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PRESENTATION

Operator

Welcome to Renesas Electronics Second Quarter 2022 Results Presentation. We thank you very much for your participation indeed. For today, simultaneous translation is available. (Operator Instructions) Now the speakers, you are requested to turn on your video.

Today's session is attended by our representative Director and CEO, Mr. Hidetoshi Shibata; our Senior Vice President and CFO; Mr. Shuhei Shinkai; and our Senior Vice President and General Manager of Automotive Solutions Business Unit, Mr. Takeshi Kataoka. And also some other staff are present.

First of all, we would like to have Mr. Shibata say a few words of greetings, and then Mr. Shinkai will explain the second 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 session is the same one as those presented and posted on the IR site of our homepage.

Now Mr. Shibata, please begin your remarks.

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

Good afternoon, everyone. This is Shibata. The second quarter of this year, as you can see, these results are already available. There were so many uncertainties such as natural disasters and the longer-than-expected lockdown in Shanghai, China. There were many events, but we were able to finish the quarter with the results coming in higher than expected, slightly higher than expected.

Still, the outlook is still uncertain. Therefore, for now, because the channel inventory has come down to a good level, so the third quarter shipment will be subdued. But the die bank will be expanded. And there are products that are being ramped up over the longer term. So we would like to continue sourcing the -- from the foundries earlier than expected than usual so that we can respond to the -- any upside in the demand so that we can respond agilely, both ways, upside and downside, depending on the situation.

So if you can look at Page 4 of the presentation, compared to before, we have added one line in the presentation of the results, which is the profit attributable to owners of the parent. I'm sorry that this may sound like [preaching to Buddha] -- but there are so much volatility and the risks of the foreign exchange. So these are elements that are not affected by the actual operations.

Depending on the volatility of the exchange rate, the profit attributable to the owners of parent could be affected significantly. So we decided to reflect numbers that exclude the foreign exchange impact. So you could see the actual state of the operation. So that one line was added this time around.

So we have been able to achieve favorable results up until the second quarter. But since the future is still uncertain, so we wanted to be prudent here for the future outlook.

So Mr. -- with that, I would like to hand over to Mr. Shinkai.

Shuhei Shinkai - Renesas Electronics Corporation - Senior VP & CFO

This is Shinkai, CFO of the company. So I would like to begin the -- present the results for the second quarter of the fiscal year ending March -- December 2022 using the presentation materials.

If you can go straight to Page 3, disclaimers. From the first quarter, the Dialog acquisition is reflected. And from the second quarter, most of the PPA impact of Celeno was also added.

Next page, this is the result of the financial results, the second quarter results. If you look at the dark blue columns in the middle, the revenue was JPY 377.1 billion. Our gross margin was 58.6%. Operating profit, JPY 145.3 billion. Profit attributable to the shareholders of the company, JPY 8.4 billion. And the profit attributable to the parent, JPY 120.4 billion. Excluding foreign exchange impact, EBITDA was JPY 165.2 billion, and the exchange rate was JPY 124 to the dollar and JPY 134 to the euro.

And if you look at the first half results, you look at right-hand side, the dark blue columns on the right-hand side. As Mr. Shibata mentioned at the outset, the net profit, excluding the exchange impact, is also added here. I would like to add some comments here. Within our group, we are conducting cash pooling inside the group. So the nonconsolidated company at the headquarters, we have intercompany loan at the headquarters. And depending on the valuation changes of these headquarter's cash, the changes in exchange rate is affected by the financial income on the PL.

So if the yen goes weaker, this loan will increase, and therefore, it will have a loss on the PL. But if it goes the other side, you will have a positive impact on the PL. And this exchange impact is so large. So in order for us to show the impact of the profit net income, we have decided to indicate the profit level without including the exchange rate impact. And this is the revenue trends on a quarterly basis.

If you look at the far right, you see the second quarter results. On quarter-on-quarter, this was 8.8% increase. And year-on-year, this is 73.1% increase. If you exclude the impact of Dialog, this was 50.8% and 9.2%, respectively. And the breakdown of automotive business and industrial and the IoT business is listed up as you can see from the numbers here. And year-on-year, automotive 58.3% (sic) [54.3%]; and Q-on-Q, 6.4%. For IoT and industrial, year-on-year, 96.8%; and Q-on-Q, 10.8% increase.

Now next page, this is the second quarter revenue and gross and operating profit margin. The total company -- if you look at the total company, if you look at the margin versus the forecast, revenue was higher than -- by 0.6% compared to the forecast and partly half by the foreign exchange impact and half by other elements. For the IoT, there was a slight delay.

And in terms of the gross margin, plus 1.1% compared to forecast. And the factors behind this include, as you can see, the product mix improvement as well as the improvement of production costs. Those were the positive elements affecting the gross margin. And operating expenses came down due to the R&D, and therefore, the expenses landed at 0.2% lower compared to the forecast.

And as for the operating margin, there was an increase of 30.4%, and this is 70% due to the foreign exchange impact and the remaining came from the improvement of operations. The gross margin improved by 0.2% quarter-on-quarter, and this was due mainly to the production recovery and also -- which was partly offset by the reduction of production costs. And operating margin, there were some seasonality elements and -- which resulted in an increase of margin.

And next page, please. This is the inventory, the in-house inventory. If you include in-house inventory and the channel inventory, there is a separate slide explaining the inventory trends, but let me first talk about the inventory in-house. If you look at the total company, at the far right, DOI has been increasing on a Q-on-Q basis. By segment, automotive, flat; and industrial and IoT are recording an increase.

However, for the industrial and IoT, there was an impact from foreign exchange -- quite significant impact from the foreign exchange. And the inventory value and also from the cost element, if we just exclude all the foreign exchange impact for both automotive and IoT, DOI has increased by approximately 3 days on a Q-on-Q basis.

Next page, please. Next, we'd like to talk about sales channel inventory as well as WOI. So WOI overall has declined Q-on-Q. And on the other hand, if we try to look at per segment, automotive saw the increase, whereas industrial, infrastructure, IoT saw a decline. Now here, it does not include any FX impact. So this is just based on a management accounting basis. So please move on to the next page.

So here, we look into some of the inventory analysis. And so if you look into the inventory analysis, so the majority of this has to do with the ForEx impact. But then once again, if we try to exclude ForEx impact, again, still we did see 3 days worth of increase in the OI. And so when it comes to inventory valuation, it does reflect the cost of goods increase. But then this is something that we did observe back in 2Q, but we expect that it is going to continue in Q3 as well.

Also for the raw material, so BCM response, we looked into some of the materials that could hold some risks, and we wanted to make sure that we procure enough. And we also did see an impact on the price hike of some of the materials, and that is why we saw this increase. We saw the increase value-wise. And Q3 onwards, we do believe we still have to continue this BCM response. In other words, any materials that we need, we will make sure that we'd be able to procure. Also work in progress.

So there's a lot of outsourced items. And including the advanced purchase order for 2023, we wanted to make this advanced purchase ordering. And so that is the main cause behind this. And the foundry capacity is pretty tight. And so we know that it's going to happen from second half and onwards.

So we want to make sure that an ample advanced purchase and automotive SoC would be one of the main items here. And we expect that from Q3 and onwards, there is going to be advanced purchase for the foundry part. Again, automotive SoC is going to be the main part, but then also for MPCs, if this is something that we'd be able to go from -- in that front, we'd like to do so. Also, die bank, we do want to expand this, the increase in internal manufacturing capacity so that we'd be able to support the overall activity.

Also for the finished goods, in Q2, we are doing production to be prepared for Q3. So this is a seasonal factor. So the former Dialog, anything for smartphone are the products that's we'd be talking about. In other words, that's the product, that finished goods that saw an increase. And for Q3, especially for the post-processing activities, we do believe that, that part of the production is going to decline in Q4. And so we want to make sure that we'd be able to offset that through advanced production planning to be done in Q3 to be ready for Q4.

Looking into the sales channel inventory, again, for industrial, infrastructure, IoT in Q2, we did find that Q-on-Q increase in the end demand, and so WOI decreased. But then the actual value is increasing, and there are some reasons behind that. So first of all, we wanted to respond to the increased demand. But also, we wanted to adjust to the product mismatch, which really accounts for 2/3 of the works here, the impact here, but then also the unit price impact. Again, this is partly due to a ship and debit adoption. And so again, this is really what is causing the 2/3 of the increase in Q2.

Now as we look into the Q3, we still do want to make sure that we'd be able to act accordingly to the demand. And so WOI, we basically expect that this is going to just see a flattish growth in Q2 to Q3. Also for the automotive, I'm sure we write this inventory expansion. But in Q2, we have

already been able to expand inventory. And so I think we have already -- we do already have this fulfilling amount of inventory. So therefore, in Q3, we do want to cope with the end demand. In other words, we expect that this inventory level is going to be decreased in Q3. WOI in Q3 will also decline.

Moving to the next page. So now here we look into the wafer input basis fund and utilization. Now Q2, that was like 90% plus. However, this 12-inch line, which is in purple, there's an increase there. And this was due to the recovery operation ever since the Fukushima plant stalled back in March. And so this is just a tentative type of move.

Please move on. So EBITDA and free cash flow. So Q2 EBITDA, that's JPY 165.2 billion. And if you look at the right-hand cash flows, the operating cash flow was JPY 138.7 billion, and free cash flow was JPY 114.2 billion. If you look below, you see the gray bars. This is the cash out from investing activities. In Q2, that was JPY 24.6 billion, and we expect this is going to increase as we go down the road.

Now please move to the next page. Here, we look at our forecast for Q3. So if you'd be able to look at the dark blue bar, indicating Q3. So for revenue, compared to the midpoint forecast, we expect it is going to be -- this is JPY 384 billion, which is a 1.8% increase Q-on-Q. For the gross margin, we expect it's going to be 56.5%, which is going to be Q-on-Q negative 2.1 percentage points. For operating margin, that's 34.5%, which is going to be a decline by 4 percentage points Q-on-Q. As for the currency FX, we expect it's going to be JPY 135 versus dollar and JPY 138 versus euro.

So if we'd be able to further move on. Looking into some appendix pages, if I can just jump to Slide 17. So here, we look at GAAP versus non-GAAP adjustment or reconciliation. So some of the non-continued -- nonrecurring items, for example, Naka factory fire impact and there's also the Fukushima revamping operation cost, that's also included.

And if we'd be able to jump to Page 20, here we look into the CapEx trends. In Q2, there was the Kofu factory CapEx, that was included. And so including that, that would be JPY 90 billion. If we exclude that, for example, some of the increased capacity for the other existing plants have been decided. And so some of the major capacity increase is going to be completed with Q2.

Moving on further to Page 22. So here we talk about the impact of the earthquake in Fukushima and also instantaneous voltage drop at Kawashiri factory. Now for the Fukushima, we are able to keep -- do as expected for Kawashiri site. Here, we have similar forecast figures. There was the wafer disposal and utilization decline. And this was the place where we did have some die bank. And so -- but then the financial impact, we believe it is going to be small.

So that concludes my explanation.

QUESTIONS AND ANSWERS

Operator

Thank you very much. So with that, we'd like to now start Q&A session. So maybe ask Shibata-san and Shinkai-san to turn -- Kataoka-san to turn your video on. (Operator Instructions) So with that, we'd like to start Q&A session. So if you have any questions, please.

First, from Daiwa Securities, we'd like to ask Sugiura-san.

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

This is Sugiura from Daiwa Securities. My first question is about your revenue forecast and your observation. Now we did hear your Q3 guidance. But if possible, for example, what would be the split between auto versus IIBU? And for example, if you'd be able to look into like IoT versus industrial, what kind of breakdown do you expect? And you did mention that there are uncertainties ahead, and I am aware of that. But then as you look into this October-December quarter, what is your view or what is your expectation?

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

Well, thank you very much for the question. So excluding FX, so automotive, compared to Q2, we expect there is going to be a bit of a decline. And for industrial IoT -- industrial, infrastructure, IoT, we expect flat -- a flattish growth. That is how we created this forecast.

And looking at the industrial, infrastructure, IoT, if we talk about how we categorize, so IoT -- within what we call IoT, there'll be PCs and also some mobile phone related areas. And these are some of the more weaker segments at this moment. But then anything other than that, other areas, we do believe that it is relatively doing well at this moment.

And on the other hand, it's not that we are seeing any major changes. But mainly for data centers, DDR5 transition is somewhat delayed. Therefore, the demand for DDR4 is becoming stronger. But still, there's a tightness in supply in DDR4. So we haven't been able to supply products that meet the demand. So in terms of revenues, this is likely to weaken just slightly, because there's a strong backlog for those products.

Therefore automotive, as I said, overall, we will continue to wait and see and ship the products, looking at the channel inventory level and the consumption level. So that is the phase that we are currently in. And for other segments, we are seeing some flattening in the consumer and mobile. If you exclude those segments, I think by and large, other areas are quite stable and firm.

Of course, there are some ups and downs depending on some suppliers, but that's the outlook -- the background of the outlook for the third quarter. Of course, for the fourth quarter, there are still so many things that are not really clear. But what I can say at this moment is that by and large, overall, automotive and industrial, IoT, they are both expected to show flattish growth or a slight decrease. That is our basic assumption.

And with that -- based on that assumption, we will input the wafers and develop the shipment plans. But again, it's very difficult to foresee the future. So we have to establish a structure readiness so that we can respond, no matter what the market -- which direction the market goes.

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

Okay. Then second question is about the chip prices. In the last 2 years, the semiconductor industry is seeing a very tight supply and demand situation. And I think the price increase was accepted by many people in the market. But nowadays, I think the supply has become -- resumed and therefore this tight situation will unwind in the future.

So should we consider that the pricing pressure will be heightened in the future? Or would you say that because the trade behavior has changed, do you think they will be more susceptible to price hikes in the future? So your current view will be fine. So can you share your view with us?

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

Right. But then on the other hand, as you can see from the press articles, the wafer procurement cost at the foundry level has been constantly increasing. And as you know very well, the energy prices, the energy costs are rising. So as a result of that, the electricity cost in our production has surged quite significantly.

And as Mr. Shinkai mentioned, some of the raw materials, as we shared with you during our last earnings call, compared to before, it's like tenfold higher compared to before. Otherwise, we won't be able to get a hand on our raw materials. So the cost pressure remains to be very strong. Therefore, on that backdrop, we are not in a phase to reduce our prices. So we would like to continue to have a close communication with our customers so that we can gain their understanding. That's it.

Operator

Mr. Yasui from UBS Securities.

Kenji Yasui - UBS Investment Bank, Research Division - Executive Director and Analyst

This is Yasui from UBS Securities. So I have 2 questions. So my first question, so for automotive side, especially for -- on the impact per die, so I know that it used to be like JPY 100 billion type of business scale, which seems like it is going to stabilize around JPY 160 billion at this moment. So it has now increased by 1.6x.

And I do believe this is a great increase. And so the impact per unit has increased. And this is something that we've been observing ever since this COVID pandemic. But then what is your observation here? Because in the past, 5% to 8% range was something that we thought, but then at this moment, we're talking about much better mix.

And so what is your assumption at the moment if you'd be able to speak about that? That's my first question. And then my second question is more simple. So currency sensitivity, so it's a very sensitive area. But then how do you look at this on a more annual basis? Especially after the acquisition, what is your currency sensitivity?

Shuhei Shinkai - Renesas Electronics Corporation - Senior VP & CFO

So I'd like to answer your first question. But we have Kataoka-san. So we -- may I ask Kataoka-san to answer, first of all?

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

Yes, this is Kataoka. Thank you for your question. So the content growth per unit is I think the point of your question. So yes, it is true that we have more new applications at the moment. And so I know there are a lot of numbers being told. But then at the moment, it's like 14% to like 10%. That's the amount of the content growth that has been usually expected, especially with xEV, any power semiconductors are expected to grow.

And so that is why we're seeing, this very high growth at the moment. And even as we look from here, it's probably around this 10% range of content growth. That's probably the amount that we should be able to expect. Now the number of cars itself, I'm sure this is something that you feel, but it's not exactly growing. It doesn't seem like it's going to grow that massively.

But then -- so there will be some ups and downs, of course. But still, overall, it is going to just keep on gradually increasing, but it's going to be pretty stable in that sense. But then, of course, we have to look at the inventory at the moment.

In other words, not enough inventory to keep the production going on. And so -- because we're not -- there's not much of a car production going on, there's this buildup of inventory. So that is something that we are observing at the moment. That is how we look at it, but that's my response.

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

Thank you very much. And also for the currency sensitivity, I'm sure Mr. Shinkai will be able to make a follow-up comment if required. But I totally agree with your comments. But then at the moment, there's too much volatility. And it's never easy at the moment because we're seeing such an immense volatility. So compared to the past, it's important to go take a step ahead and do some hedging. And so all the way to next year, we are actually doing the hedging all the way to -- that would last for the entire next year.

Now as for the sensitivity for sales, it's not that it's going to really go down, even with this situation. But then anything below the operating profit line, we're trying to control the currency sensitivity. That's how we're trying to adjust our operations. So there's a floor that we'd be -- the ceiling that we'd be setting so that this sensitivity would always fit in this certain bandwidth, if you will. So I hope that answers your question.

Kenji Yasui - UBS Investment Bank, Research Division - Executive Director and Analyst

Well, yes. So the content growth, especially for this past 2, 3 years, I feel like it is really growing. So if -- can you tell me if that's the right understanding? And then also, you talked about the currencies hedging. Of course, you can't do this forever. But -- so right now, you have this JPY 1.5 trillion of revenue. And with that, how do you -- what kind of volatility do you expect? And what kind of sensitivity would you keep in mind?

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

Well, again, to answer your first part of the question, well, it's never like a new story, and it's probably something that we've always been finding. It's like this continuous trend. And in other words, first of all -- and there's this limit to how much cars OEMs would be able to make. And of course, that means there is more shift to more added value type of vehicles, especially U.S. and European OEMs. They already say that to the public.

In other words, cars with higher price point is going to be what people are going to be focusing on, and there's more semiconductors going into these vehicles. And as we see this high-end type of cars going, that means there's going to be more consumption of semiconductors. So that's one growth driver. And also the peers are also saying this, but there's more shift to EVs overall. And of course power discrete -- of course, this means there's going to be increased demand to power discrete.

But then if we look at how our clients are going, as more EVs come into the space, there are a lot of -- it seems like there's electronics, a lot of areas are getting more niche. And so that means we're not just talking about just power discrete, that's also going to mean the overall semiconductor consumption is going to increase. So I think this is the second type of trend that we find.

And the third trend is something that has been continuing for a more longer time. So this entry-level vehicles -- even with these entry-level vehicles, there's a lot of advanced technologies being used. And so with all these 3 elements compared to like a year or 2 years ago, there's more content growth. And that is contributing to our revenue increase. And I think this is like a trend that we're seeing more intense nowadays. That is something that we actually do feel.

Also for the currency sensitivity, so what are we feeling? So per dollar, like JPY 1 fluctuation that would change the revenue by like JPY 8 billion or so. And in terms of operating profit, that would be like JPY 3.5 billion on an annual basis. That's the level of the volatility or the sensitivity we find for U.S. dollar.

Euro, not much -- not that much of a change. So JPY 1 fluctuation can change the revenue by JPY 900 million and operating profit by JPY 700 million. So that's the sensitivity. Now compared to the past, it does seem lower in terms of sensitivity. That's all.

Operator

Now we would like to move on to the next question, which is from Citi Securities, Fujiwara-san.

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

This is Fujiwara from Citigroup Securities. Okay. I also have 2 questions, if I may. One, regarding your order receipt activities, this time last year, you said that you're going to finalize the orders for fiscal 2022. What is the ordering -- order receiving activities this year? What is the status? Maybe will this lead to allocation or not? And also for the orders that have been received so far, you said that you will not permit any canceling. But have you seen any negotiation for potential canceling of the orders? That's my first question.

And my second question is about inventory. Automotive versus IIBU, can you separately answer for those different segments? For automotive, the channel inventory has been increasing and has come up to a very sufficient level. So both the customers and also for the channel, including BCP, have you been able to achieve the target level? Going forward, would you be starting shipping only for the sake of satisfying the end demand? That's my first question.

And also, the second question is just about the DOI level being exceeded for the in-house inventory. So can you just elaborate on the subcategory level, IIBU, industrial and IoT? Can you give us a breakdown of the inventory level in-house?

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

Okay. I would like to answer the first part of the question. And the second question will be answered by Shinkai-san. Okay. So regarding the ordering activities, well, we find a little bit of difficulty because as we have been stating from before, we are continuing activities just like last year. However, maybe the timing was too fast for us. The numbers are still very strong and bullish. We are still seeing a lot of backlog.

When I think about it, it's -- this is like unbelievable. So we would like to meticulously spending -- in the next 2 months or so, we would like to once again review because there are situations relating to our own sales. And of course, there are things that we have to approach the customers, and we have to convince them that they don't have to rush and they don't have to be concerned so that the real true order booking for next year is something that we would like to achieve spending the appropriate amount of time.

Of course, it would have been better if we were able to show you some numbers during this earnings call today. But I believe the order level is too strong at the moment right now. Compared to the third quarter forecast that we have, the order booking level is too far detached compared to what we see for the third quarter. So we would like to properly make an adjustment and see what happens. Okay, then, Shinkai-san can you continue with the second question?

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

Regarding the -- question regarding the selling to the automotive sales channel, your observation is correct. So going forward, we would like to match and make an adjustment with the selling, looking at the end-user demand. That is the operation that we are contemplating for the future. And also for the in-house inventory for the industrial and IoT business, by segment, as Shibata-san mentioned, it's similar to the outlook that we have. For infrastructure and IoT, the inventory level has slightly increased.

But for IoT, PCs and those mobile-related demands, these segments are also included under IoT. So there is a slight sense of excessiveness, excessive inventory level. And on the infrastructure, because of the mismatch of the components, we have not been able to ship them, and they are stagnant. So they are what we're seeing right now.

So those are the 2 major elements. And of course, this is just a onetime thing. But in the area of IoT business, due to technical reasons, we have not been able to ship some of the products. So that is also affecting the DOI as we speak today.

Operator

Your next question will come from Yamamoto-san from Mizuho Securities.

Yoshitsugu Yamamoto - *Mizuho Securities Co., Ltd., Research Division - Senior Analyst*

This is Yamamoto from Mizuho Securities. I only have one question. But for the auto side, you said -- I do believe I heard something like you're going to control the amount of shipment from the automotive side. Now oftentimes it happens when due to some external factors -- in other words, what the customers will be saying. And it's not exactly something that you'd be able to take the initiative in controlling or increasing the shipment.

But then I think you have always been saying that you try to communicate well with the clients. But then is it -- have you been able to do that enough so that you know that there is going to be a decline in the amount of the order or the demand? And that is why you are able to think that you'd be able to control your shipment? Is that the way to take that, because then it is just responding to what you find the clients to be doing.

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

Well, thank you very much. That's a good question. So for IB, well, we do have this channel partners, and at the same time, we are also able to know the end users would be doing. And we actually are able to make this very good communication with -- between these parties. And even for this year, ever since January, when I look back, I realize that what kind of -- when I look back, what kind of communications we've been doing. We'd be able to really speak using data about what we've been doing. And then we'd also be able to communicate, so what should we do from here.

And so that is where we'd be able to sort of come to an agreement that, yes, let us control down the amount of output from here, the amount of shipments from here. So it is a bit different from what we've been doing in the past. The view that we'd be able to see has better resolution, if I may. And in addition to that, this is something that I have perhaps said before, but if we are able to really capture the end demand, then we'd be able to know how much our output would be. And of course, this is something that we have intentionally tried to do.

Yoshitsugu Yamamoto - Mizuho Securities Co., Ltd., Research Division - Senior Analyst

So in that sense, you also did mention that perhaps you went into capturing -- catching the orders at a too fast pace. But then because you've been able to do that, you were able to have this very good communication with the customers. And so even if there would be some change in how the customers are reacting, you have a better visibility to be able to respond to that. Is that the way to understand this?

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

Yes. It just depends on which client we're talking about, because there are some clients that we have better visibility, some that we don't. And when it comes to like next year, how much orders we'd be able to attach, there are some clients that would be able to share with us their view, but then there are some clients that would just keep their very bullish numbers.

And so again, so it really depends on which client we'd be talking with. And it will be better if we'd be able to sort of coordinate everything so that we'd be able to have good communication and better understanding with all the clients, but that is something that we're trying to do.

Operator

Now we would like to move on to the next question. This is from Eguchi-san from Nihon Keizai Shimbun.

Ryosuke Eguchi

This is Eguchi from Nihon Keizai Shimbun, from [Nik J] newspaper. All right? So my first question regarding procurement. And the other question is about production. The first question relating to procurement. You are making advanced ordering and also for BCM-related ordering. So that is increasing, especially for raw materials. Those materials that potentially has a risk, you are ordering in advance -- all in advance.

Specifically related to gas from Russia, what are the actual products that you are ordering? And this will -- has this led to cash outflows earlier than expected? And what are your views regarding the price movements of those materials?

And my second question is about production. Inventory adjustment will be happening in the future. So if you are going to advance the ordering production for the back-end products in the third quarter, if you are going to front-load the production in the third quarter, does it mean that in the fourth quarter you are going to put the brake on the production level in the fourth quarter? Is that what is likely to happen from the third quarter to the fourth quarter? Can you comment on that?

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

All right. Depending on the country, there are differences in the timing. But roughly speaking, there are 3 things, front-end and back-end. If I mix together, there are 3 major elements here. One is the die bank. Because now we're having a die bank, that means the back-end-loading will have to come down. So that's a simple production adjustment.

And also another thing is that this is a very internal discussion. But in the last 2 years, especially after the disaster last year, the operation was really 24/7. We were very squeezed, and therefore, we wanted to give a holiday to our employees -- consecutive holidays to our employees. So that's another thing.

And also the third element is about the front-end. As we've been discussing from before, the resilience of the factories, we are taking measures to improve the resilience, and that has to suspend the operation of the factories. So in order to do this, we would like to secure a good amount of time to do this during the year-end holiday season. So those are the 3 elements. So towards the end of the year, we would like to reduce the operation of the factory. So therefore, we have to produce beforehand, ahead of the schedule. So that's the one thing that I wanted to share with you.

And also regarding the wafer advanced ordering and also for the raw materials, that will entail cash outflow earlier than usual. Let's say -- we are safe to say that. And also regarding the raw materials, the most typical ones are the -- relating to the invasion by Russia into Ukraine. And other than those elements, there are no materials. There are some materials that are continuing to be quite tight in terms of supply. So we would like to get a hold on them, these materials in advance.

And also for the work-in-progress, the wafer advanced ordering. Again, for the overall semiconductor business, I think the supply and demand has largely matched. But for specific foundries and specific functions, they have -- a very strong tightness still continues depending on some products. So some process nodes, some special factories are providing these to us, and these are continuously surging in terms of shipment.

R-Car Generation 3, for example, and 40-nano -- micro -- RH850 and also 28-nano, RH850 nano. So the 40-nano is the biggest one here in terms of quantity. So they continue to be tight in terms of supply. So whenever we have a little bit of leeway, we would like to secure the wafers in advance. Because definitely, this is likely to definitely grow in the years ahead. So we would like to secure wafer even by one slice as much as possible.

Operator

From Toyo Keizai, may we have Sasaki-san?

Norihiko Sasaki

This is Sasaki from Toyo Keizai. I have 2 questions. My first question is about the reoperation of the Kofu plant. Now I know there was a (inaudible) subsidy. But then are you trying to increase the internal manufacturing here? And also, I know this is about power semiconductor, but then I think this is something that you have expected that there's going to be an increase in demand. But is this going to be triggered and driven by EVs?

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

Thank you. As for increasing the internal manufacturing, well, on value-wise, you probably would not see that much of an increase there. Why? It is because we'd be focusing into a more advanced node, logic and MCUs, and that's something that we'd be procuring from foundries. And that part is going to certainly increase. And so if you try to look at the value-wise proportion, internal manufacturing proportion probably will decline.

But with that said, we can't just, of course, just group everything into one. So when we talk about power discrete, basically we're going to be manufacturing on our own, and that is our clear policy that we have. And so for there, we will, of course, make -- have no hesitance in increasing the capacity if that's going to be required. And that's where you'd be seeing more our internal manufacturing. I hope that answers your question.

So that power semiconductor, in other words, this is something that is going to see an increase in applications or in EVs or non-EVs? Well, I think you can see EVs and non-EVs. And of course, volume-wise, you probably see more going into EVs. But then even for application other than EVs, as people try to decrease their carbon footprint, a lot of things are going to be electrified. Electrification is really the trend. And so power discrete, I'm sure, would be very popular even outside the EV space.

Norihiko Sasaki

And my second question is about your partnership with Tata. And so you have already acquired your entities in the U.S. or in the Western countries. And so I think this is really going to mark your footstep into other markets, including India. But can you speak a little more about this?

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

Well, I think this is something that we'd like to have Kataoka-san respond, first of all, and I will follow up if necessary, but Kataoka-san, please.

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

Yes, this is Kataoka. So India, as you know, it is a very large population country. We know the population is just going to continue to increase. And so it's really the future market that we want to focus. And of course, when it comes to -- it's more about 2 wheel motors than 4 wheels. And in this space, we want to work with Tier 1 OEMs, OEM Tier 1s from now. And that's exactly what that's really the partnership that we'd like to create.

And especially India, you have to look at, for example, air pollution and how you'd be able to control. And so that is why there's more demand for EV motorcycles. So that's one trend that we are observing. And so the partnership with Tata, well, of course, there's (inaudible) their system solution entity within the Tata Group.

And so -- and if you wanted to increase your footprint presence in India, it is going to be important that you be able to work with the local company there so that you'd be there to be able to support the OEM Tier 1s in the India market. And so that's really the focus with this partnership. And also, of course, being able to work with Tata Group is also very significant in itself, but that's my response to your question.

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

Well, thank you. And also, if I may add, India, overall, we know this is a market where -- I mean we have to admit that we were behind others in going into this market. But then even in terms of revenue and even in terms of our R&D activities, we want to accelerate our exposure to India. And if we focus on application, of course, we'd like to go into communication infrastructure these non-auto areas.

This is also something that we'd be interested in going together with Tata Group of companies, and we are trying to accelerate these activities together. And also even into the software development, as you know, in India, there's IT -- there's really talented IT engineers. And so we would like to leverage their help so that we'd be able to accelerate our work here.

And of course, otherwise, there might be some other distant pieces of news that we'd be ready to announce. So I hope to be able to look forward to what more we'd be able to tell you on this front. So thank you very much.

Norihiko Sasaki

So in that sense -- so this is Tata. So this is really -- you're talking about ABU. But as you try to do these R&D activities, do you think there is a potential for partnership with the IIBU side?

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

Yes, we'd be doing for both ABU and IIBU.

Operator

Now we'd like to move on to the next question, which is from Maekawa-san from Crédit Suisse.

Hideyuki Maekawa - Crédit Suisse AG, Research Division - Research Analyst

This is Maekawa from Crédit Suisse Securities. I have 2 questions. The first question is about the semiconductor demand for automotive. Maybe I have a misunderstanding, but let me confirm anyway. Previously, traditionally OEM Tier 1s and BCP inventories have been built up, and that was the major trend in the past, according to my understanding.

But this time around, according to your explanation, you understand that the demand level at the customer level is quite very sufficient. So you are going to ship your products in line with the actual demand in the future. So maybe it might happen to be so that the users conducted a survey and realized that the customers' inventory level is sufficient. Is that the case?

And also, when we look at the sales trend between other regions, are there any differences in the sales pattern between China, United States and Japan maybe? And my second question relates to the China market. Of course, the smartphones and PCs, those demands might be weaker, and that's understandable. But when you look at the mass market in China, I think those markets account for a good bulk of your sales in China. So what do you think about the inventory level and the sales trend for those demands in China?

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

Well, as you rightly pointed out, in China, the consumer mobile has been quite weak in the recent months. Of course, the industrial demand continues to be strong on the other hand. And as you know very well, China was the fastest in the transition to EVs. And therefore, the inquiries for automotive demand has been quite strong, especially for the short term, for the near term. So of course, the situation is mixed, but electrification and also other industry sector that is related to the electrification, we are seeing a very strong demand from those sectors.

But when you look at the overall China market, because the consumer demand is still very strong, so the demand -- the high demand that we have seen in the past is not likely to continue for an extended period. So in terms of regions, Europe and Japan, for the next 6 months or so, will continue to show strong demand, China is expected to slow down a little bit. That is the overall view that we have.

For automotive, maybe Kataoka-san can supplement with additional comments later, because he is available here. But this relates closely to the trend of electrification. But Europe and China, relatively strong in demand for automotive, automobiles. And Japan, relatively speaking, is somewhat soft, I believe. That is the impression that I have. But maybe Kataoka-san, if you could supplement.

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

This is Kataoka, okay? As you know very well, in the beginning of the year, the 85 million or 90 million units was the projected car manufacturing level for the year, and that's based on the historical trend. But due to COVID-19 and also the difficulty of getting access to components, the annual production is coming down to somewhere between 80 million to 85 million units. In that environment, China alone, getting over the COVID-19 outbreak and also -- they are also promoting this tax reduction policy.

And also the local OEM market share in China has increased to a level over 50%. So especially in the xEV-related OEM demand, we are seeing a very strong growth. So China continues to be very strong. On the other hand, Japan, as we have been continuing to increase the production, there was -- the demand that we were not -- the car manufacturers were not able to sell the -- inventory level has been increasing. So therefore, we are closely

watching the inventory level at the channel and also the Tier 1s. So we are expecting that there will be some adjustments for the inventory in the coming months in Japan. That's all from myself.

Operator

It is almost time to end the session. So the next question will be the final question. So [Yamazaki-san] from Kyodo Press.

Unidentified Participant

This is [Yamazaki] from Kyodo. I'd like to ask about your business environment. You talked about less visibility, uncertainties down the road. And can you explain that a little more about what you are observing at the moment? And also -- how do you forecast -- how do you foresee the future for the semiconductor industry? For example, we talk about semiconductor shortage. And when do you think this is going to be resolved in the end, if we'd be able to hear your view?

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

Yes, thank you. So uncertainties around the macro economy, of course, this is something that we all feel. And everyone is taking part today, as you work. This is probably the first time we all experienced a world like this. There's this large war going on. It's been going on for quite a long time. And this is causing an increase in energy cost, and we're seeing the implication to the food now. And at the moment, there's this immensely high inflation. And this is being observed in various advanced nations.

And also what is very unique -- now in the past, we've always been talking about the impact of COVID. And there were people -- we didn't really have much time to -- much place to spend money on. And so -- in other words, a lot of people will now want to spend more on what better experience they'd be able to enjoy, for example, eating out or traveling. And so the uncertainties to how we see the electronics side of the market grow, I mean, there is more uncertainties on how things get developed here.

But at the same time, this move towards non-carbon energy. And it's -- and at the same time, there's more intelligent equipment. We're not just talking about EVs. But to this all, it's going to just continuously keep on increasing the demand to semiconductor. And so that's what we're observing in this macro economy. But -- and this increase in this demand is probably going to, in the end, offset this a lot of other unknown things that's happening in the world.

And is it really going to be all this increased new demand that's going to prevail or is it going to be this macro, that uncertainty that's going to propel, this is something that we would have to see. But if we look back on the 1 to 2 years -- and of course, this is something that we'd probably be -- say, but whenever we can't secure a product, for example, it's not just semiconductors, people want to secure ample inventory.

And probably -- there's probably going to be this rebound from that momentum somewhere in the 6 months' or 12 months' time. And so it is something that we will have to pay our attention to, to see how things are going to develop. But to make sure that you don't misunderstand me, I will say what I do know. It was all that we -- we still have this very large backlog, order backlog. And I oftentimes think that, yes, I want to go out and buy a car.

But we know that a lot of cars, you can't really access it, because a lot of these orders, you can't place an order right now. And so it's really -- there's a lot of unmatch of what people want to do, what people can do. And so which vendor, which product is going to keep on growing from here? I mean with all these, it's just even more unclear.

But then, we're not trying to be pessimistic here. We will be careful because there still is a good chance that we might be able to outperform our expectation, but it is going to be important that we be able to endure the current situation. That's how I see things. I hope that answers your question.

But then again, overall, the supply-demand balance of semiconductor, if we try to aggregate everything on a macro, I think a lot of things are already being supplemented and fulfilled. But then when you talk about a specific production capacity, like a product that absolutely needs a certain product, that's exactly where there's a lot of increased demand. And it unfortunately happens to be some area where we can't really expect for capacity increase.

So the tightness is really being intensely seeing in specific items. And -- but then you can't complete an entire product set just because you are missing one semiconductor. And so there are a lot of cries around that. We hear that. And we hope that the overall trend would move so that the overall demand and supply would balance out.

And hopefully, we'd also be able to help contribute in increasing the capacity, especially where it's needed. But then, of course, it's not something you'd be able to do overnight. But hopefully, by next year, I'm hoping that we'd be able to see a better room to breathe across the industry. Thank you very much.

Operator

Okay. Thank you. Now we would like to finish the Q&A section at this juncture. Well, finally, Mr. Shibata has the final remarks. Mr. Shibata, the floor is yours.

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

All right. So again, I have to say, at the risk of repeating myself, to be candid with you, to be frank with you, we're not saying that the situation is going to worsen. The things are just unclear. So we have to be ready so that we can respond whichever the market direction goes. And if we need to increase the inventory, we'll do so. And in areas that we have to be prudent, we will be prudent. So we will be quite a -- take different approach as necessary.

In September, the semiannual long-term strategy update is planned to be held in September. And unlike the last time, we do not have a major strategic agenda this time around. So the -- we will downsize the scale this time around, compact -- we will have a compact presentation, only myself and Shinkai-san. We are not going to invite the product heads this time around. So please be advised that, that will be the case for this year.

In the beginning of next year, we are going to hold a full fledged meeting with the full team available so that we can make a comprehensive presentation. So we will like to differentiate our project as adequate.

So thank you very much, ladies and gentlemen, for bearing with us for a such a long time. And we look forward to your continued patronage. Thank you.

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

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