

Wedbush Transformational Technologies Management Access Conference

Company Participants

- Betsy Van Hees, Analyst
- Chris Evenden, Director, IR

Other Participants

- Unidentified Participant, Analyst, Unknown

Presentation

Betsy Van Hees {BIO 6078412 <GO>}

Good morning, everyone again. My name is Betsy Van Hees and I am the semiconductor analyst here at Wedbush Securities.

We are very excited to have Senior Director, Investor Relations Chris Evenden all the way out here from Santa Clara, California, NVIDIA. This is going to be a little different than what we have had prior.

We're going to have a little fireside chat, Chris and I. So I wanted to start things off, Chris, with you just giving an overview of NVIDIA telling everyone a little bit about the Company.

Chris Evenden {BIO 18934997 <GO>}

Overview of NVIDIA. So NVIDIA founded 20 years ago started as a GPU company. What that meant was we were improving the gaming experience for PC gamers.

And as we evolve the technology, improved the technology we have leveraged that IP into new markets. So the first adjacent market we went into was professional graphics. So we levered the technology to go into professional graphics.

And that's the product we called Quadro. Then as we advanced the GPU technology and made them more programmable we leveraged it again to go into compute. So this is using the GPU for the math, not for graphics at all. That's a business we called Tesla.

We are now actually leveraging the technology to provide that GPU power remotely, that's a business we call GRID. And finally we are using the same GPU technology

integrated into an SOC for mobile computing applications. And that is Tegra and we have those markets in mobile and automotive as well.

So where we are now, we are a \$4 point something billion company. About 60% of our revenue is from the GeForce business, about 20% from Quadro, about 10% to 15% from Tesla and most of the rest from Tegra.

Betsy Van Hees {BIO 6078412 <GO>}

Perfect. Thank you.

So Chris the next question I wanted to ask, well it's a very casual fireside chat here, the next question I wanted to ask you is you guys had a great quarter, great guidance, once again congratulations. I was wondering if you could just talk a little about what drove that for you guys?

Chris Evenden {BIO 18934997 <GO>}

Sure. So the standout of this quarter and of the previous quarter actually is the core GPU business, specifically gaming. So when we model or we analyze our GeForce business internally we look at two fairly distinct markets that it sells into.

One is gaming. So that is consumers buying a PC largely with gaming in mind. So they might make up excuses to their significant other about what the PC is for but gaming is definitely a significant part of that.

And some of that business is you're buying a boutique PC, some of it is you are buying aftermarket GPUs to upgrade the PC. Some of it is iCafe from China, which is in itself a significant business, for example.

The other element of the GeForce business is mainstream PCs, largely notebooks. So this is an OEM that is buying a GPU to differentiate their notebooks and define their notebook as being a premium notebook, if you like. And that's a much weaker business as we are seeing long-term weakness in the mainstream notebook market as I think everyone is seeing.

And so that business I think is -- the market of mainstream notebooks, I think, is in long-term decline. However, PC gaming is in good health and that's what we have been seeing and that is up I think 57% year on year. Up very significantly year on year and still doing very very well.

A lot of new games came out in the fall. And I think perversely the fact that consoles now for the first time in their history are essentially PCs, architecturally the new consoles are just PCs, what that means is it is much easier for the game developers to port their AAA console content to PCs as well. So I think we will see a continued strong stream of content for the PC platform.

And China there are some interesting developments. China has long been our biggest gaming market but they are -- EA's pieces tended to be lower there but now we are seeing that decline climb. Games like Blade & Soul, which is a high production value game, high production values means high resolution content which means you get better GPU, which means more revenue for us.

So all of these factors have been driving very very strong gaming revenue in the last couple of quarters. Then year on year Tegra is up significantly as well, Quadro is up. It's been that generally broad-based but gaming I would say is the standout strength.

Tesla is up very strong. Tesla is continuing to grow nicely. That's an important point.

Questions And Answers

A - Betsy Van Hees {BIO 6078412 <GO>}

And if anyone has any questions just raise your hand. It's a very open Q&A.

One of the biggest things I hear from investors. And I am sure you hear the same thing, is the gaming market. The gaming market is dead because you can go ahead and get free games on android. So why are you going to go out and spend all this money on paying for games? Yet you guys continue to have tremendous growth and continue to see that as a very important driver.

A - Chris Evenden {BIO 18934997 <GO>}

Well the gaming market -- PC gaming -- people have been telling me that PC gaming is in decline ever since I entered this industry over a decade ago. If I believed any of them it would be very depressing.

It couldn't be further from the truth. PC gaming is extremely healthy. There's a bunch of reasons for that.

I think the biggest reason is sort of alluded to in your question, which is the business model in PC gaming is quite different to the traditional console model of charging \$60 for shrink-wrapped software, sort of fire-and-forget model. PC gaming is a very open platform, it's very innovative.

We have seen a lot of that innovation in China again, partly because China it is impossible to charge for software. So you find other ways of monetizing your content. And you see innovation in terms of subscriptions in terms of free-to-play, in-game transactions, micro-transactions, downloadable content, all of these innovations generate revenue for the software developer without actually requiring a \$60 upfront fee.

In fact, the analysis, I think it was DFC did the analysis and it suggests that something like 80% of PC gaming software revenues are now -- let me say I'll say it the other way around -- about 20% of PC game software revenues are shrink-wrapped software and the rest is downloaded games, downloadable content, all those other things. And so there's a lot of innovation around monetizing the content.

But of course regardless of how you monetize the content you need a decent PC to play that content on. And that's what GeForce gives you. And so all that innovation is rewarding game developers but it is also rewarding us as well.

And I was going to say as an American, I'm not actually American, I don't know if you can tell. But as someone a little American. I've lived here for over a decade.

Sometimes you can be forgiven for believing that PC gaming isn't in good health. Because if you go into Best Buy and it's really hard to find a PC with any sort of graphics in it at all. The console is almost ubiquitous here.

But travel a bit in the far east and I think you will develop a very different impression. Actually, another example of the misleading evidence of your own eyes is I flew over here yesterday from San Francisco and as I walked out of the plane, I am always at the back of the plane for some reason, I don't know what I'm doing wrong, everyone is using an iPhone. Everyone is using an iPhone.

Yet worldwide iPhone share of the smartphone market is under 30% now. We live in a box to some extent.

And also not only is PC gaming not huge in America it is not bought in Best Buy. People are buying the graphics cards on Newegg, they are building their own PCs using Newegg, they are buying Razer PCs which is a company that if you are not a gamer you probably may not have heard of. And they are downloading the games. They are not going to GameStop to buy a shrink-wrapped CD or DVD, they are actually downloading the games.

But then again like I said go to Asia, go to some of the iCafes there and see -- here, I think it was Starbucks that the brand proposition of Starbucks is a place between work and home. And that's the function that iCafes so in China -- they are a meeting place, they are a social place, they are a place that people go to hang out. And they are a very lucrative business and they are moving up market as well with more premium offerings and so that's good for us.

A - Betsy Van Hees {BIO 6078412 <GO>}

So the PC gaming market is not in the decline and hasn't been in a decline in the last decade since you have been in the industry?

A - Chris Evenden {BIO 18934997 <GO>}

The strongest piece of evidence I can give you to demonstrate that the PC market is not in decline is just look at our revenue. It's written there. (multiple speakers) accounts.

A - Betsy Van Hees {BIO 6078412 <GO>}

Good point. Excellent point.

I do want to, before we leave the consumer side of the GPU business, the notebook, obviously the notebook side you talked about that as having its challenges. And you've got integrated graphics and that's always been -- attach rate is slowing down -- and has always been a big bear case on NVIDIA aside from the PC gaming.

So kind of wanted to touch about that market for you guys. Then I also, the other question I had before we leave the PC gaming is the ASPs, just talk a little bit about the ASPs? You said they're on Newegg and how positive that is for your corporate gross margin.

A - Chris Evenden {BIO 18934997 <GO>}

Sure. So yes people talk about attach rate, which is the percentage of basically the number of the GPUs shipped expressed as a percentage of the number of CPUs shipped. And people talk about how integrated graphics, which is the free graphics that comes with every PC, how that might be a threat to us.

I think they are missing the dynamic there. I think the attach rate it is certainly not going to increase this year. It may well decrease but the driver for that is not people starting to play graphic games on integrated graphics.

The driver for that is pressure on the mainstream notebook market in general and specifically cost pressure on the manufacturers of those devices. So I mentioned at the beginning that a GPU defines a notebook as premium but also so too does a solid-state drive and so too does this touchscreen.

And so I think touchscreen penetration seems to have leveled out in touch screens now. But SSDs I think will continue to increase and that will put pressure on the GPU attach rate. And so that market is certainly not a growth market for this year, I would say that we are certainly modeling that to decline for us.

Now, having said that gaming notebooks are growing quite nicely and the core gaming desktop market is growing nicely as well. So overall the GeForce business is healthy. I think the units will be down year on year but the ASPs will be up and the revenues will be up.

And to your point, the profit margins will be up as well because that's a much richer mix for us as well. The ASPs are significantly lower on OEM business because it's a cost-driven sale whereas the gaming sale, if you like, is a value-driven sale. And since

we are providing something that someone specifically wants and so the ASPs are stronger and we can charge appropriately for the value we provide there.

A - Betsy Van Hees {BIO 6078412 <GO>}

One of the things that -- there are so many things about NVIDIA that's great. You guys have fantastic technology but the foresight that Jen-Hsun has had in terms of the innovation and the changes that are made.

Because as you guys saw the declining of the PC market and of course the gaming market continues to be robust, you guys ventured into other areas. And Jen-Hsun said on the call that Tesla and GRID are becoming interchangeable when you talk about the two. So if you're able to talk about GRID you've got like 50 deployments, I think it is right now going on?

A - Chris Evenden {BIO 18934997 <GO>}

GRID. So GRID there are actually hundreds of trials worldwide. So --

A - Betsy Van Hees {BIO 6078412 <GO>}

Well then I stand very corrected.

A - Chris Evenden {BIO 18934997 <GO>}

So GRID as I mentioned, is serving up broadly speaking, is serving up graphics in the cloud. So serving up graphic -- the power of a GPU remotely and there are number of ways you can monetize that technology.

One of them is by making Citrix and VMware better. So virtual desktop-linked infrastructures, improving those. One is by providing gaming remotely. One is by being more flexible in how you provide graphics power to heavy graphics users and small organizations like architecture firms who are doing some high-quality rendering from time to time.

We are moving forward in all of those. The one we are most focused on in the immediate term is the virtual desktop infrastructure opportunity. And that's the one that we have nearly 600 trials running worldwide now.

And that's a number that has increased for the last two quarters at least, has increased about 40% of cost, which is extraordinary. And it's early days yet, it is still only just into double digits in terms of revenue but that's all parlor projects.

So the question is when do those start converting to production and what is the conversion rate and what is the size of a typical deal. And that is impossible for me to characterize right now because it is still early days.

We fully supported Citrix as of December of last year. So we've announced that we are fully supporting VMware ESX with the next version of that but VMware hasn't said

exactly when that is coming out but it's a few months away.

Then there's a delay before we get full production implementation. So by the end of this year I would think that we will have some data that we can use to characterize that properly and I think it's going to be a material business for us Q3, Q4 of this year.

I think it should be significant revenues. And of course the margin profile for that business is extremely good as well. And with luck we will be building in a recurring revenue component as well from the software and software maintenance.

A - Betsy Van Hees {BIO 6078412 <GO>}

So then Q3 and Q4 material, that's great and then beyond that's really the next leg of the story into calendar year 2015 and 2016 when you look at the growth projections and I'm sure as you guys are modeling out your business?

A - Chris Evenden {BIO 18934997 <GO>}

Yes, Jen-Hsun I would say is more enthusiastic about GRID than anything -- he's not lacking enthusiasm for any of our businesses. But GRID certainly is the one that he sees the most immediate significant contribution from. And just looking at the interest I was at Synergy last year, which is the Citrix user show -- I didn't go this year because it was last week, (inaudible) I was a little bit preoccupied.

And the enthusiasm is just extraordinary because we removed one of the big obstacles to adoption of virtual desktop infrastructures, which is user resistance because IT departments love virtual environments. They love the security, they love the manageability, they love the idea that if you leave your laptop on a plane all you have lost is a laptop, there is no data issues.

They love the fact that they can back it up. All the data is where they can get their hands on it.

Users have issues with it because some implementations can be a bit clunky. It doesn't support video very well at all. It doesn't support even the most basic of 3D applications.

So think that AutoCAD, for example, which is not a market for us because it is running today mostly on Intel integrated, that is not supported. Although it is fairly 3D it is too much 3D for virtual desktop infrastructures. So we can now support that. So we removed those obstacles.

So the ecosystem, if you like, around Citrix and VMware is very very excited about that. And it's a whole new market for us and the enterprise desktop has never been a place we have played and this enables us to get into millions of seats in front of millions of users.

So it's a wonderful opportunity and it is something where we are leveraging our existing IP to provide something of demonstrable value. So the corporate desktop. So yes, very interesting business.

Q - Unidentified Participant

(inaudible) whether he's using a virtual desktop or regular PC?

A - Chris Evenden {BIO 18934997 <GO>}

On repeat the question for the benefit -- the question was, are we saying that the user can't tell that he is using a virtual desktop or his own local PC. I don't know that we will ever be that invisible but we are certainly bringing the two experiences much much closer together than they were before.

And so we are allowing you to use any of the applications that you were using on your local PC on your virtual desktop and that certainly was not the case before you had GPUs in the server. So it's not only is it improving the user experience it is actually broadening the applicability of virtual desktop environments as well to a wider variety of users.

A - Betsy Van Hees {BIO 6078412 <GO>}

So before we leave the GPU space I just wanted to talk about the competitive landscape. So AMD/ATI, your former employer, has been making some big pushes into the market as of late. So I am just wondering if you could just talk about the competitive landscape with AMD sort of refocusing and reenergizing that business?

A - Chris Evenden {BIO 18934997 <GO>}

I love the idea that they weren't refocused or energized on this before. For as long as -- even before I joined NVIDIA, they were very very focused on winning workspace and share with us, for example. And now they are making more aggressive noises right now but I don't think their behavior has changed significantly.

Staying on workstations a moment, the charge we are trying to win business -- so we have about eight, according to IDC we have 82% unit share but we estimate we have over 90% dollars share in workstation. Now AMD recently redefined a consumer win as a workstation win. So they in one fell swoop increased the size of the workstation market.

So technically they will gain workstation share but they won't gain it off of us, they will do it by growing the market, by redefining the existing skew. The problem they face in gaining workstation share off us more broadly is that we have a better solution, we have better software compatibility, we have better testing, we have better performance, we have better relationships with -- not just with HP and Dell, who sell the majority of the cards. But also with the customers as well.

And the strategy of cutting prices to win business doesn't work in workstation because these people that our using your high-end workstations, they are the ones

with the sharp end at generating wealth for the company. You don't skimp on what you provide them. They are sitting on a \$10,000 workstation, their salary is probably at \$200,000, let's say, their software is another \$20,000 to \$100,000 depending on what they are actually running.

So \$2,000 for a graphics card, or \$1,500 for a graphics card, that \$500 saving is immaterial when you consider the loss of productivity if from a lack of stability from using an untested solution. So we have a very strong defensible position in that market.

At the very low end there is some transactional business that is guided by price. And so there may be some movement back and forth there but in terms of revenue share I don't see that changing significantly.

The story is broadly similar in GeForce as well actually. So there's these notebook units that we were talking about, they actually are a large proportion of the number of units sold each quarter but they are actually a small proportion of the revenue and an even smaller proportion of the gross profit.

And so you can actually by dropping significantly on price you could win a nice large piece of notebook business without moving the revenue needle at all. And so while any data is good I always like to surround the market share data with a big caveat which is it is unit data, it's not revenue data.

So if you see movement share, movement in the share, I would caution you to understand that it is unit share and you probably need to do some more drilling down before you decide what it's actually down to revenue. And at the high end, again, I am very confident with our technology.

We've only just started introducing Maxwell. The 750 and 750 TI that we launched last quarter has been extremely successful worldwide and I think that bodes well for the rest of the Maxwell range as we introduce it through the year.

A - Betsy Van Hees {BIO 6078412 <GO>}

I want to now talk about Tegra. We spent a good amount of time and we've got not too much time on Tegra. But very important in, once again, innovation and seeing the future and making that change and seeing what was happening. And so Tegra has had its successes and it's had some good times and bad times but it looks like it is back on track again.

Congratulations on having a quarter-on-quarter revenue growth. I was wondering if we could break down the markets a little bit more in depth in terms of where you guys are refocusing your energies versus where you were a year ago especially after GTC and the Analyst Day where Jen-Hsun talked about the smartphone market and not chasing the mainstream.

A - Chris Evenden {BIO 18934997 <GO>}

That's right. So with Tegra again we are leveraging our core IP, which is the GPU and we are integrating it with the CPU and all the other components that you need to build an SOC, a multimedia computer on a chip. And so the vision there five or six years ago was to build -- smartphones was one of the markets we were going after.

There are a number of markets within Android and smartphones are certainly the largest in terms of units. And with Tegra 4i we thought that we had a really really good chip there but obviously it hasn't had the success that we hoped it had despite its strength as a product.

So that our challenge is -- some of my investors never tire of reminding me of -- getting into that market. And so we had made the decision that we can't solve that problem with Tegra 5i because Tegra 4i was a good chip. So even with hindsight I think we think that's a good product.

So the product was not the issue, the market structure, the domination by certain providers, whatever it is you can't fix it with Tegra 5i. So let's stop banging our head against that particular brick wall and move on.

Now having said that we are still seeing some success in the high-end smartphone market with discrete chips. So a separate SOC and a separate baseband. So the phone now that is shipping the most units right now is the Xiaomi Mi3.

And so we will continue to offer products to the very high-end smartphone market. We will continue to offer products for tablets as well and we are looking at various other ways to monetize into that market as well.

Then with providers like SHIELD we are looking to build -- so SHIELD is a handheld gaming device, android-based -- we are looking to build the gaming ecosystem on Android. We do believe that the Android will have a significant gaming segment within it and I'm not talking about someone who necessarily will buy everything.

People who buy SHIELD are obviously buying it for games. But there will be people who buy tablets -- there will be gamers that buy tablets. And if you are someone who likes to play games and you want to buy a tablet anyway for all the reasons that you and I want to buy a tablet, then you may as well buy one that has actually supports your hobby of playing games as well.

That we think will be a significant niche opportunity for -- we call it niche but it will be a large opportunity for us. So that is a market we can go into there with SHIELD and the software work that we're doing that we can build that ecosystem.

Then of course automotive is the one that right now is the easiest to point to as an unqualified success. That is growing very rapidly year on year. It's a very stable business.

We are right across the models in the Volkswagen Audi Group, we are top to bottom in BMW. We have one other major manufacturer that hasn't announced it and obviously we are working hard on others as well.

So we have something like a revenue pipeline -- pipeline is probably not the right word -- commitments for over \$2 billion worth of revenue. So if we just sat on our hands for the next five or six years that revenue would come in. And clearly we are not just sitting on our hands, we are clearly going out and trying to win more.

And the market dynamics that are working for us is that the electronics are becoming a more and more important part of the car experience. If you sit down in a new BMW or a new Audi you can just increasingly it is a fully digital dash. And the quality of that dash says a lot to the driver about the car.

Then also programmability of the GPU, we sort of touched on it, we haven't talked about Tesla much today. But just as a GPU is good at taking data and turning it into an image, it is actually good at taking an image and turning it back into data. So we can take input from all the cameras around the car and we can discern a lot about the environment that the car is driving and.

So Audi for example with their I think VSAS they call it they have a very specific term, it's basically advanced driver assistance systems. So parking the car, warning if you getting too close to the car in front of you. The system we have even recognizes speed signs, speed limit signs by the side of the road to alert you to that and tell you if you are going too fast.

It recognizes whether you are drifting outside the white lines and can alert you to that. If you have got your blinkers on and you are moving over the white line you are probably just drifting. And so there's all sorts of things that are very important technology steps on the routes to a fully automated car.

And that's something that maps very very well to Tegra. And so that market is continuing to play to our strengths and so we see that as a strong opportunity for growth.

Whereas before our role was driving the NAV system now it's driving the NAV system and the actual instrument cluster and increasingly also in getting involved in these driver automation systems as well. So the opportunity in each car is actually growing even as the number of car opportunities is growing as well.

A - Betsy Van Hees {BIO 6078412 <GO>}

So the \$2 billion, is that for the high-end, or is that moving into the midrange car as well?

A - Chris Evenden {BIO 18934997 <GO>}

So any Europeans in the audience would know, Scotia is a manufacture, which is part of the Volkswagen Audi Group. But we are in Scotia and that is most definitely a mainstream manufacturer.

Audi we are in the A3, BMW we are in the Mini. It's not limited to share premium cars.

I think when we market it we love to talk about the Tesla automotive cars, we love to talk about Lamborghini, we love to talk about Bentley. But the reality is it is stretching right into the mainstream now. And our modeling suggests -- I forget the market research firm now. But they say there's 100 million cars in 2017 made.

And so we think our opportunity in 2017 is about 40 million units. So that's not 40 million cars because there will be more than one unit per car, on average. But it's still a very very significant opportunity for us at that point and that is actually gauged somewhat by geography as well as which manufactures we are in, not just by going into the mainstream cars. But we haven't found a way to get into the tougher motives \$1,000 car yet but we are definitely moving into the mainstream.

A - Betsy Van Hees {BIO 6078412 <GO>}

So it sounds like you guys really have the early mover advantage. You guys got in. Now, who is nipping at your heels and how are you going to be able to maintain the dominance that you currently have today to continue to have that \$2 billion and grow it even larger?

A - Chris Evenden {BIO 18934997 <GO>}

In automotive that's a good question. So the traditional competitors in that space are Freescale and TI. But I think they are, we have significant strength -- how are we doing for time?

So we have significant strength in computing and the user experience that they don't have and I think that is why we have had this early success. Qualcomm had certainly made a lot of noise about wanting to get into cars, Intel has made a lot of noise about getting into the car. It's a complex software stack with long product cycles.

So I think we are in a pretty strong position. And as I said I think our unique depth of knowledge, particularly when it comes to advanced driver automation now, is a very significant differentiator for us, the software stack.

I haven't talked about this so far today but we actually have more software engineers than hardware engineers. Although we are classified as a semiconductor company. And if you did it on the basis of the engineers we have you would ask reclassifies us a software company that makes chips as well.

And that's a huge -- if you think about how what the difference is between our product offerings, the difference between GeForce, Quadro and Tesla is just software, it's the same chip. And to some extent that is true of our offerings within Tegra as well.

The software stack is incredibly important and I think that's a huge part of the value we provide. There's a little red flashing --

A - Betsy Van Hees {BIO 6078412 <GO>}

I know. I wish we had more time. Thank you. So much, Chris.

We really appreciate you coming out here to New York. Thank you very much.

A - Chris Evenden {BIO 18934997 <GO>}

Thanks for inviting me.

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