# 76th Quarterly Results of Infineon Technologies AG
# Intro Statement for Analyst Call
# Reinhard Ploss / Dominik Asam

**Reinhard Ploss:**

Thank you, Alexander, and good morning everyone, or “konnichiwa”.

## Group performance in Q1 FY19

Infineon has started into its 2019 fiscal year with a December quarter that evolved according to plan: our **Revenues** declined by 4 percent quarter-over-quarter, in line with normal seasonality, to 1 billion 970 million Euros. Year-over-year our revenues grew by 11 percent.

The **Segment Result** for Q1 was 359 million Euros, corresponding to a **Segment Result Margin** of 18.2 percent, even slightly ahead of our guidance.

In our last quarterly update in November, we already described a mixed demand picture, ranging from areas still in allocation to those already seeing a slowdown for several quarters. Now, at the beginning of the New Year, this picture is getting even more divergent. Also our **book-to-bill** ratio of 1.1 for the December quarter has to be interpreted in a differentiated way: on the one hand, demand in several end markets remains lackluster or even slowed down further. This applies to traditional automotive applications, servers for data centers, smartphones and the multisource business. Against a background of continuing macroeconomic uncertainties, customers adopt a wait-and-see approach. Unresolved trade tensions blur the picture for economic growth in China going forward. Inventories throughout the supply chains are at comparatively high levels, indicating that it will take some time for a recovery to feed through to the suppliers.

At the same time, we continue to see strong momentum in a significant part of our business. For differentiated high-power components for electric drivetrain and a number of industrial applications, demand still exceeds supply. This is what gives us confidence in our ability to return to the growth path in the second half of our fiscal year, despite generally lower visibility.

## Division-level performance in Q1

Now to the divisions.

### *Automotive*

Automotive **revenues** in the first quarter were 846 million Euros, down 2 percent sequentially, but up 10 percent against a very strong December quarter of the prior fiscal year. The continued strong demand for high-power products for electro-mobility including 48 volt mild-hybrids dampened typical seasonality.

The **Segment Result** decreased to 117 million Euros from 127 million in the previous quarter, driven by lower revenue. The **Segment Result Margin** stood at 13.8 percent.

The **book-to-bill ratio** stood at 1.1 for the December quarter, influenced by diverging demand patterns: global car production has been shrinking in calender year 2018, with still decent growth in the first half and an accelerating deterioration in the second half of the year. China as a key market saw a decline of the annual number of cars produced by 4%, the first such negative development in eleven years. In Europe, the impact of WLTP continues to take its toll on car production. For 2019 a slow recovery to around 1 percent car sales growth is predicted, with production growth probably lagging, given high dealer inventories at the outset of the year. It remains to be seen if a much awaited stimulus program in China might provide upside.

This deceleration is obviously affecting our business with traditional automotive applications, such as engine management or body and safety functions. In these areas content growth is not as dynamic as in those where structural trends are fuelling demand. There is an ongoing strong momentum for our solutions for the electrification of the drivetrain, where several product categories remain in allocation. Recently the EU resolved on $CO_2$ emission targets for 2025 and 2030. These are 15 percent and 37.5 percent, respectively, below the 95 grams to be achieved by 2021, calling for car OEMs to significantly increase their efforts to electrify their fleets. Advanced Driver Assistance Systems are the other main area of growth and provide attractive opportunities for our system solutions, including radar sensors and our AURIX™ automotive microcontroller. Taking the areas of EV and ADAS together, we continue to expect a year-on-year growth of 50% plus. Furthermore, the second generation of our AURIX™ automotive microcontroller is becoming a prime choice for the connected car and we have witnessed encouraging design-wins: a major European OEM selected the AURIX™ 2G for its main telematics module for all of its brands, and a large European Tier1 chose AURIX™ 2G for its gateway platform for in-vehicle networking. Besides performance, the built-in hardware security module is often the decisive factor to clinch a design win.

*Industrial Power Control*

Industrial Power Control recorded quarterly **revenue** of 352 million Euros, 2 percent lower than in the previous quarter, but up by a staggering 19 percent year-on-year.

Whereas industrial drives and home appliances saw typical seasonal declines, renewable energy and traction proved quite resilient. Solar even showed a strong increase, which is remarkable for the seasonally weaker December quarter and can be explained by China feed-in tariffs expected to be hiked again in the new year.

The **book-to-bill-ratio** stood at 1.1, representing a mixed picture of products suffering from a broad deceleration in the market and elevated inventories in the distribution channel such as gate drivers on the one hand, and high-power modules still in allocation on the other.

The **Segment Result** for the December quarter was 69 million Euros, compared to 73 million Euros in the previous quarter, resulting in a **Segment Result Margin** of 19.6 percent.

The uncertain global economic environment leads to an overall cautious market sentiment for industrial applications. Also in terms of bookings, demand patterns are diverging. For gate drivers the momentum has considerably softened, reflecting a mean reversion in home appliances and industrial automation from previously quite elevated levels. Wind and solar power as well as traction, however, still exhibit good growth momentum with continued strong order intake for our high power modules. With our differentiated product portfolio, we are addressing critical customer needs. From a regional perspective, we continue making inroads into the Japanese market. In the past quarter we achieved two important design wins with our intelligent power modules there, in line with our aim to offer complete system solutions.

*Power Management & Multimarket*

Now to Power Management & Multimarket: the segment posted **revenues** of 617 million Euros, a sequential decrease of 5 percent over the prior quarter, but up 13 percent year on year.

The quarterly decline was mainly due to lower demand for standard MOSFETs as well as controller ICs and power stages for servers, in-line with the weakness in the global server and data center business. In both categories, inventories within the channel are above their long-term average reach, as trade tariffs announced and introduced in the second half of 2018 had caused demand swings. Distributors are now working swiftly to bring stock levels down. Additionally, the softer smartphone market led to a deceleration in handset-related products. Overall, we experienced slower order intake and a higher level of cancellations, resulting in a **book-to-bill ratio** of 0.9 at the end of the December quarter.

In stark contrast to this, AC-DC power supplies saw healthy demand and rising sales volumes, for instance for telecommunications infrastructure, driven by early 4.5G and 5G network buildouts. This is another area in which we continue to be supply-constrained.

The **Segment Result** came in at 155 million Euros after 181 million Euros in the previous quarter, yielding a **Segment Result Margin** of 25.1 percent.

We are currently seeing a mixed demand picture for PMM. Longer-term growth drivers remain strong and intact. Underlying trends like big data, artificial intelligence or cloud computing will lead to more and larger data centers being built. 5G installations and also low-speed electrical vehicles are further demand drivers. Current business activity and order patterns, however, are temporarily subdued. This in combination with high inventories means we are currently undershipping end demand. We expect this to continue in the current quarter. Relevant data points on a possible pick-up of demand should emerge after Chinese New Year, which coincidentally is today. So best wishes to the listeners from that region for the year of the Pig!

On the bright side, high-voltage power switches continue to see positive momentum and we are re-allocating some of our production corridors to that segment to better serve customers. This and further capacity being ramped will support PMM's growth in the second half of our fiscal year.

Components for mobile handsets such as antenna tuners, filters, low-noise amplifiers or silicon microphones, albeit the by-far smaller part of PMM, weigh on growth in the near term due to sluggishness in the smartphone market. However, we expect to see a more positive dynamic after the seasonally weak March quarter, also due to new sensor product launches later on in the year.

### *Digital Security Solutions*

Now to Digital Security Solutions. The segment recorded **revenues** of 149 million Euros, a decline of 9 percent compared to the previous quarter, and minus 8 percent year-on-year.

The negative revenue development was mainly due to ongoing stock measures at some smart card customers, combined with typical seasonality in the consumer authentication business. Order entry improved again towards the end of the quarter, bringing the **book-to-bill ratio** to 1.3, making us confident that demand is currently troughing, with moderate improvements looming in the second half of the fiscal year.

The **Segment Result** came in at 16 million Euros, the **Segment Result Margin** stood at 10.7 percent, driven by the decline in revenues.

Already in previous quarters, we described the segment's ongoing transition from more traditional, card-based applications to higher value security solutions, which are often embedded in or bundled with other components. We have enhanced our position in key applications like payment and the connected car with recent security solution launches, like SECORA™ Pay W for payment functionality in wearables and the Trusted Platform Module OPTIGA™ for automotive applications. The latter will be used by Volkswagen, enabling services like secure software updates over the air, car sharing, or parcel delivery to a car's trunk.

To protect digital transactions, we introduced a blockchain security starter kit.

It is encouraging to note the recently agreed EU Cybersecurity Act, which includes, among other aspects, an enhanced mandate of the EU Cybersecurity Agency ENISA and targets to create a framework for European cybersecurity certification.

### Handover to Dominik Asam

With this, I would like to hand over to Dominik in Munich who will lead you – one last time - through our key financial figures.

**Dominik Asam:**

Thank you, Reinhard, and good morning everyone.

### Revenue, Gross Profit, Gross Margin and OpEx, adjusted Gross Margin

Let me start with some more details on the margin development.

**Gross Profit** was 779 million Euros, after 814 million Euros in the previous quarter. Despite the 4 percent revenue decline the **Gross Margin** remained almost constant at 39.5 percent, versus the prior quarter's 39.8 percent. Excluding Non-Segment-Result effects, the adjusted Gross Margin stood at 40.4 percent. **Research and Development expenses** and **Selling, General and Administrative expenses** came in at 236 million Euros and 218 million Euros, respectively. The net **other operating income** amounted to 2 million Euros.

The Non-Segment-Result amounted to minus 32 million Euros, predominantly related to amortization and other charges resulting from the International Rectifier acquisition. As you can see on the chart, of that amount 16 million Euros hit our Cost of Goods Sold, 1 million Euros R&D and 15 million Euros SG&A.

### Investments, Depreciation and Amortization

Our investments into property, plant and equipment, intangible assets and capitalized development costs in the first quarter of the 2019 fiscal year amounted to 408 million Euros, after 417 million Euros in the prior quarter.

**Depreciation and Amortization** including Non-Segment-Result effects went up slightly from 226 to 230 million Euros. Included in these figures are 25 and 26 million Euros, respectively, related to the amortization and depreciation of fair value step-ups from the purchase price allocation from International Rectifier. The portion of depreciation and amortization included in our segment result therefore moved from 201 to 204 million Euros.

### Tax

**Income tax expense** in the December quarter was 56 million Euros, against 54 million Euros in the previous quarter. This results in an effective tax rate of around 18 percent. Our cash tax rate was 15 percent, a level we expect throughout the 2019 fiscal year.

### Discontinued operations/Qimonda

As you will recall, in the fourth quarter of the last fiscal year we recorded a **loss from discontinued operations** of 159 million Euros, related to adjustments of provisions in connection with the ongoing Qimonda litigation. There are no new developments to report in this matter and hence our result from discontinued operations was zero in the December quarter.

### Free Cash Flow

Continuing with **Free Cash Flow from continuing operations**, we recorded a net outflow of 221 million Euros in the December quarter, after an inflow of 227 million Euros in the prior quarter. Included in this swing is the cash-out of net 123 million Euros for the acquisition of Siltectra in November as well as payouts of annual success bonuses for fiscal year 2018 at the end of the calendar year.

### Gross Cash, Net Cash

Our gross cash position as of December 31st, 2018 amounted to 2.3 billion Euros. Net of financial debt of 1.5 billion Euros, our cash position stood at 0.8 billion Euros.

### RoCE

Our reported after-tax **Return on Capital Employed** stood at 15.7 percent in the December quarter. Excluding acquisition-related bookings, in particular goodwill, fair value step-ups, amortization and deferred tax effects, the adjusted Return on Capital Employed stood at around 23 percent, well in excess of our cost-of-capital.

### Handover to Reinhard Ploss

As this will be my thirty-third and last quarterly earnings release at Infineon, I want to take the opportunity to sincerely thank you all for your unwavering interest in Infineon as well as the shrewd questions and thought-provoking comments over the last 8 years. I have thoroughly enjoyed the constructive dialogue with you and hope you will continue to accompany Infineon's growth trajectory. Let me now hand back to Reinhard who will comment on our outlook.

**Reinhard Ploss**

Thank you, Dominik.

As said in the beginning of this call already, the current market environment is showing high levels of uncertainty. Therefore, we are monitoring demand trends carefully. In our view, the quarter ahead will be a difficult one, characterized by inventory reductions by certain parts of our customer base. We are, however, also seeing indications for normal or even slightly better than normal seasonality in several of the markets we address starting in the June quarter. This is the context in which we provide our guidance as follows:

## Outlook for Q2 FY19 and for FY19

Assuming an exchange rate of 1.15 for the US-Dollar against the Euro, we expect **revenues** in the currently running second quarter of our fiscal year 2019 to remain flat compared to the December quarter, plus or minus 2 percent.

Breaking it down by divisions, ATV and DSS are expected to grow quarter over quarter, whereas IPC should see stable revenues and PMM a mid-single digit percentage decline.

At the midpoint of the guided revenue range we expect a **Segment Result Margin** of 16 percent of sales, burdened by annual price declines in particular in ATV and DSS, which usually occur in the first calendar quarter, and some inventory corrections.

Now to our outlook for the full fiscal year 2019: Adding together the actual figures for the first and our projections for the second quarter, plus our expectation of a decent seasonal recovery in late spring/early summer, we should be able to reach the lower end of the range that we guided for in November, which was 11 percent plus or minus 2 percentage points. In other words, we expect annual revenue growth of around 9 percent, meaning that Infineon would again significantly outgrow both the total semiconductor market as well as its particular market segments.

From a divisional perspective, ATV is expected to grow faster than group average. IPC should see growth at and PMM below the average for the group. DSS revenues are expected to decline by a low to mid-single digit percentage.

We as management are determined to safeguard our profitability also in times of lower growth and have initiated steps such as strictly limiting hiring. Consequently, at the predicted revenue level we still expect a **Segment Result Margin** of 17.5 percent of sales.

In the same vein, we adjust our ramp plans to a reduced revenue projection and will cut our previously communicated investments into equipment by an amount of 100 to 200 million Euros. At the same time, we will continue to invest into our in-house manufacturing capacities for such products that continue to see strong demand and are in allocation. This will enable us to capture market opportunities and foster growth in the second half of our fiscal year. For the current fiscal year, we now expect **investments** – which include also capitalized development cost – of around 1.5 billion Euro. We will proceed with the building of the new 300-millimeter cleanroom in Villach.

Our guidance for **depreciation and amortization** for the fiscal year 2019 remains unchanged at around 1 billion Euros.

## Closing remarks

Ladies and Gentlemen, let me summarize the key points:

- Our market environment has become more challenging, but we are navigating it well so far.
- Evidence of this is our first fiscal quarter, which we completed exactly as predicted in terms of revenue, and even slightly better than anticipated in terms of segment result.
- Our core power business remains resilient, with structurally rising content across a number of applications. But several end markets currently experience a more pronounced slump than previously anticipated and Infineon is not isolated from macro uncertainties.
- Consequently, we adjust our plans to protect margins on the one hand, and facilitate above industry average growth on the other.

## Opening of Q&A

Ladies and gentlemen, this concludes our introductory remarks and my colleagues are happy to take your questions.