Consolidated Financial Results Briefing for 2Q FY2023/3

(October/31/ 2022)

Summary of QA

Note: This document has been translated from the Japanese original for reference purposes only. In the event of any discrepancy between this translated document and the Japanese original, the original shall prevail.

Q1. Did actual results of 2nd quarter exceed your expectations?

A1. In the 1st half of FY22, there is an increase of 3 billion yen in net sales, an increase of 2 billion yen in operating income compared to our expectations when we created current consolidated forecast earnings. This is due mainly to an increase in product revenue, and the positive impact of the depreciation of Japanese yen.

Q2. Please explain the sensitivity to changes in foreign exchange rates.

A2. Foreign exchange sensitivity analysis is calculated based on the assumption that 1 Japanese yen appreciate・depreciate against the U.S. dollar will have an impact on net sales of 1 billion yen and operating income of 0.35 billion yen. For the 2nd half of FY22, the impact of 1 Japanese yen fluctuates in exchange rates is expected to reduce by half compared to the impact in 1st half.

Q3. Will dividends per share be revised up if annual actual consolidated financial results exceed the consolidated earnings forecast (the latest annual dividends forecast is 160 yen per share)?

A3. Whether to revise our latest dividends will be determined appropriately in accordance with our dividend policy, taking into consideration not only annual actual consolidated financial results, but also up-front development investments necessary and the maintenance of a well-balanced corporate financial standing. Therefore, currently, we cannot provide a clear answer.

Q4. What is the situation about design wins?

A4. Since there may be significant fluctuations in design wins amounts from quarter to quarter regarding to the scale of design wins, the quarterly changes of design wins may not represent the overall trends. We will explain the year-on-year change in forward disclosures. In the 1st half of FY22, acquired design wins increased steadily.

Q5. What is the situation about purchase orders from customers?

A5. Orders poured in recently due to our customers' demand to secure their inventories and to accumulate components in advance under the circumstance of recent chip shortages. In the mid of 1Q, the order amount calmed down and tend to be stable. Meanwhile we have already received sufficient orders to achieve our consolidated net sales of current fiscal year.

Q6. Will you be affected by U.S. broadening export controls against China?

A6. Although further review needs to be conducted upon the restrictions, we assume that there is no impact on our consolidated earnings forecast of current fiscal year. We are persisting in complying legislations and regulations in countries and areas, meanwhile we will work on a geographically well-balanced business expansion.

Q7. Will inventories continue to increase compared to current level? Please explain the forward trends of inventories.

A7. The balance of inventories at the end of current fiscal year is forecasted to increase to approximately 45 billion yen. This is due mainly to customers' request to secure manufacturer components in advance. The assembly of such components to finished goods is expected to be completed from next fiscal year. With the shipment of the finished goods, revenue is recognized meanwhile the level of inventories will drop accordingly.

Q8. Please explain the reason of the decrease of 13% in operating income in 2nd quarter actual results despite there is an increase of 7% in net sale compared to previous quarter.

A8. This is due mainly to the difference in timing of NRE revenue recognition which is at the point of customer acceptance and the timing where R&D expenses incurred related to design and development of projects.

Q9. Does it rarely happen about design and development delays or specification changes after acquiring design wins? Please explain the impact on NRE revenue in such cases.

A9. Due to our model of collaborating design process with customers, there were a few specification changes historically. In the case of specification changes, we will request additional NRE revenue in accordance with development expenses incurred related to the changes. There were development delays due to causes of customers' side or our side. The development delays had an impact on the timing of NRE revenue recognition but no impact on NRE revenue amount.

Q10. Did NRE revenue contribute little to operating margin in current 2nd quarter?

A10. After we secure a new project contract, we earn NRE revenue in design and development stage, which is roughly equivalent to our estimated expenses relating to a project's design and development process. We continued to acquire design wins in the 2nd quarter. NRE revenue in 1st quarter weighted more but does not mean NRE revenue in 2nd quarter constitutes little portion of total net sales. NRE revenue is recognized at the point of completion of deliverables of projects respectively.

Q11. Please explain the definition of NRE revenue. Is it nearly the payment in advance from customers? Does NRE revenue correspond to R&D expenses incurred in design and development stage?

A11. We generally make mutual agreements with customers on NRE revenue in design and development stage. NRE revenue is roughly equivalent to our estimated expenses relating to a project's design and development stage, including expenses such as labor costs, outsourcing costs, tooling costs, and so on. We decide the payment terms of considerations based on customers' creditworthiness. We usually receive the consideration in advance in case such as the customer is a startup company.

Q12. It is indicated that the design wins from overseas customers in automotive markets weighted more than Japanese customers. Please explain the reason on that. What the current situation most Japanese device manufacturers are facing is, receiving orders from domestic automotive manufacturers meanwhile struggling to get orders from overseas customers. Why could you prevent from such predicament?

A12. Our collaborative design process is aiming at customers who require customized SoCs to differentiate their products and applications in end-market. Under such design model, we are attracting customers especially headquartered in the U.S. and China who are not satisfied with general-purpose ASSP. In the meantime, we will continue working on a geographically well-balanced acquisition on design wins.

Q13. Are changes in demand and supply of automotive market foreseeable? How will your business performance be affected by the changes?

A13. In the automotive application market, we develop next-generation custom SoCs for power autonomous driving, etc. The demand and supply relationship, the market growth, etc. of automotive market will be affected by the macroeconomic environment. However, the demand for SoCs we are developing for next-generation will continue to grow for the time being, which can fluctuate independently of economic fluctuates.

Q14. It is indicated that your operating income margin is inadequate as a semiconductor company concentrating on cutting-edge technology areas. Will you take any measure to improve the operating income margin such as raising sales prices?

A14. We have been implementing an ongoing business transformation since 2018, and the progress of the business transformation gradually emerged. However, it will still take some time to have complete impact of business transformation on our actual business performance. Operating profit margin is expected to increase to 10% of current fiscal year compared to 7.2% of previous fiscal year. Operating profit margin in the medium-term in the low-to-mid 10% range. Taking into consideration that we are conducting business in a competitive industry, we intent to increase the efficiency of our research and development operations to improve operating profit margin.

Q15. The increase in gross profit margin of 20% seems to be inadequate in accordance with the increase in product revenue. How do you think about your marginal profit ratio?

A15. Our standard cost to sales ratio is set to be 60%. Recently, the gross profit margin slightly dropped due to the changes in our product mix, that is, an increase in the proportion of large-scale design wins acquired since 2018 to net sales. Despite the slightly drop in gross profit margin, the overall net sales increased and result in the increase of operating profit margin. Based on the situation that recent actual cost to sales ratio is higher than the standard of 60%, we will work on improve our gross profit margin by gaining cost advantages over competitors in cutting-edge product areas.

Q16. Please explain why gross profit dropped while cutting-edge product revenue increased. Is it due to cost such as from third-party foundries increased significantly?

A16. Cost, especially cost of wafers, will drop in accordance with the products development process from cutting-edge, 1st generation, 2nd generation, etc. respectively according to experience accumulation. Although there is a lack of stability in in manufacturing yield of our cutting-edge products, this will be covered by the experience curve effect, which will lead to more efficient SoCs manufacture. Therefore, the gross profit will initially drop but will recover gradually.

Q17. Are there gaps of profit margin by application market?

A17. The profit margin by application market makes no reference to the characteristic of the application market but depend on the profit margin of individual design wins belong to the application market. The profit margin of individual design wins is determined by the competition with our rivals.

Q18. Since your competitors are also from overseas, please explain what kind of your overseas competitors is?

A18. We are competing with ASSP manufacturers headquartered in the U.S., in automotive application market as well as 5G networks.

In addition, we are also competing with ASSP manufacturers headquartered in Taiwan, etc., in areas where have relatively low integration of custom SoCs (e.g., 16nm, 28nm).

Q19. Please explain the factors driving customers dissatisfied with ASSP of general purposes.

A19. Under ASSP design platform, once ASSP vendors completed the development of proprietary application, the subsequent development is also limited in such environment to "lock-in" customers to their particular ASSP architecture and prevent from losing the initiative. In addition, as the semiconductor industry enters the "More than Moore" era, it is no longer possible to optimize the functions and capabilities of SoCs by only concentrating on the improvement of finer process. Unlike ASSP vendors who usually limited to their proprietary IP, we are able to utilize the latest technologies and resources across the semiconductor ecosystem, including IP. EDA tools, etc., horizontally. Our flexibility in combining various technologies from across the ecosystem has become one of our strengths.

Q20. Does your design and development stage cover everything from RTL, netlist, physical design to mask data?

A20. We deliver mask data to foundries (e.g. TSMC) for fabrication. Therefore, our design and development stage cover from initial design to mask data preparation. As a fabless semiconductor provider, we cover design, quality assurance and sales of our products.

Q21. Please explain your holding strategy on IP library,

A21. We retained own IP succeed from Panasonic Holdings Corporation of TV solutions, Fujitsu Limited of digital camera/printer/optical network solutions. Under our collaborative design process, we conduct the optimal selection of IP from across the semiconductor industry ecosystem and not limited to our own IP. We develop our proprietary IP if considered to be necessary, on the other hand, we combine the various IP from the semiconductor ecosystem to meet the needs of customers.

Q22. It is indicated that your profit margin is lower than ASSP vendors'. Is lower margin a barrier to entry to custom SoC segment, that is, there is no merit for ASIC and ASSP vendors to enter custom SoC segment aggressively.

A22. Selecting and combining the most appropriate IP, tools, and wafers from semiconductor industry ecosystem for customers shall be know-how in SoC custom segmentation, which is not easy to imitate for ASSP vendors. Therefore, we treat the capability to select and combine the most appropriate things for customers be the barrier to entry.

Q23. It is heard that certain projects in design wins were subsequently cancelled. Were there any cancellations in current 2nd quarter?

A23. We believe a certain of cancellations may occur due to various changes in customers' circumstances. The cancellations consist of cases where the customer gave up using the SoCs in their business even if the design and development stage completed, as well as customer terminated the projects during the design and development stage. There is no cancellation of projects in current 2nd quarter, but we recognize we are facing the risk of certain likelihood of cancellations in our business.

Q24. Will constraint continue result from limitations on available manufacturing capacity of foundries? Will there be an improvement in your business performance if available semiconductor manufacturing capacity increase?

A24. In previous years, available semiconductor manufacturing capacity is extremely restricted in both advanced and mature technologies production. From this year, the available capacity has been gradually increased and are provided for us by foundries in the area of advanced technologies (7nm, etc.). We will make sufficient use of additional capacity provided by foundries to accelerate mass production. However, capacity in 40nm & above areas continued to be constraint and we will keep working on securing the capacity. There are also highly limitations on available capacity of assembling and testing process of back-end manufacturing.

Q25. When will your medium-term financial goal expected to be achieved?
(Total net sales growth with a CAGR in the high 10% range; operating profit margin in the low-to-mid 10% range)

A25. We did not schedule a specific fiscal year for the medium-term financial goal. This financial goal is a KPI that we aim to achieve in the medium term of few years based on a certain business environment.

Q26. The available capacity has been gradually increased and provided by foundries for us in the area of advanced technologies (7nm, etc.). In areas other than 7nm and 40nm, are you able to fully meet, or still restricted to fully meet current product demand from customers?

A26. Capacity in 40nm & above areas continued to be constraint, and we will keep on negotiating with customers in case we cannot fully meet their product demand.

Q27. How is situation of your customer diversity?

A27. The net sales of the customer who contributed most to FY21 net sales is weighted less than 10%. We are working on increasing customer diversity to avoid customer concentration.

Q28. How do you see the impact on the current semiconductor market and the risk of recession?

A28. Our business focused on custom SoCs based on advanced technology areas, our growth based on the start of mass production stage of the design wins acquired in recent years throughout our ongoing business transformation. There is an additional positive impact result from gradual available semiconductor manufacturing capacity increase. Therefore, there are no revisions on consolidated earnings forecast of current fiscal year and our medium-term financial goals.

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