Infineon Technologies AG, Q2 2023 Earnings Call, May 04, 2023 (EditedCopy)

TEXT version of Transcript

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Presentation

Operator [1]

Good morning, everyone. Welcome to the conference call for analysts and investors for Infineon's 2023 Fiscal Second Quarter Results.

Today's call will be hosted by Alexander Foltin, Executive Vice President, Finance, Treasury and Investor Relations of Infineon Technologies.

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

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

Alexander Foltin, Infineon Technologies AG - Head of Investor Relations [2]

Good morning, and welcome, ladies and gentlemen, to our earnings call for the March quarter on which you have our Chief Executive Officer, Jochen Hanebeck; our Chief Financial Officer, Sven Schneider; and our Chief Marketing Officer, Andreas Urschitz.

After our prerelease a couple of weeks ago, we will now provide greater detail following our usual procedure. Jochen will open the call with remarks on the market situation and divisional performance, followed by Sven commenting on our key financials. Jochen, again, will provide the outlook and highlight key messages. The illustrating slide show, which is in a fresh new look, I shall point out as a brand ambassador, is synchronized with the telephone audio signal and available at infineon.com/slides.

After the introduction, we will, as always, be happy to take your questions. Kindly asking you to restrict yourself to one question and one follow-up. A recording of this conference call, including the aforementioned slides and a copy of our earnings press release as well as our investor presentation are also available on our website at infineon.com.

And now raising the curtain, Jochen, over to you.

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

Thank you, Alexander, and good morning, everyone. With 2 quarters of the fiscal year in the back, the 2023 business scenario for Infineon is unfolding in a favorable way. Some weeks ago, we upgraded our perspective on the March quarter and on the full fiscal year. The key reason for our incremental confidence is the ongoing strength and resilience of our automotive and industrial businesses, in particular, e-mobility and renewables.

Tellingly, the 2 segments addressing these markets both posted operating margins north of 30% in the past quarter. A clear focus on long-term structural opportunities for decarbonization and digitalization and customer value creation through system solutions are proving to be the right recipe for profitable growth.

Meanwhile, our market sentiment hasn't really changed much compared to the last earnings call 3 months ago. Amid a generally volatile macro environment, automotive and industrial applications continue to show broadly robust dynamics. In contrast, there is the well-known cyclical weakness in consumer computing and communications businesses.

Overall, Infineon continues to navigate these waters very well as our numbers for the March quarter show. Revenue in the second quarter of our 2023 fiscal year came in at EUR 4.119 billion, up 4% from the previous quarter despite a currency headwind. Compared to our original expectation, the automotive and industrial businesses grew more strongly.

On the back of the higher revenue, our profitability continued to develop favorably, with the segment result of EUR 1.180 billion. The segment result margin came to 28.6% after 28.0% in the quarter before. Additional volume, positive mix effects and Brazilian pricing contributed to this margin expansion despite some currency headwinds.

Meanwhile, our backlog of confirmed and unconfirmed orders keeps trending down as expected, reflecting normalization in customer ordering patterns. At the end of March, it stood at EUR 36 billion after EUR 38 billion 3 month ago, still more than 2x our annual revenue.

Now let's take a closer look at our divisions. Automotive crossed the EUR 2 billion quarterly turnover mark for the first time ever, recording revenues of EUR 2.080 billion, an increase of 11% compared to the December quarter. All product groups contributed to this noticeable sequential growth, in particular, microcontrollers, specialty memories and power components. Year-over-year growth was 40%, with some currency support. Reflecting the relative strength of the business, ATV accounted for half of the group revenue in the past quarter.

In line with the revenue increase, profitability in the March quarter expanded further. The segment result improved to EUR 647 million, equivalent to a record segment result margin of 31.1% compared to 28.4% in the previous quarter. Customers are honoring the value of our solutions and our long-term commitment. This can be seen from the fact that Infineon topped, again, the global list of automotive semiconductor manufacturers based on market data for 2022 from TechInsights, formerly Strategy Analytics. With our unrivaled portfolio breadth, we are either #1 or #2 in all major world regions, with the exception of North America, where we are #3.

In terms of product categories, we maintained our global leadership in automotive power and, for the first time ever, climbed to #2 in automotive microcontrollers. This is clearly mirroring our exposure to the 2 structural megatrends, EV and ADAS, which is supporting the resilience of our business at a time where supply shortages for standard automotive components are generally easing and lead times continue to normalize.

For microcontrollers, on the other hand, we expect tightness to last throughout this calendar year. For power parts related to vehicle electrification, regardless of whether silicon or silicon carbide, we anticipate supply limitations to be long term, driven by 2 factors: ongoing EV adoption and increasing demand from renewable energies. Eventually, the market will transition from an allocation-based environment into a normalized supply and demand regime for most products, again, with a notable exception of high-power components.

Somewhat higher levels of inventories in particular for microcontrollers and system-on-chips reflect the desire to move beyond a just-in-time concept and, instead, establish a more resilient value chain setup. We believe that the strong secular content increase, coupled even only with a stable automotive market will sustain the steady growth trajectory of our business. With our leadership positions in the automotive semi space, we will continue to be well positioned for success and market share gains, which is fully confirmed by recent design wins and innovation activities.

Let's start with our upcoming third generation of the AURIX microcontroller. Continental and Infineon will be collaborating in the development of a next-generation electrical -- electronic vehicle architecture. This server-based solution will feature Infineon's high-end AURIX TC4 as zonal controller. Due to its unique features like integrated resistive RAM, it will allow key vehicle functions to move from standby to active within fractions of a second. It is an important building block for the next generation of E/E architectures and can make the crucial difference when it comes to efficiency, safety and comfort in future vehicle generations.

To stay with this topic, BYD has awarded Infineon to deliver not only the MCU but also intelligent power switches for their new zonal E/E architecture. This body zone controller enables significant smarter and safer power distribution within future cars and acts as a strong proof of the success of our P2S approach.

On the e-mobility side, we are expanding our long-term cooperation with Delta Electronics from industrial to automotive applications. In the joint innovation lab, we will be developing more efficient and higher-density solutions for the fast-growing market of EVs, covering key components like DC-DC converters and onboard chargers.

Last but not least, we have further deepened our relationship with Hyundai, and we will deliver silicon carbide components for the upcoming Genesis high-end car models covering a significant triple-digit million euro lifetime revenue. This is further strengthening our existing business relationship with the Hyundai-Kia Motor Corporation.

Now to our division for industrial applications, formerly which IPC, we have recently renamed Green Industrial Power or GIP. Historically, the focus on power semiconductors for efficient energy supplies for industrial drives has been very successful, and we expect that business to continue to grow. Going forward, however, above-average growth is driven primarily by decarbonization and will, therefore, come from the field of renewable energies and the expansion of the necessary storage and transmission capacities. The name change took effect 1st of April without any organizational changes.

The segment printed a record quarter. Revenue for the 3 months period ending in March amounted to EUR 558 million, up 12% from the previous quarter and 30% year-over-year, with growth coming from all application areas. Driven by the revenue increase, profitability improved further. The segment result increased to EUR 181 million, corresponding to an unprecedented segment result margin of 32.4% after 28.8% in the prior quarter. The overall market outlook for GIP remains positive, with strong demand in decarbonization-related applications overcompensating the macro-driven weakness in home appliances and demand for general purpose drives going back to long-term growth rates.

Infineon is making green cost-efficient electrical energy possible. We have a leading position in the fields of wind energy and solar power, with our power semiconductors setting the standard for higher efficiencies levels throughout the entire energy generation and conversion chain. In this regard, we are proud to report a triple-digit million euro design win for our high-power modules for offshore wind parks built by a major European energy company.

Continued progress in energy efficiency, be it for industrial or automotive application is supported by the proliferation of silicon carbide. As you have seen from yesterday's press releases, as indicated, we have taken further steps to broaden and secure our supply of silicon carbide-based materials. We have signed multiyear supply agreements with 2 Chinese silicon carbide suppliers. Both SICC and TanKeBlue will deliver competitive and high-quality wafers and boules for our manufacturing of silicon carbide semiconductors, each covering a double-digit share of the forecasted demand in the long term.

The agreement will focus on 150-millimeter silicon carbide material supply in the first phase, and both suppliers will also support Infineon's transition to 200-millimeter wafer diameter. We see this as a proof that the merchant material market is developing as predicted by us. With this multi-supplier and multi-country sourcing strategy, we increased the resilience for the benefit of our broad base of currently around 3,600 silicon carbide customers and are securing new competitive, top-quality sources globally that match the highest standards in the market.

Now coming to Power & Sensor Systems. In the second quarter of our 2023 fiscal year, the segment's revenue took a step down and declined by 11% to EUR 925 million. This was driven by the well-known softness in consumer computing and communications applications. Macro factors are weighing in on consumer confidence whereas on the data center side, the inventory digestion is ongoing.

The lower revenue left its mark on the segment's profitability. With a segment result of EUR 197 million, PSS achieved a segment result margin of 21.3% in the March quarter, yet better than originally predicted. While applications linked to decarbonization like solar installations by residential customers and automotive charging continue to thrive for the majority of our PSS markets, we currently do not see any improvement. We will continue to monitor the inventory situation carefully and adjust our loading accordingly.

In total, while the near-term conditions are challenging, long-term underlying trends remain strong, in particular, including vibrant demand for gallium nitride-based solutions. To significantly strengthen our capabilities in this field and to accelerate our road map, we announced the acquisition of GaN Systems at the end of February. We are currently working on the required regulatory approvals and expect closing of the transaction now within this fiscal year.

Let's finalize the divisional overview with the Connected Secure Systems. On the back of easing supply limitations, CSS increased revenue to EUR 550 million, 4% more than 1 quarter earlier. This was driven primarily by payment applications, embedded security and microcontrollers. The segment result improved to an all-time high value of EUR 155 million, equivalent to a record segment result margin of 28.2%, sharply up from 23.5% in the quarter before. Supportive pricing and higher volumes were overcompensating a negative currency development.

While demand in consumer markets remains weak, we see the long-term growth opportunities for consumer as well as industrial IoT applications as undiminished and our design win trajectory to continue. Also in Q2, our microcontrollers and connectivity solutions have been selected by major OEMs in home appliances, smart home, automotive and industrial applications. As of today, demand for smart card ICs remains resilient, which is also illustrated by our latest significant design win in the area.

Infineon has been awarded a 10-year contract by the United States Government Publishing Office to supply security solutions for the U.S. passport. This is the third time we were selected as a supplier for this electronic document. We will provide the chip, the software and the packaging to accelerate acceptance and integration of our solution. This is once again a proof how our P2S solution strategy adds value for our customers. The award signifies Infineon's technological capabilities, our secure U.S.-based supply chain and our reliability as an innovative and committed supplier.

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

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

Thank you, Jochen, and good morning, everyone. In financial terms, the very strong trajectory of our 2023 fiscal year has continued in the March quarter. Evidence of our overall resilient business is that we have kept our gross margin at a high level. Gross profit amounted to EUR 1.920 billion, corresponding to a gross margin of 46.6%. The adjusted gross margin, which excludes nonsegment result effects, stood at 48.6%. The development of our operating expenses further supported profitability. Research and development expenses were EUR 487 million, essentially flat quarter-over-quarter. Selling, general and administrative expenses went slightly down from EUR 410 million to EUR 394 million in the March quarter.

The net other operating income was EUR 34 million, containing some disposal gains, which were grouped into our nonsegment result, which totaled minus EUR 107 million. Of the overall amount, EUR 81 million corresponded to cost of goods sold, EUR 8 million to R&D expenses and EUR 54 million to SG&A expenses. Other operating income amounted to EUR 36 million.

The financial result for the quarter under report was minus EUR 17 million after minus EUR 24 million before. Income tax expense amounted to EUR 237 million for the second quarter of the current fiscal year, equivalent to an effective tax rate of 22%, in line with our expected range of 20% to 25%. Cash taxes in the March quarter were EUR 171 million, resulting in a cash tax rate of 16%. For the entire fiscal year '23, we expect an overall cash tax rate of around 20%.

Our investments into property, plant and equipment, other intangible assets and capitalized development costs in the March quarter amounted to EUR 565 million, somewhat down from EUR 605 million in the quarter before. This is a typical seasonal pattern, and we expect investment numbers to go up in the next 2 quarters.

Depreciation and amortization including acquisition-related nonsegment result effects were EUR 434 million in our fiscal second quarter after EUR 429 million in the preceding quarter.

Our quarterly free cash flow from continuing operations came in at EUR 193 million, positively influenced by the proceeds from the sale of our DC-DC converter business.

Looking at the components of trade working capital, it becomes evident that inventories increased slightly, albeit at a much slower speed than in the quarter before. Reach went from 140 to 143 days. This reflects that we are taking actions on our inventories.

Having said this, not all stocks are equal. Given the ongoing tight supply of some product categories and the high strategic relevance for our customers, there are cases where we are deliberately keeping higher stock levels. For others, we will lower production rates going forward at the expense of higher idle costs in the coming quarters.

Now to our liquidity and leverage figures. Despite the positive free cash flow, our gross cash at the end of March decreased to EUR 3.4 billion following the payout of our dividend of EUR 417 million in February. Our gross debt stood at EUR 5.4 billion, corresponding to a gross leverage of 1.0x. Net debt stood at just under EUR 2 billion, equivalent to a net leverage of 0.4x. As you will have noticed, S&P Global Ratings has added a positive outlook to our BBB rating in February.

To close the financial part, let's look at our after-tax reported return on capital employed. With 18.4% for Q2, we clearly exceed our cost of capital and continue along our value creation path.

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

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

Thank you, Sven. Picking up from my remarks at the beginning, we continue to see bifurcating semiconductor markets, amid macro and geopolitical volatility.

On the one hand, strong underlying trends are supporting automotive applications, especially e-mobility as well as industrial ones, in particular, renewables. On the other hand, market conditions for consumer-related applications, data centers and communication infrastructure remain weak for the time being.

Certainly, the supply situation is generally improving. Shortages are less pervasive, and customers are reacting to contracting lead times, but they are not overreacting. Rather, they recognize the value of product availability, particularly in the areas of strong secular growth.

Overall, this makes us incrementally more optimistic about the second half of our fiscal year, which, revenue-wise, we are now seeing as moderately up from the first half. Adjusted for negative currency effects as we are moving our assumption for the U.S. dollar exchange -- U.S. dollar-euro exchange rate for Q3 and the remainder of the 2023 fiscal year from $1.05 to now $1.10.

Outlook for Q3. For the currently running June quarter, we expect revenues of around EUR 4 billion, essentially flat compared to the previous quarter, considering the adverse U.S. dollar assumption. By division, we expect ATV to post a small sequential increase and GIP to stay flat. For PSS and CSS, we foresee a quarter-over-quarter decline.

For the group segment result margin, we project a level of around 26% for the third fiscal quarter, reflecting the weaker U.S. dollar and anticipating some cost increases like additional ramp-up costs as well as the impact of active cycle management, meaning incremental underutilization charges to keep inventories in check. Specifically, the slowdown in consumer computing and communications will become more notable in this regard.

For the full 2023 fiscal year, we now expect revenues of around EUR 16.2 billion, plus or minus EUR 300 million. In other words, we are adding EUR 700 million to the midpoint of our annual revenue expectations comparing to EUR 15.5 billion before despite the less advantageous currency assumption of now $1.10 for the U.S. dollar exchange rate. Like-for-like with a former rate of $1.05, the increase would have been close to EUR 1 billion.

Most of the additional projected revenue is coming from volume and mix effects based on robust dynamics in many of our key target applications. Using our meaningfully upgraded guidance, the annual revenue growth rate would come to 14%. By segment, we expect ATV and GIP to grow above and CSS at the expected corporate average rate year-over-year. For PSS, we expect annual revenue to fall short of last year's level.

Now to our margin expectations for the 2023 fiscal year. We expect the adjusted gross margin now to land around 47% compared to 45% previously. This upgrade reflects the strong first half of the fiscal year and also factors in the before mentioned headwinds, which will be visible in gross margin development of the second half year. For the segment result margin, we now anticipate a level of around 27% after around 25% before, the weaker U.S. dollar notwithstanding.

Our forecast for investments in property, plant and equipment, other intangible assets and capitalized development costs is unchanged. We continue to project a level of around EUR 3.0 billion.

By the way, earlier this week, we had the pleasure of hosting EU Commission President, Ursula von der Leyen, and German Chancellor, Olaf Scholz, for the groundbreaking ceremony of our new large-scale fab in Dresden for power and analog mixed signal products. We are pleased with the political support fostered by the European Chips Act and especially proud that we achieved this important milestone for an easier, safer and greener future in record time since our announcement last November.

For depreciation and amortization, we now expect a value of around EUR 1.8 billion, including amortization of around EUR 450 million, resulting from purchase price allocations that will end up in our nonsegment result compared to EUR 1.9 billion previously.

For our free cash flow, we now expect a level of around EUR 1.1 million, reflecting the fall-through from incremental revenue and profitability. Assuming an unchanged spend of around EUR 700 million for major front-end buildings, our projected adjusted free cash flow would come in at EUR 1.8 billion, representing around 11% of sales.

To be clear, none of our projected numbers is incorporating any effect related to the planned acquisition of GaN Systems.

Now ladies and gentlemen, it's time to summarize. Our 2023 fiscal year continued to on a very strong trajectory in the March quarter. With EUR 4.1 billion of revenue, we achieved a segment result margin of 28.6%. Market dynamics in key application areas like automotive and industrial, in particular, e-mobility and renewables remain robust. Customer value product differentiation and supply certainty. At the same time, consumer-facing markets and spending on IT infrastructure are still sluggish with no immediate improvement in sight. We are meaningfully upgrading our annual outlook in terms of revenues and profitability while absorbing an adverse currency effect.

Determined execution and cautious vigilance will remain key in the coming months and quarters. Secular topics of decarbonization and digitization remain the fundamental of our business. Our solutions provide answers to the current challenges of the green and digital transformation.

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

Question And Answer

Operator [1]

[Operator Instructions] The first question is from the line of Alexander Duval with Goldman Sachs.

Alexander Duval, Goldman Sachs Group, Inc., Research Division - Equity Analyst [2]

Congratulations on the strong results. Firstly, I wanted to ask about automotive demand. We've heard about China EV sales being a bit weaker in the last month or so, yet Infineon dynamics on revenues for automotive are above expectations, and you seem very positive on electromobility still. So could you provide a bit more color on the primary drivers of that demand that seems to keep surprising to the upside and what makes you confident you won't see a correction on the auto side?

Secondly, one of your competitors appears to be having some issues ramping on silicon carbides, whereas others continue to make progress. I wondered if you could give an update on your latest situation there and perhaps put into context the significance of this new Chinese wafer supplier agreement or agreements you've talked about today.

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

Yes. Thank you very much, Alexander, and I will try to answer your questions. So in auto demand, we see, in particular, 2 areas which are very strong. The demand for our microcontroller families, the AURIX families but also others, keeps on growing. There are still customer escalations, and we only expect that situation to come somehow into balance the second half of this year. And we are also providing or getting here more capacity support from the foundries, and that will continue into next year. So the AURIX story is certainly a big success story of Infineon.

Same is true on the e-mobility side. I can say that the big chunk of our CapEx this year goes besides wide-bandgap also into IGBTs and related technologies to serve here the demand on e-mobilities and renewables, so unabated demand even. Also here, still escalations on the table for '23, '24 to get sufficient capacity, especially also on the silicon side.

In terms of China demand, you're right. The year started sluggishly in China on auto, but our expectation is that it will pick up towards the second half of the year, and we will see here growing car sales in China.

With respect to the silicon carbide, so your second question, we are making good progress on our internal capacity expansion. You know in our first phase, we do that in our filler facility. So here, we are on track. And we are also on track with our critical second phase being the Kulim -- the third module in Kulim. The module is -- the building is on track. The first processes have been qualified in Kulim. So very good progress in that regard.

In terms of silicon carbide supply, we qualified 2 Chinese supplier, which we intend to mainly use for [China-for-China] business, which is going to be a substantial chunk. And with this, we are now, I think, with 5 or 6 suppliers in the silicon carbide space for 150-millimeter. All the suppliers will move towards -- with us towards 200-millimeter, and we see it as a proof of our prediction that this merchant market is developing as we predicted. These suppliers are, in terms of quality and competitiveness, are comparable to leading-edge non-Chinese suppliers.

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

And Alexander, if I may just add -- it's Sven speaking, on the silicon carbide ramp, just to support what Jochen just said. Revenue-wise, we expect around EUR 500 million this year, which is fully in line with our targeted revenue.

Operator [5]

The next question will be from the line of Andrew Gardiner from Citi.

Andrew Michael Gardiner, Citigroup Inc., Research Division - Research Analyst [6]

I was wondering if we could dig into some of the near-term cycle dynamics that you alluded to during the prepared commentary. Sven, in particular, you mentioned that you are slowing the fabs in some areas for certain product lines to help manage the inventory on your books and presumably down through the channel as well. Can you characterize where you see inventory levels at the moment, be it at OEMs and through the distribution chain as well? And can you help sort of quantify the magnitude of those underutilization charges within your overall profit guidance?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [7]

Yes. I may start with that question, and then Sven will chip in. So in general, we are reducing the under -- utilization in our fabs, but it's not overall dramatic, right? We are still around 90% for front end and the 80s for our back end. And it's really geared around the [3] segments. We see a certain slight increase in our inventory at the disti, but our own inventory is pretty much under control. I think the 3 days increase is not really that material.

Further down the value chain, of course, transparency, for us, is diminishing. What we hear in the market is that the Tier 1s are building up inventories, especially for strategic parts like microcontrollers, where clearly the just-in-time concept doesn't work at all. And I think this is, again, a desired state of -- state because just-in-time for semiconductors simply does not work.

But Sven, you may want to add to this.

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [8]

Yes. Thank you. Andrew, on the idle costs, let me maybe start by also giving you the bridge from the last call to this call. Last call, we were saying, the total idle cost for the full fiscal year would be in the magnitude of EUR 450 million to EUR 500 million. Now we are bringing that number, of course, logically down to a level of EUR 350 million to EUR 400 million given that we increased our revenue line by -- currency adjusted by EUR 1 billion from EUR 15.5 billion to EUR 16.2 billion. So that's the total amount.

So EUR 350 million to EUR 400 million is the estimate now for the fiscal year. And if you look at the split, we had around EUR 70 million in Q1; around EUR 100 million in Q2. I expect that number to go slightly up in Q3 and Q4, and then you are in the middle of the ballpark range I mentioned.

Operator [9]

The next question is from the line of Francois Bouvignies with UBS.

Francois-Xavier Bouvignies, UBS Investment Bank, Research Division - Technology Analyst [10]

My first question is maybe for Sven on the margin side since you just talked about the underutilization charges for the full year. If we look at the full year gross margin adjusted, you have 47%. You did around 49% in H1. So it would imply a gross margin around 46% or so. And the underutilization charges is not looking extremely high versus H1 based on your comment, Sven.

So I was wondering, can you explain us the trend on the gross margin side? Especially on the pricing side, I'm sure you saw that we have mixed messages on the pricing dynamics. So I was wondering how your pricing is evolving in the second half of the year? So that would be my first question.

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [11]

Thank you, Francois. Expected questions. So I will start with the gross margin, and then I will hand over to Andreas for the pricing. So on the gross margin front, let me start by saying we increased the gross margin for the full fiscal year from 45% to 47%. I think that's something we should always start with. The first element is you now go into a first half versus second half comparison. That was your key question. Then we have a couple of headwinds, which we have mentioned in the intro, and I'm happy to give you more color here.

The first one is idle, as you said. So there will be incremental idle, not dramatically, but they are visible.

Secondly, there is the currency impact. I mean we had a better, stronger dollar in the first half than the second half, and you know our sensitivities with regard to currency, revenue and segment result-wise.

Thirdly, we are ramping Kulim, wide-bandgap and now also starting to ramp Dresden module 4. And this comes with some incremental ramp-up costs. Also, I don't think any surprise here.

And the last one is, if you look at the business mix and if you think about the current weakness in consumer communications and compute and if you look especially at the still strong Q1 for PSS and if you now look at how it's trending in Q2 and expected to trend in Q3 and Q4, you have a negative contribution from still the second biggest division we are having. And these elements together lead us to the guidance of around 47%. And let me conclude by saying around 47% may also be 48% at the end of the year. Let's see.

Francois-Xavier Bouvignies, UBS Investment Bank, Research Division - Technology Analyst [12]

Okay. Great. Very clear. And my follow-up question would be on the silicon carbide, especially 200-millimeter road map. You signed 5 to 6. Jochen, you said on the different suppliers, which is helpful on 150-millimeter. Can you update maybe on the 200-millimeter time line? When do you think it would be a reasonable assumption to have a 200-millimeter within your umbrella? And having the Chinese review, is it a strategic component to get the Chinese local client OEMs, if you see what I mean? Just how strategic is it?

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

Francois, just a quick one, sorry. Then Jochen will take your 6- to 8-inch conversion, but we did not answer the important pricing question, so I would love to hand over to Andreas' firstly.

Francois-Xavier Bouvignies, UBS Investment Bank, Research Division - Technology Analyst [14]

I didn't want to waste my follow-up with that, but yes. But okay, Sven.

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [15]

No problem. We're not forgetting the questions, hopefully.

Andreas Urschitz, Infineon Technologies AG - Chief Marketing Officer & Member of Management Board [16]

Francois, Andreas speaking. I was awaiting your follow-up on pricing after Sven's comment. So here it comes.

In Infineon's target markets, we see resilience in pricing. This is mostly backed by 3 elements. Point number one. The strategic importance of Infineon semiconductor products for our customers is, give or take, seen very, very high as a result of the past couple of years development.

Point number 2. Thus the high value of our products for our customers' value proposition is considered to be high, which customers therewith then also honor with a proper pricing range and so to say, their willingness to accept pricing for value.

Third point. Coupled with our long-term capacity and supply security agreements, so we have been mentioning in the last quarter 1 call, our reach regarding capacity reservation agreements, which especially reach for power semiconductors, sensors but also microcontrollers, let me reconfirm that we view and we see pricing to stay resilient throughout the near future.

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

Yes. Thank you, Andreas, and I'm happy to take the silicon carbide question. So first of all, transition to 200-millimeter will happen. We expect a time frame from today's perspective, maybe 2 to 4 years, but it comes when it makes sense. And what many people forget is that at the beginning, yields for 200-millimeter will be lower from the boule growth also to the processing. And don't forget also 200-millimeter wafers will be thicker, right? The standard thickness is 500 micrometers as compared to 350. So the gain on the area of 1.78 you lose on the thickness by 1.42. And ultimately, this transition to 8-inch is -- or 200 millimeters is only a cost topic. So it will come, but it will come when the cost equation makes sense and not when the marketing argument is out there.

China, indeed, we believe that it's a positive argument for our Chinese customers to be served with Chinese substrate source. And there might be also some other customers in the -- outside China which are happy to take this source. For us, it's multisource, multi-country, again, establishing, nurturing the merchant substrate and boule market, which is the base of our strategic thinking that differentiation is moving away from boule and substrate and towards device and package and application know-how. This is where the music will play in the future in silicon carbide.

Operator [18]

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

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

Frankly, congratulations on your #2 automotive microcontroller position. I think it's an exceptional achievement given where you're coming from, from 5 or 10 years ago. Infineon has always been known as a leader in power semiconductors, but I think we should also now consider then early [the] microcontrollers. So really, congratulations.

My question is a bit more pragmatic, though. The bear case from the investment community on your company and some of your peers is that obviously, you have benefited from exceptional pricing dynamics over the course of the last 2 years, and your margins reflect that, which are now almost 10 points. Your gross margin was 10 points above where they were prior to COVID. So what I wanted to ask you is in what scenario do you think your gross margin could fall back to those sort of high 30s? And is that a realistic scenario for '24, '25? And I've got a follow-up.

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

Yes. Thank you, Didier. First, for the flowers on our MCU strategy. Indeed, it was a long journey, but it played out nicely.

With regards to your gross margin question, I think we are really in a different regime as compared to pre-COVID. And particularly, in the automotive and industrial space, the starting point for any discussion in the future is the current price level compared to, again, what Andreas highlighted, capacity reservation agreements. The strong demand and the requirements on the capacity expansions, I think, will always give us good arguments why we are not going to sell our capacity under a fair market price. And of course, we will continue with activities like value-based pricing P2S going into the solution space, combined with software. All that will make our portfolio more stickier going forward.

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

And Didier, if I may just make one additional comment on the more short to maybe midterm. If you think about our PSS segment, as I mentioned before, I mean, this is currently at much lower levels than all the other divisions. So if the 3C markets are coming back, that would be an additional positive element for the margin development going forward.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [22]

Yes. To stress that even there is no doubt that PSS will achieve similar business performance as before after the correction in the market.

Didier Scemama, BofA Securities, Research Division - Director in EMEA Equity Research & Head of European IT Hardware [23]

Actually, that was my follow-up because one of the players in the RF front end market yesterday, call it -- talked about a little bit of an improvement in Android market, and they saw significant improvement in their booking activity in the Android smartphone market in China. I know you haven't mentioned any of -- any improvement in PCs. But I think Intel and AMD also said that inventory levels are at low levels, and they think things are going to get better in Q2 in the second half. So maybe just give us your level of conviction on an improvement in the second half. And more importantly, what did you assume in terms of the PSS revenue trajectory in your H2? So that's the calendar Q2, Q3.

Andreas Urschitz, Infineon Technologies AG - Chief Marketing Officer & Member of Management Board [24]

Andreas speaking. So let me take the first portion of your question, market, what is the market picture. As you know well, a good piece of Infineon's top line is related to our strong position in the server market. And since you mentioned the word computing, I'm relating to that. So what we observed in the current situation is that the industry that is in server business is just in the midst of a transition from, so to say, architecture, mostly VR13-based towards VR14. So that is a positive and demand-driving element, which we expect to kick in very soon.

And the other element is then also the so-called ChatGPT effect, if I may say so, where we clearly can observe our customers and their customers' demand. So talking about data center operators going in a direction to support ChatGPT-like applications going forward. And also that is an incremental demand driver probably going to take place as early as second half of 2023.

Sven?

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [25]

Yes, Didier, on your revenue-related question. So if you think about PSS in Q3, I would say it's slightly down, maybe mid-single-digit percentage compared to Q2. And in Q4, I would expect the Q2 run -- flight level again. Both numbers have a slight negative currency effect included. So just to put that into perspective. But I just want to stress, it's not getting worse at all. I mean you know that if we communicate something, then we want to see real evidence. And here, we have also said that the Q2 in PSS was slightly better than expected in the last guidance.

Didier Scemama, BofA Securities, Research Division - Director in EMEA Equity Research & Head of European IT Hardware [26]

Got it. So you're assuming no recovery really in smartphones in the second half in your guidance for the full year PSS.

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [27]

Yes. Correct.

Operator [28]

The next question is from the line of Sara Russo from Bernstein.

Sara Russo, Sanford C. Bernstein & Co., LLC., Research Division - Research Analyst [29]

Can you hear me?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [30]

Yes.

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

Yes, we can.

Sara Russo, Sanford C. Bernstein & Co., LLC., Research Division - Research Analyst [32]

You recently announced that you've broken ground on your Dresden site, including that you're seeking public funding of around EUR 1 billion and also that it's aligned to the EU Chips Act, which is still making its way through approval channels. Can you provide any further information on the process to secure that and any potential timing update?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [33]

Yes. Thank you, Sara, for your question. We got the approval for -- to start early measures, meaning that we can start the construction work at our own risk. So we do -- have not received final funding approvals. We expect them to come in '23 and in '24. But given the political support for the project as evident on Tuesday, I have no doubt that we will get what we have figured into our business case.

Sara Russo, Sanford C. Bernstein & Co., LLC., Research Division - Research Analyst [34]

That's great. And any other views on the EU Chips Act and how Infineon is engaging with that process or looking at future funding opportunities?

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

Thank you. We welcome the EU Chips Act. We welcome the focus on R&D and Pillar 1. I think this is, long term, crucial to build up the ecosystem in Europe. We welcome also the funding to build up capacities. I think this is the right direction as we know that the semiconductor industry is vital for the green and digital transformation.

The process of the EU Chips Act makes good progress now that there is an alignment with all involved parties, and we expect that things will go, from now on, smoothly. And hopefully, more projects will come and beef up the ecosystem in Europe further.

Operator [36]

The next question is from the line of Jerome Ramel with BNP.

Jerome Ramel, BNP Paribas Exane, Research Division - Analyst of IT hardware and Semiconductor [37]

Just a follow-up on the prices. You gave 3 reasons why prices are resilient, but you didn't mention inflation. So I was just wondering, if I look at your energy cost, if I look at the foundry cost and so on, is it de facto assuming that you will pass on these inflation costs to your customers on top of the 3 arguments you made?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [38]

I think we have to -- have given you an overall equation, and Sven has given you some of the elements like increasing ramp-up costs. Of course, we have some cost increases elsewhere, but we also have prices on the supplier side coming down with freight cost, with also relaxation in the OSAT space. So all that plays out and, really, the delta arguments Sven has given before.

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

And Jerome, on the energy side, we see, for example, and I don't want to call it deflation but a reduction of the higher expectations. So that's positive. But if we talk for '23, and I don't want to go beyond that, then generally speaking, we are in a position to pass on these normal inflations as just mentioned.

Jerome Ramel, BNP Paribas Exane, Research Division - Analyst of IT hardware and Semiconductor [40]

Okay. And maybe as a follow-up, if I look at the guidance for second half of this year for the revenue, it is marginally higher than the first half, or maybe you're a little bit conservative there. But what I want to -- maybe to understand, and I know you're not going to guide for 2024, obviously, but looking at your SAM and looking at your CapEx you are investing, is it fair to assume that you are calibrating the company for further growth in the coming years? Or I don't know how to phrase that, but just looking at your SAM, should we expect further growth and not a stabilization like we are starting to see in the second half of this year?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [41]

Yes, absolutely. I mentioned the investment areas for our CapEx. I said silicon IGBT and related technologies, wide-bandgap, meaning silicon carbide, gallium nitride, and of course, a big chunk this year goes into construction elements of new clean rooms. And we absolutely build on our growth story driven by decarbonization and digitalization. And we stick to our target operating model of more than 10% growth year-over-year.

Operator [42]

And the next question is from the line of Matt Ramsay with TD Cowen.

Joshua Louis Buchalter, TD Cowen, Research Division - Vice President [43]

This is Josh Buchalter on behalf of Matt. You mentioned a bunch of comments on favorable pricing environment, but I wanted to ask, I guess, about the CSS segment specifically. I mean just given the guidance implies sort of a back half sharp deceleration versus your prior -- versus the first half of the year and there's been some comments from your peers about some pricing weakness in low-end China, is it safe to assume that you're not seeing any of that and even with the volume decline, you're seeing stable pricing in your broad-based microcontroller franchise?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [44]

Yes. I think we have some elements in that portfolio, which are very sticky and where we benefit from long-term price increases, and therefore, overall, our position might deviate from your reference point.

Joshua Louis Buchalter, TD Cowen, Research Division - Vice President [45]

That's crystal clear. And then for my follow-up, I wanted to ask about the -- I guess, the topic of the day or every day. With your 2 announced substrate partners, can you -- the press releases, I guess, mentioned the targeting double-digit percent of the long-term demand. I mean that's a pretty wide range. Any more, I guess, guidance you can give us on the expected contribution from SICC and TanKeBlue. I mean should we expect output from them helping you grow as early as fiscal 2024? Or is that more of a long-term story?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [46]

No, it will kick in already this year. As we said, we are -- have qualified and are qualifying depending on the details of the product family now. So we will ship parts in '23 based on this. Look, we have now, I don't know, 5 or 6 -- 5 qualified performing suppliers. And how we exactly play out the share, of course, it's subject to normal procurement procedures. In addition, maybe this geopolitical element of China. And of course, in addition, wafer versus boule supply is another element in the equation.

Operator [47]

And the next question is from the line of Sandeep Deshpande with JPMorgan.

Sandeep Sudhir Deshpande, JPMorgan Chase & Co, Research Division - Research Analyst [48]

I have 2 questions, if I may. Firstly, actually, a follow-up on the earlier -- to an earlier question, which is that your second half revenue is not very different from -- in terms of the guidance from the first half revenue. On the other hand, your backlog is pretty big of EUR 34 billion, and you've got more capacity in the second half available than in the first. So maybe you can walk through why this is how your guidance is looking. Or is it simply Infineon conservatism?

My second question is regarding the whole China market. And I mean some of your peers have talked about price weakness in the China market. But the bigger question I have there is regarding the new companies in China, whether it is in microcontrollers or power semiconductors and whether they will have a potential to disrupt, not just your market but your peers' markets. Given the amount of investments that they are making based on what we are hearing from semiconductor equipment companies you supply, many of these companies are going to invest very substantially now in lagging edge markets given that the leading edge has been blocked by the United States.

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [49]

Sandeep, it's Sven here. I need to speed up a bit in my response because there are still a couple of investors lining up. So on your first question, yes, EUR 8.1 billion plus EUR 8.1 billion is EUR 16.2 billion. Second half is at $1.10. The first half was at $1.05 on average. So you please also factor in the EUR 250 million to EUR 300 million. So then you see that the second half is higher than first half.

On backlog, reduction from EUR 38 billion to EUR 36 billion, yes. But as we kept saying, we can sleep very well with that number. It's significantly above 2x annual revenue. And from the EUR 2 billion decrease, 1 quarter is currency-related, and 3 quarters are order related.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [50]

Sandeep, this is Jochen. Taking the question on China. Indeed, our assumption is that China will invest, in particular, in those nodes, which are not affected by the U.S. restrictions. Silicon carbide is a case in point in that regard. We mentioned 2 suppliers we have now qualified. Our last counting was 50 companies try to do silicon carbide boules or substates in China. We do not see really Chinese competition on the device side yet. But in principle, let's say, low-end products like in the past as well of MOSFETs for e-bikes will be manufactured in China. Our answer to that is driving the technological innovation forward, going for wide-bandgap, going for P2S solutions, which including software, which gives us, again, distance to competition and, of course, also broadening our growth beyond China into countries like Japan, Korea and North America.

Operator [51]

And the next question is from the line of Lee Simpson with Morgan Stanley.

Lee John Simpson, Morgan Stanley, Research Division - Equity Analyst [52]

Great. If I take you back to some of your earlier remarks about the variability of supply tightness, I wonder if you could maybe just qualify for us where that is, I mean, maybe by product category, where things are loosening, where indeed you're seeing ongoing tightness in the supply chain and maybe how that might inform the changing of the days of inventory that you may have in the back end of the year. Is it a target for your [DI] number in particular?

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

The tightness is really in the areas I mentioned before. It's in-house. It's IGBTs. It's silicon carbide. It's gallium nitride. So the whole power frame is still under allocation. And in terms of foundry supply, as I mentioned, the microcontrollers, in particular, for automotive are still tight, getting better second half but, again, ramping strongly also into next year. So it will be a continuous journey for the next years to match here demand and supply.

Lee John Simpson, Morgan Stanley, Research Division - Equity Analyst [54]

Yes, but the noticeable absentee is MOSFET. So are we to assume that MOSFETs are loosening and are part of that variability?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [55]

The low-end MOSFETs is certainly less in allocation. The areas I talked about is more the higher voltages, starting from -- with IGBT, silicon carbide and gallium nitride.

Lee John Simpson, Morgan Stanley, Research Division - Equity Analyst [56]

That makes sense. Great. And maybe just a quick follow-up around silicon carbide. And you referenced already the tightness of supply, but if that continues into next year, clearly, there will be some pricing power for you and your peers. So I just wondered if there was a scope here for you to outline the -- maybe the size of your dollar targeting for this year in the silicon carbide supply for '23 and maybe how you think that might grow next year and possible impacts on margin structures as a result.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [57]

Yes. We are not giving any guidance for next fiscal year, but of course, an allocation situation is always a situation which is favorable in terms of pricing in general speaking.

Lee John Simpson, Morgan Stanley, Research Division - Equity Analyst [58]

And no update for this year on silicon carbide?

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

On silicon carbide, we are going for the 500 million this year, and we are in tight supply.

Operator [60]

The next question is from the line of Aleksander Peterc with Société Générale.

Aleksander Peterc, Societe Generale Cross Asset Research - Equity Analyst [61]

Yes. Just very briefly, I would just like to understand on PSS, where -- at which point do you see this market to be bottoming out -- or this division to be bottoming out. You said that the report this quarter was slightly better than expected. Q3 is still down. Should that then be the low point of this cycle for this division? And then I have a very quick follow-up.

Andreas Urschitz, Infineon Technologies AG - Chief Marketing Officer & Member of Management Board [62]

Let me -- Andreas speaking, hello. Let me reiterate what I've been trying to say before on the server market, which is a good reference point for the PSS business since it makes up quite a chunk of PSS' revenue. Here, we have certain structural effects within the industry in servers, so to say. The rise of AI applications and AI machine learning data center demand, plus and also changes in the architectures for, so to say, CPU-based hyperscale servers, that both effects together makes us expect that the second half of the calendar year 2023, we're going to see the one or the other elements of movement going up with regards to demand, yes.

Aleksander Peterc, Societe Generale Cross Asset Research - Equity Analyst [63]

Okay. And then just a quick follow-up on Siltectra. Could you give us an [indiscernible] of progress with this process where you are right now in the industrialization of the solution?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [64]

Yes. It's on track. The industrialization to a bigger scale will take place in the new Kulim facility. So there, it will really then kick in, in terms of volume.

Aleksander Peterc, Societe Generale Cross Asset Research - Equity Analyst [65]

Okay. And if you look at your road map for 200 millimeters, I'm hearing from around the industry that the message to 200 is a lot more difficult than expected. Do you see by the end of the decade, the majority of our output being on 200 versus 150 millimeters in silicon carbide? Or is that too optimistic?

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [66]

Yes. We predicted these challenges in the transition. And as I said before, from my perspective, 2 to 4 years for high-volume change over to 200 millimeters because really, the devil is in the detail. And ultimately, 200-millimeter is a pure cost play. And again, as I said before, don't get fooled only by the wafer diameter. The thickness increases. So that's, first, decremental for the 8-inch transition and the yields. So it will take time. We have the experience from 4- to 6-inch, but by the end of the decade, I definitely assume that the industry has overcome the problems. They are not fundamental, but they are tedious in detail.

Operator [67]

And the final question is from the line of Janardan Menon with Jefferies.

Janardan Nedyam Menon, Jefferies LLC, Research Division - Equity Analyst [68]

Two questions. One is, again, on the silicon carbide side. You previously, as with all the presentation, said that you get a roughly $250 discount or lower price from Chinese suppliers on the same kind of quality of wafer. So do these agreements give you an advantage in the market in terms of being able to price lower or increasing your margin? And prior to these agreements, were you at a disadvantage versus your competition in terms of not having vertically integrated when you were discussing with your customers? And if that was the case, does this disadvantage now go away? That's the first question. And I have a short follow-up on another topic after that.

Jochen Hanebeck, Infineon Technologies AG - CEO, Labor Director & Member of Management Board [69]

Yes. The silicon carbide pricing is currently determined by the market as we are in allocation. So there is no desire here to pass on productivity at this point in time. The customers are concerned about supply. The whole equation on the cost structure is really more than the substrate, right? It's the epitaxy. It's the device concept. We also stress that our device -- 30% more devices fit on a wafer. It's all about packaging concepts. By the way, that gives us a very nice heads-up position in the industrial space where many customers require the packaging solution fitting to their application. So I know that silicon carbide is sometimes reduced to the boule or the wafer topic, but that's not real reality.

And again, my prediction is differentiation will move away from boule and wafer towards the device, the packaging and the application know-how. So therefore, we reconfirm our merchant market prediction, which we, by the way, took after the failed Wolfspeed acquisition, and we said 10 years later, there will be a merchant market, so we are on track.

Janardan Nedyam Menon, Jefferies LLC, Research Division - Equity Analyst [70]

Understood. And then for 2 consecutive quarters now, you announced results quite late in the quarter, including, for instance, in the December quarter, you were sort of halfway through the quarter. But in 2 successive quarters, you have beaten your segment margin guidance by almost 300 basis points. I'm just trying to understand the factors behind that. I mean what is happening quite late in the quarter? Is it because of the escalation that you're getting from customers you're able to charge significantly higher pricing and, therefore, getting that sharp beat of expectations by 300 basis points? What is changing quite late in the quarter, which you could not predict previously and leading to this sort of upside? And how do you see those factors playing through in the rest of this fiscal year?

Sven Schneider, Infineon Technologies AG - CFO & Member of Management Board [71]

Yes, Janardan, thank you. Great question. I mean the quarterly performance was different, and I don't want to go now into all details, but it was a combination of different things like volume fall-through. It was, as I said earlier, less increase in energy costs. We had some very, very positive price contribution in the first quarter, as mentioned before. So there were a couple of these elements, which helped us. And of course, you have then also some structural effects and mix effects, which also matter. I mentioned, for example, the first very strong consumer quarter.

Going forward, let's see. But I think I gave part of the answer to one of your colleagues when I said on the gross margin front, it's an around level. So we will see how this will develop going forward, and I think you know us well.

Alexander Foltin, Infineon Technologies AG - Head of Investor Relations [72]

And no better way to end the call, I have to interject here now. It's time to wrap up. Apologies to my colleagues from the press and communications side, we're already over time. Thanks for all the questions to the analysts. We are concluding now our fiscal second quarter conference call.

For further questions, if there are any, feel free to contact us in the IR team here in Munich. Thank you very much. Take care, and have a good spring time.