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PRESENTATION

Operator

[Interpreted] Hello all, if you like to hear this session in English, please click the globe icon on the bottom and select English channel.

Ladies and gentlemen, thank you very much for attending Renesas Electronics Earnings Call for the Third Quarter of Fiscal 2022, despite your busy schedule. We thank you very much indeed. Simultaneous translation is available today. Please click the globe icon at the bottom and select your preferred language. Speakers, you are requested to turn your video on.

Today's session is attended by our CEO, Mr. Hidetoshi Shibata; our Senior Vice President and CFO, Mr. Shuhei Shinkai; and Senior Vice President and General Manager of Automotive Solutions Business Unit, Mr. Takeshi Kataoka, as well as some other staff. Mr. Shibata will first make an opening statement and then Mr. Shinkai will explain the third quarter results, followed by a Q&A session. We expect to finish the entire session in about 60 minutes.

The materials to be used for today's presentation is the same as the one posted on the IR website of Renesas Electronics. Mr. Shibata, please turn your microphone on and begin your statement.

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Hello, good afternoon everyone. This is Shibata. This time around, the results this time, because this is our third quarter, so there's nothing so much noteworthy that we should highlight so much, (technical difficulty) by Mr. Shinkai later.

As far as our third quarter results are concerned, overall, I think I would say the results were in line with our expectation. The end demand for automotive was slightly higher than expected. So towards the fourth quarter, the channel inventory for automotive will have to be replenished to some extent. So that's something, because we believe the demand is quite firm.

Other than automotive, from third quarter to the fourth quarter, we have seen an apparent change in the market conditions. So PC, mobile, all the weakness in the middle point are now expanding to the peripheral parts, peripheral meaning that the printers and also -- rather than the PC per se, smartphones, especially in China, the inexpensive range and also some high-end -- some things that we are very concerned about. So therefore, we have provided a sequential guidance this time around.

Compared to usual, the guidance numbers this time around are, to some extent, worrisome to me and we still presented these numbers with some concerns in our mind. That's the frank and candid opinion that I have. But the details will be provided by Mr. Shinkai from here onwards.

So I will give the microphone to Mr. Shinkai now.

Shuhei Shinkai - *Renesas Electronics Corporation - Senior VP & CFO*

[Interpreted] Yes, this is Shinkai, CFO, thank you very much. Allow me to go over with you the Q3 presentation based on the materials we have provided. So please move to the next page.

So here we have the financial outline for Q3. And if you'd be able to look at the dark blue column, so revenue, that's JPY 387.6 billion. Gross margin at 57.0%. Operating profit, that's JPY 142.8 billion, meaning the margin is 36.8%; and profit attributable to owners of parent, that's JPY 96.4 billion. Now if we exclude foreign exchange impact, then the profit attributable to owners of parent is JPY 115.4 billion. EBITDA, that's JPY 163.4 billion. And as for the currency assumption, that's JPY 135 versus U.S. dollars and JPY 139 versus euro.

And we have the comparison -- the numbers of comparison versus forecast in the 3 following columns, which I'd like to go explain afterwards. But then we also have in the next blue column that 9 months year-to-date figures. Now again, we have shown the net profit, excluding ForEx impact. And this is because we wanted to show the more normal steady profit level.

And at the same time, this is something that we went over in the previous session, but then there is this group cash pooling. And because with this purpose, we have intercompany loans in dollars. And so this intercompany loans, the timing on this valuation can recognize gains or losses from ForEx on the consolidated financial expense. And so if we have weaker yen NPL, that means we see more loss.

Now of course, we're trying to work to reduce our exposure to foreign exchange. And this is specifically about revisiting how we pull cash, and we hope to be able to accomplish that during this year. And so this currency loss, you will still find this until our Q4, but then from next year, we are trying to minimize our exposure to ForEx in this form. In Q4, how much -- we still do believe there is going to be an impact. But then we know that JPY 1 fluctuation hindering approximately JPY 3 billion impact. And so weaker yen causes loss and stronger yen costs gains.

Moving on to the next page. In here, now we look at quarterly revenue trend and Q3 is shown on the far right. Overall on year-on-year, we have seen an increase by 50% and Q-on-Q, that's a 2.8% increase. Breakdown, as you can see, so Q-on-Q for the automotive side, that's minus 3.7%, whereas Industrial, Infrastructure, IoT, that's plus 7.8% Q-on-Q.

Next page, please. So now here we look at the revenue and gross operating margin for Q3, so starting from the total. Now versus the forecast, so if you'd be able to look at the top right, as for the revenue, again, we have been able to find from the midpoint (inaudible) increased by 0.9%, which is a JPY 3.6 million upshot. And there has been a ForEx by third and on this we will be excluding the forecast. And so this mainly comes from the industry infrastructure, IoT.

Gross margin compared to the forecast, we have been able to surpass this by 0.5 percentage points. And there has been some slight positive coming from currency here. Now we are trying to prepare for any yen appreciation risk. And so we're trying to make sure that we'd be able to do a currency hedge so that we'd be able to have this very stronger floor for dollar versus yen. And so that means weekly an upside is going to be limited in that sense.

Now as for the product mix, we have seen a positive -- plus, slight positive, and mainly coming from Industrial/IIoT. And for the production recovery and production cost, it was pretty much in line with our forecast. Operating expense, we have been able -- we have seen a decline by JPY 6.4 billion, and we have seen a decline of R&D and SG&A. And so therefore, OP margin, we have been able to see this increase by 2.3 percentage points.

Now Q-on-Q is also shown on the bottom right. And for the OP margin on a Q-on-Q basis, we have seen a decline by 1.7 percentage points. Now as for the revenue, there has been a positive currency impact, but then if we exclude currency impact, we have seen a negative trend. And we have seen a positive growth in IoT. And -- for the gross margin, we are seeing a minus 1.6 percentage points, which has some slight positive impact coming from currency.

On the product mix, this is something that we've been able to see some slight positive due to IoT. And as for the production recovery due to post-process mainly, we have seen a decline. So therefore, gross margin Q-on-Q, we have seen a decline by 1 percentage points. But then on R&D, this also has increased by JPY 2.5 billion. Next, we look at this per segment. If you'd be able to look at left-hand side. So on gross margin and operating margin, you can see that there is a bit of a difference between the segments on Q-on-Q.

So for gross margin, production recovery, Automotive has more internal production. And so that is why we're seeing a contribution more on this automotive side. But then from Q3, in other words, from the second half, we are going to be revisiting how we calculate the notice of provisioning. And in other words, this was something that we did allocated the same rule for the entire company, but now we're going to be looking at this current business segment. And so that means that this is going to have a positive impact to the margin for the IIoT, but not so for the Automotive. But then if you look at this on a total company basis, the impact is neutral.

Our next page is about the inventory. And later on, I will be talking about the Q-on-Q change as well as the future forecast. But then at the moment, here, we look at the in-house inventory. Now the total DOI has increased by Q-on-Q. It increased at Automotive, but then for IIoT, it has declined. So the increase we're seeing on the Automotive side is because we have this advanced purchase for die bank for work in progress. But then for finished products, this is because we're doing advanced production, which I would like to go on, explain later on.

Next is about the inventory and the sales channel side. And again, on the far right, we have the total figure. And you can see that WOI on a Q-on-Q basis has been on a decline. Now we're seeing a decline in Automotive, some slight increase in Industrial/Infrastructure/IoT.

Moving on to the next slide. Here, we look at the analysis. So first of all, starting with the left-hand side, this is about the in-house inventory. So we have been seeing an increase in Q2 to Q3, and 30% of that was coming from currency and 10% was through the valuation -- inventory valuation change. If we look at the details, for example, the raw materials, we wanted to make sure we have a good BCM response. In other words, if we know there's a material at risk, we wanted to make advanced purchase, for example, wafer or substrate or maintenance parts. So these are some of the items that we decided to make some advanced purchasing. And this is something that we will continue doing in Q4, so there will be a slight increase here.

Next is the work in process. In Q3, there was advanced purchase order as well as increase in die bank inventory. Now as for the advanced purchase, this is something that we did touch in our previous session, but we are trying to do some ramp up production. And so we wanted to make sure we'd be prepared. But we're basically talking about Automotive SoC. And for die bank, again, we wanted to have good BCM response, especially for products that we are internally manufacturing. And so that is why we're building up our die bank inventory. And so this is something that we are able to do well for the legacy type of products. But then when it comes to some of the growth products, we do not believe we have ample inventory yet.

And for the work in process, likewise, in Q4, we do -- we are going to be increasing building the die bank inventory, especially for some of the products that we need to supply more, which means that work-in-process, especially for the Automotive side will keep on increasing. On the other hand, for Industry/Infrastructure/IoT, we will be looking at the demand trend to lower down the wafer start, but then we do have to look at some of the lead time. And so that means we will still see a tentative increase in inventory in Q4. But then from thereof from Q1 next year onwards we'd like to make sure we optimize the inventory level.

Now for the finished goods for Q3, we wanted to prepare for anything that we will be decreasing the utilization date for -- day for Q4, especially around post process, and that is something that we did in Q3. And Q4, for the Automotive side, we are going to be increasing the advanced production for Automotive side. And also for the channel -- sales channel side inventory. Now what we can see for both Automotive and IIoT is that we are going to be responding to the end demand. In other words, we do not want to eat or consume too much of the future demand at an early stage. And for that perspective, again, this is something that we did touch upon in the previous session. But in Q3, we have decided to hold down the inventory for maybe our Automotive side and IIBU in Q4.

Now for the IIBU in Q3, we have implemented measures for the final demand. In other words, we know the end demand there on Q-on-Q is flat and inventory level has also remained flat. In Q4, we are again going to be responding to the demand level. Now -- for the end demand, we expect it is going to go down Q-on-Q. So in other words, that means WOI is going to slightly increase. For the Automotive side, the replenishing of the inventory, we do believe we have been able to accomplish that at the point of Q2. And so we have decided to hold down the sell-in amount at Q3, looking at the end demand. And there still was this strong trend in the end demand, and that is why WOI has declined. In Q4, we do want to be careful as we foresee how the end demand would go. But then Q3, we did sort of decline on the inventory amount and so we hope we'll be able to build up again in Q4. And so Q-on-Q, we expect ABU to increase here.

Moving on to the next page. Here, we look into the utilization rate. Now here in Q3, the input basis was 85%. And in Q4, we expect there is going to be a slight decline. Towards the year-end, there is going to be the regular maintenance at each of the fabs or factories. And so that is why the operational utilization date will be declining. And so that is why we expect the utilization rate in Q4 is going to flow down.

Please move on to the next page. Now here, there is not much points that I would like to highlight, but Q3 EBITDA was JPY 163.4 billion. Operating cash flow JPY 144.9 billion, free cash flow was JPY 128.3 billion. So that's the highlights here.

Moving on to the next page. This is the forecast for the fourth quarter. If you look at the dark blue portion in the middle of this table, revenue at the midpoint is estimated to be JPY 385 billion. And Q-on-Q, 2 columns down to the right, down 0.7%. For the gross margin, 54.0% is projected on a Q-on-Q basis, this represents a decline of 3.0%. For the OP margin, 30.5% on a Q-on-Q basis, this is a negative 3.6 percentage points. The currency rate, we are assuming JPY 144 to the dollar and JPY 142 to the euro.

If I can add some more comments regarding the details here for the operating revenues. If you exclude the currency impact, the foreign exchange impact, our Automotive almost flat and IIoT negative growth is projected here. And for the gross margin, product mix, IIoT is going to decline. Therefore, we are projecting a deterioration of product mix. For production recovery, as I mentioned earlier, in the year and the new year period, there's a regular maintenance plan. So the utilization operation day is going to come down, and therefore, the production recovery is going to come down. For the production cost, we are expecting a Q-on-Q increase because of the power cost increase and also the startup costs for the Kofu factory and also the regular maintenance costs are also included in here.

The next page, please. If you can go to Page 17, this is the non-GAAP and GAAP reconciliation bridge. In the third quarter, of course, for the primary non-recurring items, the Yamaguchi plant's equipment sales, approximately JPY 8 billion were recorded. And the next -- this is CapEx, the status of CapEx. Up until the second quarter, the big ticket items production increased our investments have been completed. So in the third quarter and fourth quarter, the mid-single digit is decided for the capital expenditures.

So that's all for myself. Thank you very much for your attention.

QUESTIONS AND ANSWERS

Operator

[Interpreted] Thank you very much. Now we would like to move on to the Q&A session. Shibata, please turn your video on. (Operatory Instructions) Due to time restrictions, we may have to ask you to limit the number of questions to two questions per one questioner.

Now we would like to move on to the Q&A session. If you have a question, please indicate by the raise hand button. Now from Daiwa Securities, Sugiura-san.

Toru Sugiura - *Daiwa Securities Co. Ltd., Research Division - Research Analyst*

[Interpreted] This is Sugiura from Daiwa Securities. I have 2 questions. One is about the Q4 guidance for revenue. Your assumption is used for that. I would like to ask some supplementary questions. For automotive, it's flat, excluding the foreign exchange impact, according to your explanation, the finished cars production status, how are you projecting this? And what's your assumption for the production of finished cars? And for IIoT, you are going to expecting -- you are expecting a decline on a Q-on-Q basis. I think there are some seasonality and there are some decrease for the sales to some customers. But does the projection this time around include something much larger than that in the decrease. So can you divide by Industrial and Infrastructure and IoT for the projected numbers of sales for those different sub-segments?

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] For automotive, almost a flattish growth is projected by and large. And on the other hand, our direct customers, in many cases, are the Tier 1 suppliers and those Tier 1 suppliers, inventory level, we have to keep a very close eye on the inventory level of those Tier 1s. And although the automotive market is expected to be flattish, but the device consumer at the Tier 1 level compared to the third quarter is expected to slow down in the fourth quarter. Maybe slowdown is slightly different in terms of nuance. But we have made advanced orders in the third quarter. So we are going to go through an adjustment period in the fourth quarter. I think that is a more accurate discussion. So the sell-in of our devices, if that remains flat, the channel will increase in -- the channel inventory will increase. That's how we look at it at this point of time.

For the IIoT business, industrial, this applies to many different companies. But I think industrial encompasses many different components. Hard core factory automation, if I limit that conversation to that segment only, I think the growth is still continuing and solid numbers are expected for that segment. On the other hand, when it comes to interrelated, that I said at the outset and also PC peripherals, in the third quarter we are expecting a significant drop compared to the third quarter in the fourth quarter. So for many other things, low teen when foreign exchange is flat, a low-teen level of decline is projected.

And for the IoT portion and broad-based, long-tail customers, many of them are included here. So I would say, maybe some demand decline as anticipated. But rather than that, I think inventory adjustment is something that we see more strongly so. So in terms of device consumption from Renesas, a 10% or so decline is projected if the foreign exchange is assumed to be flat. So, cloud and data center that will continue to remain flat, and remains solid, firm growth is expected there. So that's the overall picture that I am anticipating.

Toru Sugiura - *Daiwa Securities Co. Ltd., Research Division - Research Analyst*

[Interpreted] Then my second question is about your profit margin. This is a question relating to your profit margin. Shinkai-san mentioned and gave us some qualitative comments during his presentation. So once again, let me ask this question. The third quarter actual for Automotive and the semiconductor gross margin has come down quite a bit. So what is the major factor behind this? And also for the guidance for the -- profit margin for the fourth quarter, I have a question. Gross margin and SG&A because of the Kofu factory start-up costs, I think SG&A is expected to go up. So from Q3 to Q4, ABU and IIoT, if you divide between the 2, what are the factors that will have a negative impact on the gross margin? Once again, can you streamline that and then explain to us if you can give us a breakdown of the impact from each element to the extent possible, that would be appreciated.

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Okay. So that will be answered by Mr. Shinkai. Shinkai-san, please answer.

Shuhei Shinkai - *Renesas Electronics Corporation - Senior VP & CFO*

[Interpreted] In Q3 to Q4, the bridge between Q3 to Q4, I'll try to organize that and come with -- comment on that. So from Q3 to Q4, 3 percentage points decrease and the composition for that will be product mix 40% of that, and production recovery and production impact 20% or slightly more than 20%, and production cost slightly less than 20%. That is the breakdown.

And as far as the product mix is concerned, on a macro basis, Automotive flat, IIoT negative. So the product mix will deteriorate. So that impact is something that we account for. And also for Automotive -- inside Automotive, the internal mix within Automotive, there is a slight impact from that. One thing, the low margin -- those products were relatively low margin. Those sales are expected to grow and the high-margin sales, product sales is expected to come down. That's one thing.

And also there are non-device sales that we don't have a final outlook developed yet. And we have just made a conservative projection for those. So for those reasons, the Q-on-Q product mix is expected to decline or deteriorate. Just as a confirmation, for the product mix, Automotive accounts for the bulk and for the utilization decline also have a stronger impact on the Automotive because in-house production is higher. But the production recovery will be affecting both segments of IoT and automotive. So for the gross margin of the Automotive side is going to decline higher in the fourth quarter. Yes, of course for the production cost, the -- those at the production cost and relating to internal production, so just like the production recovery, the Automotive (technical difficulty).

Operator

[Interpreted] Thank you very much. Next (technical difficulty).

Unidentified Analyst

[Interpreted] My question is about your ABU inventory level. Now the inventory of sales channel has been increasing, but then you have been declining, you mentioned that approximately JPY 160 billion amount of sales. So if the production level is going to continue as today, that's really the level of the revenue. Now I know, for example, that the supply chain today that because of supply chain issues in semiconductor, they're going to be reducing their production volume. So for example, how much sufficient is the supply for semiconductor for automotive purpose. For example, is it going to be really rare like just 1 out of 1,000 is not going to be enough.

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Well, since we have Kataoka-san is here, why don't we first ask Kataoka-san to answer.

Kataoka Takeshi - *Renesas Electronics Corporation - Senior VP & GM of Automotive Solution Business Unit*

[Interpreted] Yes. So do we have enough -- is there ample supply? That's something I would like to respond. So yes, there are some products where the supply is still short. And so that is why, for example, people like Toyota would be making their announcement. In other words, they are saying that they're going to be declining their production level. They have been making downward revision compared to what we announced initially. So that is something that we are observing.

But then if you look at this on a macro level, the shortage is becoming more -- more gradually, they are getting more relaxed or the situation is becoming gradually better. But then because we're hearing these announcements like Toyota, we do want to be careful. And so that is why we have -- that is -- that's what's behind the adjustment of the inventory in Q3.

Yes. And also for the first part of the question. Now in a nutshell, there's still areas that we don't know. But then this Q3 level, is it going to continue? And would that give us better visibility? That is quite a difficult conclusion to make. My feel is that there probably will be yet a little more increase from what we're observing right now. And what's behind that is again something that we've been discussing from before. In other words, there's more EV, ADAS, there is the production volume, contents growth. There's a lot of talks behind this. And what is holding down this increase, I guess, has to do with what you asked as your second point.

In other words, the components required to make a car will the OEMs, car OEMs have sufficient parts. That's really the theme. And talking about our own device mix. Again, you heard from Mr. Shinkai. SoC, there is this advanced purchase. But then, for example, 40-nano MCU, we would very much like to make an advanced purchase. But then even if we do that, we're going to be eating away consuming that right away. So even if we have no matter how much we have, we never will have enough. And so how much supply can we secure? We do have to look at that. And so those are some of the factors that we have to look at. And ever since last year to this year, as we have been observing, we still have to ask if this current trend that we're observing is going to give us a large growth next year. We still are not exactly sure. But then at this moment, we do believe there is still a chance that we will be finding growth next year. So that's my answer.

Unidentified Analyst

[Interpreted] So I know there are 2 questions, and I know I was trying to make it technical, and that was supposed to be one large question. So I'd like to ask a little more, which is about foreign exchange. And again, I want to be technical, and I'm going to be asking a little more questions here. So what is your currency -- the sensitivity to currency. And for example, on an annual basis, can you tell us? And also, now we know this currency is fluctuating. And is this currency change, fluctuation changing your share, because the Japanese products from outside, people outside must be really cheap. And do you think this is going to give you an opportunity to increase your share? Can you give us your feel?

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Now for the market share, well, just because yen is weaker, it doesn't mean that the price in dollar is going to be lowered. And so basically, we are -- we do not believe we're going to see any contribution like that from currency. But as for sensitivity, let's ask Mr. Shinkai.

Shuhei Shinkai - *Renesas Electronics Corporation - Senior VP & CFO*

[Interpreted] Yes, for the annual basis, I think that was your question. So if we look at the Q4, allow me to just talk about the Q4 base as the baseline. And so the assumption of the currency for Q4 is -- again, we did talk earlier about how we try to make a currency hedging, hedging of the currency. So that means JPY 1 fluctuation versus dollar, that means to the revenue that is going to change by JPY 1.2 billion and gross profit will be JPY 600 million, OP were JPY 300 million. As if this is for a euro, likewise, JPY 1 fluctuation can change the revenue by JPY 300 billion, GP by JPY 300 million, and OP by JPY 200 million.

Operator

[Interpreted] Now from Goldman Sachs, I would like to invite Takayama-san to raise a question.

Daiki Takayama - *Goldman Sachs Group, Inc., Research Division - MD, Co-Head of Japan Equity Research & Equity Research Analyst*

[Interpreted] I have 2 questions. I think I'm allowed 2 questions. So my first question is about the foreign exchange. Now, Shinkai-san mentioned the hedging, you mentioned that from next year onwards, you might review the way of hedging so that you won't have any impact on the non-recurring basis. So once again, why are you doing this? And why are you going to change the practice so that you won't have any profit impact just like other companies. So can you give us the rationale behind this decision?

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] So Shinkai-san can comment this further, because…

Shuhei Shinkai - *Renesas Electronics Corporation - Senior VP & CFO*

[Interpreted] Yes. So the reason why we are going to review the methodology is because the cash grouping inside the Group is something related to this. So I'm talking about the currency of -- if you can look at Page 4, the profit -- the foreign exchange gains and losses that will have an impact on the profit attributable to the parent. In order to minimize the impact, we are doing this. The currency impacting the profit would be the financing expenses, and that means intercompany loan balance, which is denominated in dollars. So depending on the foreign exchange level, this will grow or shrink and that will have an impact on the consolidated profit. And therefore, the intercompany loan, rather than the intercompany loan, we would like to look into other methodology for cash pooling. And by doing so, the impact on the financing expenses can be minimized. So that's the rationale behind this. And therefore, maybe you misunderstood with something different.

Daiki Takayama - *Goldman Sachs Group, Inc., Research Division - MD, Co-Head of Japan Equity Research & Equity Research Analyst*

[Interpreted] All right. So my second question, I'm sorry, is about -- it does not have any direct relationship with what you have commented today. After the fourth quarter guidance, some events that could have some impact on the first quarter performance, I would like to summarize the pros and cons. These expenses may no longer be there. But for the raw material cost, I think could be somewhat better reflected and the utilization you can -- I think there are something you can do more. But on the other hand, the IIBU, which is expected to decline may moderate.

So to the extent possible, to the extent that you have visibility, can you give us your projection and guidance into the first quarter? And then after that, over the longer term, I think 25 percentage point to 30 percentage point is something that you are projecting for the longer term. So do you have any feeling that you'll be able to manage within that range over the longer term? So that's the point that I would like to confirm.

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Well, after all, everything is dependent on the semiconductor demand changes on the macro basis, and that will change the outcome significantly. So the question is very difficult for me to answer. But the level that we are currently projecting, if the fluctuation turns out to be within the range that we are projecting, and maybe Shinkai-san can add some comments later if need be. But the possibility, if there's going to be a negative impact, that one element that could have a negative, turn to the negative would be the production recovery. At this point of time, the demand is not likely to change significantly to the pessimistic side. But if that happens, we may have to shrink the production quite significantly. And therefore, the production recovery will have a significant negative toll on us if that turns out to be the case.

Product mix, as you rightly pointed out, for the short term, PC, mobile and peripherals and also the high-end smartphones, those are the things that we have concerns about. At this point of time, if the demand for them declines in the future, the IIBU product sales is likely to come down. And therefore, in comparison with the AA Automotive, the product mix overall for the company will deteriorate. So those are the 2 things towards next year that could have the negative downward pressure on us. Those are the primary 2 components that may have a downward pressure into next year.

Shinkai-san, did you have anything?

Shuhei Shinkai - *Renesas Electronics Corporation - Senior VP & CFO*

[Interpreted] I have -- I shared the same view with you and in fact the production recovery impact, I think, will have the biggest impact on the gross margin, I believe. And therefore, depending on the outcome of that, the results may look quite differently depending on the production recovery trend. Overall, the cost is rising, including raw material cost and also the personnel cost. But those things could be passed on, for example, or some other methodology can be used in order to absorb such impact. So that the -- we shall be able to maintain the operating margin within the level that we have just mentioned. I think that's reasonably possible for us to do.

Daiki Takayama - *Goldman Sachs Group, Inc., Research Division - MD, Co-Head of Japan Equity Research & Equity Research Analyst*

[Interpreted] The raw material costs and other costs, passing on those costs, you are -- you believe the environment allows you to do this quite smoothly without any problem. Is that correct?

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Well, whether that's smoothly or not or swiftly or not, I'm not really sure, but we are meticulously trying to convince customers to gain their understanding. That remains unchanged.

Operator

[Interpreted] Next, Mr. Hirakawa, please unmute yourself and ask your question.

Mikio Hirakawa - *BofA Securities, Research Division - Research Analyst*

[Interpreted] BofA Securities, this is Hirakawa. I have 2 questions, too. Now for the question, I know it's the same question, but then Texas Instruments have given their outlook, and the money side is really going to go down. But still, it is still seeing some growth, so strength. And -- but then Texas Instruments GI did not really mention about how strong and robust or continue will strength they be able to find on the automotive side, but then how -- what is your perspective on the automotive side semiconductor? So that's my first question.

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Well, I already said what I need to say, I don't really have any additional comments other than what I have mentioned, but Kataoka-san, would you have anything?

Kataoka Takeshi - *Renesas Electronics Corporation - Senior VP & GM of Automotive Solution Business Unit*

[Interpreted] Well, this is Kataoka. So yes, we know that OEMs, they want to keep on producing more like they want to increase their production volume by 10% or 20% next year versus this one. And of course, they want to have more revenue. And if there's going to be contents growth, that is also something that is favorable. And if that is all achieved, then we should really see a good growth in demand. But then every time, I mean, this is parts, we're not just talking about semiconductors. There's always this part shortage, which does limit the production volume. And probably the production volume is not really going to change from this year. And if we'd be able to keep that in mind, I think that's one way to discipline ourselves in thinking how we'd be able to keep the inventory, but that's my response.

Mikio Hirakawa - *BofA Securities, Research Division - Research Analyst*

[Interpreted] So in other words, it's not about the OEMs production volume demand, but it's really about how much parts could be supplied. And that's what's going to determine your semiconductor business, as well as the relationship with the OEMs production volume. Is that the way to take it?

Kataoka Takeshi - *Renesas Electronics Corporation - Senior VP & GM of Automotive Solution Business Unit*

[Interpreted] Well, contents, number of contents, as well as the car production volume probably would be some of the indicators. For the past 2 years, this is something that we've been doing. But for the past 2 years, we know that we have really been focusing on capturing the high-growth market, high-growth customers. And -- but this is something that we have been trying to change over the past 2 years. And I think this is something that we have discussed in the past. And so that is why our sales in China is actually increasing at the moment.

There are, of course, pros and cons to these activities. And so this is a secular growth, in terms of secular growth, China market as well as India market, of course, India market could be scale-wise smaller, but then these 2 markets are really supporting the overall activity. But then when it comes to our device family, we know there still are very, very tight items yet. And -- and sometimes we will not be able to find such a high growth year. And so that is why it goes back to the comment, like we hope to be able to have a good growth even though it may not be a dramatic growth.

Mikio Hirakawa - *BofA Securities, Research Division - Research Analyst*

[Interpreted] My second question is something that we saw at the very end of the presentation that was about capital expenditure plan. Kofu power semiconductor is going to have a large portion in that CapEx. Now we know that when it comes to power semiconductors, there's going to be a lot of investment. Many people are going to do that. So Renesas Power Semiconductor, well, how do you see the competitiveness in terms of your technology? And how do you mean to secure your accounts? What is your outlook into the next fiscal year? So that was my second question.

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Now the competitiveness of our product, I don't know, if I say this too much, I might be misunderstood, but I know our products are being very much highly appreciated by our customers. So we're not that worried about our competitiveness in that sense. But what we do have to be very concerned is the macro situation in terms of demand and supply. At that moment, when we look at things in the longer term, needless to say, there's going to be more shift as you see like in the auto space. But then anything for the affordable areas or anything for industrial areas, IGBT growth is still going to be very strong.

And so we feel confident in making our investment. But then we know if all players are still going to just keep on adding the capacity, then there may be oversupply, and that is going to be a concern. And so we don't want to determine looking at how others could be building up their capacity. It's really about building our technology. And if we find a customer that would appreciate our work, those will be the customers that we want to transact with.

And it is something that we have tried to do, but it's something that we want to focus even more and not just send Kataoka, but I am also going to be participating in really building our customer base because that is going to, in the end, work as a differentiator in how we'd be able to offer our products. And it is something that we have tried to do. And so we do feel confident in what we are doing now.

Operator

[Interpreted] The next question is from [Eguchi-san] from Nikkei Shimbun. Please unmute yourself and begin your question.

Unidentified Analyst

[Interpreted] My name is [Eguchi] from Nikkei. Can you hear me?

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Yes, I hear you.

Unidentified Analyst

[Interpreted] Okay. Let me begin my question. The first question regarding Automotive business. You explained earlier, so I would like to reconfirm once again if that is possible. To some extent, the Automotive semiconductor shortage is now beginning to moderate on a gradual basis. Does that means that the number of items that is insufficient is coming down? Or is it rather because the overall supply is enough, but the Tier 1s and OEMs are not fully supplied. So does that mean that only a particular sector is facing shortage? Or do you see an overall shortage across the board? So that's the first question. Among them, among the products that you offer, are there any products that you have not been able to meet the demand, if there's any of such products? Can you identify which component is facing shortage?

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Well, from before, the general direction has not changed that significantly. In terms of the total quantity, I think we have a good supplier already. I think we are quite sufficient, and that remains unchanged before. But still having said that, there are some components that still have some inefficiencies and over time, some of them have made a transition, for example, and some of them, the shortage level is now moderating.

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So previously, if you make up the list of components that have undersupply, the quantity was so large in terms of the shortages. And of course, the list, the items on the list is now also coming down. So in terms of the variety of components and shortage and the quantity shortage is now coming down. And therefore, I would say that the supply-demand tightness has moderated.

As far as our devices are concerned, if there's any shortages, I would say, as we have communicated for some time before the (technical difficulty) this is very still tight. So once we produce it, that will be sold off immediately. They'll sell immediately. So there's a very tight demand and supply situation for that product on a macro basis.

And depending on some products, such as the analog semiconductors mainly, as we have stated from before, the mature node processes, especially those that we outsource the foundries for production, they continue to face shortage. Some of them still face shortages. So as we speak today, and I think going into the future for some time, I would say I'm not really sure if the hand-to-mouth expression is adequate or not. But once we procure them and supply them, they will sell immediately. So that's the situation.

But Kataoka-san did you have any additional comments?

Kataoka Takeshi - *Renesas Electronics Corporation - Senior VP & GM of Automotive Solution Business Unit*

[Interpreted] As Mr. Shibata just mentioned, the mature nodes in particular, such as the legacy products, such as ASICs, for example, those -- not all of them, but certain ASIC types still have a very tight supply and we are affected by that. And of course, this could be critical to some components of Automotive, and that remains unchanged before. But however, the degree of severeness now moderated compared to before.

And in our case, as Mr. Shibata mentioned, 40-nano MCU, this product in particular, we would like to produce even one more and because once we -- we produce it that could sell. So -- but because of the capacity constraints and therefore, together with foundries, we are working on this to address the problem. That's it. Thank you.

Unidentified Analyst

[Interpreted] My second question, in relation to your capacity, how you plan to expand your capacity and the competitors' analog in-house fab and foundries capacity expansion has been discussed, I believe. But once the mature node supply situation eases, at which timing the fundamental capacity or the production supply will increase to some in the near future? Or do you think this tight supply situation will continue for some time?

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Supply demand is also -- makes sense only when there's a demand. So for the near-term, I think the demand has a stronger outcome on the impact on the outcome, I believe. Because when it comes to certain production processes, we are distinguishing with multiple products. So the underlying compute or computing products or mobile products, those -- when those consumer products demand comes down, the capacity will become available gradually. So for the short-term, let's say, in our case, as we have introduced targets towards next fiscal year, the capacity will increase gradually. And I believe the competition will also gradually increase their capacities. But more than that, depending on the demand side, the supply-demand balance will be affected more by the demand side. That's it for myself.

Operator

[Interpreted] Thank you very much. Next from Citigroup, Mr. Fujiwara. Please unmute yourself and ask your question.

Takero Fujiwara - *Citigroup Inc., Research Division - Research Analyst*

[Interpreted] This is Fujiwara from Citigroup. I hope you can hear me.

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Yes, we hear you.

Takero Fujiwara - *Citigroup Inc., Research Division - Research Analyst*

[Interpreted] I have 2 questions as well. First question is about your in-house inventory. Now I did see that for the Automotive side, you have been able to come very close to your target level, but then you're still trying to expand the die bank inventory, like you said. So this in-house inventory, as you try to build this up, how long do you think it will take before you have suffice inventory? Do you think -- I mean, I am thinking that it's probably going to be in the near future when you have ample inventory level. But then when you do, are you going to try to increase your capacity?

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Shinkai-san, can you answer that question?

Shuhei Shinkai - *Renesas Electronics Corporation - Senior VP & CFO*

[Interpreted] Yes. So for the die bank inventory, as I mentioned earlier, as for the growth products, we still do feel we have enough number of inventory and how long is it going to continue (technical difficulty) the year-end or perhaps by Q1 next year, we believe we will be able to have this suffice inventory level. And so therefore, what is going to be the impact of utilization? Now this inventory level alone is not going to just push up the utilization. When we be able to fill the die back inventory, is that going to really change? No, we don't really believe so. And this die bank, and there are die bank, which we stock at the foundry, there are some that we stock at in-house and so even when we say die bank inventory, the increase of the products in process is not directly going to change the utilization rate of what we have internally in internal production.

Takero Fujiwara - *Citigroup Inc., Research Division - Research Analyst*

[Interpreted] And if I'd be able to ask a follow-up question, for example, 40-nano MCU and for the growth areas, that's something that you procure from foundry. That's my guess. But other products, if you'd be able to have a good ample inventory through this -- within this year, do you think you'd be able to have enough inventory for what you produce internally. But is that correct? And -- but still, that's not really going to change your utilization?

Shuhei Shinkai - *Renesas Electronics Corporation - Senior VP & CFO*

[Interpreted] Well, to be more specific, for die bank, within the die bank inventory, most of that on a value-wise basis is for foundry, for the foundries. And for internal production, it's probably like half. And so -- in other words, again, this die bank inventory and the buildup of die bank inventory is not really adding utilization. And so even if we are able to fill up this, let's say, we do not have to keep on building the die bank, that's not really going to really change the utilization.

Takero Fujiwara - *Citigroup Inc., Research Division - Research Analyst*

[Interpreted] My second question. Maybe it's too early to ask at this point, but then when you -- how do you see the demand outlook for FY '23, the year '23. So in these 3 months, what kind of change have you observed? And at the same time, even at this moment, economic slowdown is really being felt. But then do you see -- have you ever heard of any order cancellation?

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Well, is the cancellation increasing? No. And when we look at the order backlog, it is still very high, high level. And I feel like I have been saying pretty much the similar thing all the time. And in the end, it's really about -- is this really true. Now we certainly look at what the peers -- other people are saying. Now when we try to compare that with our own operating plan, I do believe the current order backlog level is really going to support our operation into the next year as well. And so if we're going to believe what we are seeing, we still can feel confident that we will be able to find growth here. But then there's always a chance that the situation may dramatically change.

So what I have been -- it is just a repetition of what I have been saying from before. But what -- the trend that I have been saying at the end of last year to the first half of this year. It's not about trying to build up an order backlog that people would not be able to cancel, because it could be just eating away the future demand. So what is important that we communicate together with the customers and really ask, do you really need to purchase this today? And we're still doing that type of conversation with our customers.

If we -- I feel like the current situation is just going to keep on as it is into the next year, in other words, a very strong order backlog. With that said, there will be some gradual -- well, we're hoping to be able to negotiate so that we'd be able to find a more optimal level of order. In other words, ask the customer, do you really need to order that much? And so I know, I do have to apologize if we're not really being clear. But in number -- if we talk in numbers, we always talk about a very strong number, but I do always sense that one day situation may change. And we don't want to feel surprised and we don't want to be belated in our response when some change occurs. And so that is why we want to be able to have good negotiation discussion with the customers. And if we have to revisit the backlog, we do need to do so.

Operator

[Interpreted] Since we are running out of time, we will now take the last question. And so this will be the last question. [Sasaki-san] from Toyo Keizai. Please unmute yourself and begin your question.

Unidentified Analyst

[Interpreted] This is [Sasaki] from Toyo Keizai. Thank you very much for your very kind presentation. I just have one question, which may be overlapping with the previous question. Regarding outlook for next year and the order backlog. I think you have received a very long order going into the future and the customers are placing large amounts in their orders. So -- and I think that will be eating up the demand for the future. So do you think the trough will become larger in the future? How do you see that trend in the future? And what are the countermeasures for that? You're just going to communicate with the customers and gradually trim down the actual order and so that you will adjust to the actual demand. Is that your countermeasure for that?

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] All the things that I was supposed to answer was already (technical difficulty) earlier, in order to avoid that, we will try to limit the channel inventory, and we would like to ensure that we have a good communication with customers so that we can review the backlog from time to time. Beyond that, if the demand disappears much larger than expected, we may have to anticipate some impact from that. However, as for the inventory and also for the backlogs are concerned, the deceleration risk in the future, we don't want to forget about that and see a sudden change in the future. We would like to avoid that by all means.

Unidentified Analyst

[Interpreted] So sorry for the overlapping question. My second question is about your foreign exchange. I would like to ask another question. You talked about the foreign exchange sensitivity earlier and the yen's depreciation, I think, is a positive factor for your business. But do you welcome this yen's depreciation? Or do you see any disadvantage from the weaker yen? Or as a manufacturer based in Japan, do you have -- what's your view on the financial policy or the monetary policy of Japan?

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] Well, of course, many things are already being conveyed in the media. So our views are not so different from what is reported by the media, we too, in many regards, maybe this is different from localization, but in many regards, we are moving forward and pushing for diversification, as you may know very well. So therefore, our employee base, Japanese account for less than 50% of your total employee base.

And in-house production and the utilization and sourcing from foundries. In that regard, we are taking a fab-light approach. So the foundry procurement is increasing and that's denominated in U.S. dollars. So if you take this into consideration, the weaker yen will have an increased factor on the cost. And in terms of R&D and also for the cost of goods, it will have a negative impact, so that we are seeing a stronger impact on cost increase because of the weaker yen. And raw materials besides that. And as Mr. Shinkai mentioned, utility costs, especially the electricity cost is increasing significantly. So the weaker yen has a down cost increase pressure, which is unfavorable for us.

However, on the other hand, through foreign exchange, the -- when converted into Japanese yen is inflated to some extent. So that is a benefit side of the weaker yen. But when the revenue increases in terms of company operation, the -- that will relax people's mindset. So we don't want to sit on that and be complacent about that. So if you consider all these things together, as a trend, a moderate depreciation of yen or if the yen stabilizes, if that is the case, I think it will make it easier for us to respond to the situation as adequate. But if the yen depreciates in this very volatile fashion, volatile fashion in a very short period of time, that makes our operations more difficult.

So again, even if we sacrifice the upside to some extent, we would like to solidify the floor so that we can have a solid operation. So because we are not looking into a near-term future only in order for us to deliver results in 5 years' time, 10 years' time, it is more important that we have a solid operation. So we don't -- we hope that there won't be significant volatility in the foreign exchange market. That's our view.

Unidentified Analyst

[Interpreted] If that is the case. So therefore, a moderate yen depreciation is a welcome development for you, but you don't want to see a volatile -- a hugely volatile market. So we just would like to operate the company in view of the currency situation. All right. Thank you very much for your comment.

Operator

[Interpreted] Thank you very much. With that, we'd like to end the Q&A session. So I'll maybe ask Mr. Shibata to make a closing remark. Mr. Shibata, please.

Hidetoshi Shibata - *Renesas Electronics Corporation - Chairman, President, CEO & GM of Corporate Planning Unit*

[Interpreted] So yes, thank you very much. Now the Q3 result, I do not believe they were much new news this time around. And so I do guess your interest would be, first of all, about our margin. But then what determines our margin is really the revenue, as well as enactment. And so it is not just about Q4, but we hope you would be able to observe and share information about the upcoming Q1, we're hoping we'd be able to send you the information without misleading you as much as possible. And we'd like to do this to our best as much as possible and really be able to share with you what we are observing. And so once again, thank you very much for spending your time with us in your busy schedule. Thank you very much.

Operator

[Interpreted] Thank you very much. We will end the Q3 announcement. Thank you very much.

[Statements in English on this transcript were spoken by an interpreter present on the live call.]