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Q2 Fiscal 2024 (July 31, 2023) earnings call script

Louis Gerhardy, VP Corporate Development

Good afternoon and thank you for joining our second quarter fiscal year 2024, financial results conference call. On the call with me today is Dr. Fermi Wang, President and CEO, and Brian White, CFO.

The primary purpose of today's call is to provide you with information regarding the results for our second quarter fiscal year 2024. The discussion today and the responses to your questions will contain forward-looking statements regarding our projected financial results, financial prospects, market growth and demand for our solutions, among other things.

These statements are based on currently available information and subject to risks, uncertainties and assumptions. Should any of these risks or uncertainties materialize or should our assumptions prove to be incorrect, our actual results could differ materially from these forward-looking statements. We are under no obligation to update these statements.

These risks, uncertainties and assumptions, as well as other information on potential risk factors that could affect our financial results, are more fully described in the documents that we file with the SEC.

Access to our second quarter fiscal 2024, results press release, transcripts, historical results, SEC filings and a replay of today's call can be found on the Investor Relations page of our website. The content of today's call as well as the materials posted on our website are Ambarella's property and cannot be reproduced or transcribed without our prior written consent.

Fermi will now provide a business update for the quarter, Brian will review the financial results and outlook and then we will be available for your questions.

Dr. Fermi Wang, President & CEO

Good afternoon. Our fiscal Q2 revenue was approximately flat sequentially and consistent with our guidance. Our AI business grew sequentially and year-over-year, while our video processor business was down sequentially and down about 50% from a year ago. Our blended ASP in Q2 was above \$12 and is on-track to grow about 20% year-over-year, thanks to the richer mix of AI SoCs, highlighting the value of our emerging AI inference business.

Our mid to long term growth outlook for the AI inference processor business remains positive, however the near-term environment is very challenging for our overall business. Customers are now more aggressively reducing their inventory, and we are now seeing some pockets of weak end-market demand which complicates our customers' ongoing inventory reduction efforts. Given this, we have reduced our 2H outlook. We are not expecting a recovery in calendar 2023, but we do anticipate our customers' inventory will normalize by the end of the year and set us up for a return to growth in calendar 2024.

We continue to expand our position in the rapidly evolving AI inference processor market. Cumulatively, we have shipped more than 17 million AI inference processors into device end-points for IoT and auto applications, and we are now expanding our AI inference processor reach into vehicle autonomy. As announced on the last earnings call, we continue to evaluate the AI inference accelerator market opportunity.

I will now summarize the status of our 3 major SoC product families; video processors, CV2 and CV3.

First, video processors for human viewing are expected to be about 40% of total revenue this year, down from 55% last year and they typically command a single digit ASP. For several years we have been prioritizing our limited resources on AI technology and products, and for this reason we anticipate our video processor revenue to continue to contract. However, the revenue impact from the video processor contraction in F2025 is anticipated to be significantly lower than what we are experiencing this year.

Second, our CV2 family of SoCs established Ambarella in the AI inference market, and these SoCs are expected to approach 60% of our total revenue in fiscal 2024, up from 45% last year. This family of AI inference SoCs commands an ASP close to \$20 and serves computer vision applications for auto and IoT. CV2 remains an important growth market for Ambarella in the mid to long term.

Third, our CV3 family of SoCs first began to sample 1 year ago. Based on our 3rd generation of AI inference technology, these SoCs target more challenging AI inference workloads such as partial or complete mobile system autonomy. The CV3 family of SoCs range from \$50 to more than \$400 per SoC, and our autonomous driving software stack, optimized to run on CV3, can add hundreds of dollars per unit of incremental software value.

The AI inference processor embedded in our CV3 SoC is the starting point for our evaluation of the Gen AI acceleration market. In the last quarter we began to port META's LLaMA 2 to the CV3-AD-High, and we expect to have Chatbot demos available later this year. We will provide updates on our continuing evaluation and I am encouraged to see Generative AI opportunities emerging on both the server and device side of the market.

I will now summarize representative customer activity in the quarter.

Design activity in the enterprise security camera market remains robust at major customers worldwide.

Motorola introduced its H5A multi-sensor camera based on our CV2 AI SoC. The camera offers up to a 360 degree view utilizing up to 4 image sensors with up to 32 megapixel resolution and AI analytics.

Axis, a unit of Canon, announced the 2MP M4215 cameras and the 4K M4218 cameras, both based on our CV25 AI inference SoCs, targeting indoor surveillance applications.

Japanese market leader iPro announced the expansion of its Rapid PTZ X-Series and S-Series with 16 new models based on our CV25 and CV22 AI inference processors. These are the smallest cameras in their category with resolutions of 2MP, 6MP and 4K.

Dynacolor introduced its model Q next generation multi-directional camera using our CV5 AI processor to support four 5 megapixel sensors.

In South Korea, Hanwha launched three new bi-spectrum AI cameras based on our CV2 AI SoC. These cameras provide 4K visual and thermal views simultaneously for the rapid detection and classification of vehicles or intruders.

I will now talk about representative customer activity in the automotive market.

In our May 30th earnings call, I mentioned the positive feedback we received at the Shanghai Auto Show for our CV72AQ AI inference processor, a derivative of the CV3 family of SoCs. During Q2 I visited Tier 1s in China, and I'm pleased to report multiple Tier 1 wins for L2+ applications. We expect some of these Tier 1 projects to commence production in the second half of calendar year 2025.

We are pleased to announce our first CV5 win in a passenger vehicle. We expect this win to enter production in the next 12 months. In this application the CV5 will support AI inference processing for multiple cameras.

Additionally, in July GAC Motor AION unveiled its Hyper GT intelligent coupe including an L2+ ADAS intelligent driver assistance system based on our CV22AQ.

Recently, the Chinese government passed a new policy allowing camera monitoring systems ("CMS") to replace conventional left and right side mirrors. The policy also covers interior rear view mirrors, with CMS-enabled models being legal beginning in July 2023. These CMS systems represent a significant opportunity for Ambarella's CV2 family of AI inference processors.

During the quarter BAIC, one of the largest automotive OEMs in China, began selling SUVs equipped with a CMS system based on our CV22AQ.

In the automotive after-market, Toyota introduced its wireless back-up camera system for trailers, based on our H32AQ video processor. The camera will be an option for Toyota's model year 2024 Sequoia and Tundra trucks.

Canopy, the startup resulting from Ford and ADT's 2022 joint venture, introduced its first product, the Canopy PickUp Cam. Based on our CV25 AI inference processor, the camera provides full HD recording, 180-degree field of view, person detection and reach-in detection for the bed of a pick-up.

In June, action camera maker Insta360 announced its Go3 camera, a lightweight but powerful 2K camera that utilizes our H22 video processor.

These representative engagements indicate a healthy pace of continuing customer design activity for our AI inference processors. Our investment strategy is aligned with the anticipated market demand for more sophisticated, software intensive, AI inference applications. In the last 3 years, thanks to the CV2 family, we have demonstrated the ability to capture more value per win as customer demand migrates to AI from video processors. Looking forward, we believe our newer products, such as CV5, CV72 and CV3 are well positioned to support the increasingly sophisticated AI inference workloads our customers are anticipating. As these new products ramp, and as we also capture more software value, we anticipate our blended ASP will continue to rise.

While actively managing expenses through the current market turmoil, we will continue to drive our strategic R&D investments to fully realize the AI inference market opportunities we have discussed today.

Brian will now discuss the Q2 results and the outlook in more detail.

Brian White, CFO

Thanks Fermi. I'll review the financial highlights for the second quarter of fiscal year 2024 and provide a financial outlook for our third quarter ending October 31, 2023.

I will be discussing non-GAAP results and ask that you refer to today's press release for a detailed reconciliation of GAAP to non-GAAP results. For non-GAAP reporting, we have eliminated stock-based compensation expense and acquisition related costs, adjusted for the impact of taxes.

For fiscal Q2, revenue was \$62.1 million, in line with the mid-point of our prior guidance range, flat to the prior quarter and down 23% year-over-year. Sequentially, IOT revenue was up slightly, while Automotive revenue was down slightly.

Non-GAAP gross margin for fiscal Q2 was 64.6%, at the high end of our prior guidance range.

Non-GAAP operating expense was \$46 million, below our prior guidance range of \$48 to \$50 million, driven by continued expense management and the timing of spending between quarters. We remain on track to our internal product development milestones.

Q2 net interest and other income was \$700 thousand and our non-GAAP tax provision was \$800 thousand.

We reported a Non-GAAP net loss of \$6 million or a \$0.15 loss per diluted share, equal to the prior quarter.

Now I'll turn to our Balance Sheet and Cash Flow.

Fiscal Q2 cash and marketable securities decreased \$10.9 million to \$216.5 million. DSO was relatively flat at 45 days, while inventory declined from 151 to 147 days, down \$6.5 million from the prior quarter. Cash used in operations was \$6.8 million and capital expenditures for tangible and intangible assets were \$5.4 million. Free cash flow, defined as cash from operations less CAPEX, was -20% of revenue for the quarter and positive 4% on a trailing twelve-month basis.

We had 2 logistics and ODM companies represent 10% or more of our revenue in Q2. WT Microelectronics, a fulfillment partner in Taiwan that ships to multiple customers in Asia, came in at 54% of revenue. Chicony an ODM who manufactures for multiple IoT customers was 14% of revenue.

I will now discuss the outlook for the third quarter of fiscal year 2024:

The near-term revenue outlook is challenging. Customer inventory management actions have accelerated and pockets of end-demand softening have appeared. Considering these factors, we estimate that our fiscal Q3 revenue will decline to approximately \$50 million, plus or minus 4%, driven by our IOT end market. At this time, we anticipate that this revenue range could continue into our fiscal Q4, with sequential revenue growth resuming in our fiscal Q1.

We expect fiscal Q3 Non-GAAP gross margin to be in the range of 62% to 64%.

We expect non-GAAP OPEX in the third quarter to be in the range of \$46 to \$49 million, with the increase compared to Q2 driven by higher R&D tied to new product development activities.

We estimate net interest income to be approximately \$1 million, our non-GAAP tax expense to be approximately \$700 thousand and our diluted share count to be approximately 40.1 million shares.

Ambarella will be participating in Evercore's Semiconductor Conference on September 6th, the Asia Investor Conference on September 12th hosted by NASDAQ and Morgan Stanley, Bank of America's Future Car Series on September 28th, and the Mobility Conference hosted by UBS on October 2nd. Please contact us for more details.

Thank you for joining our call today, and with that, I will turn the call over to the operator for questions.

Q&A

Dr. Fermi Wang, President & CEO

We appreciate your interest and support, I look forward to seeing you at one of our upcoming events, goodbye.