

Q2 FY2022 (July 31, 2021) earnings call script for August 31, 2021 1:30PM PST

Louis Gerhardy, Corporate Development & Investor Relations

Good afternoon and thank you for joining our second quarter, fiscal year 2022, financial results conference call for the three months ending July 31, 2021. With me on the call today is Dr. Fermi Wang, President and CEO, and Casey Eichler, CFO.

The primary purpose of today's call is to provide you with information regarding the results for the second quarter of our fiscal year 2022. 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 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 business operations and financial results, are more fully described in the documents that we file with the SEC, including the Annual Report on Form 10-K filed on March 31, 2021 for fiscal year 2021 ending January 31, 2021 and the form 10-Q filed on June 8, 2021 for the first quarter of the fiscal year 2022.

Access to our second quarter fiscal 2022 results press release, historical results, SEC filings, a transcript of our prepared remarks and a replay of today's call can be found on the Investor Relations portion of our website.

We will now have a business update from Fermi, I will review the financial results and then Fermi, Casey and I will be available for your questions.

With that I will turn it over to Dr. Fermi Wang...

Dr. Fermi Wang, President & CEO

Good afternoon and thank you for joining us.

We are pleased to report significant market and financial momentum as our AIoT¹ transformation continues to play-out.

¹*AIoT refers to Artificial Intelligence enabled Internet of Things hardware*

Q2 revenue was above the high end of our guidance, up 13% sequentially and 58% on a year-over-year basis. Our Q3 outlook is also well above the consensus estimate, led by computer vision (CV) new product cycles in existing markets as well as our penetration into entirely new markets. CV continues to drive our blended ASP higher, and the positive operating leverage inherent in our model was apparent with non GAAP operating margins increasing 450 basis points, sequentially, reaching 16.9%.

Cyclical forces continued to constrain our performance. Wafer supply from Samsung's Austin, Texas wafer fab, following the Texas freeze earlier in the year, reached a low point in Q2. While we are seeing a recovery from this Texas fab, and expect the recovery to continue in the 2H, we do not anticipate a material improvement in the industry-wide supply chain challenges.

CV momentum continues to rapidly build. Since introducing our CV SoC family to the market we have had more than 240 unique customers purchase engineering parts and/or development systems, with almost 60 unique customers achieving production status in the 1H of this year

Even at this early stage of our transformation, we are realizing a revenue mix that is of higher quality and with more diversification. A majority of our revenue is now driven by enterprise capex, public infrastructure spending and consumer durable good investments. For example, our Automotive and IoT camera business, mostly security cameras today, both decisively achieved record quarterly revenue levels, while our non-focus Other revenue, mostly discretionary consumer leisure goods, represented 10% of revenue, a record low.

I will now update you on our target market progress.

In June we announced the expansion of our AI vision SoC portfolio with the introduction of our new CV5S and CV52S SoCs. Based on the CVflow[®] architecture, the 5nm SoCs target IoT security applications with Linux OS, a new SDK including multi-imager and smaller form factors. These new SoCs cameras support applications requiring 360 degree coverage, long range viewing, and advanced encoding and AI performance to more accurately identify individuals or objects in a scene. During the quarter, 8 weeks after receiving first silicon, we shipped our first CV5S development systems and software developer's kits to customers. This is a significant accomplishment at such an advanced node, and I'm thankful for the strong execution from our hardware and software teams that made this happen.

Also in June, in advance of the annual ISC-West trade show in Las Vegas, we held a virtual event that was attended by over 50 leading customers worldwide. The event featured over twenty demonstrations, including a first look at the new CV5s in a multi-imager system, and our latest access control reference design based on our continuing partnership with Lumentum and ON Semiconductor. We have already secured multiple design wins for the new CV5S as well as new customers in the access control market.

Motorola Solutions has become one of our largest customers, and we were pleased to see they acquired Openpath, a technology leader in access control systems, further validating the significant opportunity in this growing market segment. Motorola's video security portfolio now includes IP-camera makers Avigilon, Pelco and IndigoVision, as well as Edesix, a UK-based police body worn camera supplier and Watchguard, a supplier of police vehicle cameras. All of these companies are Ambarella customers.

Ambarella's CVflow AI Vision SoCs continue to gain share in the professional IoT security camera market, with most major manufacturers having chosen our CV SoCs. During the quarter, European giant Bosch introduced its first three families of cameras based on Ambarella's CV SoCs. Bosch introduced the 5000i based on our CV22 and the 7000i and 8000i based on our CV2 SoCs. By winning these 3 major platforms at Bosch, the scalability of our CV SoC portfolio is demonstrated.

In addition to our SoC share gains in professional security outside of China, last quarter we spoke about opportunities to gain market share within China, and we announced 2 new customers. Today we are announcing 2 additional customers, Milesight and FSAN.

First, Milesight introduced its CV25-based AI-Pro-Bullet Network Camera family, available in 2, 5 and 8MP versions and including advanced analytics, people counting, face detection and ultra-low light operation.

Second, FSAN introduced a non-contact facial recognition temperature measurement system based on our CV28M SoC. The tablet device can recognize people with masks on and uses dual sensors.

Also during the quarter Canada-based March Networks, introduced its new VA Series IP Cameras based on our CVflow AI vision processors. Our chipsets make them fully compliant with the U.S. National Defense Authorization Act, or NDAA, and power the cameras' advanced video analytics.

Turning to the automotive market, , we continue to make progress in the fleet management market due to the efficiency of our CV SoCs as well as the advantages of our “open platform”, which allows OEMs and tier 1s to create differentiated, multi-functional products. Last quarter we announced four examples from the Shanghai auto show, and this quarter we are pleased to announce three additional wins, KeepTruckin, Yandex and Solera.

Earlier in August, fleet management leader KeepTruckin announced it was partnering with Ambarella to deliver its new AI Dashcam for Front ADAS, Driver Monitoring and Telematics. The AI Dashcam uses a single CV22 SoC to simultaneously provide AI and image processing for its dual-camera system, which integrates one camera for the front ADAS with incident recording, and a second RGB-IR camera for the driver-monitoring system (DMS) with recording.

This morning we announced Yandex, a major internet service and product company, introduced its SignalQ2 driver monitoring camera for its ride-hailing partners, powered by Ambarella’s CV25 SoC. The Yandex DMS camera will be deployed across the Yandex Taxi partner fleet, which consists of over 700,000 vehicles starting in 2022, and is also being offered to other delivery fleet van companies.

Also during the quarter, Solera's Omnitracs division announced its next generation fleet solution using SmartDrive technology with our CV25 SoC. This combo system simultaneously processes data from two sensors, Monochrome and RGBI, to enable DMS and recording functionality.

In the passenger vehicle OEM market, Chinese car maker Dongfeng introduced its new Aeolus Max car featuring a driver monitoring camera based on Ambarella's CV25AQ processor.

With this market progress you can see we are winning because of our efficiency, both in terms of performance-per-Watt and performance-per dollar, and our open platform and flexible architecture, which allow our customers to capture software value and introduce differentiated, often multi-featured, combination, systems.

In conclusion, we are leading a significant shift in how cameras are used, and providing the corresponding step-function increase in processing performance. In addition to human viewing, now, all through the lens of a camera, data can be collected and then processed in our SoCs, enabling new levels of safety, security and efficiency through partial or complete levels of automation across multiple industries. This processing we provide is occurring in purpose built IoT edge-endpoints, not in servers where fundamentally different, and more expensive, SoC architectures are used.

The global economic picture is strong. New stimulus programs are in the works, like the Infrastructure Bill in the U.S.. Supply-side cyclical dynamics are extended. But to be clear, the inflection you are seeing with Ambarella, what gets us most excited, is how we are driving AI into numerous IoT endpoint verticals and how we are demonstrating we can capitalize on these tremendous growth opportunities to drive shareholder returns. The demand for deep learning in AIoT endpoints is a new and critical phase of the digital transformation that is just beginning to impact so many verticals.

Our confidence in our long-term prospects is high. We expect to achieve record revenue in F22, ahead of the \$316M reached in F16, and we remain comfortable that CV revenue will be at least 25% of total revenue for the year.

Before we get into the financials, I would like you to mark your calendars for our Capital Markets Day we plan to host at our Las Vegas, CES location on Tuesday afternoon, January 4th. This event will allow us to more thoroughly discuss the inflection we are seeing and provide a corporate strategy update.

With that, I will ask Louis to review the Q2 financials and provide a Q3 outlook.

Louis Gerhardy, Corporate Development & Investor Relations

I will now review the financial highlights for the second quarter of F22 ending July 31st and provide a financial outlook for our third quarter of F22 ending October 31st.

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 adjusted for the impact of taxes.

In Q2 the industry wide supply chain challenges remained significant, and in this period we believe we experienced the worst of the wafer shortfall from the Texas freeze, as previously forecast. However our operations team and manufacturing partners worked diligently to support the strong and broad based demand, and they successfully minimized disruptions for our customers.

Our revenue of \$79.3 million was 5% above the high-end of our guidance, representing a sequential increase of 13% from Q1 and a 58% increase from the year ago quarter.

Automotive revenue increased about 10% sequentially, security grew more than 20% sequentially, and “Other” product revenue was down more than 20% sequentially.

Non-GAAP gross margin for Q2 was 62.8%, slightly below the 62.9% in the preceding quarter.

We incurred some higher costs to manage the supply-chain challenges, but the pricing environment and mix remained relatively stable, sustaining gross margin above the high-end of our long term model.

Non-GAAP operating expense for the second quarter was \$36.4 million, compared to \$35.4 million for the previous quarter. OPEX was slightly below the midpoint of our guidance as G&A was lower than forecast.

We continued to demonstrate strong positive operating leverage, with operating margin on a non-GAAP basis up 450 basis points sequentially, reaching 16.9%, and up from 2.2% a year ago.

Other income of two hundred and eighteen thousand dollars reflects the low interest rate environment.

The Non-GAAP net income for Q2 was \$13.1 million, or \$0.35 per diluted share compared with non-GAAP net income of \$8.9 million, or \$0.23 per share in the first quarter. In the second quarter the non-GAAP earnings per share were based on 38 million diluted shares.

Total headcount at the end of the second quarter was 827, up 9% from a year ago, with about 81% of employees dedicated to engineering. Approximately 68% of our total headcount is located in Asia.

Total accounts receivable at the end of Q2 were \$38.3 million or 44 days sales outstanding, versus \$34.5 million or 44 days sales outstanding at the end of the prior quarter.

Net inventory at the end of the second quarter was \$42.1 million compared to \$33.1 million at the end of the previous quarter. Days of inventory increased to 115 in Q2 from 102 the prior quarter. On a sequential basis, work-in-progress was up sequentially to support the rising demand, while finished good inventory was down and at 2 year lows.

In Q2 our operating cash flow was a positive \$14.4 million, or 18.2% of revenue, versus an outflow of \$4.5 million the prior quarter. Cash and marketable securities were \$449.2 million, up from \$435.5 million at the end of the first quarter.

We had two 10% plus revenue customers in Q2. WT Microelectronics, a fulfillment partner in Taiwan who ships to multiple customers in Asia, represented 62% of revenue and Chicony, a Taiwanese ODM who manufacturers for multiple customers, was 16% of revenue. Dahua and Hikvision, combined, represented a high single digit portion of revenue.

I will now discuss the outlook for the third quarter of fiscal 2022:

During the 2H of the year, we expect output from Samsung's Austin, Texas, wafer fab to continue to recover from the February freeze. Nevertheless, we continue to experience a variety of industry-wide supply chain challenges. While extended lead times for wafers and substrates persists, our outlook is also constrained by the shortages of other company's components on our customers' bills-of-material.

Based on these factors and our best judgement at the current time, we expect total revenue for the third quarter ending October 31, 2021 to be in the range of \$88 million to \$92 million. Revenue from automotive and IoT cameras, primarily security, is expected to increase about 10% sequentially. Other revenue, off a low base, is expected to have a seasonally strong quarter, but still down on a year-over-year basis.

We estimate Q3 non-GAAP gross margin to be between 61.0% and 63.0% compared to 62.8% in the second quarter. While we are seeing some higher costs to manage the supply chain, a healthy mix and a relatively stable pricing environment may cause our gross margin, in the short-term, to temporarily exceed the high-end of our long-term model of 59% to 62%.

We expect non-GAAP OPEX in the third quarter to be between \$36.0 and \$37.5 million

The Q3 non-GAAP tax rate should be modeled in the 3% to 6% range.

We estimate our diluted share count for Q3 to be approximately 38.3 million shares.

Ambarella will be participating in the Jefferies 1x1 Conference tomorrow, September 1st, Credit Suisse's Asian Technology Conference on September 7th, Deutsche Bank and Colliers Conferences, both on September 9th, Evercore Autotech & AI Forum on September 21st and Berenberg's CEO Conference in New York on November 9th. And as Fermi noted, please mark your calendar for our Capital Markets Day on January 4th at our CES location in Las Vegas.

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

Q&A Participants

Dr Fermi Wang, President and CEO

Casey Eichler, CFO

Louis Gerhardy, Corporate Development & Investor Relations

Dr. Fermi Wang, President & CEO

I'm very proud of what our employees have achieved in the face of so many different challenges in recent years. I'm convinced years from now we will all look back at F22 as a major inflection point for Ambarella, and we are excited about our future. Thank you and good-bye for now.