Q2 2021 Earnings Call

Company Participants

- Hock E. Tan, President and Chief Executive Officer
- Ji Yoo, Director of Investor Relations
- Kirsten Spears, Chief Financial Officer and Chief Accounting Officer

Other Participants

- Blayne Curtis, Analyst
- CJ Muse, Analyst
- Christopher Danely, Analyst
- Craig Hettenbach, Analsyt
- Harlan Sur, Analsyt
- John Pitzer, Analsyt
- Ross Seymore, Analsyt
- Timothy Arcuri, Analyst
- Toshiya Hari, Analyst
- Vivek Arya, Analsyt

Presentation

Operator

Welcome to Broadcom Inc.'s Second Quarter Fiscal Year 2021 Financial Results Conference Call. At this time for opening remarks and introductions, I would like to turn the call over to Ji Yoo, Director of Investor Relations of Broadcom Inc. Please go ahead.

Ji Yoo {BIO 21112206 <GO>}

Thank you, Operator, and good afternoon everyone. Joining me on today's call are Hock Tan, President and CEO; Kirsten Spears, Chief Financial Officer; Tom Krause, President, Infrastructure Software Group; and Charlie Kawwas, Chief Operating Officer. Broadcom also distributed a press release and financial tables after the market closed describing our financial performance for the second quarter of fiscal year 2021. If you did not receive a copy, you may obtain the information from the Investors section of Broadcom's website at broadcom.com.

This conference call is being webcast live and a recording will be available via telephone playback for one week. It will also be archived in the Investors section of our website at broadcom.com. During the prepared comments, Hock and Kirsten will be providing details of our second-quarter fiscal year 2021 results, guidance for our third quarter, as well as commentary regarding the business environment. We'll take questions after the end of our prepared comments.

Please refer to our press release today and our recent filings with the SEC for information on the specific risk factors that could cause our actual results to differ materially from the forward-looking statements made on this call. In addition to U.S. GAAP reporting, Broadcom reports certain financial measures on a non-GAAP basis. A reconciliation between GAAP and non-GAAP measures is included in the tables attached to today's press release. Comments made during today's call will primarily refer to our non-GAAP financial results.

I'll now turn the call over to Hock.

Hock E. Tan {BIO 1460567 <GO>}

Thank you, Ji. And thank you, everyone, for joining us today.

In Q2, semiconductor solutions revenue grew a strong 20% year-on-year to $4.8 billion with Infrastructure Software revenue growing an expected 4% year-on-year to $1.8 billion. Consolidated net revenue was $6.6 billion, up 15% year-on-year.

Now, on the last earnings call we had, we talked about how strong broadband and networking bookings were from hypercloud and service providers even as wireless was declining seasonally. In Q2, just past, not only do we see broadband and networking sustaining, we now see a recovery of bookings from enterprise. And on the supply side, hourly times have now stabilized, but the book -- but the volume of bookings we are experiencing today continues to grow. Now, we intend to meet such demand and in doing so, we maintain our discipline process of carefully reviewing our backlog, identifying real end-user demand and delivering products accordingly.

With that as context, let me provide you more color. Starting with broadband, which interestingly not going through somewhat of a renaissance, revenue grew 28% year-on-year and represented 18% of our semiconductor revenue. As discussed during our broadband teaching, the work, learn and play from home environment is driving global service providers to expand connectivity to the home. In our broadband carrier access business, PON fiber or otherwise known as PON, grew over 40% year-on-year, mostly with existing generation 2.5G, but with next generation 10G PON representing only 30% today, there is significant room for content growth as 10G PON deploys over the next few years. Not to be outdone by fiber, cable operators in the U.S. are driving deployment of DOCSIS 3.1 cable modems, we saw an 80% year-on-year growth and planning to accelerate the upgrades to next generation DOCSIS 4.0.

Our broadband technologies, in fact, are enabling service providers to complement the 5G they deliver -- to deliver best experience for consumers. Now overlaying all this last-mile broadband upgrades, we see a demand surge for the latest WiFi 6 and 6E technology to enable the last 100 feet of connectivity in homes. Broadcom has emerged as the clear market and technology leader in WiFi for exercise gateways to the home and to enterprises with over 50 million parts shipped in Q2 alone, all a year-on-year revenue growth of some 30%. On the other hand, as we might expect, with the push into higher performance fiber, copper DSL, digital subscriber line deployments for wireline broadband declined 30% year-on-year. And with a lack of live events during the pandemic, video declined 20%. But with an onset of 5G, service providers are competing for subscribers leading to technology upgrades globally in fiber, cable, and Wi-Fi connectivity. We are seeing this investment cycle in broadband extending into 2022. And so for Q3, we expect to sustain double-digit year-on-year revenue growth in this segment.

Moving on to networking. Networking grew 10% year-on-year and represented 32% of our semiconductor revenue. We experienced tailwinds from hypercloud and telcos, partially offset by headwinds from enterprise. Revenue for switching was up 30% year-on-year, primarily driven by the strong ramp of our Triton and Tomahawk 3 for over 400G platforms and hypercloud data centers. In the networks, service providers have been investing in 5G infrastructure worldwide where the demand for our Jericho2 at Metro/Core and Qumran at the edge have been robust with revenue up 35% year-on-year.

On the other hand, enterprise demand in networking has not yet recovered, still down double-digits from a year ago. And finally [ph] as we go into the back half of the year, we expect to see hypercloud upgrading to a next-generation Triton, Tomahawk 4 or over 800G switching platforms and sustained strength by service providers in network routing. And accordingly in Q3, we expect networking revenue to maintain the trend of low double-digit growth year on year. We found the complete recovery of enterprise demand.

Speaking of enterprise, let's talk about server storage connectivity, which represented approximately 12% of semiconductor revenue. This end market is largely driven by enterprise and in line with our guidance, revenue was down 16% year-on-year. You may recall, however, in Q1, this was down 22%. And as the economy starts to recover, we have seen an improving demand trajectory. And so in Q3, we expect service storage connectivity revenue to be down high single digit percentage year-on-year. With the launch of Intel's Ice Lake, AMD's Milan, as well as future ARM-based servers, this space is turning quite exciting and innovative for us both in hardware and software. And we will provide obviously more color during our next meeting in July on our server storage business.

Moving on to wireless, Q2 revenue was down 16% sequentially reflecting seasonality with wireless representing 34% of semiconductor revenue mix. Nonetheless, on a year-over-year basis, wireless revenue was up 48%, reflecting a very favorable compare year-on-year as well as content increases in RF [ph] and WiFi.

In Q2, we were able to ship more than we had originally planned. And accordingly, in Q3, we expect the growth trend in wireless revenue to sustain, but at over 30% year-on-year.

Finally, industrial and other represented approximately 4% of Q2 Semiconductor Solutions revenue. Resales grew 34% year-over-year in Q2 driven by a recovery in automotive and China. Inventory in the channel continues to deplete as what we shipped and the distributors grew only 23%. Turning to Q3, we expect resales to continue to grow double-digit percentage on a year-on-year basis. Summary, Q2 Semiconductor Solutions segment was up 20% year-on-year. And in Q3, we expect revenue growth year-over-year to be of a similar amount.

Turning to software. In Q2, Infrastructure Software produced another quarter of daily and predictable results as revenue grew 4% year-on-year and represented 27% of total revenue. Now, if we exclude professional services, our enterprise software revenue grew 7% actually year-over-year. And as further indicate -- indicator of the quality and sustainability of our products, over 90% of our software bookings represented recurring subscription and maintenance with an average contract life span from core customers pretty much close to three years. We continue to believe our Infrastructure Software business is on track to grow at or better than mid single-digit percentage year-over-year, which is again what we expect to see in Q3.

Summarizing this, demand continues to be robust and so our Q2 consolidated net revenue grew 15% year-over-year. We expect the momentum to sustain in Q3 and total revenue to be at $6.75 billion or up 16% year-on-year. With that, let me now turn the call over to Kirsten.

Kirsten Spears {BIO 19712531 <GO>}

Thank you, Hock. Let me now provide additional detail on our financial performance. Revenue was $6.6 billion for the quarter, up 15% from a year ago. Gross margins were a record 75% of revenue in the quarter and up approximately 180 basis points year-on-year. Operating expenses were $1.2 billion, down 1% year-on-year, driven by lower SG&A offset in part by increased investment in R&D.

Operating income for the quarter was $3.8 billion and was up 25% from a year ago. Operating margin was 58% of revenue, up approximately 470 basis points year-on-year. Adjusted EBITDA was $4 billion or 60% of revenue. This figure excludes $133 million of depreciation.

Now a review of the P&L for our two segments. Revenue for Semiconductor Solutions segment was $4.8 billion and represented 73% of total revenue in the quarter. This was up 20% year-on-year. Gross margins for our Semiconductor Solutions segment were approximately 69%, up 290 basis points year-on-year, driven primarily by higher product margins. This margin improvement comes from content growth as we deploy more next-generation products in broadband and (Technical Difficulty). Q2 operating margins increased to 53%, up 580 basis points year-on-year. So while semiconductor revenue was up 20%, operating profit grew 35%.

Moving to the P&L for our Infrastructure Software segment. Revenue for Infrastructure Software was $1.8 billion and represented 27% of revenue. This was up 4% year-on-year. Gross margins for Infrastructure Software were 90% in the quarter, up 100 basis points year-over-year. Operating expenses were $355 million in the quarter, down 8% year-on-year as we've completed the integration of Symantec. R&D spending at $228 million is up

1% year-over-year. Operating profit was up 10% year-on-year on top-line growth of 4%. Operating margin was 70% in Q2, up 360 basis points year-over-year.

Moving to cash flow. Free cash flow in the second quarter was $3.4 billion, representing 52% of revenue. Day sales outstanding were 33 days in the second quarter compared to 51 days a year ago. We ended the second quarter with inventory of $1 billion, an increase of $52 million or 5% from the end of the prior quarter. We should also note in Q2 we spent $126 million on capital expenditures.

On the financing front, we extended our weighted average debt maturity to approximately 10 years from nine by exchanging notes. Our weighted average coupon decreased about 5 basis points to 3.7%. During the quarter, we made $1.5 billion in payments on debt obligations, ending the quarter with $9.5 billion of cash and $40.4 billion of total debt of which $278 million is short-term.

Turning to capital allocation. In the quarter, we paid stockholders $1.6 billion of cash dividends. We also paid $461 million in withholding taxes due on vesting of employee equity, resulting in the elimination of approximately $1 million AVGO shares. We ended the quarter with 410 million outstanding common shares and 450 million diluted shares. Note that we expect the diluted share count to be 449 million in Q3. The Board of Directors have approved a quarterly cash dividend on our common stock of $3.60 per share in Q3. Based on current trends and conditions, our guidance for the third quarter of fiscal 2021 is for consolidated revenues to be $6.75 billion and adjusted EBITDA of approximately 60% of projected revenue.

That concludes my prepared remarks. Operator, please open up the call for questions.

Questions And Answers

Operator

Thank you. (Operator Instructions) Our first question comes from the line of John Pitzer of Credit Suisse. Your line is open.

Q - John Pitzer {BIO 1541792 <GO>}

Yeah, good afternoon, guys. Thanks for letting me ask the question. Hock, I've got two quick ones. First, within your wireless business, you've been able to sign long-term contracts with your key customer. And I'd argue that's benefited both you and them, it's given you the confidence to invest in the business properly. And then the confidence that you'll have supply for them when they need it. I'm just kind of curious, given how tight things are elsewhere in the semi business, have you been able to parlay this into any longer-term customer contracts? And what implication might that had as we all start to worry about the "end of cycle?"

And then secondly, just on your comments about enterprise recovery, can you elaborate on that? Was that specifically a storage comment or is that also a networking comment?

A - Hock E. Tan {BIO 1460567 <GO>}

Okay. Let me take the question one at a time. On arrangements, we have long-term agreements, John. And this is something we have been thoughtfully carefully putting in place. We've I'll call strategic customers. We just don't go, do it as if it's commoditized. We're very thoughtful about doing it and we do it in very specific areas where we know for sure that the technology is fairly, fairly difficult complex to manage and which requires substantial amount of R&D spending. And we have been doing it for a while now. We've strategic customers in call businesses. So we just don't do it across the board. And what you pointed out is very, very correct. It's a mutual, then it's a structure, it's an agreement with mutual benefit. We have the confidence to invest in R&D to make CapEx capacity investment. And in return, we offer the best leading-edge technology in specific areas in a timely manner to our critical customers.

So, yes, we have been doing it and we will continue to thoughtfully do it in a very appropriate manner. On the second part, okay, which is -- if you could repeat the question, John, let me be sure (Multiple Speakers)

Q - John Pitzer {BIO 1541792 <GO>}

Just to elaborate a little bit on your comments about an enterprise recovering brewing [ph], was that mostly within storage or was it networking? I'm little bit surprised given some of Cisco's comments that you're not a little bit more positive on the enterprise network space.

A - Hock E. Tan {BIO 1460567 <GO>}

It is across, it is for enterprise spending. It is -- I won't say across the board necessarily and trying to define enterprise very appropriately. As you notice in my comments, we classified service providers telcos as a separate animal [ph], different from traditional enterprise. And so -- and as I pointed out, based on broadband, telcos have been investing big time. Service provider telcos have been investing in a huge manner over the past 12 months. But traditional enterprise, the companies, whether it's the banks, the manufacturing sector, various retail customers, airlines as examples. No, these guys are in a recovery mode. And not surprising, we are seeing pandemic easing, let's say, in North America. And as it eases, we see a step-up in spending, but we do not see spending spiking up.

Now obviously if you look at some businesses -- that warehouses that require WiFi networks, campus networking environment, you do see that improving. But to say across the board, all enterprises are just spending money. Not -- we are still seeing and as I showed that in server storage connectivity, we still see a year-on-year things are not up to what it was a year ago. And then applies not just on data centers, namely compute, it also applies to data centers in enterprise, campus environment, we see less of that, but across the board.

Q - John Pitzer {BIO 1541792 <GO>}

Helpful. Thank you very much.

Operator

Thank you. Our next question comes from the line of Harlan Sur of JPMorgan. Your line is open.

Q - Harlan Sur {BIO 6539622 <GO>}

Good afternoon. Great job on the quarterly execution, strong margins and free cash flow generations. Hock, I think as you mentioned, we're still in the early phases of the 400 gig networking upgrade cycle with your hyperscale and telco customers. I know two of your big cloud taking customers have already started the upgrade. Let's say, there are another two more that are going to start the upgrade cycle here in the second half of this year and quite a bit more next year. And then as you mentioned, you still have Tomahawk 4 ahead of you. So, given the extended visibility that the team has with the strong backlog, do you see the cloud and telco upgrade cycle an inevitable recovery in enterprise driving continued year-over-year growth in networking into next year?

A - Hock E. Tan {BIO 1460567 <GO>}

No, I don't. We don't really trying to guide more than one quarter at a time first of all because we're not that smart to be able to do that. But on a broader trajectory, it does appear fairly much the trend as we see it, which is the hypercloud guys will go -- will push out in the second half as I indicated on their data center side, on Tomahawk 4, the 800G platform. In fact we have substantial backlog for delivery in the back half of the year for Tomahawk 4. So we see that going on. But -- and we use -- you're right, we see the recovering step by step of data enterprise, though I do not see that really taking off in terms of reaching the level it was a year ago, probably until 2022.

What we do not know for sure is, would that give pause to hypercloud in their spending. And that part -- I'm just putting everything on the table, we're not sure whether hypercloud spending will necessary continue into 2022. We sense it would. We see some of the backlog, but as enterprise steps up, one relevant (inaudible) is economy starts to rebalance in that side. But what we do see in broadband is service providers, the telcos in particular, are for sure upgrading and here this is a longer cycle of upgrade and we see them upgrade and we see the backlog associated with it through 2022.

Q - Harlan Sur {BIO 6539622 <GO>}

Great. Thank you.

Operator

Thank you. Our next question comes from Ross Seymore of Deutsche Bank. Your question please.

Q - Ross Seymore {BIO 20902787 <GO>}

Hi, guys. Thanks for having me ask the question and congrats on the strong results. Hock, I want to dive a little bit into the lead time commentary that you had with that stabilizing. Two quarters ago, you talked about the size of the book, the backlog you had. Last quarter, you talked about the year-over-year and even in some instances the sequential growth being so large in bookings and now we're hearing that the lead times are stabilizing. People could interpret that a bunch of different ways as far as the implication on the demand side of the equation or that supplies catching up to it or frankly people are just ordering so far out that they're not willing to extend that any further. So I was hoping to double-click on that lead time commentary and get your feelings as to why it's stabilizing? And do you take that as a positive or negative?

A - Hock E. Tan {BIO 1460567 <GO>}

Oh, I just make a comment to say we have stretched our lead time so far, Ross. Good point you bring up. And I'm glad you bring it up to give me a chance to clarify. A set of quick comments I made in my opening remarks that we are comfortable at the lead times we are on. And so what it is as customer, our customers are comfortable seeing our lead time now. But one, we have found rather remarkable over the last quarter is that even as our lead times remain stable, consistent, the volume of bookings we receive every week continues to grow. I made that comment and thanks for the opportunity to make that -- reiterate that point. Same lead time, stable for last three months, but the booking rate we are seeing every week continues to step up.

Q - Ross Seymore {BIO 20902787 <GO>}

Great. Thank you.

Operator

Thank you. Our next question comes from Vivek Arya of Bank of America Securities. Your line is open.

Q - Vivek Arya {BIO 6781604 <GO>}

Thanks for taking my question. Hock, I had another one on the supply situation. If there were no supply constraints, how fast would your semiconductor business be growing? And kind of part B of that is what is driving the shortages for you right now? And what are you doing to resolve it? And do you have any kind of gut feel on when the supply situation will become normal? Thank you.

A - Hock E. Tan {BIO 1460567 <GO>}

Great. One of the first -- I'll answer the first and the last, in between I'm not sure. But on the first, it's -- we will not put ourselves in the situation, nor should anyone doing because there is also a certain amount -- you do not -- we do not want our customers and I don't think any of our peers want to do that either to buy too hot, to create buffers, to buy ahead of what they need. So we try to manage, identifying as I said, and go to a process of rigorously understanding true end demand. In other words, we look for drop date quantities as of terms used in industry. And we ship to those droplet quantities and maybe a little more. And what you see today is the true growth rate we are representing. We are not hiding what could have been. There is no one could have been. We are shipping to what we believe with the customers consider is the true real demand.

Now having said that, we may be delivering doing JIT, just in time, but nonetheless we do try to fulfill what customer truly want just on the -- in the timely basis. And that still continues today regardless of the size of the backlog we have, but this really in that regard. And from our perspective, the challenges we have in the supply chain is a constant side challenges to ensure that we get components, whether it's wafers, substrates, getting our products assembled, tested, and any of the small components on a timely basis to make sure that we can keep this thing running. And if you look at the size of our inventory versus the size of our cost of goods sold, our revenue quarterly, you can see that we run pretty close to just in time through our entire supply chain. And we've been able to do it and sustain that. And so what we're reporting to you like 20% year-on-year growth on semiconductor component is in our view a pretty decent reflection what is truly end demand needs out there.

All right, next question.

Operator

Our next question comes from Timothy Arcuri of UBS. Your line is open.

Q - Timothy Arcuri {BIO 3824613 <GO>}

Thanks a lot. Hock, I guess I wanted to ask you what you think the long-term growth rate as of your semiconductor business? You're sort of trending to the high teen this year, but that's kind of due to easy comps and you have the compressed iPhone [ph] launch and the pull forward of some of these technologies due to the pandemic. So once this all sort of normalizes, what do you think is the right long-term growth rate for the business? Are you still thinking 5% or do you think maybe just given the strength of the bookings recently that it could be that (inaudible)?

A - Hock E. Tan {BIO 1460567 <GO>}

That's a hell of a question. And I'll tell you in this, right now we are in the midst of a very strong demand and that's also created perhaps, as we all know about, severe imbalance between demand and supply as demand and supply works to catch up. But if you look at it long enough, I think the dynamics underlying the -- fundamental dynamics underlying the semiconductor industry hasn't yet changed, at least I haven't seen it to change. So, Tim, that's my best and that's the one best answer I can give you, which is I haven't changed my thinking if we look over the next 10 years, how this industry will behave, because it is a relatively matured industry. It's evolutionary. Technology is still evolving, which is great for us and it keeps getting better and better, but is evolving. Disruption, as people like to say, in this industry is less often event. It's evolutionary and I have not seen anything that tells me there is a fundamental change.

Q - Timothy Arcuri {BIO 3824613 <GO>}

Thanks, Hock.

Operator

Thank you. Our next question comes from Craig Hettenbach of Morgan Stanley. Your line is open.

Q - Craig Hettenbach {BIO 6185428 <GO>}

Thanks. Hock, just given the ongoing strength in the free cash flow and improved balance sheet, can you just talk about your thoughts on the M&A environment and also -- and/or buybacks? How you're thinking about cash deployment as you go forward?

A - Kirsten Spears {BIO 19712531 <GO>}

Yeah, I'll take that one. This is Kirsten. Relative to capital allocation, first and foremost, we're dedicated to paying 50% of our free cash flows to our shareholders. And so that would be first. Secondly M&A, if we can -- accretive M&A, it would be the second objective. Then thirdly, stock buybacks and at the end there would be debt repayments. So I think that's how we're looking at capital allocation in that order. There isn't anything yet on the M&A front that I can talk about, but if anything does come up, we'll let you know.

Operator

Thank you. Our question comes from Blayne Curtis of Barclays. Please go ahead.

Q - Blayne Curtis {BIO 15302785 <GO>}

Hey, good afternoon. Thanks for taking my question. Just curious, a little more detail on the gross margin. It's a record gross margin. Any color on product or segment? And then I guess as you look forward here, if you could describe what you're still dealing with in terms of excess cost due to COVID. And then how to think about it as enterprise comes back? Should that be additive to the gross margin?

A - Kirsten Spears {BIO 19712531 <GO>}

I expect gross margin next quarter to be about the same as it was this quarter. And then as you know, at the end of the year, we're expecting wireless to come back in for that normal ramp that we have and for the margins will come down a bit towards the end of the year. But at this point side, I see us being able to sustain the margins that we experienced this quarter, mostly coming from networking and broadband.

A - Hock E. Tan {BIO 1460567 <GO>}

Blayne, and the result, perhaps repeating ourselves -- myself too much from past conversations that I had reviewed with all you guys, our gross margin has this natural trend of continuing to keep expanding year-on-year, not necessary quarter-on-quarter, but sequentially as much as year-on-year simply because we tend to have a chance to go to a new product life cycle -- product -- new next-generation product across some of our franchise products. And it's a combination of all this.

So the natural growth of our expansion of gross margin for our business, especially in the semi side, particularly in the semi side, which I assume your question is related to Blayne is, as I've always said, we have a gross margin expansion range of 50 to 150 basis points year-by-year. And it's an average across our 24, 25 different -- well, I should take out software, just hardware, about 20 or so different product lines, each with a different product life cycle and each going towards new generation product each time because as you know each time we come to a new generation product, we get a lift in margins -- in product margins, which translates to gross margin.

So, it's not unusual to see us go to the higher end of the range. And in this particular case, year-on-year is a bit more than the high end of range and that's probably related to perhaps separate mix of products in this environment because there are still puts and takes across our product range, not everything is on fire. And based on that, we end up with higher than the normal 50 to 150 basis point range. But I don't think this is something that will go on forever. But you should expect that year after year, you will see that 50 to 150 basis point improvement in gross margin on the semiconductor side.

Q - Blayne Curtis {BIO 15302785 <GO>}

Thanks a lot.

Operator

Thank you. Our next question comes from Toshiya Hari of Goldman Sachs. Your line is open.

Q - Toshiya Hari {BIO 6770302 <GO>}

Hi, guys. Thank you so much for taking my questions. I had two actually. One on wireless and one on the cost side. Hock, in terms of wireless, I guess, in Q2 revenue came in better than expected. I just wanted to understand was that primarily supply being better or were there dynamics on the demand side that came in better than expected? And then sticking to wireless, as you think about the next-generation product cycle at your largest customer, how are you thinking about the content opportunity at this point? You pretty much know what's locked in. If you can comment on RF and WiFi and touch and maybe compare and contrast this uplift in this cycle vis-a-vis past cycles that would be super helpful.

And then on the cost side, based on the comments you just made about gross margin expansion and some of Kirsten's comments, I doubt cost inflation is having impact on your business. But if you can speak to wafer pricing and substrates and what you're seeing from a cost perspective over the next year or so, that would be super helpful. Thank you.

A - Hock E. Tan {BIO 1460567 <GO>}

All right. Let's start with the first one. And if I lost track of the last two, you better remind me, Toshiya. But on wireless, you're right. What indicated on Q2, wireless was kind of high-end than we had originally planned. And it's all -- and a lot related to demand. Of course, it's demand. We will never shift just because we have the products. It's based on demand (inaudible) and so we are happy to fulfill it. And part of the demand may actually come a bit from Q3. Not sure 100% yet because this demand comes in short cycles and it may -- and perhaps that's why we are bit careful about telling you Q3 year-on-year improvement. It's still 30% plus year-on-year growth. I'm not saying 40% plus. But we don't know for sure except we know that we do pull in some from Q3 to Q2, not much. And that allows Q2 to perform that 48% year-on-year growth, which is great. But Q3 will still be pretty good year-on-year as we fully expect.

And related to content and all that, I prefer, at this point, in this sensitive arena, we've a highly sensitive situation to not answer that question at all. No offense, please, but I can't answer that question. But I'll be happy to take the third question, which is -- yeah, we have cost inflation in this environment where, as we all know, the semiconductor supply chain is on the severe constraint on its ability to provide. Now we are very large. We are very, very large customer and a very loyal customer to many of our suppliers, all of our key components. And so, we believe we are treated very well. Having said that, where prices are concerned, our cost not. We see cost inflation. And in this environment, we are very, very open to talking to our customers who are in turn very open to being able to address cost inflationary, cost pressure in a higher purchase price on your site. So we're good, which is why our margins has been stable.

Q - Toshiya Hari {BIO 6770302 <GO>}

Thank you.

Operator

Thank you. Our next question comes from CJ Muse of Evercore. Your line is open.

Q - CJ Muse

Yeah, good afternoon. Thank you for taking the question. I guess another question on the supply chain and I guess a bigger picture question, Hock. If you think about your increased lead times, you talked earlier to John's question about selective strategic agreements with key customers. At the same time, we're taking multi-year kind of take-or-pay contracts with foundries. Curious if you see any structural changes to the semi industry as we kind of emerge post pandemic?

A - Hock E. Tan {BIO 1460567 <GO>}

Okay. My frank opinion, I don't know. They shouldn't be. Same question that was asked is, do you -- do I think the semiconductor industry over the next 10, 20 years will grow any faster or slower? And my view is, no, I don't think -- I don't see any fundamental things that have changed. See while we are in the flick of this storm, so to speak, of course all hell breaks loose as the expression goes. But these are cycles we all have seen many times in the semiconductor industry. And maybe this in -- and this is a bit extreme with in the context of the pandemic over the course of 2020, now extending partnering to 2021.

But the supply will step up at some point and demand is always there because people need technology, people need performance, need the technology that we all offer in the products we provide. And we will be competing the same way we have been competing. And it's not necessarily related to creating long-term agreements or any such thing. It's about being able to provide the best technology, the best products in a timely manner for your customers. And it also matters that you do any agreements. Even the end of the day, you lack the technology or you lack the products that customers need to make themselves successful or to be able to deploy in a very well -- in a good manner. And that's has always been the semiconductor industry. And that has -- that will -- I do not see anything that changes there. Now, make -- putting long-term agreements may make life easier, but I think it's just a mix. We still have to establish ourselves that we can outperform, out engineer the competition.

Q - CJ Muse

Thank you.

Operator

Thank you. Our next question comes from Chris Danely of Citi. Your line is open.

Q - Christopher Danely {BIO 3509857 <GO>}

Hey, thanks again. There is a lot of talk, worry, speculation, old wives tales whatever about this big inventory build of handsets in China, any thoughts there Hock and team? And what would be the potential impact for Broadcom?

A - Hock E. Tan {BIO 1460567 <GO>}

Well, not directly. If there is such as a big overhang sitting out there, not directly because our wireless business -- our wireless products, as we have fully articulated, pretty much sells to two large customers largely and we're talking about handset. We do not sell much if any to the handset product -- handset guys OEMs that is in China. And we sell to two big customers, one in North America, one in Korea and these are very high-end flagship status phones and that's it. Now, then it could be indirect blowback and that I do recognize in certain markets if there is an excess of inventory that needs to be just thrown out there. But on the other side, on a direct basis, we do not see any -- we do not expect to see any (inaudible).

Q - Christopher Danely {BIO 3509857 <GO>}

Thanks, Hock.

Operator

Thank you. At this time, I'd like to turn the call over to Ji Yoo for closing remarks.

A - Ji Yoo {BIO 21112206 <GO>}

Thank you, operator. In closing, please note that Hock will be presenting at the BofA Securities Technology Conference on Tuesday, June 8. Following our networking and broadband teach-ins earlier this year, Broadcom and Bernstein will be hosting a teach-in on our storage businesses on Wednesday, July 21, at 12:00 PM Eastern, 9:00 AM Pacific. Hock will be joined by Jas Tremblay, General Manager of our Server, Storage, Connectivity business; Jack Rondoni, General Manager of our SND [ph] business; and Dan Dolan, Marketing Head of our Hard Disk Drive business.

That will conclude our earnings call today. Thank you all for joining. Operator, you may end the call.

Operator

Thank you. This concludes today's conference call. Thank you for participating. You may now disconnect.
