SYNAPTICS – THIRD QUARTER, FISCAL 2022 CONFERENCE CALL
Prepared Comments

MUNJAL: SAFE HARBOR

Good afternoon and thank you for joining us today on Synaptics' third quarter, fiscal 2022 conference call. My name is Munjal Shah 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, which can be accessed from the investor relations section of the company's website at synaptics.com.

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, including our expectations regarding the potential impacts on our business of the COVID-19 pandemic and the supply chain disruption and component shortages currently affecting the global semiconductor industry. 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 our most recent Annual Report on Form 10-K, 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 Michael.

MICHAEL: BUSINESS OVERVIEW

Thanks, Munjal, and I'd like to welcome everyone to today's call. We reported another excellent quarter with revenue above the mid-point of our guidance range due largely to strength in our IoT products. Our results showcase that our diverse portfolio, constructed over the last few years, can weather challenges in one or more product groups. Higher revenue and a record IoT mix led to record profitability in the quarter with non-GAAP gross margin above 60% for the first time in the company's history. We delivered record non-GAAP operating margin and our non-GAAP EPS was above the high end of our guidance range. I am particularly proud of our IoT product group which accounted for 64% of our total revenue and grew 99% year-over-year.

This quarter, we overcame some well-documented headwinds. First, as many have reported, Chinese handset sell through was weaker than expected. Although we haven't seen any erosion in our share position, we experienced weaker than expected revenue across our Chinese customer base. In addition, our narrow exposure to a North American handset maker caused underperformance against our initial expectations which will also continue into ensuing quarters. That customer, once a significant portion of our total revenue, now represents only a mid-single digit percentage. Outside the mobile handset area, we are seeing some softness in PC sales. We believe our business has sustainability due to our overweighted exposure to commercial SKUs, but we are forecasting a modestly down year for overall PC units.

In spite of all of these challenges, we continue to report strong revenue growth and record gross margins and earnings. Why? Our strategy to diversify our portfolio has paid off in spades. We are a stronger company with a more diversified portfolio and customer base. We have a series of growth drivers in our IoT product offerings that continue to do well, more than offsetting choppiness in mobile or PC. These growth drivers are: Wi-Fi/BT combo chips, Display Drivers in Virtual Reality headsets, TDDI circuits in automotive, and our family of video interface products. All four of these areas of our portfolio are growing faster than the company overall, and we view each as a sustainable franchise.

The first of our growth drivers is wireless connectivity which continues to have the best overall trajectory as we continue to win new designs and ramp at new customers. We have shown particular strength in Wi-Fi 6E combo chips in video applications, primarily in over-the-top and traditional operator set-top boxes. In these applications, customers value our differentiated ability to sustain high bandwidth in challenging multipath environments. In addition, we have been able to cross-sell our combos into both traditional Synaptics platforms as well as new DSP Group sockets, such as video conferencing systems. Our GPS solutions are performing well, particularly in wearables. Our 'Triple-Combo' wireless device is being sampled and we are engaged with early customers that want to take advantage of a single chip that features Wi-Fi 6E, Bluetooth and Thread/Zigbee protocols. To support the momentum in this business, we are accelerating our own engineering capability. While we have already taped out two organic devices, we are adding more engineering talent to deliver the product roadmap we have in place. As such, we announced the opening of our Wireless research and development center in France, expanding our presence in Europe and leveraging a strong base of local analog and RF expertise. Combined with the talent from our DSP Group acquisition and some additional hiring, we feel we are in position to develop leading edge wireless products purpose-built for the IoT market.

The second of our growth drivers is display drivers that are specifically designed for Virtual Reality headsets. As this market grows, Synaptics will benefit given our incredibly high market share. Our traction is across geographies as we have market leadership with designs shipping in almost all major platforms. In particular, we are doing well with OEMs in China that have gaming and entertainment content suited for these headsets and whose early sales results have been impressive. We are the clear technology leader for virtual reality displays and offer solutions that enhance the user experience by increasing pixel density at the focal point of the eye. Our market leading roadmap supports higher precision displays, and we expect that we will continue to win as the technology evolves. We are seeing strong design-win activity giving us confidence for the back half of the calendar year and beyond.

TDDI circuits for automotive displays is another growth driver for Synaptics. As we have reported before, automotive panels are in the early innings of migrating from discrete touch and display ICs to an integrated TDDI. Our share of TDDI continues to be high and as the market continues to move rapidly in this direction, we see significant top line benefit. This quarter, we had multiple designs ramping across all the geographies which will become more evident in the second half as new cars are launched. As with our other growth drivers, we have a leading roadmap of TDDI solutions that we expect will enable us to maintain our leadership as automotive display sizes increase.

Our fourth significant driver of both top and bottom-line growth is our family of video interface products which have traditionally been applied to docking stations. The docking station market continues to do incredibly well beyond the initial remote work demand, driven by an entire workplace and technology refresh cycle. In fact, Dell, who has a significant market share lead, just announced three new docking stations featuring four of our devices. While docking has been our historical area of strength, our video interface products are finding their way into a whole host of new devices. First, we are continuing to see traction for wireless docking bringing with it expanded Synaptics content. Second, we are applying our products to smart monitors. Finally, customers are using our technology in a host of video conferencing designs. All of this is fueling growth in the core of our video interface products. However, beyond the core, we have opened a new frontier with a set of products for protocol adapters and converters which is a completely new opportunity for us. Several ODMs have introduced products using our technology and we have design-wins at multiple OEM customers that could launch in the second half of calendar year. All told, driven by the incredible diversity of offerings, our video interface product group is one that we expect to grow significantly into the foreseeable future.

While these four areas drive a significant portion of our IoT growth, we are doing well across the portfolio. A couple other areas to touch on include our low power processor technology with AI and machine learning capability. Last month, at the tinyML Summit, we demonstrated how our ultra-low-power Katana and DBM10L SoCs with neural network engines can be used in both machine vision and natural speech processing. We have applied the device to occupancy counting, sound-event detection, keyword spotting, and meter reading. We are working with and have design-wins with leading OEMs for low power edge AI applications and see a significant long-term TAM potential in this new market. We are moving our video processors outside the core operator set top box market and into new areas where we have additional content to sell such as video conferencing systems, security platforms, and smart monitors. Finally, we just announced our entry into a totally new market, introducing a single chip that combines inductive, capacitive, ambient and Hall effect sensors in a single device. This opens a large TAM as it can be applied to TWS headsets, gaming controllers, VR headsets, automotive and fitness products.

After our first full quarter with DSP Group, we have been pleasantly surprised by the business. The ULE products have been robust and has presented a multitude of cross-selling opportunities including some video processors that can drive security panels. The UCC products are also performing better than expected and we have been able to cross sell wireless and video interface products into enterprise VOIP customers. Finally, demand for cordless products remains surprisingly strong and we have been able to engage a set of totally new customers with our entire product portfolio.

Let me move on to our PC product group. Our latest touch solution is seeing good traction with top OEMs designing it into notebooks that will be introduced in second half of calendar 2022. We win because OEMs like our best-in-class performance that features the highest level of NIST security. Additionally, we are engaged with OEMs as they transition to larger Haptic Forcepads and expect to a resultant ASP lift. Our biometric fingerprint solutions are seeing increased attach rates due to the need for simple, one-touch authentication. As stated earlier, we expect the PC TAM to be flat to down in the next year, but we will continue to do well due to a focus on performance which is of particular importance to commercial SKUs, increased content per box, and a gradual mix to higher ASPs.

Finally, Mobile, is now only about 17% of company revenue. Our new high-end flexible OLED display driver is starting to gain traction and we expect a more material ramp in the second half of calendar 2022. This is a new opportunity for us where we have limited share today. We continue to do well with our touch technology in China. As new handset models go to production featuring high-end flexible OLED displays, we would expect to do well, particularly as we continue to introduce solutions with better performance and more advanced features.

And lastly on supply chain, our results and guidance take into account the recent lockdowns in China. While the aforementioned areas of softness have created limited supply headroom in some areas of our business, in the fast-growing areas of our portfolio, we are still seeing supply chain challenges. Generally, we expect to see gaps to demand throughout the calendar year and beyond.

To conclude, Q3 was yet another record financial quarter for the company. As a result of the continuing shift to IoT, we are seeing improving gross margins and earnings. We have four differentiated growth drivers that we believe will continue to deliver higher than average top-line growth. While we are very happy with the portfolio as it stands today, we will continue to look to add pieces that we feel improve our go-forward prospects.

Now, let me turn the call over to Dean to review our third quarter financial results 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 the recently completed quarter and then provide our current outlook.

Revenue for the March quarter was $470 million, above the midpoint of our guidance. Revenue was up 12% sequentially with continued strong demand for the company's IoT products. Revenue from IoT, PC, and Mobile were 64%, 19% and 17%, respectively.

Year-over-year, March quarter revenue was up 44%, driven by significant growth in IoT, where we continue to see strong customer demand, and the inclusion of our first full-quarter of results related to the acquisition of DSP Group. Our IoT product revenue grew 99% year-over-year and was up 15% sequentially. With these results, IoT is now nearly twice the size of our PC and Mobile product lines combined. IoT has grown at high double-digit rates for seven straight quarters, outpacing almost all peers, making Synaptics one of the largest IoT focused semiconductor players with approximately $1.2 billion in run-rate sales.

Our PC product revenue grew 9% sequentially but was down 8% year-over-year. Overall PC demand has been reasonably stable for the past several quarters as our focus continues to be on commercial notebooks, but as Michael mentioned, we are experiencing some softness as a result of the lockdowns in China affecting our end customer's supply chain in this region.

Our Mobile product revenue grew 3% sequentially and increased 3% year-over-year, coming in lower than our prior expectations. We continue to experience a weaker demand environment for our products across both China and US based customers. We believe that China OEM end product sales have been hampered by recent local COVID lockdown protocols and by the political unrest in Europe, leading to above average inventory at these customers.

During the quarter, we had two customers greater than 10% of revenue, each at approximately 14%, both being distributors servicing multiple OEMs. A wide variety of our products ship through these distributors and, as such, don't represent any specific one OEM or end market.

For the March quarter, our GAAP gross margin was a new company record at 54.0%, which includes $25.2 million of intangible asset amortization, $7.2 million of inventory fair value adjustment, and $900 thousand of share-based compensation costs.

GAAP operating expenses in the March quarter were $165.7 million, which includes share-based compensation of $33.2 million, acquisition related costs of $13.1 million consisting of intangibles amortization and transaction costs, amortization of prepaid development costs of $2.5 million and restructuring-related costs of $11.3 million.

Our GAAP tax expense was $24.4 million for the quarter.

In the March quarter, we had GAAP net income of $64.9 million or GAAP net income of $1.59 per share.

Now, turning to our non-GAAP results.

March quarter non-GAAP gross margin of 61.1% was a new company record and above the high-end of our guidance range, reflecting a strong mix as we continue prioritizing our highest value products while passing through changing input prices.

March quarter non-GAAP operating expenses were at the mid-point of our guidance at $105.6 million, and up $11.4 million from the preceding quarter due to the inclusion of the first full quarter of DSP Group.

Non-GAAP tax expense was $20.9 million for the quarter.

Our record non-GAAP net income in the March quarter of $152.7 million was an increase of 15% from the prior quarter and an incredible 93% increase from the same quarter a year ago. This significant increase in profit has rewarded our shareholders with non-GAAP EPS per diluted share of $3.75 which was above the high-end of our guidance range.

Now turning to the balance sheet.

We ended the quarter with $755 million of cash, cash equivalents, and short-term investments on hand; an increase of $181 million from the preceding quarter driven by strong cash flow from operations of $128 million and net proceeds of $56 million from the closing of the sale and leaseback transaction of our San Jose office.

Receivables at the end of March were $298 million and days of sales outstanding were 57 days, down from 67 last quarter reflecting a more positive accounts receivable linearity during the quarter. Our days of inventory were 71, in line with 70 days last quarter and ending inventory balance was $146 million as we pipeline material expected to ship during our fourth quarter.

Capital expenditures for the quarter were $13.1 million and depreciation was $6.3 million.

We anticipate revenue for the June quarter to be in the range of $460 million to $490 million. We expect continued strength in our IoT products to more than offset softness in PC and Mobile. Our backlog position continues to be robust with many orders representing coverage for the remainder of the calendar year, especially for our IoT products. Backlog at the start of the quarter was above the high end of our guidance range as we are still significantly supply constrained, limiting our ability to service our customers' full demand. We have also factored in any known supply-chain or demand impacts resulting from the China COVID lockdown or political unrest in Europe.

We expect our revenue mix from IoT, PC, and Mobile products in the June quarter to be approximately 69%, 17% and 14%, respectively. We anticipate our IoT products growing more than 80% on a year-over-year basis, resulting in a 3-year trailing growth rate of more than 50% compounded which we believe has been significantly faster than the broader semiconductor market and faster than our IoT focused peers, reflecting a sustained growth trajectory which we've previously highlighted.

We expect our GAAP gross margin for the June quarter to be in the range of 55.0% to 56.0%.

We expect our GAAP operating expenses in the June quarter to be in the range of $158 million to $165 million, which includes intangibles amortization, prepaid development cost amortization, share-based compensation, and restructuring costs.

Finally, our GAAP net income per share for our June quarter is expected to be in the range of $1.55 to $1.85.

Now for our non-GAAP outlook for our June quarter.

We expect non-GAAP gross margin in the range of 60.5% to 61.5%, which at the mid-point of 61.0% would be approximately 350 basis points higher than the same quarter one year ago, as the strength of our product profile and diversification strategy bares tangible results.

We expect our non-GAAP operating expense in the June quarter to be in the range of $107 million to $111 million, an increase from the March quarter as synergies from our DSP Group acquisition are offset by continued investments in our organic growth opportunities such as wireless connectivity, virtual reality, video interface, and automotive applications.

We expect our non-GAAP net interest expense to be approximately $8 million in the June quarter.

We expect our non-GAAP tax rate for fiscal 2022 to be approximately 12%. We are evaluating tax law changes which, in its current form, will impact our fiscal 2023 and future tax years. These changes relate to the required capitalization of R&D expenses and the disallowance of certain foreign tax credits. As it stands now, we anticipate increasing our long-term non-GAAP tax rate to approximately 17% beginning the first quarter of our fiscal 2023.

Finally, our Non-GAAP net income per diluted share for the June quarter is anticipated to be in the range of $3.55 to $3.85 per share, on an estimated 41 million fully diluted shares.

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

OPERATOR: Q&A

MICHAEL: FINAL REMARKS

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