MediaTek 3Q22 Earnings Call

Friday, October 28, 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 third 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 third quarter financial results.

David Ku, Chief Financial Officer

Good afternoon, everyone. Now let's start with the 2022 third quarter financial results. The currency here is in NT dollar. Revenue for the quarter was NT$142.2 billion dollars, down 8.7% sequentially, and up 8.5% year-over-year.

Gross margin for the quarter was 49.3%, flat from last quarter, and up 2.6 percentage points year-over-year.

Operating expenses for the quarter were NT$37 billion dollars, compared with NT$37.6 billion dollars in the previous quarter and NT$31.9 billion dollars in the same period last year.

Operating income for the quarter was NT$33.1 billion dollars, down 15.6% sequentially and up 12.9% year over year. Non-TIFRS operating income for the quarter was NT$34.3 billion dollars.

Operating margin for the quarter was 23.3%, decreased 1.9 percentage points from the previous quarter and increased 1 percentage points from the year-ago quarter. Non-TIFRS operating margin for the quarter was 24.1%.

Net income for the quarter was NT$31.1 billion, down 12.7% sequentially and up 9.6% year-over-year. Non-TIFRS net income for the quarter was NT$32.2 billion dollars.

Net profit margin for the quarter was 21.9%, decreased 1 percentage points from the previous quarter and increased 0.3 percentage points from the year-ago quarter. Non-TIFRS net profit margin for the quarter was 22.6%.

EPS for the quarter was NT$19.54 dollars, down from NT$22.39 dollars in the previous quarter and up from NT$17.92 dollars in the same quarter last year. Non-TIFRS EPS for the quarter was NT$20.22 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. The last few months have been a challenging time for the entire global semiconductor industry amid aggressive inventory management adopted by the supply chain. Despite the challenging environment, MediaTek still managed to deliver third quarter revenue meeting the low end of our guidance given three months ago, while gross margin reached the mid-point of guidance, both were helped by our strong product portfolio and pricing discipline.

The supply chain is still in the middle of the inventory adjustment cycle. Although overall channel and customer inventories have reduced sizably after the adjustment in the third quarter, global macro environment continues to deteriorate. High inflation, strong US dollar and geopolitical uncertainty proceed to weaken consumer purchasing power in many regions around the world across almost all product segments. As a result, although channel and customer inventories are now close to normal levels, many customers continue to manage their inventories with extreme caution amid high uncertainty of future demand, resulting in lower orders for components in the fourth quarter.

Despite the near-term issues, we believe the strengths we've built over the years in areas such as 5G, WiFi, multimedia and low-power processors will lend a solid support to our business through this inventory cycle. Those strengths not only underpin our ability to sustain robust global market positions across products but also lead us to numerous future business opportunities. Therefore, we believe we are on a strong footing to tackle near-term challenges.

Now let me comment on each of our three revenue groups.

In the third quarter, our Mobile Phone business grew 7% year-over-year and declined 8% quarter-over-quarter, accounting for 55% of total revenue. Smartphone demand was affected by customers' inventory adjustments, especially in the 5G mid-range segment. However, 4G demand was strong in the third quarter and was higher than the second quarter.

We continue to expand our presence in flagship and high-end segments. Our Dimensity 9000 and 8000 SoCs have powered numerous popular models. In the third quarter, our Dimensity 9000+ was further adopted by multiple premium ASUS ROG gaming smartphones. The leading performance of Dimensity 9000+ offers extreme mobile gaming experience and is highly recognized by the market. We will continue to develop new flagship solutions with performance and feature upgrades to support our customers. Our next-generation flagship SoC will hit the market in November, and we expect it to register revenue by the end of this year.

Furthermore, our mmWave technology demonstrates fast, adaptive and reliable beamforming as well as outstanding thermal performances to achieve excellent user experience. MediaTek's mmWave SoC, Dimensity 1050, has begun volume production in the US market since the third quarter. It not only marks a milestone of our global full 5G coverage, which includes both sub-6 GHz and mmWave, but also further expands our addressable market, especially in the higher-end segment.

In the future, we expect global 5G penetration to increase to mid-50% in 2023 from high-40% in 2022. Based on the current design-in activities, we are confident to continue to gain market shares in the flagship and high-end segments while sustain our strong position in the mainstream product categories.

Now let me move on to Smart Edge Platforms, which accounted for 38% of revenue in the third quarter. This group grew 11% from last year and declined 9% from last quarter.

In the third quarter, telecommunication operators turned cautious and cut back on orders, which negatively impacted our WiFi and wired businesses. Meanwhile, demand for computing-related products declined significantly, which affected our businesses in tablet, Chromebook and monitor.

Despite the challenging market, MediaTek has made substantial progresses in several areas related to 5G modem. For example, we are gaining shares and leading in the US CPE market, and we are working closely with our strategic partner in penetrating into more notebook models as well as establishing our footprint in automotive telematics.

In addition, we are happy to see our leading product portfolio enable our business expansions with global tier one customers. We are making good progress in WiFi 7 projects and have numerous business initiatives with global customers across computing, XR, and IoT devices for future growth opportunities.

Now moving on to Power IC, which accounted for 7% of total revenue in the third quarter and grew 4% from last year and declined 17% quarter over quarter.

Despite weak demand for power ICs in consumer devices such as smartphone and PC, demand for automotive and industrial applications remain robust, mainly driven by market share gains. We expect automotive and industrial together to contribute a higher level of revenue than we forecasted early this year and to exceed 15% of total power IC revenue in 2022, as compared with 10% that we originally expected.

Now for the fourth quarter, given the uncertainties of the global macro-economic environment and market demand, we see customers in general hold back orders even though channel and customer inventories have come down from last quarter. We expect the largest impact from customers' adjustments to be in the fourth quarter. That said, we also see a few customers who took meaningful inventory cutting actions earlier have resumed certain replenishing activities in this quarter. This may indicate that further replenishments from a broader base may take place in the first half of 2023.

With that, we now expect our fourth quarter revenue to be in the range of NT$ 108 billion dollars to NT$ 119.4 billion dollars, representing a decline of 16% to 24% sequentially, and a decline of 7% to 16% year-over-year at a forecasted exchange rate of 31.5 NT dollars to 1 US dollar. Gross margin is forecasted at 48.5%, plus or minus 1.5 percentage points. Quarterly operating expense ratio to be at 31%, plus or minus 2 percentage points.

For the semiconductor industry, 2022 is a year with many unpredicted global events, unfavorable impacts from geopolitics and rising concerns over macro uncertainties. Despite our 2022 full-year revenue being below what we've previously expected, we still manage to deliver another record year in terms of revenue and earnings under this unusually tough situation.

Although no one is immune to the near-term headwinds, we will manage our profitability carefully while re-allocate our resources strategically for our mid- to long-term growth. We believe the structural growth trend of digital transformation remains solid in our industry, and we will continue to fortify our market positions by investing in key technologies early and we will leverage our competitive strengths to expand our addressable markets in computing, 5G products, wireless and wired connectivity, and in various AI, automotive and industrial applications.

Last but not least, we are fully committed to our shareholder return program. Our regular cash dividend based upon 80%~85% payout ratio remains unchanged. And in addition to the regular cash dividend, our NT$16 per share of special cash dividend will continue as part of the 4-year program ending in 2024.

This concludes my prepared comments, thank you.

[Q&A]

Q - Randy Abrams, Credit Suisse

I appreciate the remarks and also the execution just navigating a challenging environment. I wanted to ask the first one just on the fourth quarter. If you could give a little more color between segments, the relative decline? And you made a couple of comments about the inventory, some areas could be replenishing. I think last year with flagship it was enough, you had potential to grow. But if you could give an initial view with new flagship and the replenishment? How you view the first quarter seasonality at this stage as well?

A - Dr. Rick Tsai, CEO
Well, let me address fourth quarter sequential decline. Some of the areas which declined more than -- definitely more than usual are in 4G, WiFi and TV. 4G, we believe, as we said in the comments, the very strong U.S. dollar really renders the developing countries' purchasing power to be weakened and not to mention the uncertainty with that. So that has a negative impact on our 4G shipment.

WiFi, mainly because of some of the operators -- very large operators have kind of -- since they have more or less accomplished their budget earlier in the previous three quarters, so they're slowing down their fourth quarter buy-in. So that had a negative impact on WiFi, broadband, routers, and APIs. TV, we believe TV really started its inventory correction pretty early, starting early this year, first quarter or even late last year. We believe that TV inventory correction is near the tail of the cycle, the fourth quarter probably is the last part of that cycle.

As to first quarter, we mentioned a bit that the fourth quarter decline is pretty severe, and we -- but we are seeing the inventory level with most of our customers and their channel to be also going down significantly into -- we believe in first quarter, it will be more in the normal level. The issue, of course, because of extreme uncertainty of the end market or at least the immediate end market renders them to be very, very cautious in orders. Some of them, we mentioned, have started some of the re-ordering. Those customers stopped some of their purchasing about half a year ago. So we're seeing some weak signal, but some signal, nonetheless.

Q - Randy Abrams, Credit Suisse
And the second question, actually, I just wanted to ask on your 5G guidance, increasing from high-40s to mid-50s. It sounds like fairly mild for next year. Curious because you talked about the dollar strength. Is that also affecting build material or sensitivity? So a bit slower pace into next year on 5G? And I'm curious, India with the licenses, do you expect much from those markets turning on that that could give a lift? So just curious into next year how you see the 4G versus 5G and then the impact of the dollar affecting that migration?

A - Dr. Rick Tsai, CEO
Good question, Randy. We actually agree with what you just said. But China market of course is pretty much saturated with 80%-plus penetration. India, we believe -- India actually among this set back of the developing countries, India actually performed relatively well compared to other developing economies. We feel with India's again a good economic performance this year and maybe next year, it probably represents a better opportunity for the 5G penetration. We are being cautious because of the U.S. and Europe. Also the developed economies are facing still very uncertain future. That's why we're being cautious in our forecast.

Q - Gokul Hariharan, JPMorgan
My first question, could we talk a little bit about pricing environment? I think we are seeing revenues drop roughly about 20% in Q4 at the midpoint of guidance. Is that mostly volume in both smartphone -

- mobile and Smart Edge segments or are we also seeing some price concessions that you have to give to customers given the extremely weak demand environment? And what do we expect for pricing, especially for 5G going into next year? Do we see blended pricing starting to come down? It's been very resilient for the first three years, but do we start to see that come down? That's my first question.

A – David Ku, CFO

First of all, we'll start with the fourth quarter. I think the weakness in the fourth quarter is mainly driven by much lower demand on the volume side. On the pricing side, I think there are some pressure, but overall, I guess, we're holding up quite well. So that's why you can judge from the gross margin guidance, we just gave out. For the third quarter, the gross margin was 49.3%. In the fourth quarter, the gross margin guidance, the midpoint is 48.5% plus-minus 1.5%.

So as you can see, it's actually -- the pricing pressures, there is some pricing pressure always there, but actually, we're trying to be disciplined about the pricing exercise. For next year, I think that really depends on what the final product mix looks like. Right now, we see some positive trends, especially for our flagship momentum. As you can see, for this year, we're making pretty good inroad for flagship segment. And with our -- we believe with our Generation 2 flagship product coming out, the overall revenue contribution on the 5G side from flagships will be even higher next year.

I think that will provide some positive lift on the ASP. But on the other hand, due to the overall weak macro economy, we need to assume basically for the 5G making product, probably the segment on the inch level will increase. So overall, on a net-net basis, our view actually should be relatively stabilized. But again, it will really depend on what the final product mix looks like next year.

Q - Gokul Hariharan, JPMorgan

Thank you, that's very clear. My second question, could you talk a little bit about the -- just expanding a little bit on the inventory and customer behavior. What are your customers thinking about as we get into next year? Are we feeling that now that revenue is down almost 30% from the peak level in Q2 that we saw, are we almost done with that inventory clearance and we should start to move into a bit more of a restocking kind of mode as we get into Q1? Is that the feedback that you're getting from customers? And also, what's MediaTek initial thought into next year, do we think it's a growth year for MediaTek or given everybody is expecting semis to be down next year, next year growth is probably going to be a little bit hard to come by?

A - Dr. Rick Tsai, CEO

I think the customer sentiment, as you can imagine now, if you just follow this week's announcement, sentiment cannot be good. So saying that, still I think it varies just like any time, it varies among different customers, China customers or U.S. customers. I think -- and also even among China customers, some are more -- a bit more stable than the others and not to mention also Korea and the Japanese.

Our feeling is, in general, the customer sentiments are still in a very, very cautious mode. We have some pick-up in the replenishment. We are seeing that. I must say, we are encouraged by that, but we are not jumping up and down because of that. We are operating under the assumptions that the customer will remain cautious for another -- for some time.

Inventory level, and as I said in my comments, I think we are seeing many customers' inventory level has come down quite a bit. Some of them are down to, we believe, two to three months' level, which during the normal time, the replenishment cycle would have started. But in this unusual time, I think they are still -- they probably will hold that down even further. I cannot say how much further but cannot be much further either.

Next year, of course, we cannot really comment for now 2023. But with all the comments we have made just now, it's going to be a challenging year. And I don't think anybody now can say with any certainty about being a very strong year next year or it's difficult to say at least. We remain very cautious and we're managing -- our primary objective is to manage our market share. We want to -- with our product capability, product portfolios, our technology advancements, our market positions, we want to manage -- to maintain our market shares, while we exercise the discipline in pricing. We simply do not believe in, for instance, across the board price cut in order to ignite any kind of short-term demand. That doesn't work. We don't do that. We do not do that.

However, there is -- I want to bring to your attention the cost -- manufacturing cost increased since 2021 and 2022 is now starting. As you have read, I'm sure, from the many reports that the foundry partners have been increasing their price. And we believe this cost increase is more structural in nature rather than cyclical. So our pricing, in some way, need to reflect that also. Finally, of course, we strive to manage our operating expenses. We -- the most important part is really to re-allocate our people, which is our biggest resources toward the mid-to-long-term growth opportunities rather than staying on with our current mature -- more mature business segments.

Q - Gokul Hariharan, JPMorgan
So does that mean that we can still hold down to the 48% to 50% margin range that we talked about in the previous call or we think there might be a little bit of downside given this cost increase in the foundry space is still continuing even though the market is weak?

A – David Ku, CFO
To be honest, actually for 2023, there is still a lot of variables out there, but I think probably give us one more quarter, but based on the best knowledge right now, I would say the fourth quarter, the midpoint guidance, which is 48.5%, plus-minus some buffer, because every quarter, as you know, the product mix could be different, the customer mix could be different, so I think it's still a good reference point.

Q - Brett Simpson, Arete Research
Rick, I wanted to just ask about the extent to which MediaTek is under shipping demand at the moment, particularly with the Q4 guide. Can you maybe just share whether it's in smartphones specifically, how big is that under shipping that you see? And you've been through a lot of cycles, I was just keen to get your perspective on how you see this one more broadly, and when the trough of the

business -- when we see the trough and when you might return to positive year-on-year growth overall?

A - Dr. Rick Tsai, CEO

Actually, the fourth quarter sequential decline in smartphones, 5G actually is okay. It's a flattish to a bit up sequential shipment. It was 4G that had the surprise drop or maybe shouldn't be surprised because of the -- as I said, the strong U.S. dollar is really wrecking havoc in the developing economies and make people very reluctant to spend money. Our customers need to find, what should I say, ingenious ways to sell their phones into, say, Southeast Asia or in Africa, for instance. So it is 4G that gave us this smartphone decline in the fourth quarter.

You also said kind of maybe a more generic, more general look at the industry. Our industry has not seen a downturn of this I think magnitude for probably over a decade. There were fluctuations in the last 10, 12 years, but nothing compared to this -- I really would call this a severe downturn. But it's not, of course, it's not what we haven't seen before either, if you go back to 2008, 2009, 2000 the bubble. But also there is certainly a cyclical nature because of -- I mean, the last two years have been really -- we are seeing rampant growth in many ways. But the structural change, I think because of the geopolitical situation, which we never had before really in our industry, added quite a bit of complexity to the outlook of the future.

So we are treading this water as cautiously as we can, while we -- but at the end of the day, we strongly believe building our technology, expanding our product portfolio, creating new SAM out of the TAM. That's the best way to go and that's where we're putting our money in. And I'm pretty confident that with our capabilities, we will be able to do that.

Q - Brett Simpson, Arete Research

Rick, thanks. But in terms of the trough of the business, do you think that's a Q4? Do you think Q4 marks a trough this cycle or do you think that we're not through the worst yet?

A - Dr. Rick Tsai, CEO

We are looking at Q4 pretty much the bottom for us. We believe we'll see some mild recovery in Q1 sequentially, but we need to really work on it.

Q - Brett Simpson, Arete Research

And maybe one follow-up for David. David, I wanted to ask about long-term agreements with foundry customers and how you manage -- you signed a lot of LTAs in the last 12 months or so, how do you manage these LTAs? And is there any liabilities we might see from commitments that you've made? But clearly, the market has deteriorated significantly since you made those commitments.

A – David Ku, CFO

Well, first of all, we have some LTAs, but we don't have a huge liability, I think that's the starting point. And for any potential risk, we already amortize pretty much along the year, pretty much we're starting from second quarter this year. So if there is any sort of the worst case scenario, we pretty much reflect that in our cost of goods sold, which has impacted our gross margin already.

Q – Brad Lin, BofAML

I have two questions about more mid-to-long-term development of the firm. So firstly, we have learned MediaTek's strong technology development at Semicon, the heterogeneous integration seminar, and we would love to know that your adoption strategy? And should we expect MediaTek to enter new markets with the chiplet trend? And if available, may we learn its growth outlook for MediaTek? That's the first question.

A - Dr. Rick Tsai, CEO

If you follow us for the last three years, MediaTek has really moved very fast into the leading-edge process technology and packaging technologies. As the industry moves into, I think we believe sub-3-nanometer, 2-nanometer or below, the Moore's law gets blurred. So we are certainly working with the partners, for instance, the chiplet technologies with the application in both mobile sector and also potentially high-performance computing area. We put a lot of effort in that.

Q – Brad Lin, BofAML

And then my second question is maybe a little bit related is that, given the rise in ARM-based PC and even server adoption for -- and the strong potential upside of the market, so may we learn MediaTek's progress on the market? And when should we see a strong growth for the server market?

A - Dr. Rick Tsai, CEO

We do not have -- right now a business line in the server market ASSPs. We do pursue the business in that area with the major hyperscalers in the form of ASIC business model. And we're working with several of them. But that's about all I can say for now.

Q - Laura Chen, Citi

My first question is about your geographic breakdown. Just wondering that -- like we see the weak demand across regions globally, just curious about MediaTek's exposure to China, to Europe, ASEAN, other emerging markets as well as the North America. And which market you would expect to see earlier recovery, like you mentioned earlier in the first half next year? And what would be the indicator we may be looking for?

A – David Ku, CFO

I think -- in general, I think our revenue breakdown by geography is actually, China is in line with most of the U.S. companies roughly -- slightly 40%-plus, and probably no major difference actually. We do have a pretty sizable revenue across the region, especially for emerging market. But unfortunately, actually, due to strong U.S. dollars, I think emerging market is actually the area have the biggest hit in fourth quarter.

But in terms of your second question, talking about how -- which area will come back the first. Based on our past experience, normally, the currency issue is a short-term impact because for most of the emerging markets, they've been in the phone business for more than 10, sometimes even more than 15 years. So they've been going through the up and down of a strong and weak U.S. dollar. I think what we're trying to address is actually once the U.S. dollars -- regardless of strong U.S. dollars or weak U.S.

dollar, as long as it's starting to stabilize, then normally in the past experience, we see the customers on those regions will start to replenish their inventory.

So Again, we don't have a clear visibility yet. But if we want to take a wild guess, I would say probably the emerging markets, outside China, probably will be the area have the earlier sort of the replenishment activity. For U.S., for Europe, for China, I think currently, they all have their macro or geopolitical issues out there, problem is going to be some time to see those issues being turned down a little bit.

Q - Laura Chen, Citi
And for China, like Rick also mentioned that, because the 5G penetration is relatively high, do you also expect that growth in China can continue some time next year or recover anytime soon?

A – David Ku, CFO
I think 5G in China this year is pretty flattish, maybe even coming down a little bit. But from our perspective, what we gain is actually truly the segment -- segmentation market share, mainly we're talking about the flagship. So for next year, our view is actually, for the 5G, due to the penetration in China it's 80% already, for China alone, we are not going to see the volume strong growth. But in China, it will still provide some decent opportunity for us to get more market share for the flagship, which will be really helpful in terms of revenue growth.

Q - Laura Chen, Citi
And my next question is about your non-smartphone business. We know that MediaTek has a quite comprehensive IP portfolio and has been working on various ASIC projects previously like networking interface, et cetera. So may I know what's the current progress and what's about the revenue or gross margin looks like? And do you think that this business will continue to grow into next year?

A – David Ku, CFO
I'm assuming you're referring to our ASIC business or just non-smartphone business, Laura? Why don't I just go ahead and answer that. I think for the ASIC business, Laura, in general, I think there can be a pretty decent gross margin because these couple of main products. And for the ASIC products -- for the ASIC business, including the consumer product and also including the enterprise business, I think overall, we all see pretty decent and stable growth, especially for enterprise business, even though the base is pretty low right now because the design-in, design win and also the branding up schedule we receive from our customers. In general, we are still looking for a pretty stable growth in next year on the ASIC business.

On the connectivity, I think like the CEO was talking about, the fourth quarter really taken a pretty big hit. For next year, in general, I guess, we're still looking positively given the overall -- especially right now, we are getting into some segmentation gain, both from the WiFi 7 and also the high-end WiFi. But given the overall macro situation, I guess, we probably will give out the final guidance or forecast basically probably one quarter later.

Q - Laura Chen, Citi

And lastly, can you also talk a little bit about the automotive? I recall that Rick also mentioned about that infotainment. I'm just wondering that aside from infotainment or connectivity, anything we can expect for the automotive market from MediaTek?

A - Dr. Rick Tsai, CEO

Well, I think automotive, -- we do have a reasonable revenue from both infotainment or you can call a cockpit control now and telematics. Although, both are still small compared to the total size of the market. And we -- if you look at our capability also in the WiFi area or in the camera area, there are -- in our mind, there are a lot of opportunities -- and the computing capability, of course, a lot of opportunities for MediaTek in the automotive segment.

We are in the process of organizing internally the effort to have a more coherent growth initiative in this segment. But you also know that the lead time is always quite long for the automotive customers and industry. But we see a new -- with the EV conversion and autonomous driving trend, we believe this lead time will be shortened a bit compared to before. So we are – certainly this is one area that we will be pursuing rigorously.

Q - Sunny Lin, UBS

My first question is on the inventory comment that you mentioned earlier. So just wonder, if you look at Q4, which applications are you seeing inventories coming down more significantly?

A – David Ku, CFO

I think for the smartphone side, actually, we do believe both for 4G and 5G, the channel and customer inventory all coming down pretty healthily in the fourth quarter. Actually, our view, like the CEO talking about earlier, should be very close to the normal level because we do very detailed, thorough channel check.

Q - Sunny Lin, UBS

And the follow-up would be, for 2023, do you have any initial expectation for the growth of the whole smartphone market in China?

A – David Ku, CFO

Maybe it's a little bit too early to talk about that. I think we will provide a more detailed view actually one quarter later, basically, as we always did.

Q - Sunny Lin, UBS

Sure, no problem. And my second question is on competition. I think this year you guys do a pretty good job in managing inventories pretty early, but your competitor cut foundry product slightly later. Would that be a concern for the next few quarters, that competition could potentially intensify because of the inventory issues at your competitor?

A – David Ku, CFO

Well, so far actually, we didn't really see any sort of abnormal activities out there, to be honest, because we believe this time around, during this downturn, pretty much everyone acted on pretty quickly about the supply chain adjustment. So overall, we didn't really see this pressure coming. But by saying that, I think competition is always out there, but not necessarily triggered by the high inventory.

Q - Sunny Lin, UBS
Maybe just the last question on OpEx. How should we think about the amount and percentage for 2023?

A – David Ku, CFO
I think for the amount, I think overall, again, we are still finalizing the annual plan next year. I think overall, this year, for 2022, overall, the OpEx increase is roughly 18% year-over-year. I think overall our goal is actually next year growth hopefully will be much -- not hopefully, I think the growth actually will be much lower than this year's. That's how we manage that.

Q - Charlie Chan, Morgan Stanley
Good afternoon, so my first question is actually on your own inventory, because last quarter, your inventory days goes up a little bit. And this quarter, the turnover seems to be very, very slow. I know you also cutting some foundry orders. But do you think your own inventory days will come down in fourth quarter?

A – David Ku, CFO
Currently, I think inventory days in Q4 versus Q3 should be flattish or maybe coming down a little bit. But Charlie, like you say, inventory days is really a function of the inventory on hand and also the sales forecast. Probably, the way we manage that is actually to make sure the overall inventory on hand is actually continuing to come down. So for example, for Q2 versus Q3, I think our inventories on hand is actually effectively coming down. But for the day, it really depends on how much we can sell in that quarter. Given the fourth quarter guidance, actually the days will be up or flattish a little bit, it will not be coming down. But for Q1 and Q2, we do foresee actually days of inventory -- I think the amount of inventory will continue to be coming down for sure. But for days of inventory, probably we need to wait until Q1.

Q - Charlie Chan, Morgan Stanley
So what would be the normal inventory for MediaTek -- for your chip inventory?

A – David Ku, CFO
I think normal it's 80 to 90 days, should be called the normal days.

Q - Charlie Chan, Morgan Stanley
And you think that you can get there in first half next year?

A – David Ku, CFO
Yeah, first half next year, for sure.

Q - Charlie Chan, Morgan Stanley
And my second question is about your kind of low-cost 5G chip. My personal opinion is that that's pretty important, not just to the competition, but also for the further penetration in the emerging

market. As management just said that inflation is a big pressure. So if you can enable kind of more affordable 5G phones for China or other emerging markets, there could be volume upside. So my question is that whether there is a concrete plan for the low price 5G SoC? And secondly, if there is such a plan, why don't you put it a little bit forward to address this market demand?

A - Dr. Rick Tsai, CEO

We do have -- as you know, that the MediaTek has a portfolio which covers all the way from flagship to entry level. We are doing -- and we have a very large market share over there. Really, we have actually almost ready for low cost 5G. I think really things are not just like that. We really need to look at our market potential, and also very importantly, whether we can really have a reasonably good gross margin.

As I said earlier, our pricing must reflect our value. We must also earn a reasonably good gross margin. So we do not really want to just cut price to enable certain demand because that really remains to be seen whether it's true or not. So we work very closely -- we have customers who are very good at marketing and selling entry-level phones in different emerging economies, very, very good. And we work extremely closely with them and we meet their requirements through having a good product for them. And so far, I think that's worked well. And we do not plan to just go in with a very low cost SoC to sacrifice our margin.

Q - Charlie Chan, Morgan Stanley

And also, I think Laura brought a very good question about your ASIC business, because from what we can see, you have a greater IP, you have the best designers, you have a very low wafer cost from your foundry partner compared with other different service competitors. So why is it just a stable growth next year? Because from what we can see, the TAM for the ASIC business, no matter from automotive or data center, even Chinese customers, because China is now restricted for some high-performance chip design. So why your ASIC business can grow only slightly instead of a big booming?

A - Dr. Rick Tsai, CEO

Well, we understand what you're saying. It is a good market, the size of which is I guess, debatable, but we're talking about ASIC. And we're talking about I think mainly, accelerator type of ASIC chips with hyperscalers. We have the ingredients. And I agree -- I admit also that we are kind of a bit late in the game. We are engaging, but we also know who to talk to and we are now engaging with a major player. Hopefully, I can give you some different kind of news in the next few conference calls.

Q - Bruce Lu, Goldman Sachs

So I wanted to ask about the geopolitical impact to MediaTek. I think management mentioned that in the prepared remarks and repeated several times during the previous Q&A, but I thought most of the business are consumer-related and the impact should be limited. Is that the right understanding? But what I really want to know is that China and non-China, structurally, it looks like it's going to be two different supply chains and MediaTek is in a sophisticated situation with higher revenue exposure in China. If this is a structure, can you help us understand your strategy and approach moving forward to face this geopolitical tension?

A – David Ku, CFO

Bruce, I think you are right. I think when we're talking about geopolitical impact, we're not referring to, for example, the recent October 7th new policy issued by the U.S. government. Whether or not they have direct and immediate impact to our business? The answer is no. But what we're talking about is due to the geopolitical situation, the overall -- the macro economy pressure and also somehow slowing down, potentially slowing down about the economic development. And more importantly, that's somehow put a cloud on people's expectations for the future, especially when they're trying to plan out for the future. I think that's kind of a thing is what we're talking about or referring to when we're talking about geopolitical situation. We are certainly not referring to certain of our product subject to the U.S. constraint. I think that's not what we're referring to.

Q - Bruce Lu, Goldman Sachs

And how about the two different supply chains? Are you going to have a different approach or strategy?

A – David Ku, CFO

I think for the supply chain it's actually -- in the past, actually, even before the geopolitical situation, given the overall needs or demand we need on the foundry and also on packaging side, we've been pretty global already. And taking another recent news, for example, the new engagement we got with Intel is just one of the new directions. I think overall, we'll just continue to go with the globalized supply chain policy, eventually is more resilient, I think that's the trend.

Q - Bruce Lu, Goldman Sachs

No, I think I'm not asking about your supply chain, I'm asking about the entire tech supply chain, i.e., your customers. If they are the Chinese customers, they probably will prefer the domestic supplier or U.S. would not allow a non-China vendor to sell it to Chinese. That's a potential headwind for your business. Are you going to see a different approach or a different strategy?

A – David Ku, CFO

So far, actually, we haven't heard anything materially from our customers, if that's your question.

Q - Bruce Lu, Goldman Sachs

Are we preparing for that?

A – David Ku, CFO

To be honest, actually, probably not, because actually like you say, if the China customer demand everything being built in China, the answer is, probably there's no facility to build in China, for example, for the leading-edge process node. Likewise, actually, if some U.S. customers asking for that, the answer is, probably you don't have enough leading-node capacity in the U.S. So I guess, probably not in the near-term. For whatever reason, if a customer strongly demand for that, just physically, it's not available for those solutions if you ask me.

Q - Bruce Lu, Goldman Sachs

How about your networking business or other products?

A – David Ku, CFO

It is still possible. We will certainly accommodate it. By the way, like I say, this is part of the operation already. But I'm assuming you're talking about the customer trying to take a pretty extreme direction. If you're talking about the daily operation, like I said, it's already being on a global scale.

Q - Bruce Lu, Goldman Sachs

So my next question is more about the mid-to-long-term growth. I mean, what can we expect as the major growth driver when the inventory correction cycle is over, whether it's in the first or second quarter or even third quarter next year? What can we -- what is the key product we are looking at for the growth for next year?

A - Dr. Rick Tsai, CEO

Well, we think you have to look at in two aspects. One is, of course, the growth from our current product portfolio and the technology capabilities. I think for that, if you look at the world in the future, the connectivity is something that is ubiquitous, be that, especially wireless in the form of modem or in the form of WiFi. We are quite bullish about the future of the connectivity because all the -- just for all the edge devices will have WiFi. And a big portion -- some portion will carry modem and MediaTek being one of the very, very few really strong suppliers of those capabilities. We are very bullish on that. In the meantime, we also will be working towards, as I said earlier, the automotive, we're looking into the computing area, but those things take a little time. So they are more kind of three to five years out.

Q - Bruce Lu, Goldman Sachs

Are we going to have the updated three years' of revenue CAGR in the coming analyst meeting?

A – David Ku, CFO

Bruce, so far, the view has actually haven't changed yet. Again, we don't want to overshooting. So so far, it's no change. We will not really change the mid-to-long-term goal just due to the short-term volatility.

Q - Bruce Lu, Goldman Sachs

So it's still 10% to 15%?

A – David Ku, CFO

So far, that's our goal.

-End of Q&A session-