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Teradyne
3Q24 Earnings Call Script
10/24/24

Traci Tsuchiguchi, VP Investor Relations: Thank you, operator. Good morning everyone and welcome to our discussion of Teradyne's most recent financial results. I'm joined this morning by our CEO Greg Smith, and our CFO Sanjay Mehta. Following our opening remarks, we'll provide details of our performance for the third quarter of 2024 and our outlook for the fourth quarter of 2024. The press release containing our third quarter results was issued last evening. We are providing slides as well as a copy of this earnings script on the investor page of the Teradyne website that may be helpful in following the discussion. Replays of this call will be available via the same page after the call ends.

The matters that we discuss today will include forward-looking statements that involve risk factors that could cause Teradyne's results to differ materially from management's current expectations. We caution listeners not to place undue reliance on any forward-looking statements included in this presentation. We encourage you to review the Safe Harbor statement contained in slides accompanying this presentation as well as the risk factors described in our Annual Report on Form 10-K filed with the SEC. Additionally, these forward-looking statements are made only as of today.

During today's call, we will refer to non-GAAP financial measures. We have posted additional information concerning these non-GAAP financial measures, including reconciliation to the most directly comparable GAAP financial measures, where available, on the investor page of our website. Looking ahead, between now and our next earnings call, Teradyne expects to participate in technology or industrial focused investor conferences hosted by RW Baird and UBS. Additionally, please note that we are planning to host a financial analyst meeting at our headquarters in North Reading, Massachusetts in the afternoon of March 11th, 2025.

Following Greg and Sanjay's comments this morning, we'll open up the call for questions. This call is scheduled for one hour.
Greg?

Greg Smith, CEO: Good morning, everyone and thanks for joining us. Today I will summarize our third quarter results and discuss the trends we are seeing in the semiconductor and advanced robotics industries. Sanjay will then provide more color on our third quarter results and forward-looking guidance.

Generally, the market dynamics that we identified in our July earnings call have continued through the third quarter. The on-going strength of Cloud AI is driving demand in both the SOC and memory test markets and our Semi Test business is performing above our expectations.

Within Semi Test, the memory business delivered record high revenue in the third quarter on strong HBM demand. Our SoC business was driven by networking and by Vertically Integrated Producers – or VIPs – who are designing silicon for their own use in cloud and edge AI applications.

Beyond Compute and Memory, we are beginning to see stabilization, and in some cases, modest levels of improvement in other Semi Test segments.
We are seeing utilization rates continue to tick higher as testers initially purchased for mobile are increasingly being upgraded to test Cloud AI compute devices.
By the beginning of 2024 our lead times had returned to normal and while customers are not generally providing forecasts beyond a quarter or two, which limits our visibility, we do expect a broader market recovery as we progress through 2025.
Robotics, powered by channel transformation and SAM expansion, continues to outpace its peer group as it operates in a difficult macro industrial environment that has now persisted for more than two years.

Focusing in on Q3.
We delivered third quarter financial results at the high end of our revenue guidance range and above the high end of our gross margin and earnings guidance ranges. Memory and SoC came in above our plan driven mainly by AI applications. In Q3, cloud AI drove compute revenue, with notable strength in networking devices. As we have discussed in the past, AI enabled data centers require much denser networks and our incumbent leadership position in networking combined with shipments to support VIPs has resulted in a considerable shift in our revenue mix.

This year, we expect our revenue from compute to be nearly 4 times what it was in 2023. We are increasing our SOC TAM forecast for the compute market by $200 million from $1.6B to $1.8B in 2024. This compares to a $1.4B market in 2023, approximately 30% year-over-year TAM growth. The VIP portion of the compute TAM is growing fast and our current estimate for this market in 2024 is approximately $300M, of which we have roughly 50% share.

In Memory, AI-driven HBM DRAM demand remains very strong and AI-servers are driving demand for enterprise SSD NAND flash.

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Our Memory business is at record levels driven by volume shipments for DRAM wafer sort and HBM stacked die test. We are revising our estimated memory TAM expectation for the year to approximately $1.4 billion, above our prior estimate range of $1.2 to $1.3B. The memory tester TAM in 2024 is now expected to be over 35% higher than the last peak in 2021. We note that the 2024 memory TAM includes a big slug of initial tooling of HBM at multiple memory suppliers. It's likely that the HBM TAM will flatten or reduce in 2025.

Moving on to Q4.

Cloud AI demand is expected to continue into the fourth quarter. However, given the surge of memory shipments in the third quarter, we expect that our memory revenue will moderate in the fourth quarter.

While Semi Test has consistently outperformed our expectations this year, our other test businesses have continued to see softer demand. Our wireless business in particular has been impacted by the slower than expected ramp of WiFi 7 – in access points, PCs and laptops. Our HDD business continues to wait for our primary customer to work through capacity – and our Production Board Test business continues to be weak mainly due to low demand from Tier 1 automotive OEMs.

Now Turning to Robotics…

Despite roughly flat quarter on quarter revenue, our robotics business has delivered 8% year-to-date growth, despite a worsening industrial macro backdrop. We see our industrial automation peers with year-over-year declines averaging more than 10%. While the basic demand drivers for advanced robotics remain: low penetration rate, the demographics of an aging population, fewer young workers willing to do factory work, and the compellingly short ROI, the industrial market is inherently cyclical, and our customers have significantly cut back on capital investment plans. We believe a more appropriate short-term indicator of progress is to consider performance relative to the peer group rather than an absolute growth metric for this business. To consider absolute growth, one needs to look over complete business cycles.

Even in the adverse business environment, the robotics team is seeing good progress in executing its growth strategy.

Our highest priority in our robotics go-to-market transformation is the development of an OEM solutions channel for UR. This channel is highly valuable because customers purchasing cobot-based solutions from these partners get into production more quickly and have fewer problems than customers that develop custom solutions. In the first three quarters of the year, OEM revenue at UR is up over 50% compared to 2023. Innovation driven SAM expansion is central to outgrowing the market. The new heavy payload UR robots that began shipping late last year have latched well in the market and represent 16% of UR units shipped year-to-date.

The OEM channel growth and new product revenue essentially account for Teradyne Robotics outperforming our peer group in "budget constrained" market conditions.

We expect innovation driven growth to continue in Q4. The MiR 1200 Pallet Jack is a breakthrough product that brings Nvidia powered AI to solve a tough problem in the physical industrial world. Our beta customer trials have completed successfully, and we expect commercial shipments to begin late this quarter.

Earlier this week, UR launched its AI Accelerator which is a ready-to-use hardware and software toolkit that will reduce time to market for AI based workcell robotics solutions for UR's partners.

To sum up,
Based on the year-to-date outperformance of our Semi Test business and partially offset by the softer environment outside of Semi Test, we expect total company revenue growth of approximately 5%, up from our prior expectation of low single digit revenue growth from 2023. As a reminder, excluding the impact of the sale of DIS to Technoprobe, our 2024 revenue growth would be a couple percentage points higher. Our third quarter results have reinforced our belief that AI is a transformational secular growth driver across Teradyne's businesses – both in Test and in Robotics. It is powering demand in Semi Test and powering innovative products in robotics. We expect that this will only accelerate in the years ahead.

With that, I'll turn the call over to Sanjay.
Sanjay?

Sanjay Mehta, CFO: Thank you, Greg. Good morning, everyone. Today I'll cover the financial summary of Q3, provide our Q4 outlook and provide some color around 2025.

Now to Q3. Third quarter sales were $737M, which was at the high end of our guidance with non-GAAP EPS of $0.90, which was above our high-end guide of $0.86. Non-GAAP gross margins were 59.7%. This was above our guidance due primarily to product mix. Non-GAAP Operating expenses were $275M, up sequentially and year-over-year, consistent with our guidance as we invest in targeted opportunities to drive longer-term growth. Non-GAAP operating profit was approximately 22%.

Turning to our revenue breakdown in Q3. Semi-Test revenue for the quarter was $543M with SOC revenue contributing $393M and Memory $150M. Strength in SoC was driven by Compute while Mobile and industrial continued to ship at a consistent level with Q2. Memory test revenue was driven by HBM DRAM shipments, flash tooling for the new UFS 4.0 standard in mobility, and DRAM wafer sort. In memory, we continue to expect DRAM to dominate the memory mix at over 80% of the memory TAM in 2024.

In System Test Group Q3 revenue was $73M with continued weakness across the businesses. Production board test business decline was driven by weakness in the automotive end market. Storage Test weakness in SLT was tied to the Mobile end market. While the HDD end market is recovering, the demand is being satisfied with underutilized tester capacity.

In Wireless Test, revenue was $33M in Q3, lower sequentially and year-over-year on a slower than expected ramp of WiFi 7 and continued weakness in the PC end market.

Now to Robotics. Revenue was approximately $89M, flattish sequentially and up 3% year-over-year. In the quarter, UR contributed $73M and MiR contributed $15M. As noted, although the overall market is down, we are experiencing year-over-year growth tied to our SAM expansion and channel strategies.

Some other financial information in Q3. Our equity investment in Technoprobe is reflected below the line in the income statement, where we recognize 10% of TPI's profit one quarter in arrears. For clarity, as the transaction closed at the end of May, our third quarter results reflect the impact of one month of the TPI investment. We had three 10% customers in the quarter. The tax rate excluding discrete items for the quarter was 13.6% on a GAAP basis and 13.8% on a non-GAAP basis. Full year rate is expected to be 14% on a GAAP basis and 14.5% on a non GAAP basis.

Shifting to some cash metrics. At a company level, our free cash flow was $114M primarily driven by earnings and net working capital improvements in the quarter. We repurchased $25M of shares in the quarter and paid $20M in dividends. We ended the quarter with $678M in cash and marketable securities.

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Now to our outlook for Q4. Q4 sales are expected to be between $710M and $760M. Fourth quarter gross margins are estimated at 59.5-60.5%. Recall, in January we had a plan to improve gross margins back to model in the second half of 2024. The first half of 2024 had subscale revenues tied to a seasonally low Q1 and operational resiliency spends. In the second half of 2024 we are back to our model gross margins of 59-60%.

A little more color on gross margin seasonality. In Q1 2025, we anticipate revenue to be roughly 5% to 10% down quarter over quarter. With this lower volume, our gross margin is expected to be slightly below our target model.

Back to Q4, OPEX is expected to run at 36.5 to 38.5% of fourth quarter sales. The Non-GAAP operating profit rate at the mid-point of our fourth quarter guidance is 23% with Non-GAAP EPS expected to be in a range of $0.80 to $0.97 on 164 million diluted shares. GAAP EPS is expected to be in the range of $0.73 to $0.91.

A few comments on the Semiconductor test market. We are revising up our total Semiconductor ATE TAM estimates for 2024. We have provided a slide in the appendix of our earnings deck with this information. Recall our SoC TAM range has been $3.6 to $4.2 billion, with a mid-point of $3.9 billion. We now expect the SoC TAM to be at the high-end of this range, around $4.2 billion. This is comprised of compute, which we now estimate to be $1.8 billion, up $200 million from our prior mid-point estimate and Industrial to be around $400 million, up $100 million from our prior estimate. We continue to estimate Mobile to be around $800 million, Auto/MCU to be around $500 million, and services at $700 million. We are also raising our Memory TAM estimate to $1.4 billion, up from an estimated range of $1.2 to $1.3 billion.

Within our 2024 expectations, as Greg noted, we are calibrating our expectations of growth in Robotics around the relative growth of the peer group. We are targeting growth in our Robotics business to be 15-20% above the industrial automation peer group, which contemplates macroeconomic factors that are outside of our control. We are confident in the long-term growth of this business and will continue to have a disciplined approach to spending. Given the weak end market, we now expect Robotics growth in 2024 to be between 5 to 10%.

With regard to capital allocation. We will continue to target our share buybacks in 2024 to an amount necessary to offset dilution from equity compensation and our employee share purchase program.

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Looking ahead to 2025, with an uptick in utilization and an expectation of end market improvement, we will be making investments that will increase our operating expenses. However, we expect to have a plan with operating leverage. We expect revenue growth to accelerate from 2024 levels across all businesses. That said, demand from most of our end markets - outside of AI related compute and memory – is improving but remains muted and the timing and magnitude of a broader-based recovery is not known. Our variable business model is scalable and resilient with outsourced manufacturing and our operating expenses having a variable component. During a cyclical downturn we shed opex enabling greater profitability and free cash flow generation. During an upturn in the market, as we expect in 2025, we will see an accelerated opex increase tied our variable opex model.

In 2025, given our expected top line growth, we are planning a low-teens increase in year-over-year OPEX mainly to fund our Semi Test growth initiatives primarily in engineering and go-to-market. Also, approximately 30% of the growth is due to our variable compensation model. Q1 opex is expected to grow 15-20% year-over-year.

Summing up, we delivered strong sales and earnings in the third quarter as memory and compute revenue helped drive us to the high end of the range. Our Robotics team delivered year-over-year growth despite a difficult auto and industrial end market as the business continues to execute its new product development and go-to-market strategies. Overall, our mid-term fundamentals remain strong, and we are investing to accelerate our long-term growth trajectory.

With that I'll turn the call back to the operator to open the line up for questions. Operator?