

MediaTek 2Q22 Earnings Call

Friday, July 29, 2022, 3:00pm Taiwan Time

PREPARED REMARKS

Jessie Wang, IR Deputy Director

Good afternoon, everyone. Joining us today are Dr. Rick Tsai, MediaTek CEO and Mr. David Ku, MediaTek CFO. Mr. Ku will report our second quarter results and then Dr. Tsai will provide our prepared remarks. After that, we will open for Q&A.

As a reminder: Today's presentation will provide forward looking statements based on our current expectations. The statements are subject to various risks and factors which may cause actual results to be materially different from the statements. The presentation materials supplement Non-TIFRS financial measures. Earnings distribution will be made in accordance with financial statements based on TIFRS. For details, please refer to the safe harbor statement in our presentation slides.

In addition, all contents provided in this teleconference are for your reference only, not intended for investment advice. Neither MediaTek nor any of independent providers is responsible for any actions taken in reliance on contents provided in today's call.

Now I would like to turn the call to our CFO, Mr. David Ku, for the second quarter financial results.

David Ku, Chief Financial Officer

Good afternoon, everyone. Now let's start with the 2022 second quarter financial results. The currency here is in NT dollar. Revenue for the quarter was NT\$155.7 billion dollars, up 9.1% sequentially, and up 23.9% year-over-year.

Gross margin for the quarter was 49.3%, down 1 percentage points sequentially, and up 3.1 percentage points year-over-year.

Operating expenses for the quarter were NT\$37.6 billion dollars, compared with NT\$35.3 billion dollars in the previous quarter and NT\$29.2 billion dollars in the same period last year.

Operating income for the quarter was NT\$39.2 billion dollars, up 7.4% sequentially and up 35.9% year over year. Non-TIFRS operating income for the quarter was NT\$40.5 billion dollars.

Operating margin for the quarter was 25.2%, decreased 0.4 percentage points from the previous quarter and increased 2.3 percentage points from the year-ago quarter. Non-TIFRS operating margin for the quarter was 26%.

Net income for the quarter was NT\$35.6 billion, up 6.6% sequentially and up 29.1% year-over-year. Non-TIFRS net income for the quarter was NT\$36.8 billion dollars.

Net profit margin for the quarter was 22.9%, decreased 0.5 percentage points from the previous quarter and increased 0.9 percentage points from the year-ago quarter. Non-TIFRS net profit margin for the quarter was 23.6%.

EPS for the quarter was NT\$22.39 dollars, up from NT\$21.02 dollars in the previous quarter and up from NT\$17.44 dollars in the same quarter last year. Non-TIFRS EPS for the quarter was NT\$23.1 dollars.

A reconciliation table for our TIFRS and Non-TIFRS financial measures is attached in our press release for your information.

That concludes my comments. Thank you.

Jessie Wang, IR Deputy Director

Thank you, David. And now I would like to turn the call to our CEO, Dr. Rick Tsai for prepared remarks.

Dr. Rick Tsai, Chief Executive Officer

Good afternoon, everyone. Second quarter was another solid quarter for MediaTek. Quarterly revenues grew 9.1% sequentially, reaching high-end of our guidance, with Mobile Phone growing the strongest driven by the ramp of our flagship and high-end solutions.

Before I give you an update of each of our three revenue groups, I'd like to make a few comments on the recent market environment.

In recent months, macro-economic challenges add uncertainties to market demand, for example, inflation negatively affects consumer sentiment leading to reductions of IC demand. Accordingly, we've already observed our customers and their distribution channels start to adjust inventory aggressively and we expect the inventory management to continue for two to three quarters. In this environment, MediaTek will manage our inventory prudently and control our costs and expenses carefully.

Over the past 25 years, we have gone through several cycles. Although each cycle was different but the semiconductor industry's relentless pursuit of better connectivity as well as high performance and low power computing remains the same. Responding to this long-lasting demand trend, MediaTek has been heavily cultivating and developing key technologies to grasp market opportunities. These investments enabled MediaTek to launch 5G, Wi-Fi 6 and Wi-Fi 7 early in the product cycle with advanced technologies.

As a result, MediaTek today is in a much stronger global position as an industry technology leader with a broad product portfolio across Mobile, Smart Edge Platform and Power IC. Among which, we've built several sizeable businesses that demonstrate steady growth with much lower volatilities even during

market downturns. For example, our leading positions in smartphones, wired and wireless connectivity, and TV are results of structural market share gains and profitability enhancement in the past few years. We believe we can maintain such market positions despite cycles. We also have businesses such as power IC and connectivity solutions which are deployed to a wide range of applications with historically more stable demand. Therefore, we believe MediaTek will be more resilient to market volatilities than previous cycles.

Moreover, we will continue to invest heavily in the key technologies despite the short-term market uncertainties. We believe these efforts will further strengthen our market position and pay dividends going forward.

Now let me move on to our three revenue groups.

In second quarter, our Mobile Phone business grew 17% year-over-year and 12% quarter-over-quarter, accounting for 54% of total revenue. The strength mainly came from the ramp of our flagship and high-end 5G products as well as very robust 4G demand.

MediaTek 5G products are highly welcomed by customers. According to market research report, during the 618 China shopping festival, 13 out of the 20 best-selling Android models are powered by MediaTek. Among which, 5 are using our flagship and high-end Dimensity 9000, 8100 and 8000 solutions. Our higher-end solutions continue to gain share. We will continue to launch next generation flagship products with our leading computing capability and optimal power efficiency to further expand our presence in the flagship market.

Considering market uncertainties, we now expect global smartphone shipment in 2022 to be 1.2 to 1.27 billion units. Global 5G shipment is expected to be around 600 million, representing a 20% year-over-year growth. Meanwhile, 4G smartphones remain attractive to budget-conscious consumers amid high inflation concerns. For MediaTek, our successful global expansions in both 4G and 5G as well as 5G flagship entry will enable us to deliver a solid growth this year.

Moving forward, we believe that 5G penetration will continue to grow from 50% this year to more than 80% in a few years. In addition, the functionality of future 5G phones will be richer than those of today. Consequently, MediaTek is well-positioned to continue to capture the benefits of 5G transition.

Now let's move on to Smart Edge Platforms, which accounted for 38% of revenue in the second quarter. This group grew 33% from last year and 7% from last quarter, driven by continuous technology upgrades of several major products including Wi-Fi 6, 5G modem, TV, and ASICs for gaming console and enterprise switch.

However, due to weaker consumer sentiment, the demand for TV and tablets has been negatively impacted. Nonetheless, demand for wired and wireless connectivity solutions, particularly, Wi-Fi 6, 5G modem and 10 GPON remains robust.

Moving forward, we have planted several seeds for our future growth. For example, MediaTek leads the industry in introducing Wi-Fi 7 solutions which enable us to address the needs of high-end market segments with revenues starting in the first quarter of 2023. We have recently expanded our footprint into enterprise 5G infrastructure ASIC. We also continue to enhance our capabilities in power efficient ARM-based processors to address a wide range of new applications. With a rich set of product portfolio well-positioned to address the market needs, we expect our Smart Edge group will be a significant growth driver for Mediatek in the coming years.

Now moving on to Power IC, which accounted for 7% of total revenue in the second quarter and grew 33% from last year and flattish quarter over quarter.

Recently we have observed a weakening demand for power IC used in smartphone and notebook. However, the power IC used for automotive and industrial applications which account for about 10% of power IC revenue remains on track. Moving forward, faster connectivity and more powerful computing require energy-efficient and reliable power IC solutions. We believe MediaTek through our broad product portfolio and superior technology solutions is well-positioned to capture the structural growth of power IC.

Now for the third quarter, given the on-going customer inventory adjustments, we expect our third quarter revenue to be in the range of NT\$ 141.7 billion dollars to NT\$ 154.2 billion dollars, representing a decline of 1% to 9% sequentially, and a growth of 8% to 18% year-over-year at a forecasted exchange rate of 29.5 NT dollars to 1 US dollar. Gross margin is forecasted at 49%, plus or minus 1.5 percentage points. Quarterly operating expense ratio to be at 26%, plus or minus 2 percentage points.

With our diversified product portfolio and industry leading positions, we believe MediaTek can manage the short-term demand headwinds well. We now expect MediaTek to deliver a high-teens percentage revenue growth with a 48% to 50% gross margin for year 2022.

Despite short-term demand volatilities for semiconductors, the mid-to-long term growth trend driven by accelerated digital transformation remains intact. MediaTek is a leader in the industry. Our investment in key technologies allows us to participate in the technology migration cycles early. We firmly believe MediaTek will continue to capture the growth opportunities brought by the enriched silicon content as well as expansion of our market globally.

This concludes my prepared comments, thank you.

[Q&A]

Q - Randy Abrams, Credit Suisse

Thank you and a good job in staying resilient given what's happening in the environment. If I could ask a follow-up just to the guidance for third quarter and full year. If you could give a view by segment for the 1% to 9% decline. And factoring the high teens growth, it looks like you're implying a decline in

fourth quarter. So if you could give that view by segment. And is it largely the anticipation of what you commented inventory for fourth quarter or any other factors dampening sales into fourth quarter?

A - Dr. Rick Tsai, CEO

Well, the short answer is yes, the inventory adjustment period, I think we said will last 2 to 3 quarters. So we are expecting customers to continue adjusting their inventories. And of course, the demand picture for the end customer or the end consumers will remain uncertain. We believe China market demand is stabilizing. We are not sure about the speed of the recovery, but we do not expect China market to continue going down -- downward. While the U.S. market uncertainty remains, I think, higher, there are many view -- different views. But I think we believe our customers remain quite cautious with such uncertainty in the next couple of quarters. Thank you.

Q - Randy Abrams, Credit Suisse

Okay. If I could follow up, the mid-teens CAGR, that was set during good macro and before war and COVID lockdowns and inflation. Could you give a view on that? And I think additionally the way you're seeing macro, I know it's a CAGR. So is it your anticipation given the slowdown next? Or we should factor may be a bit more conservative? And then you take a bit more conservative view on OpEx increase through that.

A - Dr. Rick Tsai, CEO

You mean CAGR Randy, for 2022 or?

Q - Randy Abrams, Credit Suisse

Yes. I'm thinking how you're now looking at '23. Because I think you started the year with 20% this year and then really the target each year to achieve teens growth, but just factoring the market if we should kind of bake in a more conservative view into next year. Do you -- or do you see product trends that could be enough to maintain a good bit of outgrowth.

A - Dr. Rick Tsai, CEO

Randy, I think for 2023, with the current uncertainty in a very dynamic environment, we -- I don't think we are prepared to really comment on 2023 at this moment. We are in the process of doing the planning for next year. I hope we can give you more -- give you guys more of our thinking later on. But I think you mentioned also OpEx. Yes, it is, I think, critical that we're managing our CapEx and our inventory and trade also. We have -- we do not have a hiring increase, but we have slowed down our hiring quite a bit. And we will -- we are now having a pretty strict OpEx target for next year. We are also managing our wafer start, our OSAT business very carefully so that we can at least manage our inventory for the next couple of quarters in a much more stable manner.

Q - Randy Abrams, Credit Suisse

Okay. And the last question I wanted to ask on the pricing -- the view on pricing. And it's a two-part. If you see 5G, the different price levels for the market, flagship, mainstream, mid- to high end, do you see those bands enough new features to keep those bands continue to be more stable? And then how do you see -- if you expect, given desire to bring down inventory and customers, how do you see the

pricing a bit more rebating or factor in a bit of margin erosion through the coming inventory correction?

A - Dr. Rick Tsai, CEO

I think our position has not changed from our previous statements, our remarks last quarter. We do not see pricing reduction being able to induce new demand. And we -- I think we are exercising a disciplined pricing in the company. We do not foresee a pricing reduction in any significant degree at all. Thank you.

Q - Gokul Hariharan, JPMorgan

My first question is, could you talk a little bit more on the inventory levels, especially for mobile, both for MediaTek as well as for your Android customers level? I think last time, you did talk about inventory being in the 1- to 1.5-month run rate. How elevated are inventory levels for SoC and finished product in the channel based on your evaluation? I just wanted to -- could you also give a little bit more color on how you expect this inventory cycle to work out? I think you've said probably 2 quarters or maybe 3 quarters. Just wanted to get a little bit more clarity on how you think that is likely to play out.

A – David Ku, CFO

Let me try to answer this. I think long story short. Based on our view right now, we do believe probably the whole market would take maybe 2 to 3 quarters to adjust or digest about inventory levels on the customer hand or maybe it's also including on the inventory -- on the channel side. And the last time we updated about the inventory is much stabilized out there. We don't really see it increase significantly. Actually, it's quite on the opposite side because given the overall weak demand out there, the whole supply chain, including our customer and also the inventory and aggressively adjusting the inventory level. So we do believe about the adjustment cycle maybe around 2 to 3 quarters. It will last probably around 2 to 3 quarters.

Q - Gokul Hariharan, JPMorgan

Got it. Thank you, David. Could you also talk a little bit more about the pricing trend? I think you did answer to Randy's question, but I just wanted to go a little bit more. Typically, most inventory down cycles --

A – David Ku, CFO

You mean pricing? Again, just like the CEO, Rick, talked about earlier, we do believe the weaker demand right now is mainly caused by macro economy situation. And any aggressive pricing movement, probably is not going to induce or introduce any structural long-lasting demand, maybe just a short-term demand, but not going to change the macroeconomics for the long term. So we will not actually address our pricing aggressively. I think that's our policy and strategy right now.

Q - Bruce Lu, Goldman Sachs

I want to follow up the question about the compound growth for the next few years. Rick, you just talked about that because of macro concerns. So we are no longer to maintain our like next 2 to 3 years 10% to 15% revenue CAGR? Or you need to revisit and come out with an updated number?

A - Dr. Rick Tsai, CEO

Yes, this -- in light of the current slowdown, I don't think there's any question about that for anybody in the industry. We certainly will have to relook at, and we -- our future several years of the CAGR. Again, as I said earlier, we are now working on 2023. And from that point on, we will have a much better idea for our future CAGR. The important thing though is the major growth driving business investment and opportunities continue aggressively. We've been putting resources. We are actually reallocating resources from the more kind of -- shall we say mature business segments into the future growth segments, especially for the next 3 to 5 years. And we certainly expect and look forward to having a strong growth in that period of time. Thank you.

Q - Bruce Lu, Goldman Sachs

Yes. But if you've just mentioned that the inventory correction most likely in 2 to 3 quarters, it just started from now, then the inventory correction should be finished by the end of this year or first quarter next year. That should not impact your multi-year growth trend too much, right?

A - David Ku, CFO

Yes. Bruce, actually, like Rick said, right now there's a lot of moving targets and moving information out there. When we were talking about when to review it, it doesn't mean we're going to revise it substantially. I think that's not we're talking about. We're just talking about -- it's actually not a prudent way to give any detailed number right now given the market situation, okay? But I agree with you, just like what we talked about earlier, for the long-term growth opportunity, it's actually not changed because the whole digital transformation still continue. We don't really think the short-term cycle adjustment will change the directions of the long-term growth themes.

Q - Bruce Lu, Goldman Sachs

Okay, thank you. So the next question would be that the inventory cycle. I mean you just mentioned that you do expect it to be finished within 2 to 3 quarters. But most of the investors which we talk to, I mean, the confidence level for that is actually fairly low. So can you help us understand why do you believe this is going to be finishing within 2, 3 quarters. It won't last more than 3 quarters or longer. Or what is the possibility to get an even shorter inventory cycle?

A - Dr. Rick Tsai, CEO

We -- again, 2 to 3 quarters, what we are looking at, I think different customers, depending on their own situation, will have their view. We follow -- we actually -- we look into each of our major customers' inventory level very carefully each month. And that's how we come up with our estimates. But the -- whether -- but you have to also realize the macro economy picture certainly is the biggest factor. We believe inventory level will go down in 2 to 3 quarters. We also believe the China market will gradually recover. The U.S. market is something that we do not have really a good picture right now. So that's why we need to move month to month, quarter to quarter. Thank you.

Q - Gokul Hariharan, JPMorgan

I'll just ask one question. So MediaTek announced the foundry deal within the long 50 nanometer. Could you talk a little bit about the contour of this deal? Is this a regular foundry deal that you're

expanding, the Mr. Foundry? Or are there any more product collaborations also that are planned with Intel on WiFi and connectivity given that you already have a 5G modem relationship with them?

A – David Ku, CFO

Okay. I think we kind of made that announcement already, but let me just take this opportunity to explain in detail again. The major reason or major rationale is we – MediaTek's always been multiples foundries strategy on the mature technology. So for this time around, I think we are using Intel 16, which is this roughly 22 nanometer on the T process -- like process. For that process, we do believe globally right now is still kind of in shortage. So it's actually one of our policy or strategy, trying to find more vendors and more capacity for 2 to 3 years down the road.

In terms of the product we need to tape out there, I think most likely it will be either digital TV or mature WiFi analog die. But with all that, I guess, on the leading edge node, we still work very closely as a very close partner with TSMC. I understand out there, there's a lot of speculation or estimation of guesstimation talking about that deal link with some kind of business deal. I just want to reemphasize actually, that's mainly from a capacity planning perspective.

Q - Laura Chen, Citi

Thank you for taking my question and we appreciate you sharing your recent market dynamics. Just wondering that for the 5G market you just discussed, we kind of lower our estimate for the global 5G market. But I'm just wondering that from your perspective, MediaTek, in terms of the market share or shipment for the 4G and the 5G SoC market, what was it like for this year or maybe for the next year growth outlook, if you can provide that.

A - Dr. Rick Tsai, CEO

Laura, well, we have reported our estimate for the overall smartphone shipments, including 5G. Certainly, it's somewhat of a decline compared to last years. I'm thinking consistent with the other research organization or major players' view. The important thing to us really is to continue building our technologies and our flagship entries. And when we look at our portfolio, our offering of portfolio, we are quite confident that we will be able to maintain our market share, which we have earned over the last -- about 3 years. We really are confident that these structured improvements that we have made will keep us with the strong market position that we have now going forward into the next year. So the key here is that we will be able to keep our market share. And also, we will be able to manage our gross margin at the level we want, then things will gradually get better, we believe.

A – David Ku, CFO

Yes. Rick, if I may, I'm still trying to highlight one point because I understand right now is people looking at connectivity, but if we put in perspective, bear in mind, the 5G global shipment year-over-year still grew a very strong 20%. And even we're talking about for next year, given the relatively low penetration on 5G, we still believe 5G global shipment next year will continue to grow. So couple -- combined with actually Rick talked about earlier, our market share is not losing at all. In certain sense, actually, we still managed to grow the market share. That still represents a pretty good growth opportunity.

So when we talk to different sell side analysts, sometimes the buy-side investors, I think people worry about the short-term movement, but sometimes miss the big picture. Again, the year-over-year 5G shipments still grow a strong 20%. And when we get into this cycle, especially when we talk about 4G to 5G, product migration is a pretty good ASP accretion, okay? And also in addition to smartphone, our Smart Edge and Power IC, the diversified and balanced business portfolio are all growing very nicely.

Q - Laura Chen, Citi

Thank you, Dr. Tsai and David, that's very clear. Just a follow-up on this. Because my understanding is like our 5G products used to -- has been enjoying better gross margin comparing to 5G. I'm not sure if its situation still maintained?

A – David Ku, CFO

I think the situation is still maintained. Again, because smartphone right now still account for roughly 50% to 55% of our overall revenue. So if we have any line of business have gross margin deviate too much from the corporate average, we will not be able to reach that gross margin. So basically, right now, all product line has been very similar, some higher, some lower, I would say, by and large, very close to the corporate average.

Q - Laura Chen, Citi

Okay thank you. And I got the second question if I may have. Just following a previous question of Gokul on Intel's engagement. I'm just wondering that other than to diversify our foundry source, if there's any chance that we can leverage with Intel's resource to get into the PC-related or peripheral market with that engagement?

A - Dr. Rick Tsai, CEO

As you all know that we already have a 5G modem engagement with Intel into the notebook, PCs. Actually, we believe that the relationship between Intel and MediaTek will continue to grow. But right now, the arrangement between Intel and MediaTek, the foundry arrangement, is mainly still capacity long term -- I should say, a long-term mature technology capacity arrangement.

And I might add, we have strong confidence that the semiconductor industry will continue to grow at a very good rate. Despite the current slowdown, it will recover soon. And we definitely believe MediaTek will be part of that growth cycle when it happened. And you must realize, this is -- any time you take on a new foundry, the new process -- by the way, that process has FinFET in the process. So it does have some pretty good advantages. We are preparing for the future growth of the company because we all know that the 22-nanometer node is a very good node for many applications. And so it's kind of a -- it's also more resilient capacity structure for us going forward. Thank you.

Q - Charlie Chan, Morgan Stanley

Good afternoon. So my first question is about your 5G strategy. So first of all, I know you will keep the pricing discipline, but your foundry partner costs may go further higher in 2023. Can you pass through to customers? And can you maintain the 48% gross margin into 2023?

A – David Ku, CFO

Charlie, I think currently, the semiconductor supply chain is actually very dynamic. We have been proactively managing and dealing with it. But like you say, if necessary, we will definitely review our pricing strategy and also capacity location to reflect the industry dynamic and also, more importantly, our long-term capability to invest for the long-term capability. I think that's a quick answer.

In terms of the next year's gross margin target, I think like we talked about earlier this year, the guidance for the gross margin range -- earlier this year, the range was a 48% to 50%. I think this year, we are well into this range more on the mid- to high end. I think next year, so far, it's not finalized yet, but we do believe that actually is a good target range to start with for next year.

Q - Charlie Chan, Morgan Stanley

Got it. And also on 5G, I mean, I do believe that 5G is accretive to your blended ASP. But this year, we certainly have better flagship contribution. So next year, I'm not sure if the company wants to introduce some entry-level or lower-priced 5G? And if that's the case, do you think your plan in ASP for 5G can still go up in 2023?

A – David Ku, CFO

Charlie, I think it's maybe too early to talk about next year product mix. But in general, I think next year is one thing for sure, we will continue to introduce new products in all segments, which including the flagship and also the entry level as well.

Q - Charlie Chan, Morgan Stanley

Okay. Then my second question would be about your long-term investment. So Rick just mentioned that although you're kind of controlling the OpEx, you will continue to invest for the new technology for the coming 3 to 5 years. So can you elaborate a little bit on that? And for me, I'm particularly curious about your plan for Windows on ARM processor, because you already have a strong foundation there, but you compared to Qualcomm, just to point out, they will introduce the real project for Windows on ARM next year. So what's MediaTek progress on Windows on ARM?

A - Dr. Rick Tsai, CEO

We have been investing in the ARM-based processor for, of course, many years before, mainly for the mobile SoC and really, of course, a mobile flagship SoC application. But we also, as you probably know, leverage those SoC into other applications. ARM computing represents, of course, a quite different segment. It's more in the compute segment moving from the low power to mid-power range. As a result, we are -- I cannot share with you the details of our engagement or development status. But what I can say is that we have putting the resources, both from the technical development or the CPU, GPU capability, some software resources, and we are working with, I would say, really relevant party going forward.

But I also want to remind you, for such a major endeavor, we always take time, lead time. There will be a lead time for such business to grow. So that's why I talk about all these things for 3 to 5 years horizon, definitely not for, say, next year. That would be the case right now.

Q - Sunny Lin, UBS

Thank you for taking my questions, so my first question is on the 5G pricing. So if we look at in the past, new generation of chips tend to have pretty meaningful premium in the first few years, but then the premium will come down to drive a higher penetration. Now that the 5G pricing is still a lot higher versus 4G, just want to get your thoughts on how the price gap may evolve going into next few years? And ultimately, how much do you think a 5G chip could deserve in terms of premium over 4G?

A – David Ku, CFO

Sunny, I think based on what we see right now, the gap probably going to stay here for quite some time is mainly due to the complexity of the 5G technology. Simply put, 5G transmission, also the functionality is actually much stronger to 4G, and we just need to spend more area of putting more transistors to our product. So that's why actually the size of the chipset will be much larger. And consequently, the pricing of the product will be higher.

And based on what we see right now, there's no magic pill to against this. So in the near term, most likely, the gap will stay there. But on the other hand, I think you're talking about the penetration. The good news is actually it's at least based on what we see this year. The 5G penetration already reached to a good 50% globally already. And obviously, the pricing -- the gap of the pricing, to be precise, didn't really somehow slow down the 5G penetration or picking up. And so we do believe next year, the 5G penetration will continue to increase. So is in a way similar to 4G versus the 2G. Believe it or not, right now, we're still talking about 200 million, 300 million 2G every year, and the gap between 2G and 4G is still pretty wide out there. So it's just different product segmentation going forward. I think that's our view so far.

Q - Sunny Lin, UBS

Got it. Maybe a very quick follow-up is if you look at the cost structure for 5G, do you still see a lot of room for cost reduction going to the next 2 to 3 years? Or are you seeing most of the cost improvement has already been done?

A – David Ku, CFO

I think there are still some cost improvement area, but probably is not quite a lot. Because, again, right now for 5G, most likely we're talking about the leading edge process. Now flagship, even we talked about 4 or 3. Even for mainstream, we're talking about 7 or 6. The pricing on the supply side and also the complexity on the supply side is actually not that easy to resolve. And on our side, in terms of intellectual property, we can definitely do some improvement out there, but it's not going to be reduced substantially. So more like the cost structure will be similar.

Q - Sunny Lin, UBS

Got it. My second question is on your flagship 5G. Could you help us think through the potential upside going to 2023? I think competitively, your peer supply issue is getting resolved, and they have also switched to TSMC's 4 nanometer. And so what's the driver for you to get a higher share into next 2, 3 years? And do you see any upside outside of China?

A - Dr. Rick Tsai, CEO

Yes. Again, we are happy with what we have achieved with our first-generation flagship, Dimensity 9000, where we're actually about less than 18 months of development time. The performances and the acceptance from the market, I think it's quite good from our point of view. And during this period, we have really, I would say, learned to further improve our performance, especially from the user experience point of view. For the flagship phone, the user experience is truly critical in order to be accepted by those high-end customers. Now we have learned a great deal. And we are -- and these are not only in the hardware, IT and the process technology, but a lot of which also comes from the system software behind.

So we are fairly -- we are quite confident that our second generation SoC, which now we have silicon already, we have a pretty significant improvement over the first generation. We just believe that the -- we will continue penetrating with our offering because we have good performance. We have also reasonable optic infrastructure for our customers. Thank you.

A – Frank Lee, HSBC

Thank you. Just have a question, I guess, 2 questions. The first one is kind of the overall discussion people had on the inventory and your view of 2 to 3 quarters' digestion. But I guess just looking at the fact that we've come off kind of an unprecedented 2-year upturn and inventory level seems quite elevated across the board for quite some time. I guess just trying to understand the rationale behind why 2 or 3 quarters, where seems to be a normal cycle inventory, is all we need? Or at least the expectation is that's about how long it takes.

A – David Ku, CFO

Frank, like we explained earlier, we actually take a hard look for all the customers and channels and level of inventory. And I think one key thing to highlight, actually, overall, we're still talking about 5G shipment year-over-year growth of 20%. So which means the end selling point is still pushing out a pretty good number of phones out there. So think about that way. The digestion or the final channel is still picking out, but selling in, obviously, is actually coming down substantially, as you can tell the whole supply chain, which including our side, foundry side, and even on our customer side.

So it's a basic math. When you -- a steady outflow by a much smaller inflow -- and right now the channel inventory and the customer inventory were not going by 10 months or 20 months, with about maybe 2 plus 3 months. So plus with that patent, if that patent continue to 2 to 3 quarters, unless you believe next year, the demand will decline. Otherwise, I mean, if you're doing the math, most likely after 2 to 3 quarters, I think we should have some chance to see some picking up of stabilization.

I think just that's our view. So I still try to highlight. The key point is currently, even though people see lots of negative news, but bear in mind, there's still a pretty strong year-over-year growth. The final selling point is still pushing out phones, I would say, steadily, okay? And next year, we're still looking for more 5G phones to sell.

A – Frank Lee, HSBC

Okay. And I guess my second question is just overall on pricing. I understand the duopoly situation you have on the smartphone side, which I think will help insulate or protect downward pricing pressure

compared to past cycles. But how should we look at the other businesses where you don't have so much necessary duopoly, but potentially more competitors? As we look at this inventory cycle on the pricing point, how should we think about these other applications?

A - Dr. Rick Tsai, CEO

We are -- I think if you look at our other segments, either we have strong -- very strong market position. For the competition, it's relatively mute, I would say. Then for power IC, it is really a very broadly based segment of the pricing, again, not so sensitive to the macro environment. So that's why we believe that we are confident that going forward the key thing for us is to continue investing in our capability, our technology, our product portfolio. And we will be able to maintain our market position. And we certainly will maintain our gross profit margin. And when the market turns, MediaTek will come out stronger and healthier. Thank you.

Q - Brett Simpson, Arete Research

Yes, thank you very much. I wanted -- Rick, I wanted to ask about potential M&A with MediaTek. I guess when we look at some of your U.S. fabless peers, they've been highly active in large-scale or medium-scale M&A, and it's been relatively successful from a synergy point of view. I guess when we look at MediaTek, you have a very strong balance sheet. You're generating north of 5 billion of free cash this year. And now that we've seen valuations come back in semis, what's holding MediaTek back from being more active in the M&A side? And if you are looking at M&A, can you maybe share with us what areas might make sense in terms of complementing what you're doing today?

A - Dr. Rick Tsai, CEO

Well, we certainly are looking at M&A target. But I also must say the overall environment is not very friendly. If you look at -- actually, if you look at the deals which have failed to go through the regulatory process in different areas, different regions, countries, the failure rate is very high. It's very high. So that's why we're being cautious that we don't want to fall into the trap of spending a lot of resources than just end up paying breakup fee.

But saying all that, we understand that the -- for our future growth, again, for the next 3 to 5 years, it is advisable to look -- to have some synergy -- synergistic target. I cannot share with you which areas we're looking at, unfortunately, of course. But what I can say is that we work in that respect. And we also need to work on to have a more friendly environment for the M&A also. Thank you.

Q - Brett Simpson, Arete Research

Maybe just a second question, if I may. I wanted to get your perspective on how you see automotive as a potential meaningful market for MediaTek. I mean you have IP that's highly leverageable into autos. And we've seen some of your competitors talk about very large pipelines over the next sort of 5 years. And just sort of dovetailing into your long-term CAGR thought process, can you just maybe share with us your thoughts on how you see MTK and automotive markets, specifically in things like 5G, digital cockpit, where are you winning business? And I mean given 5G and all this looks like it's going to be a big market and it's 2-player capability, and you have a very strong modem portfolio. Just can you help us understand how you're thinking about this segment of the market?

A - Dr. Rick Tsai, CEO

Agreed. This is a segment that MediaTek -- it's not that we don't have a presence. We do. We do actually, yes, not big enough. I also agree. We understand the fact that we can leverage our IPs, I think, very -- so yes, it is part of our future growth -- in our future growth of MediaTek. We are -- of course, the automotive industry is a quite different industry compared to, say, consumer and smartphone or computing business segment. They're quite different. But because of the group into the digital cockpit as you said, and the much higher connectivity requirements, it opens the door for us.

We certainly are in the process of moving into a growth mode for this segment. We understand certainly full well that we have a very strong portfolio in the modem, then, of course, in the WiFi area, too. We will leverage. We will -- I'm not even sure leverage is a good word, and we will definitely extend and expand those IP capability into different segments and automotive be a very important one.

-End of Q&A session-