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Q3 Fiscal 2024 (October 31, 2023) earnings call script

Louis Gerhardy, VP Corporate Development

Good afternoon and thank you for joining our third quarter Fiscal year 2024, financial results conference call. On the call with me today is Dr. Fermi Wang, President and CEO, Brian White, CFO and John Young, VP Finance.

The primary purpose of today's call is to provide you with information regarding the results for our third 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 third 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.   In a challenging market our Fiscal Q3 revenue was slightly above the mid point of our guidance.   Our business appears to be in the process of stabilizing as our customers seem to be making progress with their inventory management efforts. We expect our customers to emerge from the cyclical downturn at different times throughout the next year, and considering all the dynamics at this time, we continue to anticipate we will return to growth in Fiscal 2025.

We remain determined and focused on our strategic R&D priorities for the introduction of a portfolio of AI SoCs and software targeting more sophisticated AI inference workloads.   Our confidence in the secular growth opportunity for inference AI processors and software remains high, and our long-term serviceable market opportunity (or SAM) compounded annual growth rate (CAGR) estimate has not changed.

Our CV2 family of SoCs is expected to lead us out of the cyclical downturn and represent a larger proportion of our total revenue in Fiscal 2025. As a reminder, this product family established Ambarella in the AI inference market and these SoCs are expected to approach 60% of our total revenue in Fiscal 2024. In a single chip, the CV2 products typically provide both the video processing and AI inference processing for 1 or more cameras. The average selling price of these products is close to $20, with a range below $10 to above $50.

In particular, I want to point out that CV5, the flagship of the CV2 family and Ambarella's first 5nm SoC, is forecasted to generate meaningful revenue next year with more than 10 customers in production.

Our CV3 platform is expected to generate production revenue from the automotive market in calendar year 2026 and beyond. The CV3 platform includes a family of SoCs and software, and we began to sample the CV3-AD SoC a year ago.

I am pleased to announce during Q3 we received the first silicon for CV3-AD685 SoC, the flagship of our CV3 portfolio, and we are in the midst of a successful bring-up of this extremely sophisticated 10 billion plus transistor SoC. We expect to deliver engineering samples to customers in Q1 next year, and we are on track, through the previously announced award from Continental, for the first OEM start-of-production in calendar 2027.

CV3 SoCs are based on our 3rd generation of AI inference technology and serve significantly more challenging AI inference workloads such as partial or complete autonomy in vehicles. In addition to providing, in a single SoC, the perception processing for multiple camera inputs, CV3 SoCs for the first time enable centralized processing of raw radar data as well as deep low level fusion with data from other sensing modalities. The CV3 family of SoCs range in price from $50 to more than $400 per SoC.

There are two additional elements of our CV3 platform, both of which are software. This includes Oculii adaptive AI radar perception software and our complete autonomous driving software stack, both optimized to run on CV3. Since November 2023 we have been providing demo rides to OEMs and T1s, based on CV3 SoCs and our autonomous driving stack with centralized radar processing, low level fusion and the Oculii radar perception software. We will be demonstrating this at the upcoming CES.

I would like to provide an update on our GenAI plans. During the last quarter, with the implementation of new LLM software building blocks on CV3-AD, we have now successfully demonstrated inference running Llama2-13B, with the SoC using LPDDR5 memory (instead of high bandwidth memory) and operating at a fraction of the power consumption of incumbent solutions.

Some of our existing customers are evaluating how they will implement GenAI and large language models (LLMs) at the edge of their networks. With our successful LLM demo and additional analysis, we have concluded the powerful and highly efficient AI inference processor embedded in our CV3 SoCs is well suited for these edge markets. We will have more updates on our strategy at CES2024.

Once a year we update our automotive funnel, which is meant to be a reference for our automotive customer engagements over the next six years. We completed the funnel update in November, and it increased 4% from $2.3 billion to $2.4 billion. The funnel is comprised of "won" business of about $800 million and "pipeline" of about $1.6 billion. With our automotive business expected to generate about $80 million in revenue this year, the $2.4 billion six-year funnel is an indication of the strong growth we anticipate from the auto market. There were a significant number of upward and downward revisions in the funnel calculation this year, including forecast changes and project delays from both Tier 1s and OEMs, projects won or lost in the pipeline and the addition of new projects. CV3 represents a large portion of the current funnel, even though CV3 revenue is not expected to commence until calendar 2026.

I will now discuss representative customer engagements in the quarter.

In automotive, we are continuing to win new designs in China, the world's largest automotive market. The open architecture of our CVflow AI SoCs enables leading Chinese tier 1's and ADAS software providers to develop highly differentiated, fully featured solutions.

During the quarter, GAC introduced four new passenger car models incorporating Ambarella's

CV22AQ automotive SoCs in intelligent ADAS systems. These include the GAC Trumpchi E8 and

ES9, the AION Hyper HT and the AION S Max.

Hycan introduced its V09 mini-van with an ADAS system also based on our CV22AQ.

And SAIC introduced its Maxus Dajia 7 minivan including a camera monitoring system,

replacing left and right mirrors and based on our CV22FS functional safety SoC.

In the automotive aftermarket, Asian market leader Thinkware introduced its QXD1 DVR based

on our CV25A AI SoC and the F200Pro 2-channel DVR based on our A12A SoC.

And European market leader Nextbase introduced its IQ Smart Dash Cam product line using

our CV22 automotive SoCs, featuring 4K resolution and advanced AI-based threat detection.

In the enterprise security market, a number of leading manufacturers introduced new cameras

based on our flagship 5nm CV5 and CV52 families.

Motorola introduced its new H6A product line featuring AI-based video analytics and up to

8MP resolution based on our CV52 AI processors.

Japanese market leader iPro announced its new X series featuring a total of 9 models spanning box, indoor dome and outdoor dome models up to 8MP based on our CV52 SoCs.

Korean market leader Hanwha introduced its C34404 multi-directional outdoor camera based on our CV5 SoC.

Also during the quarter, Verkada introduced its CP52 E pan tilt zoom camera based on our CV22 SoC, offering camera operators dynamic coverage of wide areas and featuring 5MP resolution and 28X optical zoom.

And Germany's IDS introduced its first Ambarella-based camera, the NXT Malibu, for live imaging analysis based on our CV22 AI SoCs.

In the smart home segment, Signify, the Philips lighting spin-off known for its Hue lighting products announced its Philips Hue Secure cameras. Based on our CV AI SoCs, the cameras can work with Hue lights to control lighting and sound alarms to deter intruders.

Also during the quarter, Ecobee, a leading home automation company, announced its Smart Doorbell Cameras, based on our CV28 AI SoCs.

In November Insta360 introduced its Ace Pro and Ace action cameras based on our CV5 and CV52 AI SoCs. The Ace Pro is the first 8K consumer action camera and both cameras include advanced AI features such as neural network-based noise reduction, 48MP computational photography, voice and gesture control and automatic video editing.

Collectively, you can see overall design activity is healthy across 13 different representiatve customers for 17 different projects; 9 in auto and 8 in IoT. Furthermore, 16 of the 17 representative engagements utilize our higher value AI SoCs. You can also see we are successfully implementing more sophisticated AI workloads in our SoCs, as highlighted with the identification of four different CV5 customer engagements.   Looking forward, we believe our newer products, such as CV5, CV72 and CV3 are well positioned to support increasingly sophisticated AI inference workloads. As these new products ramp, and as we also capture more software value, we believe we can capture more value per design win.

I would like to give an update on changes to our management team we previously announced

on October 18, 2023. Brian White will retire from his role as CFO at the conclusion of the

current Fiscal year ending January 31, 2024. I want to thank Brian for his contributions to the

company, including helping navigate the challenging inventory correction the semiconductor

industry is currently experiencing, as well as continuing to strengthen our financial team and

position us for success as we continue our transition into larger markets. I'm also pleased to

announce that John Young, currently our VP of Finance, will assume the role of CFO on

February 1, 2024. John has been with Ambarella for more than six years, serving in a variety of

finance and accounting roles, and we are confident he will continue to be a valuable

contributor as we seek to drive our transformation forward and grow shareholder value.

I will now hand it over to Brian to discuss the Q3 results and the outlook in more detail.

Brian White, CFO

Thanks Fermi. Before I begin, I'd like to thank Fermi and the board for the opportunity I've

had to be a part of the special team here at Ambarella. The timing of my upcoming transition

is facilitated by the progress we've made in developing the people, processes and tools to

support Ambarella at the next levels of growth and profitability. I have complete confidence in

John's ability to take over as CFO and the team he has to support him. I look forward to their ongoing success.

I'll now review the financial highlights for our third Fiscal quarter and provide a financial outlook for our fourth quarter ending January 31, 2024. I'll 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 along with acquisition related and restructuring costs, adjusted for the impact of taxes.

For Fiscal Q3, revenue was $50.6 million, slightly above the mid-point of our prior guidance range, down 19% to the prior quarter and down 39% year-over-year. As expected, the sequential decline in revenue was driven primarily by our IOT end market.

Non-GAAP gross margin for Fiscal Q3 was 62.6%, in line with our prior guidance range.

Non-GAAP operating expense was $44.1 million, down $1.9M from the prior quarter and below our prior guidance range of $46 to $49 million, driven by continued expense

management and the timing of spending between quarters. We remain on track to our

internal product development milestones.

Q3 net interest and other income was $1.9 million and our non-GAAP tax provision was

approximately $650 thousand. We reported a Non-GAAP net loss of $11 million or a $0.28 loss

per diluted share. Non-GAAP EPS was $0.11 better than the implied mid-point of our prior

guidance driven primarily by lower operating expenses.

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

Fiscal Q3 cash and marketable securities increased $5.8 million to $222.3 million. DSO

improved from 45 days in the prior quarter to 42 days, while days sales of inventory improved

from 147 to 145 days, down $4 million from the prior quarter. Cash from operations was $7.9

million and capital expenditures for tangible and intangible assets were $2.4 million. Free cash

flow, defined as cash from operations less CAPEX, was 11% of revenue for the quarter and 6%

on a trailing twelve-month basis.

We had three logistics and ODM companies represent 10% or more of our revenue in Q3. 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 12% of revenue and Hakuto, a logistics partner who primarily supplies multiple automotive customers in Japan was also 12% of revenue.

I'll now discuss the outlook for the fourth quarter of Fiscal year 2024:

The near-term revenue outlook appears to be stabilizing. While customers continue to manage their inventory levels and some pockets of end-demand softness persist, ordering patterns and customer feedback suggest that our revenue is leveling out and likely to resume growth in our next Fiscal year.

For Fiscal Q4, we estimate that our total revenue will be in the range of $50 to $53 million, with IOT up slightly and Automotive about flat. At this time, we anticipate that sequential revenue growth could continue into our Fiscal Q1, in the low to mid-single-digit percentage range.

We expect Fiscal Q4 Non-GAAP gross margin to be in the range of 62% to 63%. We expect non-GAAP OPEX in the fourth quarter to be in the range of $45 to $48 million, with the

increase compared to Q3 driven by CES marketing activities, R&D tied to new product development activities and less favorable foreign exchange impacts.

We estimate net interest income to be approximately $1.5 million, our non-GAAP tax expense to be approximately $600 thousand and our diluted share count to be approximately 40.4 million shares.

Ambarella will be participating in a fireside chat and hosting 1x1 and group meetings on December 5th and 6th at NASDAQ's and Morgan Stanley's London Conference. We will also be participating in Nomura's CES 1x1 conference in Las Vegas on Monday, January 8th. We expect to host more than 20 investor groups during our CES2024 exhibition from January 9th to January 12th. Please contact sell-side analysts to make reservations. We will also present and host 1x1 and group meetings at the Needham conference on January 17th in New York. 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 the support and interest from all of our stakeholders and prospective investors.

I look forward to seeing you at our CES exhibition or one of our other upcoming events, goodbye.