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SYNAPTICS – FOURTH QUARTER, FISCAL 2019 CONFERENCE CALL
Prepared Comments

JASON: SAFE HARBOR

Good afternoon and thank you for joining us today on Synaptics' fourth quarter, fiscal 2019 conference call. My name is Jason Tsai and I am the head of Investor Relations at Synaptics. With me on today's call are Kermit Nolan, our Interim CFO and Chief Accounting Officer, and Saleel Awsare, Senior Vice President and General Manager, of our IoT Division, Corporate Marketing & Investor Relations. This call is also being broadcast live over the web and can be accessed from the investor relations section of the company's website at synaptics.com.

In addition to a supplemental slide presentation, we have also posted a copy of these prepared remarks on our investor relations website. The supplementary slides have also been furnished as an exhibit to our current report on form 8-K filed with the SEC earlier today and add additional color on our financial results.

In addition to the Company's GAAP results, management will also provide supplementary results on a non-GAAP basis, which excludes share-based compensation, acquisition related costs, and certain other non-cash or recurring or non-recurring items. Please refer to the press release issued after market close today for a detailed reconciliation of GAAP and non-GAAP results.

Additionally, we would like to remind you that during the course of this conference call Synaptics will make forward-looking statements. Forward-looking statements give our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance and business. Although Synaptics believes our estimates and assumptions to be reasonable, they are subject to a number of risks and uncertainties beyond our control and may prove to be inaccurate. Synaptics cautions that actual results may differ materially from any future performance suggested in the Company's forward-looking statements. We refer you to the Company's current and periodic reports filed with the SEC, including the Synaptics Form 10-K for the fiscal year ended June 30, 2018, for important risk factors that could cause actual results to differ materially from those contained in any forward-looking statement. Synaptics expressly disclaims any obligation to update this forward-looking information.

I will now turn the call over to Saleel Awsare. Saleel?

SALEEL: INTRODUCTORY REMARKS

Thanks, Jason, and I'd like to welcome everyone to today's call. I'm happy to be speaking to you today on behalf of the Board and our Executive Leadership Committee.

As I'm sure you saw earlier this week, we announced the appointment of Michael Hurlston as our new President and CEO, and he is expected to start August 19th. He will also join the Synaptics Board on the date of his appointment. We are happy to welcome Michael as he brings with him a wealth of experience in semiconductors, especially in the markets that we are focused on, and has a strong track record in delivering results. We believe that Michael will be a great cultural fit for the company and look forward to his leadership in driving the transformation and next wave of growth for the company.

Now, I will first provide an update on our business and our corporate transformation, and then Kermit will discuss our financial results and outlook.

Fiscal year 2019 was a challenging time for Synaptics due to increased macro and geopolitical uncertainty, as well as management transitions that drove short-term weakness in our business. Despite these challenges, we kicked off our new fiscal year laser-focused on transforming into a stronger, more profitable company for the long-term.

As we talked about on our last earnings call, the corporate transformation initiative we kicked off focuses on driving innovation, unlocking the untapped potential within our extensive product portfolio of technologies and expertise, and aligning the business towards better profitability long-term.

We have identified the investment areas for higher profitability and growth. These include edge computing SoCs for consumer IoT in the smart home, fingerprint sensors and TDDI for automotive, OLED display and touch for mobile devices, audio SoCs for wired and true wireless headsets, and high speed wired connectivity for PCs, peripherals and VR. We are now executing on the transformation to deliver a stronger company with more diversified growth, higher margins and stronger profitability.

For these focus areas, we are developing differentiated solutions that encompass more software, more firmware and more intelligence. We are doing this in collaboration with our customers by aligning our roadmaps and continuing to be an essential partner for their longer-term product development.

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Based on these actions, we are beginning to deliver better margins highlighted by our second consecutive quarter with gross margin above 39%. In addition, we have a more diversified revenue mix with IoT now accounting for 30% of our revenue and mobile accounting for just 50% in Q1 fiscal 20, down from over 60% for most of fiscal 19.

Our people are the key to our company's success and our ability to compete long-term. In this area, we restructured and reduced headcount, aligning our workforce to our strategic direction. Further, we have kicked off a retention program to retain certain key engineering and management personnel to ensure continuity through this transformation.

These necessary and strategic actions are helping to establish a strong foundation for the future and our planned growth.

Now let me share with you some recent business highlights:

Synaptics remains focused on innovating in the IoT business. We have a strong pipeline of wins and are confident it will grow double-digit in fiscal year 20.

Leading our innovation is the edge computing SoC portfolio that targets consumer IoT in the smart home. We are building a strong franchise around our smart-edge AI solutions that leverage our voice and video-centric software and firmware capabilities, enabling our customers to quickly integrate their IP and accelerate time to market. Additional investments in this area will combine our latest CPU, NPU and GPU for enhanced computer vision capabilities, significantly expanding AI functionality at the edge. We are seeing tremendous interest from OEMs developing a new generation of media streamers and global service providers seeking to monetize on smart home products.

As we highlighted last quarter, we started shipping Smart Edge AI AudioSmart SoCs and we are now expecting a major customer to begin selling their products in retail starting next quarter. We are also engaging with other hardware makers and kicked off several new designs based on these SoCs to embed voice-capabilities into other consumer devices like soundbars and TVs, mesh and WiFi routers and media streamers. We expect to see these customer products at retail over the next few quarters.

Jumping to audio headset SoCs, we are building on our success with two of the world's top three smartphone OEMs with a new design win for a highly anticipated flagship phone that is expected to ship in every box at retail starting this quarter. Additional investments in this area leverage our advanced software and firmware capabilities such as hybrid active noise cancellation, unique playback processing, and cutting-edge voice pick-up technology. These technology innovations enrich the audio experience, expecting to drive greater adoption of our solutions and continued strong growth for us in next-generation wired and wireless headsets.

In the mobile business, we are focusing on higher gross margin, premium segments of the market. We continue to win OLED touch and display designs across major smartphone OEM's due to our superior performance and features.

LCD-based smartphones will remain a vital part of smartphone makers' portfolios for the next few years. Through well-established OEM and display manufacturer relationships, we see ongoing development for LCD-based handsets and are encouraged by the opportunity to support their transition to OLED.

As the industry prepares for the transition to 5G, we are also partnering with display manufacturers and smartphone OEMs to deliver high-performance OLED and LCD screens that leverage the higher bandwidth networks with better displays and resolution to give consumers a meaningful improvement in performance with faster 5G networks.

Moving to our automotive business, we are energized about the long-term opportunity and are investing in fingerprint sensors and TDDI solutions.

With regards to fingerprint, we received approval for Start of Production from our lead OEM customer and expect to see our first automotive fingerprint solution in 2020 model year cars.

Our TDDI solutions have been well received by OEMs, Tier-1s and display manufacturers worldwide. We exited FY19 with TDDI design-ins at six major OEMs across Europe, North America, Japan, and China. Many of these OEM's are planning to transition all of their future display systems to a full in-cell platform using TDDI. Additionally, we are in active discussions with several additional OEM/Tier-1s that is centered around migration to TDDI from conventional touch screens.

We expect to have another successful year of design-ins with automotive TDDI products in FY20 and we are committed to this market long term. This trend is expected to continue as TDDI offers significant cost and optical performance advantages to car manufacturers. As part of our efforts to enable this industry transition, Synaptics is expanding our product portfolio in FY20.

Within our PC business, Synaptics remains the major market share leader for both touchpads as well as secure fingerprint authentication. Growth in fingerprint for PC is highlighted with new designs at all the major PC makers, including HP, Dell and Lenovo. We are a trusted leader in secure biometrics and pleased to partner with these industry leaders.

As you can see in these highlights, we are making progress in our transformation. We've identified the right investment areas and are executing to our strategy. Our margins are improving, our business and customers are becoming more diversified and we are well underway in our transformation journey to becoming a stronger, more profitable company.

With that, Kermit will now discuss our results and outlook.

KERMIT: FINANCIAL RESULTS AND OUTLOOK

Thanks Saleel, and hello everyone.

Synaptics' revenue for fiscal 2019 of $1.47 billion was down 10% from last fiscal year. For our fourth quarter, revenue of $295 million, was down 12% sequentially and 24% year-over-year, slightly below our guidance range and reflects the impact of our customer, Huawei, being placed on the entity list and accounting for more than $20 million impact in the quarter. While we can ship our solutions to Huawei without limitation, their ability to produce phones for certain markets has been adversely impacted by the restrictions on access to certain US-based technologies as well as their ability to source other components.

Revenue in the June quarter from Mobile, IoT and PC products was approximately 54%, 26%, and 20%, respectively. We had two customers above 10% of revenue, at 18% and 16%.

For the June quarter, our GAAP gross margin was 30.6%, which includes $15.4 million of intangible asset amortization, $700,000 of share-based compensation costs, and the accrual of a $9.0 million charge for a loss on a supplier commitment agreement, which was an arrangement intended to secure a minimum supply commitment from a vendor through the end of calendar 2020. As demand is no longer projected to achieve the minimum commitments required, we have accrued an estimated loss under the supply agreement.

GAAP operating expenses in the June quarter were $123.7 million, which includes share-based compensation of $9.6 million, acquisition related costs of $3.2 million, consisting of intangibles amortization and transitory post-acquisition compensation program costs, restructuring expenses of $7.3 million, and retention program costs of $2.5 million.

As part of our corporate transformation, we initiated a restructuring in June which we anticipate will result in annualized operating expense savings exiting fiscal 2020 of approximately $40 million from reduced headcount, outside support and project costs. Also, as part of our overall plan and to ensure operational continuity and support as we transition the company through senior level management and product focus changes, we entered into retention arrangements with certain key engineering and management employees. The cost of the retention arrangement is expected to be approximately $23 million and will be accrued over the 18-month period ending November 2020.

Our GAAP tax rate was negative 1% for fiscal 2019.

In the June quarter we had a GAAP net loss of $46.2 million, or a loss of $1.35 per diluted share, and for fiscal 2019, the GAAP net loss was $22.9 million, or a loss of $0.66 per diluted share.

On a non-GAAP basis, our June quarter Non-GAAP gross margin of 39.1% was above the high end of our guidance range and primarily reflects a better product mix.

June quarter Non-GAAP operating expenses were below the low end of our guidance range at $101.1 million and up $1.9 million from the preceding quarter.

For fiscal 2019, our non-GAAP tax rate was 12%.

Non-GAAP net income for the June quarter was $13.2 million, or $0.38 per diluted share - a 63% decline year-over-year compared with $35.7 million, or $1.00 per diluted share, in the fourth quarter of fiscal 2018. Non-GAAP net income for fiscal 2019 was $141.2 million, or $4.00 per diluted share, essentially flat compared with $141.4 million last fiscal year.

Turning to our balance sheet, we ended the quarter with approximately $328 million of cash, an increase of $4 million from last quarter. The increase in cash for the quarter was primarily driven by cash flow from operations of $43 million, which was partially offset by $41 million of cash used in our share repurchase program for the purchase of 1.44 million shares.

Year-over-year, cash increased by $27 million, which was primarily driven by cash flow from operations of $154 million, partially offset by $119 million used in our share repurchase program for the purchase of 3.29 million shares or over 9% of our beginning shares outstanding, reflecting our ongoing commitment to generating shareholder value. As mentioned in the earnings release, we repurchased an additional 556 thousand shares in July, increased the repurchase authorization by $100 million and extended the expiration date to July 2021.

Receivables at the end of June were $230 million and DSOs were 70 days, reflecting a back-end loaded quarter. Inventories were $159 million and inventory turns were 5.

Capital expenditures for the year were $24 million, and depreciation was $36 million.

Now I will make a few comments regarding our quarterly outlook.

Based on our backlog of approximately $277 million entering the September quarter, subsequent bookings, customer forecasts, product sell-in and sell-through timing patterns, as well as expected product mix, we anticipate revenue for the September quarter to be in the range of $300 million to $330 million. We expect the revenue mix from mobile, IoT, and PC products to be 50%, 30% and 20%, respectively.

This guidance reflects a solid double-digit sequential increase in our IoT business, a small sequential increase in our PC business, and our Mobile business remaining flat due to ongoing demand uncertainty with Huawei. Excluding this effect, our mobile business would be showing strong growth sequentially.

I will now provide GAAP outlook data for our September quarter, and will follow with non-GAAP outlook data:

We anticipate the stock-based compensation charge in the first quarter to be in the range of $15 to $16 million.

In addition, September quarter GAAP expenses, will include non-cash charges of approximately $18 million related to intangibles amortization, of which approximately $15 million will be reflected in cost of sales. We also expect to accrue restructuring costs of $6 million to $7 million, and retention costs of $4 million in the first quarter.

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Finally, we expect our GAAP tax rate for fiscal 2020 to be in the range of 10 to 15% for the fiscal year.

I will now provide non-GAAP outlook data for our September quarter:

Taking into account our overall revenue mix, we expect non-GAAP gross margin in the September quarter to be between 39 and 41%, anticipated to be our third consecutive quarter with gross margin above 39%.

We expect non-GAAP operating expenses in the September quarter to be in the range of $96 million to $99 million.

We anticipate our non-GAAP long-term tax rate for fiscal 2020 to be in the range of 11% to 13%.

Non-GAAP net income per diluted share for the September quarter is anticipated to be in the range of $0.60 to $0.90 per share.

Now, I'd like to discuss our outlook for fiscal 2020. As a result of our shifting of investments driven by our new strategic direction and business model, we anticipate non-GAAP gross margins to improve to 39 to 41% for fiscal 2020, with the midpoint representing a key short-term milestone in our corporate transformation. We anticipate that revenue from IoT will increase by a low-teens percentage, PC will be essentially flat and mobile will be down significantly due to increasing macro-economic uncertainties related to the current US/China trade tension, and our high-end LCD mobile customer's long-term product shift to OLED. For fiscal 2020 revenue will decline approximately 10 to 20% year-over-year. We look forward to updating you as the year progresses.

With that, I will now turn the call over to Saleel to wrap up our prepared remarks.

Saleel?

SALEEL:

Thanks, Kermit.

In Summary, we are excited by the opportunities that lie ahead for us as we start our new fiscal year. Our investments in differentiated, higher-margin products have already begun to pay dividends and we expect that our focus on priorities and investments aligned to our corporate strategy will further improve our performance longer-term.

With that, I'll now turn the call over to the operator to start the Q&A session.