million of module business. You've got $100 million connectivity and $100 million routers. I'm really oversimplifying the actual buckets and allocations. But routers pulled back approximately 30% to 35% or so, but modules are substantially off in the going forward quarter. I don't expect that to sustain at those levels. I expect that inventory to be consumed.

It is a business where you end up placing a purchase order for a chipset manufacturer. So, any acquisition of those chipsets really need to make sure that the modules follow through. And so, a lot of those orders tend to be NCNRs. So you can kind of see how we had a bit of a pile up even at the end customers, even though modules is largely direct, about 80% direct business. So good visibility into those customers. Good visibility into demand. I'd say that their consumption, their end-market demand is off a little bit, but it really does come down to the ordering patterns that kind of made this happen.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Thank you, Paul. That was super helpful. And then, the other one that a lot of the customers or clients or investors are asking us is, they truly believe and I think you're saying this pretty much is Semtech is off the ground and kind of – or let's just say, hopping along the bottom with things looking a little bit brighter. But customers really want to understand maybe simplistically put, how many more months or quarters or weeks of excess inventory exist there before we maybe start to see similar positive trends at Sierra Wireless? Would you be willing to shed some color on that?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

Sure. I definitely take a kind of an end demand or consumption look at the business, and I've been going through that pretty exhaustively at least on the IC side. We've got a really good data that exists in our analytic systems here. And so, I can say confidently that at this juncture, we've got a couple of quarters underneath us where that end-market consumption has stabilized. And in fact, we're starting to see some upticks.

I'll say the possibility exists for some Q4 upsides, although we're not currently putting it in, in the forecasts. And so, it does feel like we've been skipping along the bottom here, at least for the semiconductor business.

In hardware, I think it's a bit of a couple of different factors. Its surge cycle kind of happened alongside semiconductors. But due to supply chain and cycle times, you can get a little bit of a pile up or a later effect. That whipsaw effect is coming in a little bit later stage.

But for the most part, I still have a high degree of confidence in the overall health of the business. There's not one piece of business here that I can note that is going to terminate early or accelerate into life. And so, it's merely a product, as you noted, of just kind of consuming channel inventories and then focusing our go-to-market sales efforts, making sure that we're not leaving any stone unturned.

So, in terms of how many quarters of inventory, I've largely believed that we're not going to spring back. I'm not quoting a V-shaped recovery where we're going to spring back to previous levels. I think those were largely overstated. All true, all good orders, but customers were extremely optimistic. They were telling the truth, they were just wrong in terms of how much product they needed. So, I kind of think in terms of a bit of a U-shaped recovery, how it's going to play out in the results. And I still think mid next year, recovery cycle for us would largely be in line of channel inventory drawdown, along with a methodical pick-up in POS, back to the moderate levels.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Can I sneak in just one last one? Do you think things get worse from the guidance that you gave of roughly call it $200 million? Do you think we've got to take another step down and do you think we are troughing at the bottom for your total business?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

I believe it's at the bottom.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Okay. Thank you. Thanks so much, Paul.

Operator: Thank you. Our next question comes from Tore Svanberg with Stifel. Please proceed with your question.

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

Q

Yes, thank you. Welcome, Paul. And Emeka, I assume this is your last call. So, thank you for all the interactions over the years. My first question is for you, Paul. So, it sounds like you're finding a bottom, but assuming that we kind of stay here for a while, at what point would you have to take some actions as far as the balance sheet is concerned? Because you're 5.3 times levered. That number is only going to go up next quarter. So, at what point – what are some of the things that you're looking for to take some more drastic actions?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

Well, the first step is to size the business according to what end-market consumption is. I don't want to get into the point where I cut too deep into R&D and limit our ability to grow in the future. So, philosophically speaking, we're kind of looking at all support functions and trying to optimize the organization. I will say from that standpoint, I do think that there was a lot of optimization to be had, so spending levels didn't need to be at the levels that they were in the combined entities in order to support the businesses that they have. So, I do think that there's some improvements there to be made, and I think that will be in fairly good shape.

I think that exercise, given the fact that the capital end markets are not – it's not really conducive to doing a divestiture, although we're not opposed to that. All cards are on the table in addressing the balance sheet. I am really resigned to making sure that we get there on our own organically and can develop a plan that drives 12 to 18 months of confidence in the model to drive those covenants. And I think that we've got that developed. Anything on top of that would be additional and an improvement in the current outlook. But I think that we're going to be in good shape at least for the next 12 to 18 months. If we get a recovery mid next year and this is what's in the model, then I think it's all improvement from there.

So, trying to take a fairly conservative look in terms of recovery expectation, I'm not banking on the market going up. I'm going to make sure that we size the business accordingly. Let's size the spend for the business that we have. And then as the market picks up, I think we'll be in a much better position because it will be upside from that standpoint.

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

Yeah. No, that's really helpful. And as my follow-up, and Emeka, on gross margin, I think the mix and sort of the fixed cost absorption makes sense, but at what level would the semiconductor gross margin start to improve a little bit more materially? Because you talked about some fixed cost absorption that at current levels you're not really able to overcome. So, what does the semiconductor business have to be in order to see more step function improvements in gross margin, because obviously the mix overall is moving in the right direction, right. But I'm just trying to understand the fixed cost absorption part of it.

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

So, Tore, first of all, thank you for your kind words. I really enjoyed working with both you and all the sell side analysts all over through the years. And hopefully our paths are going to cross somewhere else in the future. With regards to your question, I think, we would expect that, you know, to see the gross margin for the semiconductor business as we see maybe a change in some of the mix, an increase in the 10-gig PON, which is pretty high gross margins for us, seeing some recoveries in the LoRa business from the current levels. The LoRa business is suffering a little bit from high levels of inventory in the channel at this point. So we continue to see a mix of the ITA, industrial and automotive revenues for our Advanced Protection Systems. So, it's a combination of the mix of revenues in addition to higher levels of revenues for the semiconductor business. But I think, like Paul said, we are seeing definitely very good signs that the semiconductor business looks like it is poised to start going back up. So I would expect that as we go forward to start seeing some higher levels of gross margin as well.

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

Got it. So it sounds like for at least the October quarter, this will be a higher sort of revenue mix in consumer, especially with some of your smartphone design wins and things like that. But then beyond that, you could start to see PON and LoRa and other contributions?

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

Yes, exactly. I think you've got that right. And then, just with overall higher level stuff, revenue is actually driving the need for more inventory deals and stuff now, with that driving absorptions higher, and consequently as a result, the gross margins will start to pick up again.

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

Q

That's very helpful. Thank you again.

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

Scott W. Searle
Analyst, ROTH MKM

Q

Hey, good afternoon. Thanks for taking my questions. Paul, congrats on your first quarter, and nice job on the costs front. And Emeka, want to wish you all the best in your future endeavors. It's always been a pleasure working with you.

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

A

Thank you.

Scott W. Searle
Analyst, ROTH MKM

Q

Maybe to just dive in on the compliance front quickly, Paul and Emeka, you've done a lot on the costs side of the equation. We're a step down on the top line. Can you get back into compliance without a major recovery on the top line? Are there some other – it sounds like there's some other additional OpEx levers to pull and/or an ability to get some flexibility on the debt covenant? So, I'd kind of like to understand the thought process and the strategy beyond the initial quarter as we get into fiscal 2025?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

So I think the answer to that, Scott, is yes, for the next 12 to 18 months. And obviously, as that leverage ratio cap continues to step down, we'll need some recovery in the business beyond a year and a half or so into FY 2026. But the way I kind of look at it, as we took immediate actions for compliance for the covenants, buying ourselves some buffer in that regard, and then we need to continue to optimize cash generation in order to service the debt and then it becomes about principal pay-down. So this is really kind of a two-year haul. But in the short term, I don't see an issue with covenant compliance. I think we've got enough tools in tool bag to make sure that that continues to happen. We do need some recovery if we're going to hold on to this debt over the long-term and continue to service it and pay it down in principle through its term. But I think longer out, with the market recovery, we've got a little bit more options under our belt in terms of divestiture and the like and perhaps refinancing as well. It's going to be – this is going to be a bit more of a longer story. But in the short term, I think we've secured ourselves 12 to 18 months.

Scott W. Searle
Analyst, ROTH MKM

Q

Perfect. Very helpful. And if I could, I guess, kind of a multiple question following up on some earlier questions. From a revenue standpoint, a couple of the product lines that are seeing some headwinds, routers were down in the current quarter, modules are looking to take that step down and normalize from an inventory standpoint. I'm wondering on both fronts there. When do you see routers starting to recover? Are you seeing that supply-demand balance come back in? And then with modules, it sounds like you've got some other potential upside opportunities with Chinese OEMs not being welcome in the US and starting to see that in your order book now. So I'm kind of wondering what you're factoring in on that front.

And lastly, I think LoRa took a big step-down in the quarter. I'm wondering how long you see it at these levels before starting to recover. And then kind of putting them all together, what is the normalized level of sales that we should be thinking about 12 months from now? The combined company, if you go back 12 months ago, was around $400 million, obviously below that, obviously not a normalized environment. But what's kind of the number that we should be thinking about as the world starts to recover? Thanks.

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

So, Scott, I just have to ask a clarification question. So, were you saying routers, modules and LoRa together, those revenue levels or you're talking about the whole?

Scott W. Searle
Analyst, ROTH MKM

Q

The whole, the whole.

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

Okay. All right. So, I guess I don't have an answer for you on the whole quite yet, but I would say if I looked at demand and try to anticipate a moderate recovery, let's say, back to normal levels, I can kind of – it's pretty easy to go look over the COVID cycles, see the rush of demand and then try to draw a line through that. I think we've got some businesses that have historically grown at specific CAGRs over the last decade, so it's pretty easy to draw a line through those and say this is what it should be, independent of cycles. But I'd say we're still probably north of $1 billion. I'm attempting to put a number on it, but I'm going to admit that I haven't exhaustively looked at every single product line, but that's kind of where I would couch it for the time being on a combined basis.

In terms of routers, when does it recover? I think that this is temporary. Routers did not see that big of a blip, big of a ramp-up during the COVID cycle. There was a little bit of increased demand during the frothy buying cycle, but not extreme, not like we saw with modules. Modules is a little bit more problematic, because you had some 3G cut-overs and you had a bit of a panic that ensued in terms of modules. And so, there was a lot of double ordering out there and that's why we have a bit more of an inventory pile up.

So, modules is going to take us a little bit longer to work through. Having said that, I still like the fact that we've got a couple hundred million – let's say over a couple of hundred million pipeline increase this quarter due to just the legislative discussions that are going on in terms of who goes on the entity exclusion list. So to me, that's a nice opportunity. It really does equal market share gain and it could result in a significant drawdown of inventory in North America and EMEA as we gain market share.

So, that's kind of an optimistic view of the world. We're going to attempt to go out there and capture those sockets as best we can. And then I think routers, in terms of those fire safety applications, we've rolled out a couple of new platforms, new products. The uptake is pretty good. But there was a lot of buying by the channel during last year and up until the close of the acquisition. So I'd say that you're going to see a slow drawdown, although POS never really had a huge significant uptick and it's not really falling off nearly as quickly as the rest.

I think I covered all your questions. There was a lot in there, but hopefully, I got it.

Scott W. Searle
Analyst, ROTH MKM

Q

Great. Thank you.

Operator: Thank you. Our next question comes from Christopher Rolland with Susquehanna. Please proceed with your question.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

Hey, guys. Thanks for the question. Thanks, Emeka, for all the conversations over the years, and welcome, Paul. So, I guess...

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

Thank you, sir.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

Great. I guess, maybe following on, on kind of Quinn and Harsh's line of questioning here, in terms of the Sierra business, would you kind of put it in the combined $85 million range for next quarter? And I did notice there was some 3Q seasonality for that business traditionally before you guys owned it. I was wondering if that was coming into play here and that could help us into the January quarter for you guys? But beyond that, Signal Integrity and Protection and Sensing, we should think about both of those being up in October as well? Thank you.

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah, I think that's correct. When you say the Sierra business, we kind of, we're breaking them out in terms of connectivity. I just want to be really clear, connectivity is still pretty strong. That's a $100 million business that just clips along, and we'll slowly continue to gain market share. Good gross margin business as well, that came with the Sierra Wireless acquisition. But that connectivity business is pretty solid, independent of the hardware revenue that has fallen off.

The $85 million might be a little bit light, but it'll see a pullback. And then, I would expect routers to kind of rebound going forward. And then modules, depending on how well we do with the current opportunity in front of us, we can maybe see a little bit of upside to that over the next couple of quarters as things get quelled in. Typically there is a certification cycle that's associated with the designing in an embedded module. So, there is an activity or a time associated with that, but it shouldn't go too terribly wrong. I typically would handicap it around 60 to 90 days or so.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP
Q

Excellent. And Paul, when do you think we could get a new long-term model for the company overall? And what would be kind of a platform for doing that? Would you do that on a quarterly call? Would you put an Analyst Day together? And yeah, the timeframe on any update would be great as well?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.
A

Yeah, that's a great question. Certainly it would be very reasonable to have that in the 12 month timeframe and perhaps before. But I think we would target an Analyst Day 12 to 18 months out, and just kind of give a broad overview of an invigorated strategy, if not new strategy at that point. And then we'd lay out the long-term targets at that point as well.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP
Q

Thank you. And maybe just one last one. You guys typically give turns needed in the guide to make the guide. That would be great. And then lastly, would we ever expect any LoRa metrics again, or is that a thing of the past?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.
A

The turns metric?

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

I think that was about 50% for the quarter.

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.
A

Yeah. The turns needed in the quarter is just over 50%. I'll be honest, I'm not a huge fan of giving turns because it's not indicative of very quickly ramping revenue. And so, it can cause you to draw some misconceptions or wrong conclusions about the directionality of the business. But at this point, we're approximately 50% turned.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP
Q

Great. And LoRa metrics?

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

So, Chris, the 50% was at the beginning of the quarter, not now.

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.
A

Not at this – not – yeah, sorry, at the beginning of the quarter.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

Yeah. Understood. And LoRa?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

I'm sorry, what was your question on LoRa?

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

You used to give a ton of LoRa metrics and I think that stopped since the combination with Sierra. You used to give LoRa-related revenue, revenue guidance, operators, gateways, pipeline leads, a ton of information. Is that ever going to come back?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

So I don't anticipate it coming back by itself. I think I'm happy to give you that LoRa is approximately a $100 million business every year. We're going to be shifting the focus to more of an end-connected node focus from. And then also what pieces are necessary in order to enable that use and rollout of private networks. I think adoption of LoRa at the last mile of IoT edge, some people don't like the label last mile, but let's call it the fringe. It definitely has a value proposition there. It definitely makes sense. The totality of what has been called LoRa, inclusive in that has been infrastructure, it's been helium, it's been a number of things that at this point I just don't believe are viable. And it's not something that I want to tout. So, if you could give me a couple of quarters to better define what that LoRa rollout strategy is going to be or that wireless strategy is going to be, we'll be happy to talk to it in future quarters.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

Thanks so much, Paul. Good luck and really appreciate you taking the helm here.

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

Thank you, sir.

Operator: Thank you. Our next question comes from Cody Acree with The Benchmark Company. Please proceed with your question.

Cody Acree
Analyst, The Benchmark Co. LLC

Q

Thanks, Paul, welcome, and, Emeka, thank you for all the help over the years, it's been very much appreciated. Paul, if you could just take a step back at with the Sierra Wireless acquisition and can you just give us your high-level view of the strategic fit of the companies as you see them today?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

Yes. Thank you Cody. I'm smiling because you asked a difficult question to answer. But I'll give it my best. So, at this point, I will say the investment thesis for the acquisition still holds true today. If we look at it and we say, okay, we have a unique radio technology in LoRa. And I would further refine that to say a sub-gigahertz, low-power, low-bandwidth, far-reaching protocol, where can that best be used? And how do we create a platform or an ecosystem that makes it very easy to adopt and roll out? That is the operative question.

And so, if you look at what would be required in that implementation, that ease of use implementation, you would obviously need LoRa chips on connected endpoints, which we do have and sell today. You would need configuration software. You would need device management system software. You would need traffic routing software that would sit on a gateway or a router through some other backhaul, cellular or otherwise. So, from that standpoint, you can connect those dots. You would also need a cloud platform to enable that configuration. You'd need a Snap or Kubernetes on a router, a gateway sitting on the edge, and then that would feed into a cloud. And then that would allow you to provide API hooks into customer software or provide individual insights for those connected devices on that edge. So, all those components exist in the acquisition. Now, the question would naturally be, is the acquisition necessary to fulfill that vision? And the answer to that is no, you could go off and develop it on your own, but it certainly helps to have all these pieces together.

So now that we have those pieces, how do we best pull those pieces together for an ease of use play in IoT? And that is something that we're going to have to think really hard about. It's not enough to have the individual pieces, it's the orchestration or the coordination between those pieces and the end market in order to make that a reality. So we're going to be spending some time on that vision, reimagine what it takes to get there, independent of whether or not we need assets – strategic assets or not, and we'll work on an execution plan. So I've got a few ideas on that. We've got some of our bright minds working on that as well, and we'll be rolling that out over the next couple of quarters.

Cody Acree
Analyst, The Benchmark Co. LLC

Q

Do you think, Paul, that there is a strategic application fit with your customer base that it's obvious that, that may have not been with the initial application?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

I do. It really kind of comes down to use case. We say application, but I'd say it comes down to use case. We have one particular customer. There's two RFPs out there that are requesting the use of LoRa. And they like the aspects of LoRa. It's in a bit of a more complicated program in terms of installation and rollout that would include both cellular modules and routers and software. And so, there is a strategic application or strategic fit with certain customer use cases.

And I can give you one example. We've got a customer that was doing an installation for a field of tanks, and they want to be able to monitor each tank. Rather than putting a cellular router at each tank connected to devices that are pulling in telemetry pressure, temperature, capacity, and the depths of whatever those foods are, they would rather have one cellular router and that to have, be connected to a bunch of sensors across the field that would represent the entire tank field. And it would be a much lower cost of installation, lower CapEx requirement. And it would make that installation fairly easy in terms of configuring devices that are pretty belaborous right now.

So if you look at it, yes, it does fit really nicely with where the market wants to go. But there are some pieces missing in terms of making it a reality. And that's what we have to focus on.

Cody Acree
Analyst, The Benchmark Co. LLC

Q

Okay. Thank you, Paul. Thanks for the help.

Operator: Thank you. Our next question comes from Harsh Kumar with Piper Sandler. Please proceed with your question.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Yeah. Hey, Paul. The example you just described, actually, it fits perfectly for smart meters. And I was curious if you've received any interest from any kind of utility companies for similar deployments, because I think it would simplify smart meter installations in small cities extremely well?

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

A

It would also lower the cost and maintenance of the smart meters. So if you just look at power consumption, LPWA as opposed to LoRa, if you just look at bandwidth requirements and you could argue that bandwidth costs are fairly low on LPWA, but they're essentially free when you go to LoRa. So I do think – I'm saying private networks, but that doesn't mean that it can't be a rather large private network that's rolled out by a utility or a municipality as well. So I think LoRa is a perfect fit in those areas. And I guess from our standpoint, we would be able to support both applications. There might be some applications where they need an LPWA solution. We're happy to accommodate those, but we can also accommodate a LoRa-based solution as well.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Understood. Thank you so much.

Operator: Thank you. There are no further questions at this time. I would like to turn the floor back over to Paul Pickle for closing comments.

Paul H. Pickle
President, Chief Executive Officer & Director, Semtech Corp.

All right. Well, thank you guys for joining us today. Thank you for taking it easy on me for my first time around and look forward to talking to you in the future. Thank you very much.

Operator: Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.