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TEXT version of Transcript

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Presentation

Operator [1]

Good morning, everyone. Welcome to the conference call for analysts and investors for Infineon's 2023 Financial Third Quarter Results. Today's call will be hosted by Daniel György, Senior Director, Investor Relations at Infineon Technologies, who is stepping in for Alexander Foltin today. As a reminder, this call is being recorded.

This conference call contains forward-looking statements and/or assessments about the business, financial condition, performance and strategy of the Infineon Group. These statements and/or assessments are based on assumptions and management expectations resting upon currently available information and present estimates. They are subject to multitude of uncertainties and risks, many of which are partially or entirely beyond Infineon's control. Infineon's actual business development, financial condition, performance and strategy may, therefore, differ materially from what is discussed in this conference call. Beyond disclosure requirements stipulated by law, Infineon does not undertake any obligation to update forward-looking statements.

At this time, I would like to turn the call over to Infineon. Please go ahead.

Daniel György [2]

Thank you, operator. Good morning, ladies and gentlemen. Thank you for joining our earnings call for the June quarter, on which we have our CEO, Jochen Hanebeck; and our CFO, Sven Schneider. As usual, Jochen will open the call with remarks on the market situation and divisional performance, followed by Sven commenting on our key financials. Jochen again will provide the outlook and highlight key messages.

The illustrating slide show, which is synchronized with the telephone audio signal, is available at infineon.com/slides. After the introduction, we will, as always, be happy to take your questions. Kindly asking you to restrict yourself to one question and one follow-up. The recording of this conference call, including the aforementioned slides and a copy of our earnings press release as well as our investor presentation, are also available on our website at infineon.com.

Now let me turn it over to Jochen. The floor is yours.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [3]

Thank you, Daniel, and good morning, everyone. 3 quarters of our fiscal year 2023 are now in the rear mirror, and I'm happy to report once again on a strong set of results. On top of our strong business performance comes a number of important design wins and the major announcements with regards to our future plans in silicon carbide, which I'm sure you have seen this morning. Ask for your patience as I will address this topic at the end of my introductory remarks.

Coming first to the general market development. We are facing at the moment 3 categories of momentum. Firstly, our decarbonization-related businesses like renewables, e-mobility as well as the automotive MCUs keep performing extraordinarily well. And given the structural dynamics of those markets, we see the momentum as unabated. Then some of our businesses, like classic automotive components and industrial drives, keep a strong performance in an, as expected, more and more normalizing market environment. Lastly, our computing, consumer and communication-related businesses keep performing comparatively well in a challenging environment. While meaningful improvement of this situation is certain, inventory digestion and the recovery in end customer demand has to happen.

Considering that mixed market environment, our results are once more a strong proof point of the underlying quality of our portfolio. Let's look closer at them.

Revenues in the third quarter of our 2023 fiscal year came in at EUR 4.089 billion, basically stable in comparison to the previous quarter. The corresponding segment result was EUR 1.067 billion, with a segment result margin of 26.1%. This strong print is fully in line with our guidance for the quarter and incorporate

some of the previously flagged effects like incremental underutilization charges, additional ramp-up costs and a slightly weaker currency development.

Also, as expected, our backlog of confirmed and unconfirmed orders keeps trending to healthier levels as we witness a normalization in some of our core markets. At the end of June, it stood at EUR 32 billion after EUR 36 billion 3 months ago, still around 2x of our annual revenue.

Now let's take a closer look at our divisions. After crossing the EUR 2 billion quarterly turnover mark in the March quarter, Automotive could even further expand its revenues to another record high of EUR 2.129 billion and an increase of 2% compared to the previous quarter. In particular, microcontrollers were contributing to this further increase.

The segment result decreased to EUR 583 million, equivalent to a segment result margin of 27.4% compared to the record 31.1% in the previous quarter. The difference is due to the nonreoccurrence of premium fees for additional short-term deliveries that we benefited from in the March quarter and the result of increased input costs.

All in all, the business is doing very well in delivering strong margins on a substantially higher flight level than in the past years. To reiterate, several product categories like MCUs and high-voltage semiconductors remain rather tight, while the principal portion of the classic automotive business has now reverted to a normalized state.

For 2023, once again, the market researcher, S&P Global, has slightly revised up their forecast for global light vehicle production, now seeing a total volume of 86.7 million units. This coincides with our view that customers' interest and a certain pent-up demand will keep production growing modestly. Needless to say, content expansion will be the much more relevant growth driver in the coming years. And with our leading franchises in EV and ADAS, we are confident that we will grow our Automotive business further in 2024 and thereafter.

One of the strongest growth markets is and remains China. It is the biggest global automotive market as well the largest market for electric vehicles. According to TechInsights, Infineon is the #1 automotive semiconductor provider for China. Encouragingly, the extension of China's NEV subsidy to 2027 will support the demand for EVs while Chinese OEMs are increasing their exports volumes strongly.

From a design win side, we saw once again a very favorable dynamic. A key win shows how we benefit from the evolution of the E/E architecture. With around EUR 800 million, it is the largest contract ever we achieved at our NOR flash business. A North American OEM has decided to use several versions of our high-performance, nonvolatile memory in its upcoming platform for software-defined vehicles. The NOR flash components, on average, more than 20 per vehicle, will store code and configuration data in applications like central computer, ADAS, in-vehicle communication and infotainment.

In the field of silicon carbide, we have secured impressive new design wins as part of our planned significant expansion of our cooling facility, to which I will come later. Also, newsworthy are the very encouraging developments on our silicon carbide supply side. In line with our strong belief that the base materials will become a commodity, we are seeing great progress from our 2 recently disclosed additional Chinese suppliers. We have finished the automotive qualification for the suppliers ahead of time and are already delivering devices to our worldwide customers. For the past quarter, our share of silicon carbide materials from Chinese suppliers has reached around 20%. This share is to double in the next few quarters, allowing us to optimally serve local demand and to balance our supply.

With that, we feel confident of having the most reliable and geographically diversified supplier network for silicon carbide boules and wafers in the industry and, if I may add, also a very cost-efficient one. Looking at the prospects of the transition to 200 millimeters, we have sample material from 5 suppliers in-house to further set up our processes, preparing to switch when it makes sense from a cost perspective.

For fiscal 2023, we are fully on track to reach our target of around EUR 500 million in silicon carbide sales, as previously said, limited currently only by our Villach footprint.

Now to Green Industrial Power. The segment printed once again an excellent quarter. Revenue for the third fiscal quarter amounted to EUR 565 million, 1% up from the previous record quarter. Transportation, renewable energy and power infrastructure were the main growth contributor for this quarter.

Profitability is staying at a very high level. The segment result came in at EUR 171 million, with a segment result margin of 30.3%. From a market view, we continue to see very strong demand in our core decarbonization-related applications. Moderate growth in our automation and drives business and the clear potential of the transportation business to cover -- to recover to or above prepandemic levels in the near future.

With our EasyPACK module for MOSFETs and IGBTs, we landed an important design win at Delta Electronics. Our components covered by the low triple-digit million euro design will be used in the DC/DC converters and onboard chargers in EVs for Delta's customer, a major German premium car OEM. Our customers like Delta especially appreciate our ability to address their need for customization and supply assurance.

We continue to see a very encouraging momentum in our industrial silicon carbide-related business, with a year-on-year growth rate of over 60% achieved in the last quarter. Industrial customers and automotive customers ones alike are supporting the expansion of our silicon carbide manufacturing capacities with design wins and monetary commitments.

Since there seems to be some confusion in the market, let me reconfirm that we are consistently and by far the #1 power semiconductor supplier for solar applications by revenue. This is not only underpinned by our recent design wins but also by our leadership in silicon and silicon carbide power semis in the industrial space as a whole. Our supply agreements in solar cover, as we speak, more than EUR 3 billion alone.

Now coming to Power & Sensor Systems. For this quarter, the segment's revenue stayed almost constant at EUR 917 million. With a decline of only 1%, this was better than expected. Despite an ongoing inventory correction on the power side, our RF and sensor businesses has recovered somewhat from the very low previous quarter's levels.

The segment result of EUR 191 million came in almost at the same level as in the previous quarter, leading to a segment result margin of 20.8% in the June quarter. The segment is diligently managing production capacities, inventories and corresponding idle costs in order to balance customer needs and safeguard margins and cash flow. While seasonal fluctuations might occur, in particular in the mobile phone-related businesses, the general demand environment remains rather subdued, and inventory cleanups on the part of our customers are still ongoing. We do not expect a near-term recovery of the business from a holistic segment perspective. Specific applications like automotive charging and residential solar remains strong growth drivers.

In recent months, the potential of artificial intelligence or AI or generative AI to take digitalization to a whole new level has become apparent. PSS stands to significantly benefit from the structural growth factor over time. AI training is a very compute hungry and calls for massive build-out of dedicated server capacities. At the same time, power consumption is soaring at ever lower CPU, GPU core voltages and thereby driving electrical currents up. This, in turn, necessitates dedicated power management solutions with best-in-class density, efficiency and reliability, which Infineon is offering to all leading CPU and GPU vendors. Therefore, stay tuned.

Further bright spot during the quarter is a significant silicon carbide design win for the onboard charger in a battery electric light-duty truck of a leading North American e-mobility company.

Let's finalize the divisional overview with Connected Secure Systems. After the previous record quarter, CSS revenue came in at EUR 474 million, a 14% decline in comparison to 1 quarter earlier. This was driven by a weaker development in predominantly WiFi components and microcontrollers, with identification and payment applications staying strong.

The segment result declined to a value of EUR 119 million, equivalent to a segment result margin of 25.1%. Despite the decline in volumes, the margin level was supported by structural improvements and efficient management of our foundry corridors. From a market perspective, consumer and IoT as well as compute applications were, as expected, clearly weaker, with an immediate recovery not in sight. On the other hand,

our order backlog for the segment has now reverted back to usual levels, which we see as an indicator for a normalized market environment going forward.

During the quarter, one of many interesting design wins we secured was on WiFi components for the next generation of a quasi standard small single-board computer. And we are excited about our acquisition in the AI space. With Imagimob, a leading provider for machine learning solutions for power-efficient edge devices, we will further enhance our AI offering. It will allow us to transfer machine learning capabilities, which were primarily at home and large-scale server farms onto our microcontrollers. This strategic move brings together 2 of our key focus topics, AI and software, and will be a great enabler for our customers. Actually, there are many more exciting digitalization opportunities ahead for us, on which we will update you during our IoT roadshow in September.

Now over to Sven, who will comment on our key financial figures.

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [4]

Thank you, Jochen, and good morning, everyone. Building on the very strong financial trajectory of the first half of our 2023 fiscal year, the June quarter came in as predicted. Overall, very resilient and at a good level, given certain margin headwinds we had hinted at before.

Gross profit for the quarter under report amounted to EUR 1.821 billion, corresponding to a gross margin 44.5%. The adjusted gross margin, which excludes nonsegment result effects, stood at 46.2% in comparison to 48.6% in the previous quarter due to the earlier mentioned effects like incremental underutilization charges, additional ramp-up costs and the slightly weaker currency development.

Our operating expenses saw only slight sequential increases. Research and development expenses were EUR 496 million compared to EUR 487 million in the quarter before. Selling, general and administrative expenses amounted to EUR 396 million after EUR 394 million in the March quarter. The net other operating income was EUR 67 million, containing again some disposal gains from the sale of the Temecula site in the U.S.A., which were grouped into our nonsegment result, which therefore totaled a comparatively low minus EUR 71 million. Of the overall amount, EUR 67 million corresponded to cost of goods sold, EUR 12 million to R&D expenses and EUR 55 million to SG&A expenses. Net other operating income amounted to EUR 63 million.

The financial result for the June quarter was minus EUR 5 million after minus EUR 17 million in the quarter before. The improvement relates principally to valuation effects on some of our monetary investments, which we liquidated in connection with the scheduled repayment of our EUR 750 million bond maturing in June.

Income tax expense amounted to EUR 167 million for the third quarter of the current fiscal year, equivalent to an effective tax rate of 17%. Cash taxes in the June quarter were EUR 100 million, resulting in a cash tax rate of 10%. For the entire fiscal year 2023, we expect an overall rate for both effective as well as cash taxes of between 18% to 20%.

Our investments into property, plant and equipment, other intangible assets and capitalized development costs in the June quarter increased as expected to EUR 768 million, up from EUR 565 million in the quarter before. Depreciation and amortization, including acquisition-related nonsegment result effects were EUR 441 million in our fiscal second (sic) [third] quarter after EUR 434 million in the preceding quarter. Driven by strong operating cash flow, our quarterly free cash flow from continuing operations improved to EUR 326 million after EUR 193 million in the prior quarter.

Within this overall positive development, inventories on our own balance sheet increased in total, with reach going up from 143 to 149 days. Looking a bit deeper, it becomes apparent that finished goods actually came down quarter-over-quarter in absolute terms, whereas we saw higher values for raw materials and work in progress. As mentioned before, we are taking a differentiated look at stock levels as the supply-demand balance varies a lot by product category.

Now to our liquidity and leverage figures. The positive free cash flow, notwithstanding our gross cash at the end of June, decreased to EUR 3 billion compared to EUR 3.4 billion at the end of March. The key reason is the mentioned repayment of a EUR 750 million bond. Our gross debt correspondingly went down and stood at EUR 4.7 billion, further reducing our gross leverage to now 0.8x. Net debt came in at EUR 1.7 billion,

equivalent to a net leverage of 0.3x. These figures translate into ample financial flexibility to support our growth path, including lighthouse projects like the further Kulim expansion.

Let's close the financial part with a look at our after-tax reported return on capital employed. With 18% for fiscal Q3, we once again clearly exceeded our cost of capital.

Now back to Jochen, who will comment on our outlook.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [5]

Okay. I have to switch on. Thank you, Sven. Overall, the strong trends, decarbonization and digitalization we are addressing are intact and will allow us to close our fiscal year much better than originally anticipated in November last year. We are fully on track to reach our twice-upgraded guidance in a market environment which continues to be characterized by different patterns of demand: areas of strong structural growth, fields with resilient momentum and more sluggish areas exposed to consumer spending.

For the currently running fourth and final quarter of our fiscal year, we expect revenues of around EUR 4 billion, essentially flat compared to the previous quarter. By division, we do not expect major differences in the sequential growth development. For the group segment result margin, we project a level of around 25% for the September quarter, reflecting the demand situation in conjunction with deliberately accepted higher idle costs and some incremental ramp-up efforts as already communicated. As before, we do assume $1.10 for the U.S. dollar-euro exchange rate.

Considering our outlook for the final quarter, for the full 2023 fiscal year, we continue to expect revenues of around EUR 16.2 billion, fully confirming our previous estimate. As before, by segment, we expect ATV and GIP to grow above and CSS as the expected -- at the expected corporate average rate of around 14% year-over-year. For PSS, we expect annual revenue to fall short of last year's level. Our expectation for the adjusted gross margin is unchanged at around 47%. Also, the outlook for the segment result margin for our full fiscal year 2023 is unchanged at a level of around 27%. So both will be in line with the upgrade we have done in May.

Our forecast for investments in property, plant, equipment, other intangible assets and capitalized development costs is unchanged at the level of around EUR 3 billion.

For depreciation and amortization, we continue to expect a value of around EUR 1.8 billion, including amortization of around EUR 450 million, resulting from purchase price allocation that will end up in our nonsegment results. For the free cash flow, we now see a slightly increased level of around EUR 1.2 billion. Our adjusted free cash flow is now expected to come in at around EUR 1.7 billion, representing above 10% of sales.

As previously, none of our projected numbers is incorporating any effect related to the planned acquisition of GaN Systems. We continue to expect closing of the transaction within the fiscal year 2023.

With this, ladies and gentlemen, I would close the usual part of our quarterly earnings call and take the opportunity to take you through our plans for significantly accelerating our silicon carbide business.

As you have seen this morning, we plan to build the world's by far largest 200-millimeter silicon carbide power fab in Kulim, Malaysia. The market for power semiconductors continues to show accelerating growth driven by decarbonization. Within this market, silicon carbide shows impressive and unabated growth in automotive and in a broad range of industrial applications like solar, energy storage systems, high-power EV charging and more to come. This accelerating growth is clearly above the projections many market researchers and also we had in the past. Therefore, we have decided to significantly increase the scope of our expansion of the Kulim site to provide capacities for an annual silicon carbide revenue of around EUR 7 billion by the end of the decade.

With this side, we will be able to leverage our strong technological base like the best-in-class silicon carbide Trench technology, broadest package and customer portfolio and deepest and widest application understanding, together with an unprecedented scale and factor cost advantage. Together with our well-

diversified substrate supplier base, we are convinced that we are set up for a silicon carbide market leadership position.

Expanding the third module at the existing site in Kulim offers significant advantages, not only from an infrastructure point of view but also with the outstanding competence level of our employees on site, allowing us to establish a highly competitive world-scale fab in combination with our R&D competence center in Villach, Austria. This decision is supported by an impressive incremental design win volume of about EUR 5 billion along with about EUR 1 billion in prepayment from existing and new customers. In the automotive sector, this includes 6 OEMs, 3 of them from China. Among the customers are Ford, SAIC and Cherry. Notably, all of these long-term agreements are linked directly to OEMs who are the ultimate decision-makers in this market.

In the area of renewable energy, customers include SolarEdge and 3 leading Chinese photovoltaic and energy storage systems companies. In addition, Infineon and Schneider Electric agreed on a capacity reservation, including prepayments for power products based on both silicon and silicon carbide. We will provide more details in separate announcement with our customers in the near future.

The prepayments will contribute positively to Infineon's cash flow in the coming years and shall be fully repaid in connection with agreed sales volumes by 2030 at the latest.

With Phase 2 of the Kulim expansion, we will invest additionally up to EUR 5 billion over the next 5 years. With that, we now plan to spend a cumulative amount of around EUR 4.5 billion on major front-end buildings over the next 5 years. The investment, along with the planned 200-millimeter silicon carbide conversion of Villach and Kulim, will lead to aforementioned annual revenue potential of EUR 7 billion by the end of the decade, underpinning our 30% market share target. Our near-term revenue target is now more than EUR 1 billion in 2025.

The start of production of the second phase of module 3 is planned for mid-2027 while the already announced investment of the first phase is well on track. And production will start in the second half of 2024.

Now ladies and gentlemen, it is time to summarize. Once again, we have delivered a strong quarter and are fully on track to reach our twice-upgraded guidance for fiscal 2023. Market dynamics are clearly mixed with some businesses continuing to show unprecedented demand, while others are in a more normalized or even muted state. With our recent decision to significantly expand our silicon carbide manufacturing footprint, we are reaffirming our leadership in power systems.

With our strong portfolio geared at the long-term trends of decarbonization and digitalization, we are addressing the right structural themes and despite of any short-term cyclical movements. We will continue our determined execution, knowing that our solutions provide answers to the challenges of the green and digital transformation.

Daniel Györy [6]

Ladies and gentlemen, this concludes our introductory remarks, and we are now opening the call for your questions. Emma, please start the Q&A session now.

Question And Answer

Operator [1]

[Operator Instructions] And we'll take our question from Simpson with Morgan Stanley.

Lee John Simpson, Morgan Stanley, Research Division - Equity Analyst [2]

Just wanted to go through that -- the margin structures again around Automotive. I think you talked about 27.4% versus 31% in the last quarter, but you gave us some details around nonrecurring fees around short-term deliveries. And I think you said there was an increase in the input costs. Could you maybe just go back to that and give us a couple of numbers around that, if it's possible?

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [3]

Yes, Lee. Sven speaking. I'm happy to take that. You already summarized it well. So it's a combination of these effects. So there are some premium fees which are related, for example, to expedited delivery or extra quantities. That's something which has faded out in the last quarter to a certain extent. So these are the premium fees we were referring to, which is in line with the normalization of parts of the businesses as we have described around classic automotive, for example.

The second part are the increased input costs. And here, it's from the silicon foundries, there are some increases on externally procured products, for example, for the microcontroller business.

Lee John Simpson, Morgan Stanley, Research Division - Equity Analyst [4]

Great. Pretty clear. Maybe just to -- as a quick follow-up around sort of IGBTs and clearly, as far as your position into China is concerned, could you give us a sense for how pricing there is progressing and what sort of position you see for yourselves going into '24 as it currently looks?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [5]

Yes, I take the question on pricing. So first of all, pricing in Automotive is very firm. And I think this is what you refer to. And also pricing in many parts of the industrial business is, as it is an allocation, very firm. We even see some opportunities for silicon carbide to -- for example, on silicon carbide to increase prices.

Now in some standard components, power discretes, there is somewhat slightly weaker pricing. However, that is only relates to the standard parts, not the differentiating MOSFETs and IGBTs. And the standard part is only a small part of the -- our overall portfolio.

And of course, we remain to be a leading supplier of the Chinese EV companies. And this is still an area where we are short of supply and, therefore, no discussion for sure on pricing going in reverse.

Operator [6]

Next question is from the line of Johannes Schaller with Deutsche Bank.

Johannes Schaller, Deutsche Bank AG, Research Division - Research Analyst [7]

Just on the EUR 5 billion incremental designs that you have in silicon carbide. Just can you maybe give us a little bit more detail? If all of that happened in this quarter, so it's quite a big number.

And then maybe as a second question, just on pricing. You alluded to silicon carbide seeing some more upside. Can you maybe help us on the profitability of that business right now? One of your competitors gave a bit of color around that. And then also on the microcontroller side, I think, Sven, you spoke about higher input costs. I mean is there more scope in higher MCUs also to maybe increase prices going forward again?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [8]

Yes. Thanks, Mr. Schaller, for the question. I take the first part. So look, various customers approached us over the last 2 quarters and said, "We need more long term. We need more silicon carbide capacity until the end of the decade." And then we concluded, okay, if there is sufficient customer commitment and not only by talking but by actual monetary commitments and also supported by our market picture, which is not only geared, as you know, from the Automotive side, but also supported from the industrial space where we see more and more applications, where the value proposition of silicon carbide is emerging and becoming a reality.

So based on our market picture, based on numerous customers, we concluded it's now time to go here on a different scale and build out Kulim 3 immediately with the second phase. And that will give us a unprecedented scale and also a cost advantage compared to any other fab on silicon carbide on this globe.

And with this, I hand over for the other questions to Sven.

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [9]

Yes. Thank you. Johannes, you asked on the pricing and the profitability for silicon carbide. So happy to reiterate that our silicon carbide now, I'm talking Infineon, is profitable, as you know, since several multiple quarters. Here, there is a differentiation as we have said all along the last quarters. The industrial silicon carbide business is an accretive business but also the Automotive business is increasing significantly in profitability. So also here, we are around the company margins. So that's a very positive development.

And I think the other one, as Jochen was just saying, that's the short-term situation. Mid- to long term, we will benefit from the combination of scaling and also the diversified supplier base, which is also geared towards cost competitiveness, if you just think about the most recent supplier agreements we have communicated.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [10]

Yes. And on the microcontroller side, to finish the question, it's a very, very strong growth in this business. High or well above EUR 2.5 billion this fiscal year, growing very strongly from last fiscal year. This is based on design wins we got many years ago when we took a chance in the market to come up with new innovative products, which were then picked up by -- big time by many, many customers. We secured capacities now long term with various foundries in this regard. And towards your question, we will, of course, make sure that also over the course of time here, the market price is reflected in our books.

Operator [11]

Next question is from the line of Joshua Buchalter with TD Cowen.

Joshua Louis Buchalter, TD Cowen, Research Division - Vice President [12]

I wanted to ask about underutilization charges. Could you maybe pinpoint which segments? Are there any going on in ATV? And I guess bigger picture, how are you thinking about inventory levels? Are you managing to a target now and trying to get them lower? Or are you comfortable with where things are?

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [13]

Yes, Joshua, Sven. I'll take your question. So on the underutilization charges, because they are, I think, important to also understand the margin dynamics, let me give you here full transparency.

So in the first half, we realized, give or take, around EUR 180 million of underutilization charges. For the full year, we expect them now to be at around EUR 425 million. So you see that there is a significant increase in the second half, as communicated already in the Q2 earnings call.

The peak of that is expected to come in Q4, and that's the main reason next to the currency where we expect $1.10 for the dollar, and we have already seen the first months being weaker than $1.10. So we accept -- on top of the currency effects, this is the important driver the margin reduction from 26% to 25%.

The underutilization charges are, of course, managed, as you asked in your question, following the market demand. And therefore, you can assume that it's geared towards the weakness we continue to see in the consumer, communication, compute segment. And therefore, I would say the majority of that will be reflected and visible also in the margins of the PSS and, to a certain extent, on the consumer business for the CSS business. That's the majority what we see currently.

Joshua Louis Buchalter, TD Cowen, Research Division - Vice President [14]

That's very helpful. I appreciate that color. Then you called a high-voltage power and MCU as the sort of the higher -- remaining tight in ATV. Any help you can give us on what percentage of that business it is and sort of what's going on in the non-high-voltage and microcontroller portion of the business? Are pieces of those businesses within auto still seeing pricing firm?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [15]

Yes. If you combine high voltage and microcontroller in the Automotive space, you're talking roughly half of the division revenue. And as always, if things are tight, then there is no reason or price discussion go in one direction. There's no reason to discuss softer pricing or weaker pricing.

Joshua Louis Buchalter, TD Cowen, Research Division - Vice President [16]

But the other half of the business is fine as well?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [17]

The other part of the business falls in the category of firm pricing, as I alluded to before, because Automotive is a business with long design in cycle. So the overall statement is very firm pricing, Automotive. And then in the areas of allocation, the discussion is, if at all, about price up further.

Operator [18]

Next question is from the line of Didier Scemama with Bank of America.

Didier Scemama, BofA Securities, Research Division - Director in EMEA Equity Research & Head of European IT Hardware [19]

I'm afraid back on autos again. I think last quarter, you sort of alluded that -- to the fact that you could grow in ATV revenues in fiscal year '24 but not ready to commit to double-digit top line growth. So my question would be, are you prepared now to reiterate that or at least to give us some commentary on the trajectory of revenue next year?

And then on the margins of ATV, given your earlier comments, Sven, about peaking idle costs and also FX, assuming sort of flattish development from here, do we expect margins to trough in the current quarter, so Q4? Or the ramp-up costs are going to wait further in the first half of fiscal year '24?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [20]

So I take the outlook statement. So even if we do not give any guidance on the next fiscal year, I think it's fair to assume, and I stated also in my introductory statements, that Automotive will continue to grow because, obviously, we have here one of the biggest structural growth drivers in our hands.

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [21]

Yes. Didier, on the Automotive margin, I mean, as I alluded to already in my answer to your colleague asking the previous questions on where will we see idle coming up in Q4. I mean I expect the Q4 numbers also given that the revenue line is more or less the same -- in the same ballpark for Automotive. We are not guiding for next year. Please understand. We will be the first to guide for the next year in November, but -- so then give us please the benefit in this call not to guide for '24. And there are always puts and takes on margin. Keep growing is one thing. Ramping is the other thing. But as I said, let me come back to that in the November call, please.

Didier Scemama, BofA Securities, Research Division - Director in EMEA Equity Research & Head of European IT Hardware [22]

Fair enough. For my follow-up, I wondered if you could go back to the commentary you made on the -- I'm not sure if you said PSS or CSS or both, but on sort of backlog and order starting to recover from the depressed level of Q2. If you could perhaps comment a little bit on that. And if you just give us a bit more color on the outlook. I mean we probably don't expect a strong recovery given the demand environment. But can that be supportive again for the coming quarters for revenues and margins?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [23]

The CSS, the comment was relating to CSS, where we see the total backlog now on a normal level -- on a historic normal level. The business is still subdivided in 2 parts: government ID and payment, strong; and connectivity components related to consumer applications, weak. And here, we still have to see clear signs of recovery.

Operator [24]

Next question is from the Francois Bouvignies with UBS.

Francois-Xavier Bouvignies, UBS Investment Bank, Research Division - Technology Analyst [25]

I have 2 questions. The first one is on the investment in silicon carbide. So can you explain well, I mean, the investment and the prepayments? I think one of the market concern is around the timing of this investment. When we look at the outlook, the macroeconomic is uncertain. When you look at the Q4 guide, actually, your revenue are going to decline on a year-over-year basis, first time for a long time. So how can you reassure the market on the timing of this investment? Because when we look at the already first module you had on the silicon carbon in Kulim, I mean, it's far from full yet. You didn't start ramping it from my understanding. So maybe can you help us understand your capacity trajectory potential next year and 2025? What kind of revenues could you theoretically achieve, demand aside, in the next -- in '24, '25? And why do you need to invest now? And that's my first question.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [26]

Yes, happy to take. So first of all, silicon carbide, we are currently limited in Villach. So next year, we will only grow in Villach before Kulim 3 Phase 1 will then support us in revenue growth in 2025.

Building factories takes time. So Kulim 3 Phase 2 is providing capacity then from '27 onwards. So here, we are clearly aligned with our market models, aligned with public data, aligned with many of our customers. We are convinced that the structural growth drivers will ask for more output and especially in the second half of the decade, and that's why we are making this investment.

Of course, this investment can, in terms of equipment, always be adjusted to the exact market conditions then down the road. So we are starting now with the building, which is a certain amount out of the EUR 5 billion. It will be adjusted. But today and proven by prepayments, I mean, customers don't make prepayments lightly. We believe that this is the right step.

And please remember our decision on Villach at the time. It was also in a weaker environment. And yes, in that case, obviously, we got it right. And therefore, building semiconductor factories is always something looking into the future. And of course, we are also confident because of the breadth of application, it's not only Automotive but many, many industrial applications, which are now gearing towards silicon carbide. And in the future, also gallium nitrite, I have to say.

Francois-Xavier Bouvignies, UBS Investment Bank, Research Division - Technology Analyst [27]

Okay. And maybe my second question is, as you see the silicon carbide ramping up, what does it mean for your IGBT, especially on the high-end front, high end? Do you see any change like a change of mix basically where you see silicon carbide application increasing? Because you're not the only one investing significantly in silicon carbide and seeing the demand greater, but it has surely some implication into maybe the high-end IGBT. So does it change the road map at all on the IGBT, maybe lower investment on that front? That would be helpful to know your thoughts on that.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [28]

Yes. Look, the -- many people are indeed announcing factories on silicon carbide, and the winners will be the ones with best cost position. And we feel that with Kulim as a production site and the scale of our facility, we are -- we will be much better off than any of our competitors.

And in case there is an oversupply situation towards the end of the decade, then the ones that will win as usual, in the semiconductor industry, will be the ones with the best cost position and the best differentiation potential, which again, I repeat myself here is technology is package, portfolio, application know-how, breadth of application and customer portfolio and so on and so forth.

Now with respect to silicon here, we have with the 2 300-millimeter factories, we have achieved a very good economy of scale. We see further growth, of course. Some of the growth in the overall markets goes into wide bandgap. But also according to external markets research sources, silicon is still growing. And that is also supported by the application view. If you think about the public discussion on hybrid inverters, silicon carbide, silicon, the opportunity for silicon in entry-level cars for second axles, so it fits all nicely together in our view. And we feel that we -- as our claim is or our ambition is to be the leader in power systems, and that's why we will keep on investing into all 3 technologies. But relatively, of course, the investments now go stronger into wide bandgap, silicon carbide and gallium nitride.

Operator [29]

Next question is from the line of Sandeep Deshpande with JPMorgan.

Sandeep Sudhir Deshpande, JPMorgan Chase & Co, Research Division - Research Analyst [30]

I have a couple of questions. So my first question is regarding your margin situation. I mean when we look at your margin in the first -- in the most recently reported quarter, we've seen the margin in autos drop a lot. But then Power & Sensor Systems, which actually saw a decline in revenue, has not seen margin decline a lot. So I mean I'm trying to understand what is the -- why the margin behavior between the different divisions is so different as such when one is growing, the margin is dropping, the other one is declining, but the margin is not dropping as much? Is this anything to do with the inventory positions? And the same thing, I mean, when we look at CSS, for instance, where is these inventories in CSS? And why is the margin dropping only by 3 percentage points there when the revenue decline is so significant in CSS?

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [31]

Yes, Sandeep, thank you for the question. Happy to take that. So I mean, again, starting with the Automotive situation, I think we explained that there is a combination of some additional factors which we have not seen so much in the other divisions. For example, the premium fees and the higher input costs on wafers or inputs, which are going into material, which is still heavily in allocation, that, for example, is not the case as unfortunately, as we see the weakness in many consumer-related applications in PSS and CSS. So it's always a combination of input and price, of course, which then makes the delta.

But you are right, I can confirm that we have been a bit more pessimistic, so to say, on PSS, than they came out this quarter. But we still are -- want to see more evidence and not only some sub-pockets of PSS like RFS or some server-related businesses before we really declare it to bottoming out. So we keep being here conservative. But these are the main drivers for the situation. So on top of the group aspects, as we said before, the idle, the FX effect, which, of course, affects the divisions, all to a different extent but all are affected. You have these special ones, which are Automotive-specific or which are, to your example, more CSS-specific.

Sandeep Sudhir Deshpande, JPMorgan Chase & Co, Research Division - Research Analyst [32]

So sorry, I didn't understand the point on CSS. So why CSS is not down more given the 14% drop in revenue?

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [33]

I said that the difference, for example, is that it's a different mix effect between the what we call ICW, so the Bluetooth, the connectivity business and the payment business. And the other thing is that the increase in

input costs given that the end markets are weaker in CSS was not as much as in Automotive, for example.

Sandeep Sudhir Deshpande, JPMorgan Chase & Co, Research Division - Research Analyst [34]

My next question is on CSS itself on the inventory. I mean can you tell us where the inventory positions you see in the non-Automotive microcontroller market is at this point? Is there a pricing impact in the microcontroller market in the non-Automotive side as such? Because the consumer market remains [incredibly weak] at this point. So trying to understand where -- or the trajectory of that market at this point.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [35]

Yes. On the CSS pricing side, Sandeep, these are all design in products. We are not in this standard general purpose microcontroller markets, which others have reported about. Ours are security design in products and connectivity parts. So I don't think we can put these 2 into 1 bucket.

Sandeep Sudhir Deshpande, JPMorgan Chase & Co, Research Division - Research Analyst [36]

And what about the inventory on...

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [37]

Inventory on -- in the channel or...

Sandeep Sudhir Deshpande, JPMorgan Chase & Co, Research Division - Research Analyst [38]

Microcontroller ex autos as such, really overall. How do you see that?

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [39]

I can take that. So generally, Sandeep, the inventory levels in line with our development from the market -- end market side are in an okay-ish area for Automotive and GIP. And they are out of the normal range in PSS and CSS, and our normal range, let's now for -- just to give you 1 example, the distribution inventory, which is 9 to 11 weeks. So here for CSS, we are above the 11 weeks.

Operator [40]

Next question is from the line of Aleksander Peterc, Societe Generale.

Aleksander Peterc, Societe Generale Cross Asset Research - Equity Analyst [41]

I just like to ask [indiscernible] on the order backlog, which shrunk sequentially by EUR 4 billion, and that is the equivalent of your revenue. So from a simplistic point of view, it looks like your order intake for the quarter have been offset by potentially cancellations. Is that the right way we should be looking at this? So if you just give us a little bit of color on what are the moving parts in the backlog, and I have a quick follow-up on that.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [42]

This quarter, there is no foreign exchange rate effects in the reduction from EUR 36 billion to EUR 32 billion. So it's orders. But as always, it's the -- without limitation, right, it's over the total order book over the next years.

And yes, we printed EUR 4 billion of revenue, but you cannot take that as the only factor because there are many structural effects between the divisions and also on a product portfolio ongoing. Overall, we consider this reduction as a healthy normalization. As I always said, this number was too high, and it will probably also go further down in the next -- over the next months, and that's not surprising, and that's not at all concerning for us with respect to our growth trajectory for the years to come.

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [43]

And Alex, maybe to add, the 2 other data points which we are also always happy to share with you is that based on the EUR 32 billion backlog still unchanged, more than half is with Automotive and, give or take, 2/3 up to 12 months. So no major change on the structure as well.

Aleksander Peterc, Societe Generale Cross Asset Research - Equity Analyst [44]

Then my quick follow-up would be just on the idle capacity charges. So you clarify that we should expect the kind of a peak in these charges in the current [September] quarter. Will you then -- do you anticipate reaching a structural level in terms of your inventory to declare basically the [indiscernible] of major idle capacity charges going forward? How should we think about modeling this going forward?

Daniel György [45]

Alex, sorry, I think we lost you here for 1, 2 sentences. Could you please repeat the question?

Aleksander Peterc, Societe Generale Cross Asset Research - Equity Analyst [46]

Yes, sorry. So it was just on idle capacity charges. You specified that the peak for the year in the fourth quarter, which is a [helpful] indication. Will you, by the end of the year, reach inventory level [that is] satisfactory for you and, therefore, moderating if any [idle capacity chargers are] [indiscernible]. That was my question.

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [47]

Yes. So Alex, I'm a bit speculating because the line is really broken. I hope I got your question and I give you the right answer. So I understood your question around the idle. Will that peak in this Q4 for the fiscal '23? The answer is yes.

And then the second part, as far as I understood, it is if we are then satisfied with the inventory levels towards the end of the year. I would say, if you ask me, I should not be satisfied with the levels we currently have. It depends very much on the divisions and, within the divisions then, on the different buckets as we said. There are still products hand to mouth. We will focus very much on the ones where we see a continued weakness, and that is mostly around consumer, compute, communications. And let's then show the numbers at the end of the year, which will be the end effect of all the balancing between idle, as Jochen also said, in the intro remark, between idle revenue and free cash flow.

Operator [48]

Next question is from the line of Tammy Qiu with Berenberg.

Tammy Qiu, Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst [49]

So firstly, regarding again, your auto margin, how should I be thinking about this auto margin trend on the sort of midterm, long-term basis? Because obviously, your mix has improved and also these EV agents have been much more popular than it was previously.

And also the second question is relating to your China supply of your silicon carbide. Do you see your supplier's yield rate improving recently? And in the long term, are you willing to probably increase your percentage of sourcing from them?

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [50]

Tammy, I'll take the first part, and Jochen will take the silicon carbide part. So again, as I said earlier, please do not expect us now to guide midterm, long term of '24. But I mean I can maybe help you a little bit. If you look at our through-the-cycle target operating model, you see the 25% being the midpoint. And then in very good years, we want to be in the high 20s and, in bad years, in the high teens.

And so if you just assume that Automotive represents, give or take, close to 50% of our revenues, I mean you can assume that they should be in that ballpark as well. Otherwise, it will be very hard to reach these markets. Maybe that -- these margins, sorry, maybe that explains it indirectly without now giving you concrete numbers for the next year.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [51]

Yes. And I take the silicon carbide part. So we are very happy with the progress we make with these 2 Chinese silicon carbide supplier, SICC and TanKeBlue, we announced last quarter. As I stated, they are Automotive-qualified now with us. They contribute already 20% to the volume as we speak last quarter. And this share will likely double and then go in line with the local demand in China.

With respect to their own yields, you need to -- our yield is absolutely on a very good level. Also, compared to other suppliers, their own yields, I can only speculate, but I can assure you the material we get, whether it's boules or wafers, are of very high quality.

Tammy Qiu, Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst [52]

Okay. Just to confirm. Regarding your midterm target, at that time, you were saying you're going to increase the level of value-based pricing for segment, including auto. Is that in progress?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [53]

Yes, absolutely. Value-based pricing is our strategy and in execution. Along the thought of product to system, we are not selling individual parts. We are making proposals, we are making offers, we are designing in, we are -- have design wins on product sets. And in that regard -- including software, by the way. And in that regard, of course, we can make a very different value proposition to our customers, including also capacity reservation agreements and other services, and that is what we call overall value-based pricing. And yes, in execution across the company.

Operator [54]

Next question is from the line of Jerome Ramel with BNP Paribas Exane.

Jerome Ramel, BNP Paribas Exane, Research Division - Analyst of IT hardware and Semiconductor [55]

Quick question on silicon carbide. Have you qualified your 8-inch yet? And if not, when do you expect to qualify your 8-inch? And for Kulim 3, what's going to be the capacity in terms of wafer start per month for 200-millimeter silicon carbide?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [56]

I'm not sure whether I fully understood due to the quality of the line, but I understood it's a question about 8-inch. So I can tell you the 8 -- the second phase of Kulim 3 will start with 8-inch. That's for sure. When exactly now the transition to 8-inch will happen, whether it's in 2 years or in 4 years, we are still observing the market. As said, we have material in-house from various suppliers to set up our processes -- our own processes. So that's ongoing. So we are ready. But we will only make that transition, of course, when it's commercially meaningful. And this will play out over the next years. The EUR 7 billion at the end of the decade is then purely 8-inch in Kulim and Villach.

Operator [57]

Next question is from the line of Janardan Menon with Jefferies.

Janardan Nedyam Menon, Jefferies LLC, Research Division - Equity Analyst [58]

Just a question on your 2030 outlook on silicon carbide. At EUR 7 billion, you're going to be -- you've sort of stated your claim to be the largest supplier of silicon carbide in the market because that number is higher than other numbers from current leaders, and you've attributed some of that increase of -- to take that share to the lower cost production on this big facility or building from an economy of scale point of view.

I'm just wondering how sustainable is that because your competitors can also put up very big facilities. And is that, on its own, sufficient to give you an advantage from a cost point of view? Or does your advantage come sort of more from the fact that you are a few generations ahead in Trench technology or packaging? Is that the more sustainable advantage? I'm just talking about purely from an investment point of view, other companies can also do what you're doing. So how -- what gives you the confidence that you have a sustained advantage? And how would you see the split of industrial versus Automotive revenues roughly? I know it's difficult to predict to 2030. But roughly, how do you see that split at that point in time between industrial and auto? And I have a small follow-up on that.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [59]

Yes. Thank you for the questions. So our assumption on the EUR 7 billion is roughly 50-50 between Automotive and industrial. But of course, that can change over time.

But if you ask me today, that would be my assumption.

On the differentiation potential, it's all of the factors, cost advantage, technology application know-how, package portfolio and why do we believe this cost advantage on the fab is something hard. In principle, yes, others can also build up factories, but building a new factory is a different game than converting a factory. And to give you a bit of a feeling, such a factory in a moment where depreciation is still on, the cash cost is 50%. And a good chunk of this 50% is labor costs. And you can assume that labor cost is a lot less in Malaysia as compared to Korea to Europe to U.S. And if the factory is running out of depreciation, then of course, this share even goes up further.

Also, the building cost of a facility in Southeast Asia by square meter or square foot, whatever you like, is half of the cost compared to Europe or U.S. So I have no doubt that this facility will beat, in terms of cost position, any of the announced project. And looking forward to any plan of a competitor that, yes, tries to beat us in that domain.

Janardan Nedyam Menon, Jefferies LLC, Research Division - Equity Analyst [60]

Understood. And then just on the Automotive margin side. In the third quarter, did you still have premium fees, which could come down into subsequent quarters? Or was the premium fees sort of only a first half phenomenon? And the same on the wafer input side on the microcontroller side, has all of that microcontroller pricing, I mean, the wafer pricing being reflected? Or will there be more increases in subsequent quarters?

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [61]

Yes. So Janardan, thanks for the question. So again, guiding now only for '23, there was a reduction, as communicated from the last quarter to this -- the Q2 to Q3. I would now take the current run rate as a good proxy for the next quarter. And as I said, for '24, we will then guide in the November call again.

And please also, look at that in combination, these fees, these expedited fees for premium services, as we call it. They have to be also seen in the connection with the capacity reserve agreements. There's a lot of debate with the customer still ongoing, also shown by the prepayments now in silicon carbide where it's about supply certainty.

So there are other buckets which we are triggering and which will also play an important role in the revenue and profitability line going forward. So it's not only about the premium services, not to confuse you here.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [62]

And let me add one more aspect to the discussion on the silicon carbide factories. Of course, others in Europe or in United States, you might be able to achieve a higher level of subsidies.

First of all, that also implies that we are also confident to get some subsidies in Malaysia, of course, not to the same extent. But again, these subsidies needs to, first of all, cover the building infrastructure difference between high-cost countries and a country like Malaysia. And then, of course, ultimately, over a longer period of time, if you look for 5 more years or 5 years and more down the road, the subsidy effect will have disappeared. And what remains is the cash cost, and that determines then the competitiveness of a factory.

Daniel Györy [63]

Time to wrap up. Thank you for all your questions. With that, we are concluding our fiscal third quarter conference call. For further questions, please feel free to contact the IR team here in Munich. Thank you very much. Take care, and have a good summer.