Renesas Electronics Corporation

1Q22 Earnings Call

27 Apr 2022

Event Summary

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[Participants]	300	
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	Hidetoshi Shibata	President and CEO
	Shuhei Shinkai	Senior Vice President and CFO
	Takeshi Kataoka	Senior Vice President and General Manager of Automotive Solution Business Unit
[Analyst Names]*		
	Toru Sugiura	Daiwa Securities Co. Ltd.
	Takero Fujiwara	Citigroup Global Markets Japan Inc.
	Mikio Hirakawa	BofA Securities Japan Co., Ltd.
	Daiki Takayama	Goldman Sachs Japan Co., Ltd.
	Kenji Yasui	UBS Securities Japan Co., Ltd.
	Moderator	
	Eguchi	

*Analysts that SCRIPTS Asia was able to identify from the audio who spoke during Q&A.

Presentation

Moderator: Hello everyone. Thank you very much for taking time out of your busy schedule today to attend the Renesas Electronics Corporation's Financial Results Meeting of 1Q 2022.

Simultaneous interpretation channels are available today. Click on the "earth" symbol at the bottom of the screen and select the language accordingly.

In attendance at today's briefing are: Hidetoshi Shibata, President and CEO; Shuhei Shinkai, Senior Vice President and CFO; Takeshi Kataoka, Senior Vice President and General Manager of the Automotive Solution Business Unit; and other IR staff.

CEO Shibata will now give his greetings, followed by CFO Shinkai's explanation of the 1Q financial results, followed by a question-and-answer session. The entire briefing will last 60 minutes.

The materials used in today's briefing are the same as those posted on the IR site of the Company's website. Now, Mr. Shibata, please turn on the microphone.

Shibata: Hello, everyone. This is Shibata. I believe that there is a lot of information today, and I would like to talk about it with as much care as possible to ensure everyone's accurate understanding.

1Q sales landed with a slight upward swing. On the other hand, as you are probably aware, our inventory, both our own inventory and that of our channels, has increased to a certain extent.

The increase is partly due to the increase in the number of items, but there are also other factors such as exchange rates, price fluctuations, and discontinuous changes due to changes in ship and debit and the transaction format with the channel. Thus, I would like to explain the details of the inventory. I have prepared a single slide to explain the details, and I would like to talk about it as carefully as possible.

As you may recall, we had another earthquake in March, which unfortunately resulted in a power outage. In order to recover from that obstacle to production, we have been introducing more wafers since the second half of March. However, the losses caused by the earthquake are not necessarily included in the factory's operating rate, so it is important to keep in mind that these losses are not directly linked to sales in the future.

And the chart of backlog accumulation that we have always shown you in the past is not included in this issue. The reason for this, as several analysts have asked, is that we are in the middle of conducting a similar but slightly more upgraded exercise for the remainder of this year and into next year, which will hopefully give us a bit of a refresher on this year's backlog.

Therefore, if we show the current figures as they are, they will raise false expectations that the current figures will continue to rise, although they have been rising at the moment.

As for the current backlog refresh and next year's order intake, we are currently working on various things to be completed by the end of July, so if the timing is right, we will be able to provide some information at the next closing. I hope you will forgive me for that.

Then, please note that the GAAP numbers reflect the completion of Dialog's PPA from this time forward. As for the level of CapEx, as CFO Shinkai mentioned on Analyst Day, the Appendix shows that CapEx continues to be at a high level. We are continuing to have CapEx at a rate that is approaching 10% of sales, so I think it would be good to have your take note on this point as well.

Last but not least, today we are announcing our first share buyback of a slightly larger scale, which we hope you will also check out.

That concludes my opening remarks, and CFO Shinkai will speak to you in more detail later. Please go ahead, Mr. Shinkai.

Shinkai: This is Shinkai, the CFO. I will explain the details of the financial results for the 1Q of the fiscal year ending December 31, 2022, on the basis of presentation materials.

First, page three, please. This is the disclaimer.

As mentioned by Shibata earlier, the PPA impact of Dialog is reflected from this 1Q.

Page four, please. 1Q results.

See the dark blue column in the middle. Revenue was JPY346.7 billion, gross margin was 58.4%, operating income was JPY135.5 billion, ratio was 39.1%, net income was JPY90.1 billion, and EBITDA was JPY155.2 billion. Regarding foreign exchange rates, the results are JPY115 to the dollar and JPY130 to the euro.

See the far-right column for forecast ratios. We will explain it again on a later page.

Page five, please. Quarterly sales revenue trends.

The 1Q is on the far right. Overall sales revenue increased 70.2% in YoY and 10.3% in QoQ. Excluding Dialog, the results were 47.7% and 14.5%, respectively.

For Automotive as well as Industrial/Infrastructure/IoT, please see below. Excluding Dialog, the Automotive business accounted for 47.9% in YoY and 17% in QoQ. Similarly, the Industrial/Infrastructure/IoT business resulted in 50.2% in YoY and 12.5% in QoQ.

Page six please. This section discusses revenue, gross margin, and operating margin for 1Q.

I will begin with company-wide totals. Forecast ratios, if you look at the box on the right.

First of all, sales revenue was up 3.2% from the median, or JPY10.7 billion in actual value. About 40% of this improvement was due to foreign exchange effects, while the rest came from the Automotive and Industrial/Infrastructure/IoT, which improved by about 20% and 40%, respectively. The improvement is mainly due to production factors, such as shorter production lead time for internally manufactured products and improved replies.

Next, gross profit margin improved by 2.8 percentage points from the forecast. Of this total, production mix improvement accounts for a large segment, accounting for more than 70% of the total. Production recovery was slightly higher than forecast, but this was offset by a flat result due to the shutdown of operations following the earthquake in March. Operating expenses decreased by JPY3.7 billion, resulting in a 4.6% increase in operating income margin over the forecast.

As for the QoQ in the lower right-hand corner, sales revenue increased by JPY32.3 billion, of which about 20% was due to the impact of foreign exchange rates. The remainder is about 60% for Automotive and 20% for Industrial/Infrastructure/IoT. The 4.1-percentage-point improvement in gross margin was largely due to an improved mix. Operating expenses decreased in the 1Q due to seasonality. As a result, the operating margin improved by 7.7 percentage points.

The segmentation is as shown on the left, but there is nothing special to mention at this time, so please refer to it.

Please continue to page seven. Stock status.

We will reiterate the reasons for this QoQ increase/decrease and the future outlook for our combined inventory and channel inventory on the slides that follow.

First of all, as you can see from the overall picture on the right, overall DOI increased in QoQ, and by business unit, there was a slight decrease in Automotive and an increase in Industrial/Infrastructure/IoT.

Please continue on page eight. This is about the sales channel inventory and the number of weeks held.

The figures include Dialog from 3Q of 2021. As you can see, the overall WOI increased in QoQ. The results show that both Automotive and Industrial/Infrastructure/IoT are rising in QoQ.

Page nine please. We comment on the reasons for the QoQ increase/decrease in both our inventory and channel inventory, as well as our outlook for 2Q and beyond.

We begin with our inventory on the left. As is common throughout, the impact of inventory valuation, reflecting the impact of increased costs, and the impact of the weaker yen on foreign exchange rates account for nearly half of the QoQ increase. This inventory valuation impact is expected to continue into 2Q.

Next, regarding raw materials, we have placed advance orders mainly for raw materials whose supply is tight, and this accounted for slightly less than 10% of the QoQ increase. We plan to procure necessary raw materials in advance in 2Q and beyond, in the same manner.

In 1Q, purchases from outsourcing companies increased mainly in response to increased demand. On the other hand, there are some chips that have been held up due to production constraints in back-end processes, especially nowadays, such as FC-BGA substrates and those that are held up due to bottlenecks in tester capacity.

On the other hand, the decrease was due to scrapping of some of the work-in-progress due to the earthquake in March. This increase in QoQ of work in process accounts for more than 20% of the total. From 2Q onward, we will continue to respond to increased demand.

On the other hand, we expect that the risk of production constraints, especially in back-end processes, will continue to a certain extent.

Lastly, in terms of finished goods, 1Q saw an increase in finished goods due to logistics stagnation, including the impact of the lockdown in Shanghai in March. This accounts for about less than 20% of the total. We assume that the effects of this logistics stagnation will not be easily lifted in 2Q, and we expect finished goods to be roughly at the same level.

Then, on the right side is the inventory of the channel. First, let's look at Industrial/Infrastructure/IoT in the upper section. The increase in QoQ from 4Q to 1Q was large on an actual amount basis and also on a WOI basis, but there were three factors that contributed to the increase.

One is shipping in advance to meet future increases in demand. Furthermore, 4Q is affected by a reactionary drop in demand due to the advance of demand, mainly from specific customers. These two roughly account for about 70% of the increment.

Finally, the impact of the introduction of the ship and debit system on the unit price is the actual increase in the unit price, which accounts for about 30% of the total increase.

From 2Q onward, while we will continue to respond to increased demand, we plan to optimize shipments to avoid inconsistencies in the mix within the channel. Therefore, we expect a decrease in WOI, driven also by increased demand.

For Automotive, the increase in QoQ is due to both pre-shipment in response to increased demand and lower-than-expected demand due to lower-than-expected OEM production. As for the outlook for 2Q and beyond, we plan to continue to respond to increased demand and optimize the mix in Industrial/Infrastructure/IoT as well.

Page 10 please. Occupancy rate. The figures show the utilization rate on a wafer input basis.

As Shibata explained at the beginning of this presentation, please note that the figures are shown on an input basis and not on an actual output basis. In addition, since the capacity of the Yamaguchi 6-inch plant was deducted from the denominator of the 1Q figures, the figures appear to be slightly higher.

The utilization rate on an input basis in 1Q was just over 85%. Since there are fewer operating days in 1Q, the slight decrease in QoQ at 8 inches is due to the effect of those operating days. The increase in 12-inch is due to the increased input for recovery, as mentioned earlier.

Then on page 11, EBITDA and cash flow.

EBITDA in 1Q was JPY155.2 billion, operating cash flow in 1Q was JPY89.6 billion, and free cash flow was JPY64.4 billion. This QoQ decrease in 1Q operating cash flow is based on seasonality.

Cash outflows for capital expenditures were JPY25.2 billion in 1Q, and we expect them to remain at the same level this fiscal year.

Next, page 12. This is about the 2Q earnings forecast.

See the dark blue column in the middle of the table here as well. The median sales revenue is JPY375 billion, and the QoQ is plus 8.2%, as you can see on the right side. The gross profit margin is 57.5%, or minus-0.9 points for QoQ. As for the operating margin, it is 36.5%, or minus-2.6 points for QoQ. Regarding foreign exchange rates, we are looking at JPY124 to the dollar and JPY134 to the euro.

I will briefly comment on the contents of each.

Sales revenue includes a large amount of foreign exchange effects, and excluding foreign exchange effects, we expect sales revenue to increase by slightly less than 2% QoQ.

Gross profit margin is expected to be negative in net due to the deteriorated mix and the impact of raw material price hikes, although production will improve due to the impact of the operating days and recovery from the earthquake.

OpEx is expected to increase due to a reactionary increase from 1Q, which was low due to seasonality. As a result, operating margin is expected to be negative in the QoQ.

Page 13, please. The following is a summary of the effects of the earthquake that occurred on March 16.

The impact in 1Q and 2Q is shown in the table below.

Next, page 14. Share repurchases.

First, an overview of the deal: the planned purchase is 168 million shares, equivalent to 8.65% of the shares outstanding. The company has entered into an agreement with INCJ to tender the same number of shares.

The purchase price was JPY1,190 per share, a 12.44% discount to yesterday's closing price.

The total amount of the purchase is considered to be up to JPY200 billion in monetary terms.

The benefits to the Company are summarized on the right side, and we believe that the improvement of the floating share ratio and the elimination of overhang concerns are expected. Non-GAAP EPS growth of 9.5%. The leverage ratio is expected to deteriorate by 0.4 times compared to the actual ratio at the end of March.

Next, I will explain some slides from Appendix. First, page 18.

Here is the balance sheet, which retroactively reflects the impact of the PPA associated with Dialog, starting with these financial results.

Page 20, please. The impact of that PPA is shown in a simple punch picture.

The Dialog PPA resulted in a smaller allocation to intangible assets and a shorter amortization period due to the relatively short product life cycle of the Dialog business compared to the previous two acquisitions.

As you can see on the right side of this bridge, with the completion of the PPA, the amount recorded will be JPY27.5 billion in 1Q, and I hope you understand that this will be the run rate going forward.

Next, page 22. Capital expenditures.

In 2Q, we plan to make investments in the JPY30 billion-range on a decision basis. Of this amount, a little more than half is invested in increasing production. We are also planning to make other small investments for the future, such as investments in offices.

This concludes my explanation.

Question & Answer

Moderator: Thank you very much. We will now move on to the question-and-answer session.

First of all, Mr. Sugiura from Daiwa Securities, please ask a question.

Sugiura: Hello, thank you for your help. This is Sugiura, Daiwa Securities Co. First of all, I would like to ask about the sales forecast. In 2Q, the first concern is that disposable products will not be able to be shipped due to the power outage, and as TI commented, there may be an impact due to the lockdown of factories in China.

On the other hand, your company is expecting a revenue increase of slightly less than 10% in QoQ for 2Q, so what is the reason for an increase in revenue which offsets the current negative impact? If possible, we would like to know by application.

Related to this, with the worsening of business confidence as a concern, have there been any changes in the outlook for demand on the part of customers? Pease tell us about 2Q and, if possible, the second half of the year. Please start with the first point.

Shibata: As the announcement of TI said, it is true that the situation in China is really hard to read. On the other hand, as someone else mentioned in their report, we probably have a portfolio that is much less affected by China compared to TI, so I don't think it will have that big of an impact. Naturally, there are logistical disruptions centered on the airport, and then there is the impact on our back-end factories, which are fine for now, but it is true that we don't know what the impact will be.

Furthermore, what is more uncertain is the demand side, and although I think there is absolutely no risk of a downside from the guides we provide, we have decided that the risk is at a level that can be somehow absorbed in a certain way.

On the other hand, the March earthquake and subsequent power outages are basically factored into this guide. Of course, there is a certain amount of impact, but it is the result of our own recovery efforts and then, as last year, our manufacturing partners, who also stepped in very much to support us. In addition, thanks to various efforts on the part of our customers, we believe that the impact of scrap has been reasonably contained as a result of the combined efforts of each party.

Of course, there is nothing that can cancel it all out, but we believe we have been able to contain the impact to a certain degree. The guide is then provided with all impact risks factored in.

It's hard to say by application, but I wonder, I still think that smartphones, especially in China, are weak. Also, Chromebook has been weak in the last year, and I personally am a bit suspicious of notebook PCs and such consumer products.

Based on the numbers we can see in our system and the solid data points from our communication with customers, we feel that this is a solid continuation, but we will continue to observe the situation. Particularly in those areas, product mismatches have been occurring since about the end of last year, and this 1Q has also been partially affected by this, especially the increase in channel inventory.

In 2Q, it will go to adjustments, so we will hold back our top line a little bit there. As a result, we will try to make sure that the channel inventory is properly digested. Thus, if you add everything together and exclude the sequential effect of exchange rates, we are projecting a very moderate growth of a little less than 2%.

The situation I mentioned last time hasn't changed much over the course of the year, and I think that the current picture is solid. I really don't want to go into too much more detail, as this might cause more confusion. That's all for now.

Sugiura: Thank you. Second, I would like to ask you about the gross margin projection. Regarding the guide for 2Q, you explained that the gross margin will be lower for sequential, incorporating the mix impact and raw material cost increase.

On the other hand, it seems a little strange that sales are growing this much. Again, what is the mix impact and how much will it affect you? How much will the increase in raw material cost contribute? If possible, could you also explain if the impact of this mix is temporary and if it will reverse from 3Q onwards?

Shinkai: First of all, we are expecting an increase in shipments of products with relatively low gross margins compared to 1Q, which are mostly in the automotive field. We are thinking that this one may vary somewhat depending on that quarter. We believe that raw material costs will kick in, in a sense, in earnest from this 2Q, and will remain at a relatively high level.

Also, although it appears that sales will grow significantly, we repeat that we expect growth of less than 2% excluding the effect of exchange rate fluctuations, so we do not think that this is an incongruous trend.

That's all for now.

Sugiura: I would like to ask as a follow-up. Regarding the procurement of raw materials, should we assume that the procurement price from the foundry will also have an impact on your company? What do you think about the impact of raw materials at your company's own fabs?

Shinkai: In total, foundries, OSAT, raw materials, and components for products manufactured at our own plants, and the price of crude oil and surcharges related to electricity have all made a significant contribution since 2Q of this year.

Sugiura: Can you tell us about your company's future strategy or actions in response to that?

Shinkai: First, we are going to reduce costs. One thing we are doing is to reduce raw material costs over time. But this is a situation where supply should be a priority in the short term, so I am not sure if it will contribute very much. The rest is a partial price pass-through.

Sugiura: I understand. Sorry it took so long. That is all.

Shibata: Gross margins are a challenge in their own right, so I think it would be better not to expect them to go up that fast. The price of raw materials has been rising at a truly dramatic magnitude. We are not too optimistic about the future, as some products are said to be 10 times more expensive next month.

Sugiura: Thank you very much.

Moderator: Thank you very much. Next, Mr. Fujiwara from Citigroup Securities Inc. Please speak up.

Fujiwara: Thank you for your help. This is Fujiwara from Citigroup Securities. I would like to make two points as well. The first point is: you explained in detail about the Company's own inventory and channel inventory. I would like to know how you see the inventory situation on the customer side, the other side of the channel.

In particular, in Automotive, sales have increased by about 70% YoY. However, looking at the channel, there seems to be only a slight increase. Is it that the inventory continues to accumulate on the customer side? To what extent do you think the situation is sustainable? This is the first point.

Shibata: Kataoka will answer. Mr. Kataoka, please.

Kataoka: This is Kataoka. OEMs originally planned to increase production but have yet to receive parts and materials. Furthermore, there is the impact of China as mentioned earlier. While this is not so impactful for us, there is also the impact of the war in Ukraine. With those things taken into account, the OEM is reducing production against the original plan. This has naturally had an impact, but the inventory level of our Tier I customers has certainly risen. However, I don't think it is at a dangerous level yet.

In terms of the level, I would say it equivalent to about one or two months. For the Tier I customers, that is. However, since there are naturally variations by product and by customer, we have to optimize the products by communicating closely with our worldwide customers. For example, we are now taking actions such as to only sending certain products to customers who are really in need of that product, while terminating the sending to other customers where it piles up.

We are optimizing such measures across Renesas between auto and non-auto. To put it simply, we make both auto and non-auto products, such as 40-nanometer products, and we also make non-auto and auto 16-bit microphones. For example, if the number of autos on our side increases a little, we can shift to the non-auto side, and vice versa.

Shibata: We actually have a very detailed grasp of the inventory status of our products at our major customers, and we share this information with them. Thus, we are also tracing the inventory based on a lot of details about which products are where and how many of them are being used. So far, there are some fluctuations as mentioned by Kataoka, but there is nothing suspicious about the overall feeling of the car so far. I think it is very solid. That is all.

Fujiwara: I understand. Thank you very much. Second, you announced a share buyback of JPY200 billion, which I think is a relatively large amount. The idea is that this year it may be possible to buy back shares or pay dividends, but will shareholder returns be stopped? Or are you still considering something additional? I would like to know.

Shibata: I don't know what the future holds, but for this year I feel like it is enough. That is all.

Fujiwara: I understand. Thank you very much. That is all.

Shibata: Thank you very much.

Moderator: Thank you very much. Next, Mr. Hirakawa of BofA Securities, please speak.

Shibata: Let's start with Mr. Shinkai.

Shinkai: Alright. Let's look at 1Q for Industrial/Infrastructure/IoT. The foreign exchange impact and the valuation impact, which I have explained, are included in the overall calculation. Another characteristic of this is that the shift in the timing of specific customer's business demands contributed to this habitual increase in DOI. In other words, inventories were high at the end of 1Q, but sales themselves had already been generated in 4Q, so sales appear to be lower in QoQ, so, we think this will return to normal promptly. That's all for now.

Hirakawa: So, would it be correct to say that you are now of the view that at the end of 2Q, the DOI for Industrial/Infrastructure/IoT, which is popping up now, will go down below the range?

Shinkai: There are other influences as well, so I think it is still unclear whether it will drop neatly below this range or not. We don't have to be worried about this temporary spike though.

Hirakawa: Understood. You are saying that, while moving up and down, the FY2022 period will be roughly at this level, right?

Shinkai: It will go down from here.

Hirakawa: I see. Thank you very much. 2Q sales, excluding foreign exchange, are up 2%. However, if we break this down into volume and product mix, what would be the contribution to the increase in sales? These are regarding sales.

Shinkai: I mentioned the volume and product mix. You can assume that it is almost entirely the volume part. As I mentioned earlier, the mix is expected to deteriorate QoQ, so I think it is safe to say that it is volume that is driving the increase in sales.

Hirakawa: So, it's really the quantity rather than the effect of the price increase?

Shinkai: Yes.

Hirakawa: Thank you very much. That is all.

Moderator: Thank you very much. Now, please continue with your remarks, Mr. Eguchi from The Nikkei.

Shibata: I think there is a constant shipping risk associated with logistics. This is not a new story at all, but one that is fresh in everyone's memory. Last year, the back-end process in Malaysia was disrupted by the COVID-19, and we believe that such things will continue, so we are already thinking of it as the new normal.

In terms of upstream, it has not changed much from what we talked last time, or perhaps at the Analyst Day, and we think it will be fine for the time being. However, compared to early March, the impact of Ukraine has changed considerably, and we are currently reviewing various items on the assumption that this will be a very protracted situation.

But again, this impact will probably not be our specific impact, so. We are discussing what kind of initiatives we can take as an industry, including foundry space, and we are gradually taking the steps that can be taken. There is some uncertainty, but I think that means we are okay for the time being. That is all.

Eguchi: Thank you very much. Also, is my understanding correct that the upward pressure on material prices is still in the direction of becoming stronger?

Shibata: I think it will be stronger. And the inflation of things is continuing. Energy will become even tighter and upward pressure will continue to be strong.

Eguchi: Thank you very much. Second, regarding cars, I think the supply environment has improved considerably compared to the first half of last year. Looking at the IGBTs, power supplies, microcontrollers, and other products you supply by product, can you tell us if there is a difference in the supply-demand environment? Are you able to produce enough in response to inquiries? That is all.

Shibata: Mr. Kataoka will answer. Please go ahead.

Kataoka: My name is Kataoka. Yes, as you know, xEVs are growing, so demand related to them is very strong, especially in China. In addition, there are cases where other semiconductor manufacturers are not able to ship products even though we are able to ship them. However, I can't say much about other companies. All I can say that such case-by-case situations do exist.

As I explained last time, we have many new products such as the RH850 and R-Car, for which the demand is quite strong. To be honest, we have not been able to fully launch these new products. To be honest, we could be doing more in this area to fully leverage the opportunity.

Eguchi: I see. Thank you very much.

Shibata: Thank you very much.

Moderator: Thank you very much. Now, Mr. Takayama of Goldman Sachs Securities, please go ahead.

Takayama: Thank you very much. Let me ask you about the direction of margin management and top-line management. There is a slip in 2Q in terms of margin management, and from there, you will start from a very high level. Thus, I am wondering in what direction you will take it?

As I understand it, the growth rate of sales other than cars seems to be a little low, and there is a general push on costs, such as raw materials. However, do you think you can absorb this by, for example, raising prices and mixing them sufficiently to keep margins on a par with 1Q? Do you perhaps have a management plan to achieve such levels? Or should we stop assuming that the level will exceed that of 1Q? Of course, it depends on the external business environment, but what is your view of the margin level in 3Q and beyond?

Shibata: In the short term, in terms of quarters, I think there will inevitably be ups and downs. Staying within the 55%-60% range would be good enough for now, but moreover I would like to accelerate future investment and growth.

Therefore, going down from 58% to 57%, 56%, 55%, 54%, and so on, might not be ideal, but we don't feel the urgency to immediately turn 57%, for example, back to 58% and 59%. That is all.

Takayama: One more thing, on the top line, of course 2023 is a very difficult reading, but you mentioned earlier that the order backlog is building up quite a bit right now. What kind of work is being done now, and what kind of details can we expect to hear next?

Also, what is your main focus now to increase sales next year? I would appreciate it if you could share with us what you are doing in that area or what steps you can take now to increase sales for next year.

Shibata: As has been mentioned in the past conversations with everyone, there is naturally a kind of consensus that this trend will reverse at some point. Despite this, if we only trace the backlog numbers, we see a kind of very solid growth, in our case. Of course, one has to wonder whether these figures are true.

Since we are not sure if these order figures really reflect the end-users needs, we are asking for orders for next year in a similar manner as we did last year. In conjunction with this, we are beginning discussions on whether this amount of production is really necessary this year or not. I'm expecting that they will eventually say that such amounts are not needed this year, especially when considering the orders for next year.

My vision is to reduce the currently increasing backlog for this year and allocate the orders to next year's backlog, and that's what we're trying to communicate with our customers at the moment. Therefore, we are having conversations again, similar to last year, about how many truly necessary, non-cancelable, non-returnable orders we will have next year.

Of course, visibility will vary greatly depending on the application and sector, but it should be something that is easy to foresee in the future. This is not a one-to-one correspondence with the backlog, but my current feeling is that cloud data centers and automobiles, for example, will continue to be in a very strong position.

However, these numbers have not yet been accumulated, so I would like to build up solid numbers over the next three months or so.

Takayama: Just to add a little, in the negotiations going forward, there was a lot of discussion about the tightness of supply and demand, such as last year, when it was tight in the first half of this year and normalized in the second half. How would you describe the situation?

Shibata: Not much has changed, and I think that the second half of this year will be a sort of normalization. On the other hand, I think the demand at the end of the market is strong, and from the point of view of some customers in some sectors, they continue to be unable to gather the necessary materials to make the products. Therefore, it is necessary to separate the two, and it is still a bit premature to say whether all components will be sufficient for the required amount and whether we will be able to move toward normalization.

On the other hand, in terms of our products, I think we can probably supply enough to meet the adjusted final demand, so I think the balance will be properly maintained. What I wanted to say is that the supply situation will become a little more relaxed than it was at one point last year. That is all.

Takayama: Thank you very much.

Shibata: Thank you very much.

Moderator: Thank you very much. Now, Mr. Yasui of UBS Securities, please ask your question.

Shinkai: Yes, I would like to add something. Our overall sales are divided into two categories: Direct sales to customers and sales through channels. Since approximately 60% of sales are made through the channel, I think it would be helpful to keep in mind that that we are talking about 60% of total sales here.

Shibata: Next, share buybacks.

Shinkai: Yes. Regarding the share buyback, it will be done via the TOB method. This tender offer period sets the shortest statutory deadline. This INCJ has entered into an application agreement and expects to apply under that agreement. On the other hand, it is TOB, so logically it is available for public tender. That period is until May 31. That is all.

Yasui: The next question is, in the case of a share buyback, would it be for INCJs in the same way?

Shibata: You got me here. Actually, we do not know. We really haven't thought of anything yet, so we would like to try this first, see how it turns out, and then, after seeing how the market responds, we will consider our next steps. We are really thinking along those lines. That is all.

Yasui: Thank you very much.

Moderator: Thank you all very much. We have received other questions, but as the time has come to end, we will now conclude the question-and-answer session.

Finally, I would like to offer a few words from Mr. Shibata. Mr. Shibata, please.

Shibata: I feel that we have already talked about this, but we are still dealing with various supply chain disruptions that continue to occur on an almost daily basis, so we have announced our financial results and provided guidance while dealing with these issues. The other question is what kind of impact the fundamentals will have on end-user demand, not only due to the supply chain but also inflation, and how we can supplement this and what measures we can take to deal with it.

We have such a situation when it comes to shipments and inventory, so internally we are now trying to manage it on a unit basis, instead on a monetary amount basis. If there is any suspicious movement, as I mentioned earlier, 2Q will be focus on products for PCs, and we will adjust the channel inventory beforehand.

After a while, maybe during 2Q or later, we would like to try to provide more accurate information in order to give you a clearer picture.

Thank you for taking time out of your busy schedule today. Thank you for your continued support.

Moderator: This concludes the presentation of financial results for the 1Q of FY2022. Thank you for your participation.

[END]

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