

**Power Integrations Second Quarter 2024 Earnings Call – August 6, 2024**  
***Corrected Transcript***

**Joe Shiffler** - Power Integrations Inc - Director - Investor Relations

Thank you, Beau. Good afternoon, everyone. Thanks for joining us. With me on the call today are Balu Balakrishnan, Chairman and CEO of Power Integrations; and Sandeep Nayyar, our Chief Financial Officer. During this call, we will refer to financial measures not calculated according to GAAP. Non-GAAP measures exclude stock-based compensation expenses, amortization of acquisition-related intangible assets, and the tax effects of these items. A reconciliation of non-GAAP measures to our GAAP results is included in today's press release. Our discussion today, including the Q&A session, will include forward-looking statements denoted by words like will, would, believe, should, expect, outlook, forecast, estimate, anticipate and similar expressions that look toward future events or performance. Such statements are subject to risks and uncertainties that may cause actual results to differ materially from those projected or implied. Such risks are discussed in today's press release and in our most recent Form 10-K filed with the SEC on February 12, 2024. This call is the property of Power Integrations, and any recording or rebroadcast is expressly prohibited without the written consent of Power Integrations. Now, I'll turn it over to Balu.

**Balu Balakrishnan** - Power Integrations Inc – Chairman and CEO

Thank you, Joe, and good afternoon. As expected, Q2 marked the beginning of our recovery, with revenues up 16% sequentially and another increase expected in the third quarter. Like many of our peers, our near-term outlook reflects limited visibility and challenging macro conditions. Customers are behaving cautiously and our short lead times enable customers to order products only when needed. All these factors make the slope of recovery highly uncertain.

Nevertheless, inventory-related headwinds have lessened considerably, clearing the way for a rebound off the bottom. We consider seven to eight weeks a desirable range for channel inventory, and while pockets of excess remain at few distributors, we ended June at 7.8 weeks overall. That's down a week from the prior quarter and well below the peak of 13.6 weeks in Q3 of 2022.

The recovery is being led by our consumer category, where revenues are up 70% over the past two quarters, after falling all the way back to 2009 levels in Q4 of last year. Just as the supply chain had bulked up on inventory after the shortages of the prior year, demand for appliances fell sharply due to a confluence of factors, including the collapse of China real estate and, more broadly, higher interest rates, slower home sales, and the hangover from the accelerated purchases during the COVID times. The resulting correction had an outsized impact on Power Integrations, with about a third of our revenue coming from the appliance market in 2022. As often happens, the supply chain overcorrected, drawing inventories down to unsustainable levels and then replenishing throughout the first half of the year.

Looking ahead, appliance demand remains soft, and we expect seasonally lower air conditioning sales in the September quarter. However, we have continued to win market share and grow our dollar content in appliances through the downturn, and we look forward to the fundamental strength of our consumer business coming back to the forefront now that cyclical factors are no longer dominant.

Power Integrations is number one in the world in appliance power supplies thanks to the reliability and energy efficiency benefits of our products. As the market leader, we have the inside track on incremental content from the additional features such as connectivity, displays and LED lighting, even as designers work to meet tighter efficiency standards, such as new EU limits on standby power supply. These conflicting design challenges are driving greater adoption of higher-performance, higher-value products such as our GaN-based InnoSwitch and InnoMux-2 products and our BridgeSwitch motor-driver ICs.

In June, we introduced BridgeSwitch-2, raising our addressable power range for BLDC motors to one horsepower. The expanded power range encompasses applications such as washing machine drums, heat

pumps for cloth dryers and kitchen mixers and blenders, and doubles our addressable market for motor drive to \$1 billion. BridgeSwitch-2 is the most efficient BLDC driver solution available with standby consumption of less than 10 milliwatts and inverter efficiency up to 99%, which eliminates the need for heat sinks.

We have received our first purchase orders for our BridgeSwitch-2 in recent weeks, including two from air conditioning customers in China and another for a dishwasher pump at a major European appliance OEM. We also continue to win new programs with the first generation BridgeSwitch with the recent wins, including a range hood fan for the India market.

We are equally excited about the market reception for InnoMux-2, which we introduced in March. InnoMux-2 is a new architecture for products with multiple DC outputs, eliminating the need for separate DC-to-DC conversion stages by providing up to three independently-regulated DC outputs. This not only simplifies designs, but also increases efficiency by eliminating the compounded losses over multiple conversion stages. InnoMux-2 also incorporates our proprietary PowiGaN switches, further boosting efficiency.

Our first high-volume design began production earlier this quarter in a 24-inch monitor for a top tier PC OEM. And we have a range of designs in progress across the computing, TV and appliance markets.

We also won a wide range of designs in Q2 with our GaN, InnoSwitch and HiperPFS products, including multi-port USB PD chargers ranging from 65 to 140 watts at brands like Anker, UGREEN, and G-Power. OEM notebook design wins and India's 5G fixed wireless rollout should also contribute meaningful revenues next year. Overall, we expect 2025 to be an inflection point in the growth of GaN, reflecting the continued migration of our product portfolio from silicon to GaN as well as broader customer awareness and adoption across all end markets.

This includes a notable uptick in opportunities for GaN products at industrial customers, reflecting greater awareness of GaN in general and our highly integrated products in particular. Because of the relatively low volumes over which their engineering costs are spread, industrial customers value ease of design and are less inclined to devote resources to solving the challenges of discrete GaN solutions. We strip away the complexity from the customer's perspective by incorporating PowiGaN switches into our system-level products, so the customer doesn't have to invest the time learning about GaN to take advantage of its superior performance.

Our 900 and 1,250 volt GaN InnoSwitch products are especially well-suited for industrial applications such as utility meters, which are directly connected to the grid and highly exposed to surges and spikes, especially in markets like India, where the grid voltages fluctuate widely. We have a leading position in the India metering market, and we are encouraged by the level of interest in higher-voltage GaN products as India proceeds with its plan to deploy 250 million new meters over the next several years.

Automotive customers also value the ease of use, reliability, efficiency, and space savings of our products, including our higher voltage GaN ICs. We expect to be in production with about 20 electric vehicle OEMs by the end of this year and at least 10 more slated to begin production next year. We are adding dozens of design opportunities to our funnel every quarter with a range of applications, including emergency power supplies, 12-volt battery replacement, micro DC-to-DC converters and compressors for battery and cabin cooling.

We believe automotive will be a \$1 billion addressable market in the years ahead, with the potential to go much higher as we develop high current GaN technology to address higher power levels. On July 1, we closed our acquisition of the assets of Odyssey Semiconductor, adding expertise in vertical GaN technology, which supports much higher current than today's lateral devices. The acquisition also includes a clean room to enable quick turnaround of wafers and significantly shorten overall development time.

While success is not guaranteed, we believe we can achieve the necessary breakthroughs to make high-power GaN a reality in the next three to five years and ultimately to introduce GaN products that compete with silicon carbide in high-power applications such as EV drivetrain inverters. We are excited to have the Odyssey team on board to support those efforts.

With that, I'll turn it over to Sandeep for a review of the financials.

**Sandeep Nayyar** - Power Integrations Inc - Chief Financial Officer, Vice President - Finance

Thanks, Balu, and good afternoon. Our Q2 results are straightforward, so I will just quickly recap the numbers and the outlook, and then we will open it up for questions. As usual, I will focus my remarks on the non-GAAP results, which are reconciled to GAAP in our press release.

Second-quarter revenues were \$106 million, just above the midpoint of our guidance, while non-GAAP earnings were \$0.28 per diluted share, above the level implied in our guidance as we came in slightly better on both gross margin and operating expenses. Revenues were up 16% compared to the prior quarter with increases in all four end market categories.

Consumer, our largest category, was up high-teens sequentially. We saw strength across the board in major and small appliances as well as air conditioning, which typically reaches a seasonal peak in the June quarter.

In the industrial category, channel inventory remains slightly elevated but continued its gradual improvement in Q2. Revenue was up mid-single digits sequentially, driven by improved inventories as well as design wins across a range of applications, including metering, where we are seeing growth in India, as Balu noted.

The computer category was up more than 40% sequentially, driven largely by tablets as a key end customer has worked through excess inventory. We also saw strength in aftermarket notebook chargers and in monitors. The communication category was up 10% sequentially, driven by the clearance of inventory at a key handset customer.

Revenue mix for the quarter was 42% consumer, 33% industrial, 14% computer, and 11% communication. As Balu noted, distribution inventory ended the quarter at 7.8 weeks, down a full week from the prior quarter as sell-through once again exceeded sell-in. In terms of dollar value, channel inventory reached its lowest level in three years.

Non-GAAP gross margin for the second quarter was 54.1%, up more than a percentage point from the prior quarter, driven by the favorable dollar-yen exchange rate and higher back-end manufacturing volumes. We are projecting another sequential improvement in Q3 as both these factors will continue to provide tailwinds.

Non-GAAP operating expenses for the quarter were \$44.2 million, up sequentially as expected, due mainly to annual salary increases, which took effect early in the quarter, and also due to headcount growth.

Non-GAAP earnings for the first quarter were \$0.28 per diluted share. Diluted share count for the quarter was 57 million, down slightly from the prior quarter, driven by repurchases. We used \$11 million for repurchases during the quarter, buying back 164,000 shares.

The other primary use of cash in the quarter was \$11 million for dividends with an additional \$4 million for CapEx. Cash flow from operations for the quarter was \$18 million.

Inventory days were 312 at quarter-end, down 37 days from the prior quarter. Going forward, I expect inventory days to glide downward in conjunction with the recovery in revenues.

Turning to the Q3 outlook, we expect revenues to be \$115 million, plus or minus \$5 million, a sequential increase of 8% at the midpoint. Non-GAAP gross margin should be between 54.5% and 55% with a sequential increase driven once again by higher manufacturing utilization and the yen. This puts us on course for a full-year gross margin north of 54%.

Non-GAAP operating expenses should be between \$44.5 million and \$45 million, up modestly from the second quarter, driven mainly by the addition of Odyssey. For the full year, non-GAAP OpEx is tracking towards an increase of about 5% versus the prior year. That's well below our original plan even with Odyssey adding about \$1.5 million of OpEx in the second half of the year.

Finally, I expect our Q3 effective tax rate to be approximately 4%.

And now, operator, let's begin the Q&A.

**David Williams** - Benchmark Company - Analyst

Thanks for letting me ask a question here. I guess, maybe just the first question is maybe around how you're seeing things geographically. And China seems to be getting better in certain segments. Just curious how you're seeing that. And just from some of your comments, didn't sound like maybe you're seeing that same thing, but just kind of curious how you're seeing that geography today.

**Balu Balakrishnan** - Power Integrations Inc - Chairman and CEO

In China, our biggest exposure is appliances. And as we mentioned, we are not seeing a pickup in demand. The inventory situation has pretty much cleared out. So we are now seeing the current demand, which is actually much lower than what we would have expected. However, thanks to design wins and also our increase in ASP due to higher power levels, we are seeing a growth that is above demand. And I think that will continue through the second half and next year. But I think the actual raw demand is essentially flat at this point because of all the challenges China has in terms of the real estate market.

Now the cell phone is a little bit different because there they've moved more to low-end phones. Huawei is doing better on the high end. Obviously, we can't supply to Huawei and they're taking share away from our customers on the higher end of the market. So that situation has not improved in China.

But if you look at our overall performance, our cell phone has been down more than 50% this year. But the rest of the market, based on our projections, our internal modeling for this year, will be up more than 15%. So we are doing really well everywhere else. The cell phone market, for reasons I mentioned, has shifted in China. We are doing very well outside of China.

**Sandeep Nayar** - Power Integrations Inc - CFO

And David, one more thing. Even in the high-power business in China, the infrastructure grid, projects have been delayed a bit. So that has also impacted, which is a reflection of what Balu is saying what is happening in China.

**Balu Balakrishnan** - Power Integrations Inc - Chairman and CEO

And I would add that, having said that, next year should be a very good growth for us because all of this will be out of the picture. The cell phone situation in China, I think, has stabilized at this point. And we should see a nice growth next year in all of the areas.

**David Williams** - Benchmark Company - Analyst

Great. Great color there. So I guess, secondly, just if you're thinking about how you're viewing the second half, obviously, it seems like things are a bit more tempered now than maybe last quarter when we were thinking about a stronger second half recovery. What do you think is different today than 90 days ago? Is it simply the macro deteriorating? Or are there other maybe push and pulls that are kind of coming in here? Is it really just about the macro? Thank you.

**Balu Balakrishnan** - Power Integrations Inc - Chairman and CEO

Actually, if you go back to our last call, what we said was that the inventory situation will come back to normal by the middle of this year. And that has pretty much happened. And we also said that we will grow in the second half, but we didn't know the slope of the growth because we don't -- we couldn't see the demand picture. The visibility is very poor.

So you're correct. I think the growth in the second half is less than I would have anticipated, but that was not visible to us in the last quarter. Even now, the visibility for Q4 is very, very low. People are ordering at the last minute because they can. We have lot of inventory. They are skittish about holding inventory after what has happened in the last couple of years. So they order when they need the parts. So that makes it very difficult to look into the rest of Q3 and Q4. So I would say your observation is correct.

**Matthew Ramsay** - TD Cowen - Analyst

Thank you very much. Good afternoon, everybody. A couple of things I wanted to hit on. I guess my first question, Balu, you guys mentioned in your prepared script lots of things about the movement of the end markets in the short term. But I think what caught my attention a little bit was your commentary about an inflection potentially for GaN across your end markets in 2025 and beyond.

So maybe you could unpack that a little bit, like what you're seeing with design wins that gives you that confidence? And then the second part, I guess, is what percentage of the business today is GaN? And if you look out two, three years, like where do you think that can get based on what you're seeing?

**Balu Balakrishnan** - Power Integrations Inc - Chairman and CEO

So we have mentioned multiple times that most of our new products will be using GaN and they have been using GaN. And we got the best -- first traction on cell phones because that has much shorter design cycles. What we are seeing now is the proliferation of GaN into all of the other markets. And it's driven by our new products like InnoMux-2, InnoGaN, higher-voltage InnoSwitch with GaN.

All of these are -- will be going into production over time. And we see an inflection point starting in 2025. So just to give you a rough idea, next year, our GaN revenue could grow as much as 50%. And we see the growth rate -- the slope of the growth rate shifting, starting in 2025. And it's pretty much expected and it's nice to see that it is happening right now.

As far as exact revenues, I would rather focus on what we have going for the future. And we think by 2028, GaN could be -- GaN revenue could be \$100 million in that range.

**Matthew Ramsay** - TD Cowen - Analyst

Got it. Really appreciate the color there. I guess my follow-up question, Sandeep, with a little bit of a historic last 72 hours with the yen, maybe you could just give us a few comments about sort of variability there and how it affects the model. Remind us of the sort of rule of thumb. And if there is currency fluctuations, is that something that hits sort of the manufacturing part of the business in the current quarter?

And how long would that take to show up in the P&L if there were sustained moves? Is that a quarter out? Is that two quarters out? Just trying to get a sense given when things manufacture versus when they sell.

**Sandeep Nayyar** - Power Integrations Inc - CFO

Yes. So, Matt, as we have said before, typically, in the past, the yen impact, a 10% change in yen would affect us about 120 basis points, give and take. And it would flow within six months into our P&L. But things have changed with the level of inventory we are carrying. And so if you look at what we are carrying today is significantly larger. As a result, it takes about three to four quarters for it before it flows into the P&L. So I think the big change that you saw recently, if it holds for a while, because as you know, it's not on a daily basis that we adjust. It's over a period of time; we have the yen -- what we call a yen-sharing arrangement with our manufacturing partners.

So my take is, with the level of inventory we are saying, if this change that happened recently holds, it'll probably impact us a little bit in the fourth quarter [of 2025] or maybe in Q1 of '26. So pretty much for next year, because of the level of inventory we have, the benefit of the yen will flow.

In fact, we still see, because the yen had depreciated all this while, from this year to next year, we will still have a little more benefit from yen in the P&L, but we'll have headwinds from input costs that we saw increasing this way. But we'll also get favorability into next year from mix if the cell phone -- the growth comes from non-cell phone areas.

So if you remember what we said on the analyst day, we had kept our model. What we had said is -- even when yen normalizes, which for us means it goes back to 120, we had said that the mix will go favorable, the yen will -- could become a headwind going ahead. But yet -- and the mix would go favorable, but we would still stay in the higher end of the model. And it's kind of playing out pretty much to what we said earlier.

Now the input costs continue to be a challenge, and at least from what we have got this year is, higher costs will impact the P&L next year. But having said all that, we still feel good even for next year that our margin will be at the high end of the model.

**Matthew Ramsay** - TD Cowen - Analyst

Fine. I think there is lot of moving pieces there, but I think we got most of them. So thanks, Sandeep. I appreciate that. Thanks, guys.

**Joe Shiffler** - Power Integrations Inc - Director - Investor Relations

All right. Well, it looks like we have no further questions. Shy group today, I guess. So we'll leave it there. Thanks, everybody, for dialing in today. And there will be a replay of this call available on our investor website, which is [investors.power.com](http://investors.power.com). Thanks again, and good afternoon.