

79th Quarterly Results of Infineon Technologies AG
Intro Statement for Analyst Call
Reinhard Ploss / Sven Schneider

 **Reinhard Ploss:**

Thank you, Alexander, and good morning everyone.

[Group performance in Q4 and full FY19](#)

We have concluded our 2019 fiscal year in which end markets were characterized by a challenging macro backdrop. In terms of growth and profitability, fiscal year 19 clearly stands behind the prior boom years, but equally clearly it proves the resilience of our business in a semiconductor downcycle.

Our fourth fiscal quarter came in much as we had expected: **Revenues** stood at 2 billion 62 million Euros, corresponding to an increase of 2 percent quarter-over-quarter. Tailwind from the US-Dollar, which traded up by about one cent, was very slight. Year-over-year our revenues grew by 1 percent in Euro terms. Here the US-Dollar impact is more pronounced, at a constant exchange rate revenues declined by 2 percent.

The **Segment Result** for the September quarter amounted to 311 million Euros, equivalent to a **Segment Result Margin** of 15.1 percent, a bit ahead of our guidance.

For the full 2019 fiscal year our group **Revenues** for the first time crossed the 8 billion mark, with 8 billion 29 million Euros, a 6 percent increase over the previous year. Assuming a constant US-Dollar exchange rate, our annual growth rate would have been 3 percent, evidence of the significant cyclical pressures that hit us particularly in the second half of our fiscal year. The **Segment Result** for 2019 was 1 billion 319 million Euros, yielding a 16.4 percent **Segment Result Margin**. On the one hand, this is a quite robust figure considering the slowdown in many of our end markets. On the other hand, profitability has been going down sequentially, as underutilization charges weighed on our margins. Sven will cast more light on this issue when he talks about our financials, and I will also come back to this topic when I discuss our outlook.

As in previous years, we want our shareholders to participate adequately in Infineon's economic results. Therefore we will propose an unchanged per share dividend of 27 cents to the next shareholders' meeting. Given the higher share count compared to last year, this will result in an increase of the total dividend amount by about 10 percent to 336 million Euros.

The demand picture across many markets has not brightened in recent weeks and months, especially not in the automotive and industrial verticals which are most relevant to our business. That we are not out of the woods yet can also be seen from our **book-to-bill** ratio of 0.8 for the September quarter.

From indicators like lead times, inventory levels and order patterns we can read out that the cycle is bottoming. The eventual recovery, however, is expected to set in not prior to the second half of our 2020 fiscal year, as major global economies remain in contraction and trade tensions continue to loom.

I will comment more on this at the end of my introduction, when I will also give you a short update on our planned acquisition of Cypress.

Division-level performance in Q4

But back to the concluded fiscal year 2019 and the divisional overview, starting with Automotive.

Automotive

In the September quarter, Automotive **revenues** were 893 million Euros, a sequential increase of 1 percent. Compared to Q4 of last fiscal year, the increase was 3 percent and, respectively 1 percent, assuming a constant US-Dollar exchange rate. As can be seen from these figures, the growth dynamic has currently slowed down. Classic automotive applications continue to be in decline. Following subsidy cuts, the Chinese electric vehicle market has hit the brakes last quarter. Against this, ADAS components witness ongoing positive momentum.

The **Segment Result** of ATV amounted to 78 million Euros, resulting in a **Segment Result Margin** of 8.7 percent, compared to 98 million Euros and

11.0 percent in the quarter before. The main reason for the margin decline is the increasing burden of underutilization charges. Given that the inventory correction throughout the supply chain is ongoing, we keep production facilities running at lower volumes.

The **book-to-bill ratio** for the September quarter was 0.9 and once again stood below 1, a consequence of an overall weak car market amid ongoing macro uncertainties. The past couple of months were marked by repeated downward revisions of vehicle production numbers by market researchers. The last forecast from IHS puts the calendar 2019 global light vehicle production at 88.8 million units, a decline of 5.8 percent over the previous year. For 2020, predicted volumes are essentially flat, at 89 million cars. Especially the Chinese market paints a rather bleak picture, as a slowing economy and macro uncertainties are weighing on consumers' spending power. Channel inventories there remain high overall, we forecast that destocking back to normal levels will take about two more quarters.

In the September quarter, also the xEV market in China slowed down considerably. Sales of electric and plug-in hybrid light vehicles declined by 16 percent year-over-year as subsidy cuts and the relaxation of license plate restrictions for traditional cars took their tolls. In Europe, on the other hand, OEMs are launching a slew of 48 Volt, hybrid and full battery electric vehicles in order to meet fleet emission targets, which are being phased in from next

year on. EV penetration clearly will have to go up to avoid penalties, but an accelerating effect is likely to be felt more towards the second half of the 2020 calendar year.

In our view, these short-term fluctuations are bumps in the road. The secular trend towards electro-mobility is unbroken and is offering us very attractive growth potential over the mid and long term. We continue to shape this evolution with the broadest and most scalable portfolio of power semiconductors ranging from IGBTs to silicon-carbide components, from chips to frame-based and molded modules. Those power devices are complemented with Infineon's optimized drivers, microcontrollers and sensors to support our customers in their product strategies.

With regard to the second major automotive trend, the increasing pervasiveness of advanced driver assistance systems, we are observing an acceleration of level-1 and level-2 automation and a delay of higher levels, driven by the lack of an established regulatory framework and the technical challenges of providing safety in virtually all driving situations. This leads to the creation of a so-called level 2+ with additional functions, for which we feel well positioned with our sensor and microcontroller portfolio. For example, in radar we are expanding our leadership in sensor ICs to full chip-set offerings.

Our AURIX™ automotive microcontroller has confirmed its status as a prime choice for a broad variety of automated driving applications by a design-win awarded from a major tier-1 for domain control, gateway, radar, sensor fusion as well as camera and host control platforms.

Industrial Power Control

Now to Industrial Power Control: the segment posted **revenues** of 362 million Euros, an increase of 1 percent compared to the previous quarter. From an application point of view, renewable energy saw strong demand, especially solar, offset by sluggishness in industrial drives and home appliances. From a product perspective, it remains a tale of two speeds: medium and high-power components are proving robust, low-power discretets and gate driver markets are soft.

The **Segment Result** for the fourth fiscal quarter came in at 59 million Euros, resulting in a **Segment Result Margin** of 16.3 percent, after 15.4 percent in the previous quarter. When comparing to the margin level of 20 percent achieved in last fiscal year's Q4 on essentially flat revenues, the key difference are charges associated with lower fab loading.

The **book-to-bill-ratio** was 0.8 for the September quarter.

Many industrial market segments are late-cycle in nature, with business dynamics depending on the overall economic situation, GDP growth and sentiment. Regarding the latter, manufacturing indicators are trending weak,

with the US PMI turning into negative territory in the September quarter, following similar developments in Europe and China since last year. October data were slightly better, but amid continuing macro concerns, projects are being delayed and longer-term capex decisions held back. We and other industry participants are working hard to bring inventories back to normal levels, which is difficult due to persistently weak demand.

In this challenging environment, renewable energy is holding up well. Solar and wind remain growth engines and are among those areas suited for an early and rapid uptake of silicon carbide solutions. Other application fields which should see a rapid adoption of silicon carbide include energy storage, industrial power supplies and EV charging. For all these, Infineon is offering one of the broadest and most differentiated product portfolios, including discrete silicon carbide MOSFETs, hybrid and full silicon carbide modules. Our ability to address critical performance and quality requirements resonates well with customers, and we were able to significantly increase our silicon carbide design-in funnel throughout the 2019 fiscal year to more than 1.8 billion Euros.

Power Management & Multimarket

Now to Power Management & Multimarket: PMM ended the 2019 fiscal year with quarterly **revenues** of 639 million Euros, a sequential increase of 7 percent, or 6 percent assuming a constant US-Dollar exchange rate. Growth

mainly came from the area of mobile handsets, which saw both seasonally higher demand as well as successful product launches.

In comparison to the September quarter of last year, PMM revenues were down by 2 percent, and by almost 6 percent at a constant US-Dollar exchange rate.

PMM printed a **Segment Result** of 153 million Euros, corresponding to a **Segment Result Margin** of 23.9 percent, after 145 million Euros and 24.2 percent in the previous quarter, a very robust level in a challenging market environment.

The **book-to-bill ratio** for PMM stood at 0.6, evidence of a muted demand picture. Very clearly, sell-in to the supply chain is currently below consumption as the inventory correction that we mentioned already in last quarter's call is continuing. The current rate of inventory burn in the chain on the one hand and the level of stock on the other hand indicate that things should look better latest in the second half of our fiscal year, provided of course the global economic climate does not deteriorate further. Momentum for components going into servers and data centers sees first green shoots of improvement. Demand for power components for electro-mobility and for 5G is fairly resilient. Here we also continue to see unabated mid and long-term structural growth potentials. The same is true for battery-powered applications.

Regarding handset-related products the current dynamics are quite favorable, partially driven by seasonality, but mostly from a positive market acceptance of our products. We are encouraged by the uptake of our time-of-flight and 60-GHz-radar components. The latter is enabling motion sensing in the newly launched Google Pixel 4 flagship phone. Using an integrated antenna system, it senses presence and movement of people and objects with high precision and measures distances and speeds. With this, gesture control without touching the device is possible. We anticipate that 60-GHz-radar technology can also be deployed for smart speakers and TV sets on the consumer side, as well as industrial applications such as air conditioning equipment and smart lighting.

Also our silicon microphones are on a good trajectory, helped by the higher number of such sensors per phone, new accessories such as noise-cancelling headsets and further use cases such as interactive TVs.

Digital Security Solutions

Let's now come to Digital Security Solutions, where we recorded **revenues** of 162 million Euros in the fourth quarter of the 2019 fiscal year, a sequential decline of 3 percent. This decline is actually the net out of two opposing effects: on the one hand, operational revenues within the quarter increased, mainly from payment and authentication solutions. On the other hand, under IFRS 15 accounting rules for revenue recognition we booked lower revenues

for customer-specific products compared to the previous quarter, leading to a deduction of so-called contract assets. In general, these IFRS 15 effects are temporary in nature and level out over time.

The **Segment Result** came in at 22 million Euros, corresponding to a **Segment Result Margin** of 13.6 percent, compared to 11.4 percent a quarter earlier. This margin uptick is a reflection of the IFRS 15 effect described above.

The **book-to-bill ratio** stood at 1.3 at the end of September, influenced by the receipt of an annual order for a government ID project.

Our embedded security solutions continue to see traction in the marketplace. We recorded project wins at various OEMs engaged in different IoT verticals, including automotive and industrial equipment. Furthermore, to improve the security and performance of cloud-connected devices and services, we launched the turnkey OPTIGA™ Trust M solution. This turnkey IoT security solution is ideal for IoT applications like industrial and building automation applications, smart homes and consumer devices.

[Handover to Sven Schneider](#)

With this, I would now like to hand over to Sven who will provide comments on our key financial figures as well as an update on the refinancing of the planned acquisition of Cypress.

Sven Schneider:

Thank you, Reinhard, and good morning everyone. In my part I will focus primarily on quarterly numbers, but in some occasions also comment on full-year figures.

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

Let me start with some more details on the margin development in Q4 of the concluded fiscal year 2019. The **Gross Profit** was 731 million Euros, after 735 million Euros in the previous quarter. The **Gross Margin** declined from 36.5 percent to 35.5 percent; excluding Non-Segment-Result effects, the adjusted Gross Margin stood at 36.3 percent. As you have heard in the divisional review, we are currently incurring significant underutilization charges. These have become a meaningful drag on margins since we decided to lower fab loadings at the end of the March quarter. In the September quarter alone, idle costs burdened our result by over 100 million Euros. In the entire fiscal year the amount was close to 300 million Euros. Recognizing that production facilities, frontend and backend, will never all be fully loaded, due to structural effects, there is always a normal baseline of underutilization charges. Considering this, the economic impact of cyclical idle costs above such baseline was about 2 percent points of Segment Result Margin for the full 2019 fiscal year.

Research and Development expenses and **Selling, General and**

Administrative expenses came in at 230 million Euros and 222 million

Euros, respectively. The net **other operating income** amounted to minus 33 million Euros.

The Non-Segment-Result for the quarter stood at minus 65 million Euros, and was mainly composed of amortization and other charges resulting from the International Rectifier acquisition, accruals to litigation-related provisions and costs incurred in connection with the planned acquisition and integration of Cypress. Of the total Non-Segment-Result 17 million Euros hit our Cost of Goods Sold, 1 million Euros R&D, 12 million Euros SG&A and 35 million Euros were included in other operating expenses.

[Investments, Depreciation and Amortization](#)

Our investments into property, plant and equipment, intangible assets and capitalized development costs in the fourth quarter of the 2019 fiscal year amounted to 350 million Euros, essentially flat against 344 million Euros in the prior quarter. Our investments for the entire year were 1 billion 451 million Euros, in line with the figure of around 1.5 billion that we had guided.

Depreciation and Amortization including Non-Segment-Result effects went up slightly from 238 to 244 million Euros. Included in these figures are in each case 21 million Euros related to the amortization and depreciation of fair value step-ups almost entirely from the purchase price allocation from

International Rectifier. The portion of depreciation and amortization included in our segment result therefore moved from 217 to 223 million Euros.

Cypress financing

Before continuing with our financial result, cash flow and liquidity position, I would like to further update you on the Cypress financing. Following the 1.55 billion Euro share placement in June, we meanwhile took a second important refinancing step and successfully issued Infineon's inaugural hybrid bond, raising 1.2 billion Euros across two tranches. We are very pleased that we could tap a new investor base, diversify our sources of funding, and secure further equity without dilution. The hybrid will be completely accounted for as equity under IFRS; you do not yet see the impact in our balance sheet, given that settlement occurred on 1st of October. From a rating point of view, S&P will assign 50 percent equity credit to the instrument once the Cypress acquisition closes. In other words, 600 million Euros from the hybrid bond are to be added to the 1.55 billion Euros from the share placement, bringing the total of rating-relevant equity to over 2.1 billion Euros.

As you will recall, we announced that we intend to ultimately finance around 30 percent of the transaction value of 9 billion Euros with equity, in line with our clear objective to remain an investment grade company. Having de-risked the equity portion of the Cypress financing so substantially – roughly 80% is already accomplished – , we are now in a position to re-assess timing

and composition of the refinancing package at the actual closing of the transaction.

Just as a reminder, the fully committed bank facility with tenors up to five years for the initial financing of the acquisition of course continues to stay fully in place.

Financial result

Now to our **financial result** for the September quarter: it stood at minus 18 million Euros, including the impact of mark-to-market valuations of our holdings in not fully consolidated companies and expenses related to the aforementioned acquisition financing facility. In the preceding quarter the financial result had been minus 31 million Euros and had contained expenses related to the acquisition financing facility as well as the result from unwinding equity hedging instruments in connection with the share placement.

Meanwhile the deal-contingent currency hedges put in place for the Cypress acquisition are having a positive impact of 98 million Euros from fair value changes within the other comprehensive income, or OCI, due to the strengthening of the US-Dollar against the Euro.

Tax

Now to taxes: **Income tax expense** in the June quarter went up to 64 million Euros, compared to 28 million Euros in the previous quarter. As there

were certain non-recurring effects in both quarters, it seems more meaningful to take a full-year view: income tax expense for the 2019 fiscal year was 194 million Euros, resulting in an effective tax rate of 18 percent. Our cash tax rate was 13 percent, and thus somewhat better than the guided 15 percent. For the 2020 fiscal year, we once again view a cash tax rate of around 15 percent as a reasonable assumption, driven by existing German tax loss-carryforwards, from which we expect to benefit for around another five years.

Discontinued operations/Qimonda

With respect to **discontinued operations**, we recorded a **loss** of 2 million Euros in the last quarter of the 2019 fiscal year, mostly related to minor adjustments of provisions in connection with the ongoing Qimonda litigation.

Free Cash Flow

Continuing with **Free Cash Flow from continuing operations**, for which we saw a notable inflow of 334 million Euros in the September quarter, bringing the annual figure to a positive 39 million and 62 million Euros, respectively, if we adjust for Cypress related cash impacts. The Cypress acquisition and its financing had a negative impact of 11 million Euros in the fourth quarter, and of 23 million in the entire fiscal year.

Gross Cash, Net Cash

Our gross cash position as of September 30, 2019 amounted to 3.8 billion Euros, containing the proceeds from the share placement, but as mentioned,

not yet from the hybrid bond. Considering financial debt of 1.6 billion Euros, our net cash position stood at 2.2 billion Euros.

RoCE

Our reported after-tax **Return on Capital Employed**, or RoCE came in at 9.0 percent in the September quarter. The annual value is 12.2 percent. Excluding bookings related to the acquisition of International Rectifier, in particular goodwill, fair value step-ups and amortization, effects from the pending Cypress transaction as well as deferred tax effects, the annual adjusted RoCE stood at 19 percent.

Handover to Reinhard Ploss

I will now pass back to Reinhard again, who, as usual, will comment on our outlook.

Reinhard Ploss

Thank you, Sven.

As mentioned at the start of this call, the business environment in our markets is bottoming. The inventory correction is playing out, but given the absence of macro improvement, recovery will take more time. Coming up with a full-year prediction in such times of limited visibility obviously entails risks, both to the down as well as to the upside.

So this is what we view as our most likely scenario, excluding Cypress:

Outlook for the 2020 fiscal year and Q1 FY20

For the full 2020 fiscal year, we assume that we can deliver year-over-year **revenue** growth of 5 percent, plus or minus 2 percentage points. In other words, our growth rate will be similar to the 2019 one, and this also goes for the assumed exchange rate of 1.13 for the US-Dollar against the Euro.

Breaking it down by divisions, we see the following picture: ATV is expected to grow a bit above the group average. The global automotive market, after the severe decline in 2019, seems poised for a period of no unit growth.

Therefore, having the right products to benefit from pockets of structural content growth becomes all the more relevant. Infineon is in this strong position, driven by xEV and ADAS, for which we see clear double-digit growth rates. PMM's growth should essentially match the average for the group, carried by sensors for smartphones and other applications, and by power products for communications infrastructure and enterprise computing. For late-cycle industrial applications, overall activity is muted, but certain areas such as renewables are showing encouraging momentum. As a result, we are expecting a slightly below-group average growth rate for IPC. DSS revenue should stay flat or grow just slightly.

At the midpoint of the guided revenue range, we expect a **Segment Result Margin** of around 16 percent of sales. Incorporated in this figure are underutilization charges increasing to around 400 million Euros. Said differently, cyclical idle costs will burden our Segment Result Margin in the

current fiscal year by about 3 percentage points. Against this, we deploy a range of cost containment measures in order to safeguard our profitability.

From a timing perspective, we expect some further deceleration in the near term, exacerbating our usual seasonality. This is driven to a large extent by distributors working down their inventories. For the running first quarter of the fiscal year just started, **revenues** are anticipated to decline by 7 percent quarter-over-quarter, plus or minus 2 percentage points. Assuming inventory levels in the channel were at their long-term average levels, our revenue decline would be more in line with our usual seasonality.

As you will be quick to extrapolate, there is somewhat of an above-seasonal recovery assumption for the second half of our 2020 fiscal year baked into our full-year projection. The **Segment Result Margin** for this December quarter is expected to come in at about 13 percent at the midpoint of the guided revenue range. Given the projected revenue decline, underutilization charges will see their peak, with about 40 percent of their annual amount hitting the first quarter. This includes a two-week closing of our factories in Dresden, Kulim and Temecula over year-end. At the same time, there will be a nonrecurring positive effect stemming from a refined inventory valuation methodology. In essence, we will allocate indirect costs related to our manufacturing across earlier stages in the manufacturing process, to unfinished goods. This one-time effect will benefit our gross profit.

Now to our **investments**. For the 2020 fiscal year, we expect them at around 1.3 billion Euros, including capitalized development costs. Around one third of the overall amount will be for factory buildings and their required infrastructures as well as office buildings. We are therefore laying the foundation for benefitting significantly from structural growth potentials. This notably includes the further construction of our 300 millimeter production facility in Villach. We are aligning the speed of the construction to market developments and currently expect start of production around the end of calendar year 2021.

Regarding our Target Operating Model, we will comply with the investment-to-sales ratio over the two-year period of taking fiscal years 2019 and 2020 together. **Depreciation and amortization** are expected to amount to around 1 billion Euros again in the 2020 fiscal year.

For our **Free-Cash-Flow** we expect to reach a level between 500 and 700 million euros in this fiscal year, significantly above the 39 Million Euro that we achieved in the fiscal year 2019.

[Cypress update](#)

Before ending the introduction, let me briefly update you on the status of our planned acquisition of Cypress; in the time since our last quarterly call we have done all necessary regulatory filings and received most antitrust clearances already. The shareholders of Cypress voted in favor of the

transaction back in August. From our dialogue with the relevant authorities, we remain confident about a closing at the end of 2019 or the beginning of 2020. After closing the acquisition we will comment on updated projections for the combined company.

Closing remarks

Ladies and Gentlemen, let me summarize the key points:

- With the September quarter we closed a challenging fiscal year 2019 slightly ahead of our predictions.
- Our markets continue their stabilization. We expect recovery not to set in before second half of our Fiscal year and to benefit significantly from it due to the number of structural growth drivers we address.
- There will be both, cyclical pressures and structural growth. In our base case scenario, underutilization charges will go up, to a large extent compensated margin-wise by cost containment measures. Underlying profitability is therefore fully intact. Should market recovery take longer, however, idle costs would be more sticky. On the other hand, in case of an earlier snapback, available capacities could swiftly accommodate a higher growth rate and increased profitability.

- We continue to work on closing the Cypress acquisition. With the successful placement of our debut hybrid bond, we have already achieved a further important refinancing step.

Opening of Q&A

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