

Q1 2019 Earnings Call

Company Participants

- Roger J. M. Dassen, Executive VP, CFO & Member of the Management Board

Other Participants

- Leo de Later, Analyst

Questions And Answers

Q - Leo de Later

This is also the First Quarter that was above expectations. Can you give us a summary of the First Quarter?

A - Roger J. M. Dassen {BIO 15064806 <GO>}

It was a modest quarter in absolute terms. But indeed, above guidance, both at these net sales level and at the gross margin level. If we look at the net sales level, we recorded EUR 2.2 billion in net sales, which is EUR 100 million more than we showed in our guidance, which is primarily related to the shipment of one additional EUV system. At the gross margin level 41.6%, which is better than the 40% that we guided, in spite of the fact that we have one incremental EUV system and that is primarily related to the fact that we had a better mix for our DUV business. And finally at the net income came in at EUR 355 million, which is favorably impacted by one-off tax benefits.

Q - Leo de Later

There still seems to be uncertainty in the market. What is your view on the semiconductor market? And what is your take on the outlook for the remainder of 2019?

A - Roger J. M. Dassen {BIO 15064806 <GO>}

You're right. There is volatility in the market, I would say, primarily as a result of macroeconomic developments and that obviously has an impact on the semiconductor market as well and create some uncertainty there. If we talk to our customers and based on those conversations, in fact, we believe that our perspective on 2019 is largely unchanged.

And we talked a lot about this in the last quarter and you might recall what we said at that point in time. We said, as it comes to Logic, we believe that's going to be 50% up, Memory 20% down. And as it relates to our installed base revenue, we believe that's going to see a growth at single digit.

Q - Leo de Later

And can you elaborate on Memory and Logic? First of all, what about Logic?

A - Roger J. M. Dassen {BIO 15064806 <GO>}

Yes. We said last time, we think 2019 is really going to be a Logic year and that's -- that expectation is primarily based on what our customers are doing. We see significant technology transitions at our customers, at our Logic customers. And that really drives this impression that 2019 is going to be a good Logic year. Because those transitions -- based on conversations we have, those transitions really will happen, could have been 1 or 2 systems more or less, of course. But the direction of travel is there and I think that is a very solid underpinning for a Logic business this year. And that's why we believe that the risk profile in our Logic business is fairly low.

Q - Leo de Later

And what about Memory?

A - Roger J. M. Dassen {BIO 15064806 <GO>}

First off, let's look at what we said last time on Memory. We said, Memory, we believe, is going to be 20% down and that translates into approximately EUR 3.6 billion of revenue in our Memory business systems -- systems business. I think it would be good to just look at EUR 3.6 billion and really break it down into a number of components because there is a number of elements in the EUR 3.6 billion that are actually unrelated, I would submit to, to the global demand for Memory. And those 2 components are: first, the demand for our systems by domestic Chinese players. As you know, those are strategic investments that are actually unrelated to the current global demand for Memory. So that's one strategic component. The other strategic component is that we see customers preparing for the introduction of EUV in DRAM and that's a strategic project, it's a strategic decision. And based on conversations again with our customers, we see that that's -- that it's actually happening. So we would say that for those 2 components, we believe, the risk profile is fairly low. And those 2 components account for approximately EUR 1 billion take it together. So that brings you down from EUR 3.6 billion total system sales in Memory to EUR 2.6 billion. If you compare that EUR 2.6 billion that is contingent upon the global demand for Memory. If you contrast that to the number that we had last year, it's actually 30% down. So that's a good reflection I think of the uncertainty that exists in the market and that's totally factored into our perspective this year.

So EUR 2.6 billion is the remaining portion related to the global demand for Memory. Of those EUR 2.6 billion, we already recorded EUR 700 million in the First Quarter. So that leaves you with EUR 1.9 billion remaining for the 3 quarters to come. And that's the part that is related to the global demand and maybe uncertainty in the global demand. So I would say that the risk profile there is a little bit higher. But also the opportunity there is higher and it will be very much dependent on how the situation particularly on DRAM is going to manifest itself in the remainder of this year. But all-in-all, I think it's important to recognize that this EUR 3.6 billion has different components with different risk profiles associated with it.

Q - Leo de Later

What can you say about the margin development through the year?

A - Roger J. M. Dassen {BIO 15064806 <GO>}

So the margin that we see for Q2, we guide there between 41% and 42%, which is probably is more or less in line with where we were in Q1. On a basis -- on a revenue basis between EUR 2.5 billion and EUR 2.6 billion. So that's what we're -- and that's what we're looking at. We have significant programs in place and significant developments to expect to see the gross margin really develop favorably in the course of the second half. The first one is the introduction of the 3400C machine in the second half, which has a significantly better margin profile than the current machines. The second category is the service revenue and the service margin on EUV and that's very important, we talked about that last -- at last quarter as well. As you know, at this stage, we have significant costs because we're helping our customers gear up for EUV and for insertion of EUV into high volume manufacturing. So we have the cost at this stage. But we don't have the revenue because the way for output, of course, is still very, very modest. That will kick in, in the second half because then we will see EUV in high-volume manufacturing. So that would drive up the revenue and also we have programs in place to bring down the cost of EUV service.

So those two combined will have a significant positive impact on the EUV service margin. The third category is installed base revenue. Installed base revenue, we see good potential for increase there and also in the high margin pieces of that. Then we also see a better development of the mix, particularly the mix in our DPV business in the second half. And finally, because we will see a higher output level in the second half that will also lead to better factory loading and as a result of that better fixed cost coverage. So all those measures taken together will lead to a significant improvement of gross margin in the second half and we believe will very nicely position us for our goal of having a gross margin in 2020, which is going to exceed 50%.

Q - Leo de Later

Let's have a look at EUV. How are you progressing with EUV?

A - Roger J. M. Dassen {BIO 15064806 <GO>}

We shipped 4 systems in the First Quarter. We took 3 orders and we expect to ship another 6 systems in the Second Quarter. All-in-all on track for total shipments for the year of 30. And as you know, all of this really is in the context of a number of our customers who are putting EUV into high-volume manufacturing starting this year for Logic and then also introducing EUV into DRAM manufacturing. Good news is that at this quarter we had the first set of 3400C optics in our factory. And those optics will enable transmission of 170 wafers per hour throughput. And that we believe will make it possible to have EUV enable shrink and cost effective shrink both in DRAM and in Logic. And that's we're on track for and we'll have the first shipments of this 3400C machine in the second half of this year.

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