Orient Capital - 05/31/2018 - Dialog Semiconductor

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Female Speaker:
Hello, and welcome to the Dialog Semiconductor conference call. My name is Tania [spelled phonetically], and I will be your coordinator for today's event. For the duration of the call you will be on listen-only. However, you will have the opportunity to ask questions at the end of the conference. You can do this by pressing star, one on your keypad to register your question at any time. If at any point you require assistance, please press star, zero on your telephone keypad, and you will be connected to an operator. I'm now handing you over to your host, Jose Cano, to begin today's conference. Thank you.

Jose Cano:
Thank you, Tania. Good afternoon, and thanks [unintelligible] for joining us today at such short notice. Our call, as usual, is being hosted by Dr. Jalal Bagherli, our CEO, and Wissam Jabre, our CFO. Before I hand you over to Jalal, I must remind that today's briefing and some of the answers to your questions may contain forward-looking statements. These statements reflect management's current views, and there are risks associated with them.

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You can find a full explanation of these risks on today's press release, which is also available on the financial news section of the Dialog website. With that said, let me hand over to Jalal to talk through today's ad hoc segment.

Jalal Bagherli:
Thank you, Jose, and good afternoon to everyone. Thank you for joining at really short notice. We first spoke about the evolution of our upper [spelled phonetically] relationship in December 2017. Then, since that time, we stated the company had no reason to believe that its current expectation of business with Apple would be impacted in 2018. We now have confirmation from Apple that the main PMIC in the 2018 phone [unintelligible] will be [unintelligible]. Orders [spelled phonetically] for that particular chip have been cut by approximately 30 percent. Clearly, this is a very recent development, and it is too early to discuss implications for the '19 design cycle. Orders for all other chips designed for the iPhone platforms and the remaining Apple platforms remain unchanged.

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If you remember, in 2018 we would be sending around 25 different custom PMICs across the Apple devices. Our teams remain engaged in multiple design opportunities for '19 and 2020, and Apple will remain an important customer to us. We currently estimate that reduction in orders to have an impact to our revenue of approximately $60 million to $90 million this year. This represents approximately 5 percent of the current financial year 2018 consensus revenue number of $1,525,000,000. Before we opened the Q&A session, I would like to remind you that the company remains well positioned to capitalize on the growth opportunities in mobile and IOT. This is based on our technical excellence in power management and power-efficient technologies and a differentiated product portfolio. Dialog also has a strong balance sheet, and we aim to expand our product portfolio through a combination of internal development programs, strategic partnerships, and investment and acquisitions.

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The company remains focused on the expansion of our non-mobile system business and pursuing power management opportunities with other customers. So, with those remarks and context, I would like to -- that I wanted to give on today's statement. I'm sure you have questions, so, operator, please open up to the Q&A session, and we will take as many of those as we can. Thank you.

Female Speaker:
If you would like to ask a question, please press star, one on your telephone keypad. If you change your mind and want to withdraw your question, please press star, two. Please ensure your line remains unmuted locally. The first question from the line of Andrew Gardiner from Barclays. Andrew, you're unmuted. Please go ahead.

Male Speaker:
Good afternoon, guys. Thanks for taking the question.

00:04:00

Two, if I could. First, Jalal, you mentioned the sort of cut for the main PMIC order by about 30 percent in terms of volume terms. Can you sort of clarify, perhaps? Is this a cut, you know, that you are seeing for the new design for 2018, or is it sort of in terms of volume? Are you sort of continuing with perhaps the prior generation of PMICs for the prior generation of application processors from 2017, and you're just -- you're not getting as much of this year's evolution, or is it sort of literally sort of this year, sort of the later generation that is going to be [unintelligible]?

Jalal Bagherli:
Okay. So, I think what we're talking is the upcoming new phones that are coming in, normally launched in September. We start to ship in Q3 and then ramp through back end of Q3 into Q4.

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So, we're talking about one main PMIC which goes into those phones. As you recall, we have two chips in this cycle: one main PMIC and one sub-PMIC. And we have a bunch of other chips

into new other products, as well as -- as you call it, prior generations -- 2017 -- the current running stuff -- none of those are affected. We're talking about the main PMIC which has come in the upcoming cycle of phone launches.

Male Speaker:
Okay.

Jalal Bagherli:
I hope that's clear.

Male Speaker:
Yeah, okay. Thank you. and then, in terms of sort of forecasting or planning of production, you've already had to commit to capacity requirements with TSMC [spelled phonetically] for the second half [unintelligible]. Given this significant change in orders from Apple, how does -- you know, well, how does that affect you in terms of planning with TSMC, or perhaps financially with TSMC?

00:06:01

You know, what is the impact there?

Jalal Bagherli:
So, you know, we run a pipeline of, you know, products in terms of manufacturing. So, we have, you know, very first start with them, we have [unintelligible], halfway through, [unintelligible] at the end, and then package, and then finally [unintelligible], finally shipped. So, we have -- we typically stage material at different stages of the pipe. So, we don't add value, necessarily, until we have short-term orders to fulfill. So, we have a pipeline. The good thing about this is, as we know -- and from history, and you know, common knowledge -- these phones, when they get launched, they run for a good two, three years. So, we don't have -- I believe a near-zero risk of any obsolescence, in terms of inventory, because we haven't built that much. But anything we don't ship that we were planning to ship in Q4 can be shipped in Q1.

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The way to think about it is, from what we understand, in terms of the cycle of these products, that there are usually three individual phones or models that come out. And you know, only one of them is using a different chip. And we are qualified for all three, by the way. So, we know that at least two of the models that continue into next year will continue to consume our parts.

There is also a chance that the second source chip may not, you know, produce enough in volume or in time, in which case we will be able to ship to the third one as well. But we are -- but the numbers we are giving you is for the forecast we have from the customer, which indicates, as I said, a 30 percent reduction over a volume that would have been sufficient to do 100 percent of the phones.

Male Speaker:

Okay. So, what you're suggesting there is that the main application process is, you know, sort of similar or the same across those three models.

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And therefore, in theory, you're supplying two, but you might supply a portion of the third.

Jalal Bagherli:
Yes.

Male Speaker:
Okay. Understood. Thank you.

Jalal Bagherli:
You're welcome.

Female Speaker:
The next question comes from the line of Robin Brass [spelled phonetically] from H&A [spelled phonetically]. Robin, please go ahead.

Male Speaker:
Yes. I -- this is Robert from Hauck & Aufhauser. For the -- two questions. The first one is, how come you get the certification so late already, you know, close to September release, I would say? Is there any explanation from Apple?

And secondly, what does it also mean for your pricing? Did they also look for any discount prices going forward, or do you expect prices to remain stable from the chips you will deliver -- you will be delivering in the future?

Jalal Bagherli:
Okay. Thank you. So, the way it works is that -- not just us, everybody in the chain -- in the industry, with all other customers, not just this customer -- we get a rolling forecast for roughly about anywhere between 3 to 6 months ahead.

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So, and that forecast gets updated by customer regularly. In this case, it gets updated almost weekly. And normal weekly fluctuations are relatively small, because they check the supply chain. They check inventory, and the fell-through [spelled phonetically], and adjust the order. In this case, you know, it is quite possible that, you know, for example, if a phone is popular, that it could suddenly increase by 10 or 15 percent. When it's not, they could reduce. So, it's not outside the norm. It's only six to eight weeks that that forecast [inaudible] an order, if you'd like. The rest, you build to a visibility of a forecast, and you adjust. As I explained earlier, we have a pipeline in our manufacturing. So, you slow down, for example, materials that you have at the beginning of the line if your orders are going down, and you pull through faster if you see the orders are increasing.

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So, the very dynamic -- saying that the supply chain division of our company manages every week. So, it's not an unusual thing for orders to fluctuate, so that's quite possible. And September is a long time away in this industry, and we can manage the supply chain accordingly. I think the -- in terms of the question on pricing, there is no reason for us to move the pricing at this point.

Male Speaker:
Okay, thank you.

Female Speaker:
The next question comes from the line of Robert Sanders, Deutschebank. Robert, please go ahead.

Male Speaker:
Yeah, hi, good afternoon. So, on just -- Jalal, a question for you on this one model that is dual sourcing. So, you know, is it likely that the performance of the PMIC being potentially different is a problem, or is it likely that the chip will be so similar that Apple doesn't see a risk?

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Because I would have expected that they would have just single-sourced with one model, so I'm just trying to understand what explains this kind of tiptoeing approach by Apple if they are indeed ready with an alternative chip to you. And I have a follow-up. Thanks.

Jalal Bagherli:
Okay. I don't have that level of visibility, but I mean, if you think about the fact of what I said earlier, which is we are qualified on all three phones, it means there is no performance-related issue. Otherwise, we wouldn't be qualified from the beginning on the third model. So, I think, you know, it may be a statement of intent to just, you know, start reducing risk on [unintelligible] and have an alternative source. But you know, what we get is a forecast on what we should ship over the next, you know, six months or so. We don't get any, if you like, commentary with the forecast. It's just a series of numbers with model numbers and what we have to produce.

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So, that's what I read into that, because we are fully [unintelligible], and you know -- and the volume remains what mentioned [spelled phonetically] makes sense from [unintelligible] asthmatic [spelled phonetically] calculation of three models. If you remove one model, then you get 30 percent, roughly, down. You know, give or take a few percentage [spelled phonetically], it's roughly a third each, so that makes sense from that point of view.

Male Speaker:
And just following up on the previous question, I mean, when we discussed this in the past, Jalal,

you talked about if the -- if Apple was to give you 50 percent allocation you would immediately say, "Well, I've -- I increase the price, because I've got fixed development costs that I need to amortize over." But now that Apple have kind of stolen a march here, is there not a threat that you end up having to cut the price because you're in a situation now where, you know, the threat of losses is hanging over the company as you look into next year?

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Jalal Bagherli:
No, I think -- I was answering a different question, Robert, to be fair. You're saying if they were going forward. [unintelligible] was answering that question. If there was a new development coming which was, you know, geo-sourced [spelled phonetically] from the beginning, I would -- with the intention of geo-sourcing on the table, what would you do? And I said, you know, we have to look at things like price increases, et cetera, to cover the cost. This is a product which is already developed and is running, and we're already manufacturing it. And I don't think there is any -- I don't have any concerns in terms of the pressure on pricing on this. I understand what you're saying, but the whole point of this is to have two sources, I assume, with the introduction of a second source, and it takes volume in [unintelligible] terms and test houses [spelled phonetically] and packaging and everything else. So, it's not that arbitrary that they can say, "Okay, well, you know, let's just do 100 percent; take our ball away [spelled phonetically]," not on a running product.

00:14:07

That may be a tactic that can be played on a future product, but not on a running product, I believe.

Male Speaker:
Okay. Thank you very much.

Female Speaker:
The next question comes from the line of Kwan Lee from Credit Suisse. Please go ahead.

Male Speaker:
Hi, thank you for taking my question. So, you said that Apple is dual-sourcing. Would you know if the second source is basically then doing it internally, or you don't have any visibility on that?

Jalal Bagherli:
I have no visibility of what other source it might be, but, you know, I think the news flow [spelled phonetically] has been out there, and we've debated this, I think, before based on the questions that people ask in terms of building teams internally in Germany as well as in the U.S. So, I have to assume the highest possibility is that it's an internal source, but they have not provided me with that confirmation one way or the other.

00:15:02

Male Speaker:
And my second question would be your estimation of visibility into 2019 revenues, then. As you know, you're [unintelligible] on 2018, already. What's your --

Jalal Bagherli:
Right.

Male Speaker:
-- view on the next year's revenue?

Jalal Bagherli:
Again, it's very similar to what we discussed at the end of the quarterly results from -- if you move this one product to the side, everything has remained as we discussed. I don't have any new information on those. On this particular device, if you assume the, let's say, three models -- this is our working assumption -- and one of them is -- has a qualified second source [spelled phonetically], that this ratio would run into next year. So, similar impact to what we've just explained. Roughly, we ship similar, if not slightly more -- numbers -- in terms of a phone which is released this year, into the balance of next year.. For the full next year, it will be roughly equivalent to what we ship in the launch year.

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So, if you think about that, then a similar type of -- [unintelligible], in terms of revenue reduction, would apply to the next year's phones that use these chips. But in terms of other new things that they may launch in the following year, my commentary remains the same, which is, you know, we've developed a chip together, in terms of collaboration, validation, and we are waiting for that chip to come back from Waver Fabs [spelled phonetically] for it to be validated on the boards, by the customer. We have high confidence that it will be used again. If you assume, you know, similarly, next year would be same number of models. It would be between one through three sockets [spelled phonetically]. I assume, next year, if they applied the same method to the main PMIC, you know, one or two sockets could go their way. And so, my expectation is anywhere between one to two sockets will be Dialog.

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But I don't have any actual visibility. I'm just theoretizing based on what I've seen. We will be able to get the first forecast, I think, in -- probably in Q4. But you know, as you can see, the detailed confirmation of model-by-model can be later in 2019. So, that would be my working assumption.

Male Speaker:
Got it. Thank you.

Female Speaker:

The next question comes from the line of David O'Connor from ExEn [phonetic]. David, please go ahead.

Male Speaker:
Great. Thanks for taking my question. Sorry for the background noise. Just, Jalal, going back to kind of how we should model this going forward, I mean, you've [unintelligible] one socket are 30 percent of the business, next year it could be 60, the year after that, 90. I mean, what kind of confidence level that you can maintain in some of this business, going forward, on the main PMIC?

00:18:03

Or should we assume that this business goes to zero over time? And then I have a follow-up. Thanks.

Jalal Bagherli:
You know, I don't -- as I said, I've shared with you the visibility I have on 2019. I mean, even that product is not completed by then, in terms of overall system. But we've designed a chip that has been together, in collaboration. And that's why I have high confidence that it would be used. But beyond that, I can't tell you anything, just because I don't know. You know, I think I've been probably more open than where I can be. But we haven't got -- it's too early to have engagement on 2020, to talk about that.

All other products we have remains very strongly supported by both companies, reviewed, applied, and everything else. And you know, as I've mentioned earlier, I think, in the last call, we continue to get not only requests for quotation and information on power management, but also non-power management products.

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And we're getting significant visibility of those, and we started to quote for those as well. And most of those tend to be for 2020. And so, that's all I can share with you. But in terms of phones for 2020, I'm not even sure it's on a drawing board, so -- let alone me designing power management for it. But, you know, clearly, the central PMIC -- we now see a 30 percent reduction this year. My assumption would be there would be a bigger share loss for this particular chip or this particular replacement chip next year. But beyond that, I can't tell you.

Male Speaker:
Okay, okay. Understood. And maybe, then, on the OPIC side of things -- so, given the significant reduction here, how -- I'm not sure if Wissam is on the call, how sure is --

Wissam Jabre:
Yeah.

00:20:00

Male Speaker:
-- how are you planning on op-ex [spelled phonetically] going forward to account for this, given that previously I remember you saying that the majority portion of your R&D is focused towards Apple?

Wissam Jabre:
Yes, so, good question. Given that this is a late development, obviously we're still working through the plans for the rest of the year, but we've already taken action -- discretionary expenses -- to mitigate the impact to the extent we can for this year. It's a bit too early to quantify, I would say, 2018 op-ex. It is important, though, to note we still have a lot of development effort for 2019 products that continues along the usual timelines. And so, you know, we do have our teams in mobile systems that are working hard to bring additional design wins. And so, as we think through the op-ex, we want to make sure that we put the brakes on discretionary items, things that we can impact without really affecting the future cash flow generation as well as revenue for the company.

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But obviously I expect us to continue to be focused on generating cash like we've always been, and so we'll take whatever action needed to ensure that.

Male Speaker:
Thank you, guys.

Female Speaker:
We currently have no further questions in the queue. Please be reminded, if you would like to ask a question, to press star, one on your keypad.

As we have no further questions in the queue, I will now hand you back over to your host -- oh, there is another question in the queue from David O'Connor [spelled phonetically] from [unintelligible]. David, please go ahead; you're unmuted.

00:22:02

Male Speaker:
Thank you. Maybe just one follow-up. So, with this new [unintelligible], any update of any new wins [spelled phonetically], Jalal, or any, you know, incremental wins from other customers that can potentially offset production volumes looking out not for 2018, but looking out further? Thanks.

Jalal Bagherli:
Yeah, 2018 -- it's hard to replace the short term, obviously, but actually, in the rest of our business we're doing unplanned or better in terms of, actually, volumes, so we will be reporting at the end of the quarter, you know, on what we've been [unintelligible] during the quarter for the rest of the year. In terms of future for 2019, we have some great prospects with major customers in Asia that we've been working on for some time. We're not at a stage where I can

announce design-in [spelled phonetically], but I think maybe by the end of the quarter we will be.

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So, there are at least two main projects that we are close to winning, but we should be able to give some updates at that time. Particular things that I guess I can mention which are Bluetooth chips, and orders are running very well, at the high end of our expectation, and gaining more circuits [spelled phonetically], and equally, our Silego products, the configurable power management products -- we're making quite a lot of inroads in a lot of new customers. And again, we will take opportunities at the earnings release, or call related to the earnings release, to detail out quite a few of those, because we think they're quite significant wins.

Male Speaker:
That's helpful. Thanks, Jalal.

Jalal Bagherli:
Okay.

00:24:02

Female Speaker:
There are no further questions in the queue, so I will now hand you back over to your host, Jose.

Jose Cano:
Thank you. That concludes our call. If you have any other questions, please reach out to me or a member of the FTI [spelled phonetically] team. That's all. You may disconnect. Thank you.

Jalal Bagherli:
Thank you.

Female Speaker:
Thank you for joining today's call. You may now disconnect your handsets. Hosts, please stay connected.

[end of transcript]