Photoronics Q3 2024 Earnings Conference Call – Transcript

Photronics, Inc (NASDAQ: PLAB)
Q3 2024 Earnings Conference Call
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Company Executives

Eric Rivera – CFO
Frank Lee – CEO
Chris Progler - CTO

Conference Call Participants

Prepared Comments

Operator: Ladies and gentlemen, thank you for standing by. Welcome to Photronics third quarter fiscal year 2024 earnings call. [Operator Instructions]. Please be advised that today's conference is being recorded on Thursday, August 29, 2024. I would like now to turn the conference over to Eric Rivera, Chief Financial Officer. Please go ahead.

Eric Rivera - CFO

Thank you, Michelle. Good morning, everyone. Joining me this morning are Frank Lee, our Chief Executive Officer, and Chris Progler, our Chief Technology Officer. The press release we issued earlier this morning, together with the presentation material that accompanies our remarks, are available on the investor relations sections of our webpage. Comments made by any participants on today's calls may include forward- looking statements that include such words as anticipate, believe, estimate, expect, forecast, and our views. Forward-looking statements are based upon a number of risks, uncertainties, and other factors that are difficult to predict. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements.

We are under no duty to update any of the forward-looking statements after the date of this presentation to conform these statements to actual results. During the course of our discussion, we will refer to certain non-GAAP financial metrics. These numbers are useful for analysts, investors, and management to evaluate ongoing performance. A reconciliation of these metrics to GAAP financial results in provided in our presentation materials.

At this time, I'll turn the call over to Frank.

Frank Lee – CEO

Thank you Eric and good morning everyone. Third quarter sales came in lighter than we expected due to soft demand from Asia Foundry as a strong order rate at the beginning of the quarter lost momentum. Lingering macro uncertainty and customer concern on elevated inventory caused some to limit or defer releasing new designs. As a result, photomarket demand is slow. We wrote in lower sales for IT and FPD. High-end logic mass orders decreased, while our memory business improved in a quarter. High end FPD improved due to demand for AMOLED masks used for mobile displays as companies prepare for model release in the recovering smartphone market. Compared with the second quarter gross margin decreased due to the impact of lower revenue. Operating expenses were slightly lower than the second quarter.

EPS was $0.55. After adjusting for an FX scan EPS was $0.51, higher than last quarter and the same as last year. We continue to generate strong operation cash given our ability to invest in growth while also maintaining a strong balance sheet. As a result, we are announcing an increase of our existing share repurchase program to $100 million. Eric will give you the share details in a minute, but we believe this is the right time to restart our share repurchase activity and enhance our capital allocation framework.

Based on our optimism in the long range photomask, we are also evaluating several growth options, including strategic expansion, partnerships and other possibilities in the US, Europe and Asia. We are maintaining flexibility to act quickly in support of our global customers and partners, while remaining disciplined to ensure our investments meet financial objectives. I am very proud and very pleased with the way our team has performed during the quarter. They have taken care of the customers while managing costs and maximizing cash to maintain financial strength.

We have a great team at Photronics, and they are navigating the challenges well. Turning to the market, I would like to comment on the trend we are seeing. Photomask demand is driven mostly by design activity. Several long-term trends such as AI, mobile computing, and increased IC content in automotive, energy, and consumer applications drive new designs in both leading edge and legacy technology nodes. All required in the new photomask. As the global leader in IC mask units, we see a label of new product qualification of across the [indiscernible] each with projected revenue opportunities. This all paired with our margin strength and is positive long-term trend for our business.

In addition to new designs, photomask demand is driven by an increase in wafer manufacturing capacity. New fab are being built globally to meet the growth in applications such as data centers that are needed to support AI and to support an increase in supply chain regionalization. This is a positive long-term trend for photomask demand. Due to our broad geographical footprint, capacity, and suite of technologies, we are able to provide all of our customers' photomask needs.

We supply nearly all leading logic fab with strong market share, especially in Taiwan, China, and Korea. In the U.S. and Europe, we are seeing the initial signs of growing demand for regionalization.

Turning to display. Innovation is mostly due to new features in mobile displays and to a lesser degree new TV technology that improved performance. On mobile displays, this trend was largely supported by new premium smartphones, higher screen resolution and the need to add additional functions such as fingerprint sensor and camera while this required new advanced mask set. AMOLED continues to be introduced into larger size screen, such as tablets and laptops and the development is on the way to produce AMOLED G8.6 class. These trends all require high-quality photomask. If the technology [indiscernible] we are well positioned to benefit from these trends and grow.

While near-term demand is being challenged by dynamic market conditions, we remain optimistic regarding the long-term market outlook. Our competitive advantage, including strong customer relations, leading technology and broad global capacity position us to continue to outgrow the photomask industry. Our ability to control costs and manage cash should allow us to continue to invest in profitable growth and deliver shareholder value. At this moment, I'll turn the call to Eric to review our third quarter results and provide fourth quarter guidance.

Eric Rivera - CFO

Third quarter revenue of $211 million was down 3% sequentially with market softness across both IC and FPD. IC revenues decreased 3% quarter over quarter. High end was lower as improved memory sales were not enough to offset lower demand from logic foundries in Asia. Compared with the third quarter of 2023, high-end improved on strong US sales. High-end growth continues to be a factor for us as we see customers migrating to smaller design nodes including 22 and 28 nanometers to take advantage of the cost and performance benefits.

At the leading edge, our specialty QB business continues to grow. Year-to-date high-end IC revenue is up 23%, demonstrating our success in growing this segment of our business. Mainstream once again achieved sequential growth as demand improved, particularly in the U.S. This further validates our belief that Q1 of this year was the bottom of the mainstream downturn and we anticipate additional growth going forward.

FPD revenue was lower sequentially as well. On a positive note, high-end resumed growth with improved demand for mobile AMOLED displays. Overall, display industry dynamics continues to be soft, largely due to the same factors that are impacting semiconductor demand. As uncertainty evades, we anticipate achieving above-market growth due to our leading technology, scale, market share, and strong customer relationships. Overall our gross margin was 35.6%, down slightly as we would expect given the softer revenue and our level of operating leverage. Lended ASP held up well as price increases implemented in previous years hold firm. Our long-term purchase agreements continue to provide protection against outside risk during times of market softness helping us maintain market share and price. Delivery premiums, which were meaningful last year, are no longer material to our results as lead times have normalized.

Operating expenses were slightly lower, quarter over quarter, with operating margins compressing around 110 basis points to 24.7%. Despite softer revenue through the first nine months of 2024, we have maintained strong margins with the year-to-date operating margins of nearly 26%. Below the operating line and excluding the impact of FX gain, we achieved non-GAAP net income of $32 million, or $0.51 per share, ahead of last quarter and the same as last year.

We generated $75.1 million in operating cash flow and CapEx was $24.4 million in the quarter. Year-to-date CapEx is $87.7 million. We expect full year CapEx to be $130 million, $10 million lower than we previously estimated as some of the CapEx payments will not occur until next year. Our CapEx will support anticipated demand growth, primarily in multi-node IC capacity and capability, and to continue replacing aging tools all while we are ensuring we are increasing our return on invested capital.

Looking ahead to 2025, we see opportunities to continue investing in growth, primarily in IC to ensure we are well-positioned to capitalize on the positive long-term megatrends that are driving photomask demand. We will provide specific 2025 CapEx guidance during our Q4 earnings call in December. We further strengthened our balance sheet during the quarter, increasing the amount of cash, cash equivalents, and short-term investments to $606.4 million.

Total debt primarily for equipment leases in the US was reduced to $20.1 million. With our strong balance sheet and demonstrated ability to generate cash, we are increasing the size of our share repurchase program to $100 million and plan to restart activity under the program soon. We believe this is a good use of cash and will add value to our shareholders. Before providing guidance, I'll remind you that demand for products is inherently uneven and difficult to predict, with limited visibility and typical backlog of 1 to 3 weeks. In addition, ASPs for advanced math sets are high meaning a relatively low number of high-end orders can have a significant impact on our quarterly revenue and earnings.

With those qualifications we expect Q4 revenue to be in the range of $213-221 million. While we're seeing good order rates at the beginning of the fourth quarter, lingering macro uncertainty is keeping us cautious. Based on those revenue expectations and our current operating model, we estimate non-gap earnings per share for the fourth quarter to be in the range of $0.48 to $0.54 per diluted share. This equates to an operating margin between 25% and 27% as we continue to keep costs under control and maximize profitability.

We delivered sequentially higher adjusted EPS in the third quarter, even as demand remained soft. This was achieved by keeping a tight control on costs. We also continue to generate strong cash flow, keeping our balance sheet strong and enabling us to invest in growth. As demand in our market improve, we are in a great position to grow revenue and expand margins. I'll now turn the call over to the operator for your questions.

Question-and-Answer Session

Operator: Our first question will come from Tom Diffely with DA Davidson. Your line is now open.

Tom Diffely – DA Davidson

Yes, good morning, and thank you for taking a few questions. Eric, I was curious, you know, when we go through the results and how earnings kind of held in there despite the weaker revenue, it looks like a combination of tax and the non-controlling interest were the big drivers there. Maybe talk about each one, on tax, you know, why did it fall as much as it did? And then on non-controlling, you know, did the China percentage fall quite a bit? And if that's the case, is the profitability in China not where you want it to be quite yet?

Eric Rivera

Sure Tom, thanks for the question. So, from a tax perspective, what affected tax was the jurisdictional mix of earnings. Similar to the not controlling our drug ventures, didn't perform as well as we would've liked them to perform. So as a result. there was less income attributed to them. However, that was offset by some of our wholly-owned subsidiaries. So, as our wholly-owned subsidiaries, as the mix between earnings between our wholly-owned subsidiaries and our joint ventures, you know. benefit from additional EPS gains.

Tom Diffely – DA Davidson

So, maybe to summarize, when you do projects in North America or outside of Asia, the tax rates are better and the profitability is better?

Eric Rivera

So even within Asia, there are certain jurisdictions that just have different tax rates. So as that jurisdictional mix changes, as you have more income in lower tax jurisdictions, you benefit from a tax perspective.

Tom Diffely – DA Davidson

Okay, great. And a couple more here. So, noticed that SG&A was up quite a bit, quarter over quarter, despite the revenue dip. Maybe a little color there.

Eric Rivera

Sure, SG&A was primarily increased due to professional services fees that were incurred during the quarter.

Tom Diffely – DA Davidson

Any update on the general counsel dismissal? And does that have any impact?

Eric Rivera

There was certainly no impact to our financial results. No significant impact, I should say. No update further than that though at this time.

Tom Diffely – DA Davidson

Okay, and then just one broad question. When you look at the margin structure on the mainstream business and how over the last few years it's wrapped nicely, it kind of peaked, you know, maybe a year ago. Is the mainstream business still healthy from a price point of view or has the softness in the overall transaction run rate, you know, put it back into its old kind of sequentially declining on an annual basis?

Frank Lee

Tom, this is Frank. Our mainstream business actually is very stable because as we reported several times in the call, in the mainstream manufacturing side, there are many end-of-life tools. So, with that, we have to replace the equipment to add capacity. But in general, the capacity for mainstream segment is not increasing. So that enables us to keep a stable price.

Tom Diffely – DA Davidson

What do you think the longer-term impact is, if any, of Apple canceling its micro display project? And then how do you see OLED ramping into flat panels of a larger size over time?

Chris Progler

Yeah, so the micro display, we don't really see much impact, you know, micro display. We didn't have it marked up as a big growth driver for photo masks. So, to the extent companies like Apple decide not to commit to micro display, it does not really change our outlook on the FPD market. As far as the OLED, definitely we see the Gen 8.6 form factor starting to go into production next year, we believe. One of the large power makers already has a fab. We're talking to them about shipping initial masks into that. We do think we'll be in a good position for that high form factor mask. And the ASPs for those, because they're tough masks to make, AMOLED and Gen 8.6, much harder, much more complex than LCD. We'll see really good ASPs on those products.

Tom Diffely – DA Davidson

Okay, and I assume that you have a bit of a technology advantage over some of your newer peers in that space as well.

Chris Progler

For sure, FPD, we have pretty strong technology lead. The other thing that we see on AMOLED, a lot of take up of so-called advanced masks, things that, you know, not to use jargon but face-shifting masks and the types of technology that really helped IC evolve through Moore's Law, we're seeing the adoption rate on those for flat panel increase quarter over quarter. So, a really good take up on our higher-end masks to get more performance on panel. We think our tech leadership here is going to be a great advantage.

Operator: Okay, I show no further questions in the queue at this time. I would now like to turn the call back over to Frank Lee for closing comment.

End of Q&A

Frank Lee

Thank you. Thank you for joining us this morning. While demand has been soft through the first nine months of 2024, we have done a great a good job of maintaining margins and generating strong cash. I'm proud of the way we have performed. Looking longer term, there are several mega trends that are showing market growth. As the leading photomasks producers, we are well positioned to grow as demand improves, creating value for our customers, employees, and shareholders.

Operator: Ladies and gentlemen, that concludes the conference call for today. We thank you for your participation and ask that you please disconnect your line. Thank you.