29-Mar-2023

Semtech Corp. (SMTC)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings. Welcome to the Semtech Corporation's Conference Call to discuss the Fourth Quarter and Fiscal Year 2023 Financial Results. Speaker for today's call will be Mohan Maheswaran, Semtech's President and Chief Executive Officer; and Emeka Chukwu, Semtech's Executive Vice President and Chief Financial Officer.

Please note this conference call is being recorded. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation.

I will now turn the call over to Semtech's Vice President of Investor Relations, Anojja Shah. Please begin.

Anojja Shah
Vice President of Investor Relations, Semtech Corp.

Thank you, Sherry. A press release announcing our unaudited results was issued after the market closed today and is available on our website at semtech.com.

Today's call will include forward-looking statements that include risks and uncertainties that could cause actual results to differ materially from the results anticipated in these statements. For a more detailed discussion of these uncertainties, please review the Safe Harbor statement included in today's press release and in the Other Risk Factors section of our most recent periodic report filed with the SEC. As a reminder, comments made on today's call are current as of today only, and Semtech undertakes no obligation to update the information from this call should facts or circumstances change.

During this call, all references made to financial results in our prepared remarks will refer to non-GAAP financial measures, unless otherwise noted. A discussion of why the management team considers such non-GAAP financial measures useful, along with the detailed reconciliations of such non-GAAP measures to the most comparable GAAP financial measures, is included in today's press release.

Finally, for our prepared remarks today, we will use the phrase Semtech Organic to refer to Semtech's stand-alone results before the inclusion of Sierra Wireless.

And with that, I'll turn it over to our Chief Financial Officer, Emeka Chukwu. Emeka?

Emeka N. Chukwu

Executive Vice President & Chief Financial Officer, Semtech Corp.

Thank you, Anojja. Good afternoon, everyone. In Q4 of fiscal 2023, the company delivered net sales of $167.5 million, down 6% sequentially and 12% year-over-year. These results included $15 million of revenue from the Sierra Wireless acquisition we completed on January 12. Fiscal year 2023 revenue was a record $741.5 million for organic Semtech and $756.5 million including Sierra Wireless.

For Semtech Organic, Q4 shipments into Asia, North America and Europe represented 68%, 13% and 19% of revenue, respectively. While this represents a shift to addresses for our distributors and customers, we estimate that in fiscal year 2023, approximately 33% of our shipments were consumed in China, 27% in the Americas, 22% in Europe, and the balance over the rest of the world.

Our effort to diversify our revenue geographically are showing signs of success we see, especially in North America and Europe, for Tri-Edge, PON-X and LoRa. On a go-forward basis, we expect the inclusion of Sierra to reduce our exposure to China.

In Q4, net sales through distribution represented approximately 78% of revenue for the combined company, while direct represented 22% of net sales. Going forward, we expect to have a more balanced mix due to the addition of Sierra.

Looking at our end markets for the Semtech Organic business. Our infrastructure end market fell 18% over the prior year and 20% sequentially, and represented 37% of total net revenues. Net revenue from the industrial end market declined 18% year-over-year and 15% sequentially, and represented 40% of total net revenues.

Revenues for high-end consumer decreased 26% over the prior year, but were up approximately 1% sequentially and represented 23% of total net revenues. Approximately 9% of high-end consumer net revenues was attributable to mobile devices, and approximately 14% was attributable to other consumer systems.

Our Semtech Organic POS remains balanced, with approximately 49%, 29% and 22% of the total POS coming from infrastructure, industrial and high-end consumer end markets, respectively. With the addition of the Sierra Wireless portfolio, we will see a greater mix of IoT revenue, a new segment for us that will include LoRa and less revenue in the consumer end markets.

Q4 gross margin was 62.3% for the combined company. Q4 gross margin for organic Semtech declined 80 basis points sequentially to 64.7%, driven primarily by a return mix of the high-end consumer end market revenue.

In fiscal 2023, for organic Semtech, our growth drivers of data center, LoRa-enabled, PON, broad protection, industrial and automotive platforms drove record non-GAAP gross margin of 65.1%, up 180 basis points.

With the full quarter of Sierra, we expect our Q1 gross margin to average 48.5% at the midpoint of guidance. For the remainder of the year, we expect to see 100 to 150 basis point improvement in gross margin, driven by a higher mix of Semtech Organic revenue and achievement of material cost synergies.

We expect to achieve our long-term gross margin target of 58% to 63% through: one, sustained growth of data center, 5G wireless base stations, passive optical networks, broad protection, industrial and automotive product platforms; two, accelerated deployment of LoRa end point from improved cellular connectivity; and three, growth in annual recurring revenue from Sierra's managed connectivity, software services, and LoRa Cloud services.

We are successfully managing our operating expenses in this challenging revenue environment. Q4 combined operating expenses was $67 million. In Q4, operating expenses for Semtech Organic were down 13% sequentially to $59 million, driven by a reduction in head count and other variable compensation.

In Q1 fiscal 2024, we expect operating expenses of approximately $99 million at the midpoint of guidance, reflecting a full quarter of Sierra and the customary increase in compensation expenses typical at the start of the new year.

We now expect to achieve about $50 million of annualized operating expense synergies by the end of the fiscal year. As a result, for the remainder of the year, we expect operating expenses to be flat to slightly down on a sequential basis, reflecting the achievement of the expected synergies.

Fiscal year 2023 operating profit was a record $210.7 million for the combined company. Semtech Organic delivered a record operating profit of $212.7 million, up 5% versus the prior year, with minimal revenue growth due to gross margin expansion and controlled expenses. While fiscal year 2024 demand is starting off weak, we still expect that with the anticipated second half recovery, the Sierra acquisition will be accretive to our fiscal year 2024 earnings.

In addition, over time, as the current business climate improves and we execute on the vision behind the Sierra acquisition of driving LoRa end point proliferation, we expect to achieve our long-term operating margin target of 32% to 36%.

Our fiscal 2023 non-GAAP normalized tax rate is 12%, and we expect it to remain the same in fiscal 2024.

In fiscal 2023, cash flow from operations for the combined company was $127 million or 17% of revenue, compared to the $203 million in the prior year. The decline was primarily due to the expenses associated with the acquisition of Sierra. For fiscal 2024, we expect cash flow from operations to be pressured by transaction and acquisition-related expenses and lower profits due to the weak demand environment.

Our debt at the end of fiscal 2023 was $1.3 billion or 3.4 times leverage on a net basis. We expect to see an increase in net leverage, as we navigate through this softer demand environment. We proactively negotiated an amendment to our credit agreement to get some relaxation to our leverage ratio and interest expense coverage ratio covenants. The weighted average interest rate is currently approximately 5.64%. As we have said before, the main priority for free cash flow will be to pay down debt.

In summary, fiscal year 2023 has been a year of significant change for Semtech. We delivered record revenue and operating income and closed on the largest acquisition in our history. While fiscal year 2024, we have these challenges, I am very excited about the opportunities at Semtech at this moment in our history.

Let me summarize what I see now. One – first, we expect to see our growth drivers of data center, PON, 5G wireless regain their growth momentum as the business environment normalizes, but, more importantly, become more regionally balanced as we see revenue run for these products in North America later this year.

Second, Sierra's cellular capabilities, combined with our high-margin LoRa and LoRa Cloud technology, will open up new market opportunities for both technologies, driving increased revenues, gross and operating margins for the company.

And finally, once we have executed on our synergies and portfolio review, we expect that in fiscal year 2025, we will start seeing much improved margin expansion and EPS growth.

I will now hand the call over to Mohan.

Mohan R. Maheswaran

President, Chief Executive Officer & Director, Semtech Corp.

Thank you, Emeka. Good afternoon, everyone. I'd like to briefly comment on my intention to retire from Semtech. The last 17 years have been an incredible journey for me, and I'm very proud of the growth and transformation of Semtech and our many accomplishments during this time.

As we approach the next phase of growth, this is the right time to appoint the next leader of this highly innovative technology company. To assure a smooth transition, I am committed to staying involved until a new CEO is appointed, and will continue to be an adviser for a period of time as needed.

On January 12, we closed the acquisition of Sierra Wireless. This was the largest and most strategic acquisition in Semtech's history. Our Q4 FY 2023 and FY 2023 numbers include 18 days of Sierra Wireless.

I will now discuss our Q4 fiscal year 2023 performance by product group, our fiscal year 2023 performance, and then provide our outlook for Q1 of fiscal year 2024.

In Q4 of fiscal year 2023, net revenues were $167.5 million. Organic Semtech contributed $152.5 million, slightly above the midpoint of our guidance. In Q4, organic Semtech posted non-GAAP gross margins of 64.7%, and non-GAAP earnings per diluted share of $0.50. For the combined company, non-GAAP EPS was $0.47 per share.

In Q4 of FY 2023, our Signal Integrity product group revenue was down 21% sequentially and represented 36% of total revenues. The decline was driven mostly by the economic slowdown in China and excess inventory, as customer consumption declined.

We saw reduced demand from all our infrastructure segments across all geographies, with China data center and China wireless base station being particularly weak. Despite the softer demand, we continue to see new design-in activity for our Tri-Edge and CopperEdge platforms in both optical modules and active copper cables.

As we mentioned last quarter, Tri-Edge has been selected by a major North American hyperscaler in a new, high-volume, multi-year program to enable lower power, low latency and lower cost interconnects within their data centers. This is our first major North American hyperscaler Tri-Edge win, and qualifications are progressing well and we expect production ramps to begin in the second half of FY 2024. The benefits of Tri-Edge align well with the long-term goals of hyperscalers, focused on lowering the power and cost of interconnects within their data centers.

At the Optical Fiber Conference earlier this month, we demonstrated a 200-gig per lane optical transmission link, enabled by Semtech's latest FiberEdge 200-gig PAM4 platform and Broadcom's latest DSP platform. We remain confident that our full portfolio of data center platforms, including ClearEdge and Tri-Edge CDRs, FiberEdge PMDs and CopperEdge redrivers will enable us to rapidly grow our hyperscale data center business nicely over the next several years.

While we saw a sequential decline in our overall PON business in Q4, our 10-gig PON business reached a new quarterly revenue record. Our PON business continues to grow outside of China, and we remain confident our PON business will grow over the next several years as global demand for higher access bandwidth drives an increase in global PON deployments. At OFC, we demonstrated both a 25-gig and 50-gig PON system and our sampling products for both systems now.

Revenue from our wireless base station business was down in Q4, both on a sequential and year-over-year basis. Again, despite the current softness, we have numerous 5G base station design-ins with both our ClearEdge and Tri-Edge platforms, and we expect continued adoption of both platforms in fronthaul optical modules throughout FY 2024 and beyond as 5G deployments accelerate.

We recently announced several new innovative products that extend our leadership position in PMD and CDR platforms targeted at the data center, wireless base station, and PON segments. These new products provide our customers with a lower power, low cost and low latency needed for advanced infrastructure applications.

While our Signal Integrity product group bookings improved sequentially, the weak macro environment, particularly in China, is resulting in lower infrastructure demand in Q1 across all sub-segments. As a result, we expect our Signal Integrity product group revenues to be down significantly in Q1 of fiscal year 2024.

Moving on to our Advanced Protection and Sensing product group. In Q4, we merged our proximity sensing product group into our Protection product group and created a new Advanced Protection and Sensing product group. We made this shift to align our system protection and sensing road maps for our high-end consumer customers.

Q4 net revenue from our Advanced Protection and Sensing product group decreased 6% sequentially and 32% annually, and represented 29% of total revenues. The decline was due to ongoing weakness from the consumer segment, including from smartphones, wearables, and PCs. Consumer demand for both China and Korea remains extremely soft.

We continue to diversify our Advanced Protection and Sensing business into the broader industrial, telecommunications and automotive sectors, which we call ITA, where we see relative stability, with modest growth from the automotive market.

In addition, our increasing design wins for USB-C protection across all end markets, position our protection business for growth as USB-C becomes the high-speed interface of choice across the high-end consumer and ITA segments.

In Q4, new SAR regulations were finally passed in China, increasing the market opportunity for our proximity sensing portfolio, as smartphone customers will now need to integrate proximity sensing functions into their phones being sold into China.

We expect both our Protection and Sensing businesses to rebound as the overall consumer market improves in the second half of fiscal year 2024. However, our consumer demand currently remains very weak and inventory levels remain high. As a result, we expect our Advanced Protection and Sensing business to be down significantly in Q1.

Turning to our IoT product group. Our newly formed IoT product group has two sub business groups. The first business is the IoT System product group, which is made up of Semtech's LoRa-enabled business, Sierra's IoT module business, and Sierra's IoT router business. This business also includes the Sierra broadband module business.

The second business is our new IoT Connected Services business, which includes Sierra's Managed Connectivity Services business and Semtech's LoRa Cloud Services business. This services business is a recurring revenue business.

In Q4, total IoT revenues were $58.8 million, 18% higher sequentially and 34% higher on an annual basis, and represented 35% of total Semtech revenues. Our IoT revenues included approximately $15 million of Sierra Wireless revenue.

In Q4, our LoRa-enabled revenues were down 12% sequentially and flat over the previous year due to softer demand from China and a significant drop in Helium revenues. We do not expect any more material revenues from Helium.

The adoption of LoRa continues to grow across many IoT use cases globally, especially in North America and Europe, where we are starting to see larger LPWAN deployments. Some of the most recent more exciting announcements include Italgas in Italy issued an RFP for 7.6 million LoRa WAN gas meters, and we're seeing similar requests for LoRa WAN-based systems in utility tenders all over the world.

The Things Network Industries (sic) [Things Industries] (00:21:51) announced it has achieved 1 million connected LoRa WAN devices. The LoRa Alliance announced it has now certified 620 LoRaWAN devices. Yesterday, Amazon announced that they are expanding their commitment to LoRa with the opening of the Amazon Sidewalk network to device makers and developers with new tools and new AWS services for both LoRa and LoRaWAN developers to make it easier to deploy.

LoRa technology plays a critical role in enabling long-range community coverage with Amazon Sidewalk, which now covers approximately 90% of the US population. We announced the first third-party products based on Amazon Sidewalk from Browan, Deviceroy, Meshify and New Cosmos are now available. Additionally, we have partnered with other industry leaders on development kits and modules based on Semtech's LoRa technology that will enable device makers and developers to rapidly create new Amazon Sidewalk devices.

And finally, Frost & Sullivan recognized Semtech as the 2022 Global Company of the Year for innovative IoT hardware, based on the progress of LoRa.

We are now in the process of integrating Sierra Wireless into Semtech, so we can execute on our vision of transforming the entire low-power IoT industry by bringing together the ultra-low power and long-range connectivity benefits of LoRa technology, together with the low latency, high-bandwidth network connectivity benefits of cellular technology.

The combination of LoRa and cellular technology is a highly strategic opportunity that positions Semtech as the clear leader in the fast-growing ultra-low power IoT market. Our goal is to enable IoT deployment simplification through end-to-end connectivity, deliver disruptive edge AI networks, and deliver a unique cloud-based Sensing-as-a-Service capability that helps customers accelerate their digital transition to the Internet of everything.

Our teams are unified under our new IoT leadership, and we are currently reviewing our product portfolio to prioritize investments and identify non-strategic assets.

Now, let me comment on our fiscal year 2023 performance. In fiscal year 2023, organic Semtech net revenues achieved a record $742 million. Including Sierra Wireless, revenues were $757 million. We achieved this record revenue amid significant macroeconomic headwinds, ongoing geopolitical challenges in China, COVID lockdowns in China, the war in Ukraine, and softness in the global consumer market. In FY 2023, organic Semtech also achieved record gross margins of 65.1%, record operating income of $213 million, and record EPS of $2.80.

In FY 2023, our SIP product group grew 4% annually and achieved record revenues of $304 million, driven by record PON revenues of $142 million, which grew 58% annually; and record 5G revenues of $11 million, which grew 18% annually.

In FY 2023, our Protection products business declined 8% over the prior year. However, the broader ITA Protection business achieved record revenues of $80 million and grew approximately 9% year-over-year.

In FY 2023, our organic Wireless and Sensing business grew 40% to achieve a record $200 million. Our LoRa-enabled revenues also grew 40% for the year to achieve a record $187 million. In FY 2023, our LoRa business continued to make solid progress on the growth metrics we have established. These metrics included the number of LoRaWAN network operators, which grew to 181 at the end of FY 2023 from 166 in FY 2022.

LoRa end points reached approximately 300 million connected devices in FY 2023, up from 240 million in FY 2022. The number of LoRa gateways deployed increased 84%, from 3.2 million at the end of FY 2022 to 5.9 million at the end of FY 2023. We are delighted with the large increase in gateways deployed globally, as this LoRa infrastructure is critical to enable the broad range of industry use cases that are emerging.

With continued network expansion globally, we expect end node deployments to accelerate rapidly over the next three to five years, growing from the 300 million end devices deployed with LoRa today. Once we have completed the integration of Sierra, we will be establishing a new set of IoT metrics that represent the new IoT vision and strategy that is now in place.

Now, let me discuss our outlook for the first quarter of fiscal year 2024. The organic Semtech demand remains very weak due mostly to a weak China and consumer demand. In addition, the Sierra Wireless demand, which is typically seasonally weaker in Q1 is also being negatively impacted by the overall macro weakness in North America and Europe, resulting in both pushouts and some cancellations.

As a result, we are currently estimating Q1 net revenues to be between $230 million and $240 million. The midpoint of $235 million includes projected revenues of approximately $135 million from Sierra Wireless and approximately $100 million from organic Semtech. To attain the midpoint of our guidance range, or approximately $235 million, we needed 16% turns orders at the beginning of Q1. We expect our Q1 non-GAAP earnings to be between negative $0.11 and negative $0.04 per diluted share.

I will now hand the call back to the operator, and Emeka I will be happy to answer any questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from Scott Searle with ROTH MKM. Please proceed.

Scott W. Searle
Analyst, ROTH Capital Partners LLC

Q

Hey, good afternoon, and thanks for taking the questions. Mohan, congratulations and best of luck as – I know you're not going off to retirement tomorrow, but best of luck as you start to look down that road.

Hey, maybe just to dive in quickly on the last comment of Semtech Organic being about $100 million in the April quarter. I was wondering if you could dig into that a little bit more deeply. I know you went into the specific product categories. But how much is inventory related? What sort of a recovery should we be expecting as we go into the July and beyond quarters?

And also as well, if I could, for Emeka, on the OpEx front, it sounds like you've talked about deal synergies now moving from $40 million to $50 million. I wanted to clarify in terms of the OpEx of around $99 million to $100 million in the April quarter, if that's where we should be modeling taking out that $10 million to $12 million as we get through those integrations? Thanks.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah. So let me start with the Q1 guidance comment question, Scott. So across our different product areas, we are seeing weakness. Obviously, I mentioned China and consumer are probably the two greatest areas. And all of our businesses are going to be down on an annual basis, something between 40% and 50%, I would say. And so, it's pretty broad. It's not one specific area, but I would say consumer and China are definitely impacting us in a big way. We have a LoRa-specific issue also with Helium, which is also come down.

So there's some specific things there. But largely, I would say, on the whole, it's pretty broad. We do think we're near the bottom. I think that's important to understand is that what we are seeing now is bookings starting to get a little bit better. The customers' consuming – indicating that consumption is going to start to increase. And we haven't really seen that yet, but I think that that's our expectation as we get into the second half.

And that is really going to be the key. Obviously, as demand comes down, inventory is the issue. And I think we're seeing inventory across the consumer markets and the infrastructure markets now. So until that inventory is absorbed, the market will be [indiscernible] (00:31:23). So we're expecting the first half to be fairly weak.

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

Yeah. And Scott, on the OpEx, the $99 million that we guided toward the midpoint already factors in the synergies that we have achieved. The team has actually done a very good job of the integration so far. We've been able to drive a lot of the identified synergies. At this point, I'll probably estimate that about 80% of the identified synergies have already been achieved and baked into the numbers. And the expectation is that by Q3 that we probably would achieve 100% of the $50 million target that we have provided.

Scott W. Searle
Analyst, ROTH Capital Partners LLC

Q

Got you. And one last one, if I could, Mohan. On Sierra Wireless, it seems like they are actually performing pretty well if you're guiding to $135 million in the current quarter. There had been some channel inventory out there, I think, on the module front, but it doesn't seem like it's that onerous at this point. So I'm wondering, as you start to look into the back half, where Sierra Wireless was peaking at $160 million to $180 million a quarter, is that something that's achievable as we look out to the end of this calendar year or early next year? Thanks.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah. I think so, Scott. It's difficult. Even the Sierra business is down. Obviously, I mentioned in my commentary that Q1 is seasonally down for them, but we are seeing a little bit more weakness than we'd expect and some pushouts and some cancellations, as I mentioned. So even their business is down on a kind of 20%-ish on an annual basis. So not as bad as the Semtech business, but still down. And their business is primarily in North America and Europe.

But, yeah, I think we are still expecting the second half to be stronger across all segments. There's no indication of that in terms of hard bookings yet. But given where some of these markets have been soft for some time now, especially consumer; and if you look at China, one would expect them to come back for sure. And then, I think some of these other regional segments like North America and Europe infrastructure, I think should at least – we should start to see some improvements in the second half.

Scott W. Searle
Analyst, ROTH Capital Partners LLC

Q

Great. Thank you.

Operator: Our next question is from Craig Ellis with B. Riley. Please proceed.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

Yeah. Thanks for taking the question. And Mohan, I'll echo the congratulations on your transition into a new phase. It's been a tremendous pleasure working with you over the years.

I wanted to follow up with a point that Scott asked about, just digging in more to the Semtech side of the revenue guidance. If I look at the $100 million and look back in my model, it seems like we're at revenue levels that we would not have seen since the fiscal 2011 timeframe when the portfolio was a lot different and really didn't have the Signal Integrity contribution that it does now. So with that as the context for the question, the question is really this, to what extent do you feel like you're under-shipping normalized demand to work through excess inventory? And how long would you expect that under-shipment period to last because it does seem to be quite acute here in the current quarter?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah. I would say probably two quarters, Craig. As I mentioned, obviously, if you look at FY 2023 and take our Signal Integrity product business, as an example of that, it was a record $300 million, right? So when we now look at the current run rate and how fast that's come down, we're on a 160 kind of run rate. So it's definitely come down significantly. And I would suggest most of that is inventory, and some of that is related to China. And as I mentioned, we are expecting in the second half some ramps and some specific drivers to bring that back.

But it's across the board. Our consumer business is similarly down. Our industrial – parts of our industrial business are similarly down. I would say North America and Europe a little bit better. It's mostly China and consumer are the two major culprits. But across the board, everything is down at least 15% – 15% to 20%.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

Got it. And then, the second question is one related to some of your comments near the end of your script. One of the things that you mentioned is you've got the teams together. They are working hard and collaboratively on integration, and you'll be looking at things that are not strategic as opportunities to really prioritize resources around things that are.

So with that said, can you comment any further on the scope of things that may not be strategic? And given where we are with the global macro today versus where we were when we announced the deal, how do you look at the target $40 million in cost savings from the deal? Do you feel like there should be upside to that or does that remain a solid number, given your sense of where the longer-term opportunity is?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Well, I'll start with the portfolio review, Craig. I mean, we do it regularly at Semtech anyway. But I think now with the Sierra acquisition, obviously, a lot of the Sierra businesses are fairly new to us. And so, the board is engaged in kind of looking at what elements of the portfolio are really strategic for us and which are not. And we'll make decisions based on what we find from that. It's early days, though. We just really started that. I would give it six months here.

And then, Emeka, you want to talk about the synergies?

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

Yeah. With regards to the synergies, Craig, like I mentioned in my prepared remarks, we had estimated about $40 million on an annual basis. Now, we've increased that number to $50 million, and I just mentioned that as of now, we have achieved about 80% of that on the run rate basis. And we do expect that by the end of Q3, we would be at 100% of the $50 million.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

Got it. Thanks for that, guys. I'll hop back in the queue.

Operator: Our next question is from Harsh Kumar with Piper Sandler. Please proceed.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Yeah. Hey, Mohan, I had a question on China. So you're in a fairly unique position of reporting last quarter. So you can talk about things and times that other companies cannot. So I was curious what you're seeing. Obviously, everything looks kind of dire right now, but you sound pretty optimistic on China coming back in the back half. I was curious what you're seeing that might drive your optimism about China coming back. And just any kind of color would be helpful.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah. I think it's more harsh that when you look at some of these segments and some of the regional kind of balance here. We've seen pretty weak China now for several quarters, and so, I think, certainly Q3 and Q4 for us in our fiscal quarters and now we're also seeing it in Q1. So after three quarters of sequential decline, one anticipates that we are probably nearing the bottom. I would say, Q1 or maybe Q2 is going to be close. And then, I expect it to start to go the other way.

We're also seeing – I mean, as I mentioned, bookings are starting to trend upwards a little bit. We're starting to see some design-in activity that's been fairly quiet in China in some areas. And so, just generally, I would say that things are looking a little bit more positive coming off a very low base, though, right?

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Fair enough, Mohan. And then, on your Sierra Wireless integration, I mean, seems like you guys have made tremendous progress on synergies already in a short timeframe. I was curious in terms of maybe you could update us strategically on products or anything else, any kind of positives or negatives that come to mind that you think are worth mentioning?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Well, it's early days, Harsh. Again, we just -obviously, we're in the integration process and we're also in the road map planning process. I would say that the teams are getting together now and looking at how we can do things kind of quickly and kind of the more longer-term integration plans. But the strategic fit and the philosophy and the kind of the reason why we did the deal are all still there, and we're very excited about it. It's just a question of now how quickly we can bring out some of the new products and some of the new capabilities, and how quickly we can engage customers and get things moving.

I would say it's going to take six to nine months for us, maybe even a year. And this year – FY 2024 is definitely going to be a year of just kind of consolidation and getting the road maps in line and the portfolio kind of cleaned up and just make sure we position ourselves really for a really strong FY 2025 and FY 2026.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Understood. Thanks, Mohan.

Operator: Our next question is from Tore Svanberg with Stifel. Please proceed.

Tore Egil Svanberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yes. Thank you. I was hoping to ask the China question a little bit differently. Just because it's so weak, Mohan – I mean, I think, by now, we would have expected to see some stabilization, but it just keeps coming down every quarter, every quarter. So is there an element here of some demand destruction just given the political climate or anything like that? Or should we just purely think of this as sort of weak demand, inventory correction and so on and so forth?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah. I think it's more of the latter, Tore. I mean, it depends what you mean. I mean, for example, I can tell you that the data center business in China is very weak. Some of the big data center players in China have been pushing out their demand. So we know it's there. We know that they want to deploy. We know that government is still supportive. But I think there is an element of kind of – well, is the government really supportive of large data center companies and things like that.

So it's a little bit of both of what you said. But I don't think there's any reason to believe that there's a loss of demand. I think it's more pushing out. And we're anticipating that that will come back. Everything will come back.

Tore Egil Svanberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

That's fair. And a question for Emeka. When it comes to gross margin, so you mentioned 150 basis points a quarter. First of all, would that be fairly linear over the next, I don't know, six to eight quarters? And then, how do the three elements of gross margin improvement really play out? I assume mix kind of comes later, but if there is anything that you could share with us as far as the 150 basis point comment coming from the three elements that you mentioned in your prepared remarks?

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

So Tore, I think for this year, yeah, said for the rest of the year, expect to see 100 to 150 basis points. Most of that is probably going to come through just the Semtech Organic business, rebounding, as we go through the year. That is still the expectation. We expect that in the second half of the year a lot of the inventory probably would have made its way through, and that we'll start to ship again up to the level of consumption.

We also have some material cost synergies that we have identified, but we'll have to see how the demand rolls in. That should also be a driver of the gross margin expansion for this year.

I think the three points that I made before was probably just more reflective of what to expect on a long-term basis, right? We know that as the market recovers and the Semtech Organic business recovers and the growth drivers come in, those are very high gross margins. Those would definitely be accretive to the current levels of gross margin.

The proliferation of lower end points, right, from the combination with Sierra, like Mohan just mentioned, getting the product road map and developing the customer business development and everything, that is probably more of a two-year sort of window before we start seeing it. And then, the managed connectivity on LoRa Cloud services is probably also about probably 24 months out and things like that.

So the three drivers was probably a little bit more for the long-term gross margin target level of 58% to 63%. When we announced the deal, we said we expect that you will see probably five years' time, see us making progress towards the low end of that range. And we still believe that is the case that probably five years from now, we should be much closer to the low end of that target range.

Tore Egil Svanberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Good. Just one last one, and still for you, Emeka. So just based on the P&L and the interest expense, is it fair to say that the breakeven point would be around $240 million. Is that sort of a good number to use?

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

I think, yeah, about $240 million, $245 million, yes, that would be a good number to use.

Tore Egil Svanberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Thank you so much.

Operator: Our next question is from Quinn Bolton with Needham and Company. Please proceed.

Quinn Bolton
Analyst, Needham & Co. LLC

Q

Hey, guys. And Mohan, let me also say congratulations on your leadership, and it's been a pleasure working with you. I guess for both of you, I wanted to come back to your comment about the Sierra Wireless transaction becoming accretive. I think you said in the second half of the year as revenue recovers. And I guess I'm just trying to do some quick math. It looks to me that Sierra Wireless is probably starting to hit that accretive level at somewhere in the $160 million to $170 million range. And I'm using sort of the low to mid-30% gross margin, high $30 million to $40 million of quarterly OpEx, and probably about $18 million of interest expense on the business with the $1.3 billion of debt. I just wanted to see if those numbers all sort of feel like the right ballparks for you when you look at that accretion estimate for Sierra Wireless?

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

Yeah, Quinn. So there are usually a lot of moving parts to this, right? The synergies, the size of it, the cost reductions, all that stuff. But I'll probably think that about [ph] $115 million (00:47:14) of quarterly revenue run rate, this year, deal should start being accretive.

Quinn Bolton
Analyst, Needham & Co. LLC

Q

Got it. Thank you, Emeka. And then, just to...

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

So you are...

Quinn Bolton
Analyst, Needham & Co. LLC

Q

Go ahead.

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.
A

...definitely in the ballpark.

Quinn Bolton
Analyst, Needham & Co. LLC
Q

Okay. Okay. Thank you. And then, for Mohan, congratulations on the Tri-Edge win in North America. I'm wondering if you might be able to spend a little time discussing the application. Is this sort of a [ph] NIC to top of rec (00:47:44) switch application? Is it more an AI cluster? Is it short reach AOC replacement or longer reach optical module replacements? I'm not sure how much color you can give, but it sounds like it's an important and long-lasting win for the company. And obviously, the first win in North America seems to be pretty important.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.
A

Yeah. Quinn, I know all the details because I was with the team when they awarded us, and we discussed and negotiated and we got the win. But I can't give you any details just because they don't want us to give out any details. I can tell you it's short reach.

Quinn Bolton
Analyst, Needham & Co. LLC
Q

Okay. And then, maybe a last one, if I could, just sneak it in. Amazon announced yesterday sort of opening up the Sidewalk network to third-party developers. How long do you think it will take start to see deployment of those third-party end nodes on Sidewalk? Is that something investors should think is sort of 6 to 12 months? Could it take longer? Might it ramp faster?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.
A

Yeah. That's a good question, Quinn. And the reason is we have some products already. They've already been working with some kind of alpha/beta kind of customers and partners who already have sensing devices out there on the Sidewalk. I think we mentioned a few in our press release, some of them tied to insurance, some of them tied to leak detection, some tied to just general broad connectivity and networks.

But it is incredibly exciting. Of course, 90% coverage in the US. It's just a question of, okay, now can the Amazon machine work and the ecosystem work to build a plethora of devices and use cases, actually, around Amazon Sidewalk? And if that happens, then, yeah, that's kind of the dream, right? That's what we've been waiting for. It's starting to play out now. We'll see how quickly and rapidly. I don't think the development time is that long. It's more proving out the use cases.

There are many use cases. Obviously, there's going to be the obvious ones, and they will be fairly straightforward. But I think there will be many use cases that are tied to tags and tracking and many other types of use cases that will emerge. And that's the question is how quickly, A, the sensors can be developed and the end nodes can be developed; but also then the use case can be kind of proof of concept, how long it will take, and then all the software required for it. But the good news is that Amazon is not only the Sidewalk activity, but also the AWS Cloud activity is connected to this. So we have a pretty powerful partner behind it.

Quinn Bolton
Analyst, Needham & Co. LLC

Q

Thank you. Thank you, Mohan.

Operator: Our next question is from Tristan Gerra with Baird. Please proceed.

Tristan Gerra
Analyst, Robert W. Baird & Co., Inc.

Q

Hi. Good afternoon. And Mohan, wishing you best of luck in your future endeavors. On your commentary about gross margin improving this year on a higher mix of organic revenue, how should we look at Sierra Wireless revenue for the year – year-over-year change? And if you could talk to the market share for Sierra Wireless, how is that progressing relative to competitors? Any commentary there at the top line for the year?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

I'll take the last part, and then Emeka can talk about gross margins. But for me, I think the Sierra share equation at the moment has probably not changed much, Tristan. I think our goal, of course, is to try to expand in North America and Europe, the business. There are some large Asian competitors that have been doing well in North America.

But I think as the sensitivity towards foreign modules and foreign technologies in critical infrastructure and IoT, I would consider it to be critical infrastructure in many use cases anyway. I think that awareness becomes clear. I think Sierra has – and now Semtech has a very good opportunity to really educate to the market and gain share, particularly on the security side and also on the supply chain side. So, yeah. But for now, I don't think the share has changed any from the historical amounts.

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

So Tristan, with regards to my comments on the gross margin, I think Mohan had earlier made the comment that on the Semtech Organic business that the number we're getting to is – if it's not bottom, it's pretty close to bottom. The expectation is that as we go through the rest of the year, that will start to have a situation where a lot of the inventories have been – it's moving through the channel. That is one.

And also, in the second half of the year, we've pointed to some secular opportunities that we have that we think starts to move the needle back up towards what we have been used to in the past in terms of the Organic business. And with that happening, then the Semtech Organic business becomes a higher percentage of the revenue mix. And with that, because of the higher gross margin from Semtech Organic, that would naturally provide an uplift for gross margin.

Tristan Gerra
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. And then, for my follow-up, I think, Mohan, you had talked about the opportunity of ramping LoRa as a feature next in 5G Sierra Wireless routers. Any metrics you could provide us with in terms of whether the units for those routers on an annual basis? And once you have a 5G LoRa integrated module what adoption rate, percentage-wise, would you expect to get within Sierra Wireless router volumes, just to kind of gauge what the opportunities in terms of incremental LoRa revenue generated directly by Sierra Wireless going forward?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yeah. I think, Tristan, it's work that's starting now. I don't think we've had time, really, to kind of look at what we can do there. But very simply, remember, the Sierra has a portfolio of routers, from 5G routers to 4G and below. And our thought has always been the integration of LoRaWAN gateways, and Sierra routers provides essentially end-to-end connectivity from the sensor end point all the way through to the cloud. And we will be uniquely positioned to offer these combined routers, which could be very low priced, they could be very high price, they could be very high performance, could be midrange performance, they could be a very broad set of integrated relators.

And so, that work has to be done. I don't think there's any rocket science to it, but I think we do have to pull it together and then combine that with our Sensing-as-a-Service.

And as I also mentioned, putting intelligence onto the routers. One of the beauties about the Semtech position in LoRa is that we have the gateway chips and, therefore, we can add integrated intelligence into these routers either in the chips or in the router themselves and, I think, provide some very interesting intelligent edge opportunities for IoT.

So there's a whole portfolio of opportunity for us. We just need to go through it and see where the biggest bang for the buck and where the biggest opportunities and what are customers pulling on in the short term and medium term and long term. So very excited by all the opportunities, but we have to go through the exercise.

Tristan Gerra
Analyst, Robert W. Baird & Co., Inc.

Q

Great. Thank you.

Operator: [Operator Instructions] Our next question is from Christopher Rolland with Susquehanna. Please proceed.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

Hey, guys. Thanks for squeezing me in. I guess my first questions are going to be around LoRa. So I think you did $41 million in the quarter. I don't know if you can talk about – I think most things are going down next quarter. But if you could kind of give us an idea of what you would expect next quarter? And then, you usually give us longer-term metrics for LoRa. I don't know if you have some sort of estimate that you could give us for the full year or longer-term. You've also talked about the opportunity pipeline and the pipeline outside of China and sometimes give metrics there as well. I don't know if you had any additional metrics you could give us.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

Yes. So Chris, I mentioned on the call that we're going to review all the metrics, and that's largely because now we have Sierra, we have a much larger pipeline and we have some opportunities, obviously, to really look at the metrics that are important for our now new IoT business. So we will be putting those together, and then we will bring those out at a future discussion.

But to answer your question, I mean, we had a record FY 2023 for LoRa is $187 million. Of course, there's a lot of Helium in that. So our expectation is for FY 2024 is that without Helium, we're going to probably – LoRa is going to be probably flat to slightly down, mostly because of China, I think. So if you take the Helium out from FY 2023 and assume that's $40 million to $50 million of revenue, something in that range, FY 2024 is going to be kind of in that range, okay? And that's assuming no Helium and assuming China continues to be weak.

So we're starting off in a weak Q1, and I think things will improve. We've got a lot of momentum on LoRa, of course, as I mentioned. And we just talked about the Amazon Sidewalk and some of the other things going on there. But I think we just will have a little bit of a headwind with the loss of Helium.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

Yeah. Understood. And then, on the Signal Integrity side, that also sounds like it's going to be down, but was just wondering, from a growth perspective, once this bounces back, are you most optimistic around kind of data center, 5G and PON?

And then, just two quick ones for Emeka. Book-to-bill, I'm going to assume less than 1, but if you have any other thoughts there? And then, the turns needed in your guidance that you usually give as well?

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

A

So let me just touch on the Signal Integrity product kind of momentum. Yes, it's down in Q4. It was down in Q1. Obviously, we've guided to still that being down again significantly. I would say most of that is just inventory situation in China. We have a lot of good design win momentum in our Signal Integrity product group across all three of the major segments. So in hyperscale data center in North America, which is good. So it's not China. In our base station business, again, we have momentum in China, but we also have momentum outside China, which is also good. And then, in our PON business, similarly, I think we're starting to see some growth outside China, although China is still a very large consumer of our PON products.

So yeah, I think Signal Integrity, my sense is Q1 is going to be near the bottom, and we're going to be coming out of that quite quickly would be the comment I would make.

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

And Chris, on the bookings side, the book-to-bill was less than 1. But on the positive side, the bookings were actually up; for the legacy business was actually up about 10% during Q4. The bookings are still pretty much on the lower end of typical run rate, but it was very pleasing to see that it was up in Q4. And so far this quarter, it seems to be trending up sequentially as well. So those things are still pretty subdued, but at least it is encouraging to see that the bookings are beginning to show signs of life. And I think in Mohan's prepared remarks, he talked about us needing about 16% turns to achieve the midpoint of revenue guidance.

Christopher Rolland
Analyst, Susquehanna Financial Group LLLP

Q

Awesome. Thanks, guys.

Operator: And we do have a follow-up question from Craig Ellis with B. Riley. Please proceed.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

Yeah. Thanks for taking the follow-up. Emeka, I just wanted to go back to the gross margin point. I thought in your prepared remarks that you had said you had expected 150 to 180 basis points of gross margin through this year, so from 48.5% to 50-ish. But then, I thought later I heard you say 150 to 180 basis points per quarter, which the Semtech business really inflects off this very unnaturally low level would make sense. Can you just clarify if it's the former or the latter? And then, I'll ask a follow-up.

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

So what I did say was 100 to 150 basis points for the rest of the year. I think maybe what was confusing was the person who asked the question before sort of framed it as 100 to 150 per quarter. No, that's not what I guided to. I guided to 100 to 150 basis points for the remainder of the year.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

For the remainder of the year. Got it. And then, that leads me to the follow-up question, which is if we're going to exit somewhere around 49.5% to 50% gross margins this year. As we look at fiscal 2024, I know you've given us the three drivers to gross margin expansion towards the target model. But how would you expect fiscal 2024's margin acceleration to compare to what you'd expect this year – or excuse me, fiscal 2025 versus fiscal 2024?

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

Correct.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

I think you know what I'm talking about.

Emeka N. Chukwu
Executive Vice President & Chief Financial Officer, Semtech Corp.

A

I would expect to see continued gross margin expansion on an annual basis every year for the next several years. And I think for FY 2025, I wouldn't be – I'm not guiding to it, but I would probably still expect to see something in the neighborhood of 150 to 200 basis points of gross margin expansion, just because at that point, the expectation is that the environment has normalized and business is – a lot of the macro issues have gone out and the Semtech business, right, is rebounding to the levels that we expect, right?

Also, at those levels, some of the material cost synergies that we've identified on the Sierra side will probably be completely achievable. In addition, also hoping that I will start to see early signs that the acquisition that is cellular – the availability of cellular connectivity is leading to new use cases beginning to ramp. We should also expect to see the growth in the annual recurring revenue for Sierra's business. We have managed connectivity and a little bit of the LoRa Cloud in addition to the fact that the LoRa IP, which we have not really talked about a lot, which is actually now beginning to do very well, probably averaging about $2 million a quarter, should continue to also increase.

So there are definitely a lot of opportunities, a lot of things that would really lead to see some decent gross margin expansion on our annual business from now going forward.

Craig A. Ellis
Analyst, B. Riley Securities, Inc.

Q

That's helpful color. Thank you, Emeka.

Operator: We have reached the end of our question-and-answer session. I would like to turn the conference back over to Mohan for closing comments.

Mohan R. Maheswaran
President, Chief Executive Officer & Director, Semtech Corp.

Thank you. In closing, while we face more macroeconomic challenges in Q1, we do believe we are near the bottom. Semtech is a very resilient company, and I'm confident that we will successfully manage through the headwinds we currently face and deliver profitable growth in the years ahead.

With that, we appreciate your continued support of Semtech, and look forward to updating you on our next quarter. Thank you.

Operator: Thank you. This will conclude today's conference. You may disconnect your lines at this time, and thank you for your participation.