Synaptics®

SYNAPTICS – SECOND QUARTER, FISCAL 2020 CONFERENCE CALL
Prepared Comments

JASON: SAFE HARBOR

Good afternoon and thank you for joining us today on Synaptics' second quarter, fiscal 2020 conference call. My name is Jason Tsai and I am the head of Investor Relations. With me on today's call are Michael Hurlston, our President and CEO and Dean Butler, our CFO. 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 29, 2019, 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.

Now before we get started, I'd like to announce that we are planning on hosting our analyst day in June in New York and we look forward to discussing more details about our long-term strategy and targets with you at that time. I will be sending out more details shortly. I will now turn the call over to Michael.

MICHAEL: INTRODUCTORY REMARKS

Thanks, Jason, and I'd like to welcome everyone to today's call. I'm pleased to be speaking with all of you again today and report an outstanding quarter and finish to calendar 2019. In the December quarter, we saw unusually strong demand from our largest mobile customer as well as in our PC business, leading to results that were better than what we forecasted three months ago. We continued to be disciplined with our spending, resulting in OPEX that was lower than expected. All of this led to our first quarter of 20% non-GAAP operating margin in more than five years, and a record quarter for non-GAAP net income and EPS. Dean will go into more details on our financial performance later in the call but I'm really pleased by our team's execution and the operational control and efficiencies that we have put in place and are beginning to impact our bottom line.

Now let me update you on the progress we are making in transforming Synaptics and reshaping our business to deliver sustainable, high-margin long-term growth. Towards the end of last year, we started the process of our strategic review internally to assess our opportunities and risks. While we are still early in the process, I'm really encouraged by the highly differentiated capabilities in products like our OLED touch and our low-power, high-performance edge-computing SoCs. These SoCs feature embedded neural network and AI capabilities for smart audio and video devices and can span a variety of end markets. While we are excited about the opportunities in these product areas and will continue to invest here, we will certainly deemphasize other parts of the portfolio in order to continue to keep spending in a reasonable envelope.

As part of our portfolio optimization, we announced in December the divestiture of our mobile LCD TDDI product line for $120 million and we expect that transaction to close in the June quarter. This is the right move for Synaptics as our mobile LCD TDDI was already very margin dilutive and with ongoing ASP pressure, it would have continued to be a drag on gross margins had we not made the move to divest this product line. We do retain our ability to develop and sell discrete display and touch solutions, TDDI for OLED displays and TDDI for automotive. One of the ways we would look to use the cash from this sale is to look at inorganic opportunities to add more differentiated, high-margin, accretive assets to our portfolio. Dean will provide more details later as to the financial impact on our P&L that this transaction is expected to have.

Now let me update you on our businesses.

In mobile, as I mentioned earlier, we saw unusual strength and demand from our largest mobile customer in the December quarter and that strength continues into this quarter. Demand for the handsets that our display drivers are powering continues to exceed expectations in the short-term and we continue to benefit as this current product cycle plays out.

We are also seeing strong demand and design momentum with our OLED touch sensor. As you may remember, our first win was with the Huawei Mate 30 Pro last year and we are making very good progress with our customers in delivering a differentiated touch solution with premium features that include active pen support, face detection, and support for high report rates of 90Hz and 120Hz on the latest generation of on-cell flexible OLED displays. I'm very excited by our pipeline here and am confident that our industry-leading OLED touch controllers will be a meaningful growth driver for Synaptics long-term, driven by the ramp of flexible OLED panel production.

Moving to IoT, this business performed as expected in the quarter as new product launches with multiple customers delivered solid results. At CES last month, we announced and demoed several new IoT products including our VS600 family of edge-computing software-enriched SoCs that combines CPU, GPU and NPU with over six teraops performance to power audio, video, computer vision and deep learning AI capabilities, combining intelligence and personalization to provide an enhanced experience for consumers. We are seeing strong interest from retail device makers and TV service providers and this new family of SoCs will power a new generation of smart displays, smart cameras, soundbars, set-top-boxes, voice-enabled devices, and other emerging connected products. Our design pipeline continues to grow across all of our IoT segments and we are confident that the business will continue to be a strong growth driver for Synaptics.

In PCs, we saw unusual strength this quarter driven by a couple of different dynamics. As we talked about last quarter, we saw what we believe to be accelerated orders ahead of the anticipated tariffs that were supposed to be enacted in December but we also saw strength in the enterprise market as companies continue to upgrade to Windows 10 ahead of Windows 7 support that ended in January. While we do not expect this strength in the PC market to be sustainable, we continue to enjoy high market share in our fingerprint and touchpad product lines.

Overall, I'm really excited by the momentum we are seeing in our business. We have a strong pipeline of wins with all our major customers. Our strategy to focus on more differentiated solutions that have higher margins is beginning to pay off and our operational discipline is adding leverage to our model. We still have a lot of work ahead of us in this transformation but I'm very encouraged by the early progress we are making and our incredible team that is executing towards a stronger, more profitable future for Synaptics.

Now let me turn the call over to Dean to review our second quarter financials and provide our outlook

DEAN: FINANCIAL RESULTS

Thanks Michael, and good afternoon to everyone.

I'll start with a review of our financial results for our recently completed quarter, then provide our current outlook for our fiscal Q3.

Revenue for the second quarter of fiscal 2020 of $388 million was approximately 6% above the high end of our previous guidance range, up 14% from the preceding quarter, and down 9% from the same quarter last fiscal year. Our revenue strength for the quarter primarily reflects better than expected demand from our largest LCD display customer and from our PC customers. During the quarter we had two customers above 10% of revenue, at 21% and 13%.

For the December quarter, our GAAP gross margin was 41.0%, which includes $8.2 million of intangible asset amortization, $600,000 of share-based compensation costs, $200,000 of retention program costs, and a $1.8 million partial reversal of a previously accrued loss on a supplier commitment agreement.

GAAP operating expenses in the December quarter were $124.8 million, which includes share-based compensation of $14.5 million, intangibles amortization of $3.0 million, restructuring expenses of $13.3 million, and retention program costs of $3.4 million.

We accrued GAAP tax expense in the quarter of $12.0 million, bringing the year-to-date GAAP tax rate to 22.3%.

GAAP net income for the quarter was $19.8 million, or net income of $0.58 per diluted share.

On a non-GAAP basis, our December quarter non-GAAP gross margin of 42.9% was 40 basis points above the high end of our guidance range and primarily reflects ongoing cost savings initiatives and an overall better product mix.

The December quarter non-GAAP operating expenses were below the low end of our guidance range at $89.2 million and down $6.3 million from the preceding quarter; primarily reflecting the benefit of restructuring activities that have resulted in the achievement of the previously announced $40 million in annualized opex savings six months ahead of schedule. And to reiterate Michael's comments from earlier, I'm pleased to point out that our 20% non-GAAP operating margin this quarter was a first in more than five years for Synaptics.

Our non-GAAP tax rate for the quarter and year-to-date period was 12%.

Non-GAAP net income for the December quarter was $70.1 million, or $2.04 per diluted share - a 29% increase year-over-year compared with $54.4 million, or $1.55 per diluted share in the second quarter of fiscal 2019 and both were a record high for the company.

Now turning to our balance sheet

We ended the quarter with approximately $425 million of cash on hand, an increase of $74 million from the prior quarter, primarily driven by cash flow from operations.

Receivables at the end of December were $246 million and DSOs dropped to 57 days. Inventories were $103 million and inventory days were 42, down from 63 days in the prior quarter, reflecting stronger product demand throughout the quarter.

Capital expenditures for the quarter were $3.2 million, and depreciation was $8.1 million.

Before I turn to our guidance, let me discuss the expected impact of our Mobile LCD TDDI divestiture. We expect this transaction to close in our fourth fiscal quarter and when it does, we will receive $120 million for this product line plus an additional cash payment for on-hand inventory at that time. From a P&L perspective, let me give you a sense of the scale and scope of this mobile LCD TDDI product line. For our last fiscal year, revenue was more than $300 million and gross margins were in the mid-20s. Mobile LCD TDDI is a profitable product line for Synaptics and while most of the associated OPEX will also move off our P&L, we will retain some in the form of trapped costs that will take us several quarters to unwind. Revenue from this product line is expected to decline in fiscal 2020 compared to fiscal 19 as we have been more selective in the mobile LCD TDDI revenue opportunities we pursued so gross margins this year will be higher than in fiscal 19 but still meaningfully dilutive to the corporate average. We will provide additional color after the transaction closes.

Now let me discuss our outlook for the third quarter:

Based on our backlog entering the March quarter of approximately $284 million, subsequent bookings, customer forecasts, product sell-in and sell-through timing patterns, as well as expected product mix, we anticipate our total revenue for the March quarter, which includes mobile TDDI, to be in the range of $330 million to $350 million. We expect the revenue mix from our Mobile, IoT, and PC products to be 52%, 24% and 24%, respectively.

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

We expect our GAAP gross margins to be in the range of 39.5% to 41.5%.

We expect our GAAP operating expense to be in the range of $115 to $120 million which includes charges for intangibles amortization, stock compensation, and we also expect to accrue restructuring costs and retention related costs.

Finally, we expect our GAAP tax rate for fiscal 2020 to be in the range of 20 to 25% for the fiscal year.

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

We expect non-GAAP gross margin in the March quarter to be between 42% and 44% and anticipate this to be our third consecutive quarter with non-GAAP gross margin above 40%.

We expect non-GAAP operating expenses in the March quarter to be in the range of $88 million to $91 million.

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

Non-GAAP net income per diluted share for the March quarter is anticipated to be in the range of $1.30 to $1.60 per share.

This wraps up our prepared remarks, so I'd like to now turn the call over to the operator to start the Q&A session.

Operator?

OPERATOR: Q&A

MICHAEL: FINAL REMARKS

I would like to thank all of you for joining us today. We look forward to seeing you at upcoming investor conferences during the quarter.