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+++ presentation

Operator^ Ladies and gentlemen, thank you for standing by, and welcome to Monolithic Power Systems' Fourth Quarter 2019 Earnings Conference Call. (Operator Instructions)

Please be advised that today's conference is being recorded.

(Operator Instructions) I would now like to hand the conference over to your speaker today, Monolithic's CFO, Bernie Blegen. Please go ahead, sir.

Bernie Blegen^ Thank you very much. Good afternoon, and welcome to the Fourth Quarter 2019 Monolithic Power Systems Conference Call. I'm joined today by Michael Hsing, Monolithic's CEO and Founder.

In the course of today's conference call, we will make forward-looking statements and projections that involve risk and uncertainty, which could cause results to differ materially from management's current views and expectations. Please refer to the Safe Harbor Statement contained in the earnings release published today.

Risks, uncertainties and other factors that could cause actual results to differ are identified in the Safe Harbor Statement contained in the Q4 earnings release and in our SEC filings, including our Form 10-K filed on March 1, 2019, and Form 10-Q filed on November 1, 2019, both of which are accessible through our website, www.monolithicpower.com.

MPS assumes no obligation to update the information provided on today's call. We will be discussing gross margins, operating expense, R&D and SG&A expense, operating income, interest and other income, net income and earnings on both a GAAP and a non-GAAP basis. These non-GAAP financial measures are not prepared in accordance with GAAP and should not be considered as a substitute for or superior to measures of financial performance prepared in accordance with GAAP.

A table that outlines the reconciliation between the non-GAAP financial measures to GAAP financial measures is included in our earnings release, which we have filed with the SEC.

I would refer investors to the Q4 2018, Q3 2019 and Q4 2019 earnings releases as well as to the reconciling tables that are posted on our website.

I'd also like to remind you that today's conference call is being webcast live over the Internet and will be available for replay on our website for 1 year, along with earnings release filed with the SEC earlier today.

For the full year 2019, MPS achieved record revenue of $627.9 million, growing 7.8% from the prior year, while our industry segment experienced a significant downturn.

As always, we executed our strategies consistently. In recent years, especially in 2019, more and more first-tier companies recognized MPS' superior technologies as well as our product quality and our excellent customer support.

We see a lot more high-quality growth opportunities ahead of us. Our objective is to successfully manage our expenses to support our growth, which will, in turn, benefit our shareholders in both the long and short term.

Here are a few highlights which we achieved in 2019. Introduced leading-edge system solutions using QSMoD technologies for GPU-based, artificial intelligence and machine learning applications.

Introduced 48-volt QSMoD technology for both cloud-based and automotive applications, coupled with our design wins in QSMoD in AI applications, MPS is at the early stage of this important revenue ramp.

Won a major contract to support a tier 1 automotive supplier, which will begin generating revenue in the next 2 to 3 years. Successfully co-developed cutting-edge solutions for smart driving systems and lighting applications. Began volume shipments of high current programmable power modules for communication applications such as 5G networks.

Entered the high-performance analog market with the formation of a high-precision data acquisition business group. With input from our customers, we have completed the detailed product specifications. We expect to release these products in 2020.

The initial revenue ramp is expected to begin in 2021. The rollout of these advanced products will mark MPS' introduction in the highly profitable, high-speed precision data acquisition market segment.

We understand the road to success may not be smooth, however, we believe our commitment will pay off in the long term and our shareholders will be pleased with the results of these efforts in the coming years.

Let's go through low lights. We really don't have any, except there is one item worth pointing out. We deliberately reduced our inventory in Q3 and Q4 2019, which in hindsight was not necessary. As a result, our current inventory level is too low for MPS to maximize our growth in the next few months.

Although we can still keep up our growth rate as in the past, we, unfortunately, may not be able to take full advantage of all the potential upside. In order to fulfill customers' demand in the second half of 2020, we now have to commit tremendous effort in order to accelerate our schedule to bring up a second 12-inch fab. This has created an unnecessary hardship for our team.

Turning back to our full year 2019 revenue by market segment compared with 2018. Communications revenue, up 20.1%. Computing and storage, up 18.9%. Automotive, up 12.8%. And industrial, up 12.3%. Consumer revenue was down 10.8%. Full year 2019 computing and storage revenue grew $30.1 million over the prior year to $189.2 million.

This 18.9% increase primarily resulted from strong sales growth for cloud computing and high-end notebooks. Computing and storage revenue

Represented 30.1% of MPS' total revenue in 2019 compared with 27.3% in 2018.

Communications revenue grew $14.2 million to $84.8 million. This improvement was primarily due to initial ramping of 5G infrastructure sales. Communications revenue represented 13.5% of our 2019 revenue compared with 12.1% in 2018. Automotive revenue grew $10.2 million to $90.3 million in 2019. This growth primarily represented increased sales of infotainment, safety and connectivity application products.

Automotive revenue represented 14.4% of MPS' full year 2019 revenue compared with 13.8% in 2018.

Industrial revenue grew $10.9 million to $99.4 million in 2019. This growth reflected sales for applications in power sources, security and industrial meters. Industrial revenue represented 15.8% of MPS' full year 2019 revenue compared with 15.2% in 2018. Consumer revenue fell $19.9 million to $164.2 million, with the exception of home appliances and wearables, all major consumer markets decreased between years. Consumer revenue represented 26.2% of MPS' full year 2019 revenue compared with 31.6% in 2018.

Switching to Q4. MPS had a record fourth quarter with revenue of $166.7 million, 1.2% lower than revenue generated in the third quarter of 2019, but 8.6% higher than the comparable quarter of 2018. Our market segment revenue from computing and storage grew 27.8% year-over-year. Automotive grew 8.6% and communications grew 8.5%. Industrial was essentially even with Q4 2018, while consumer revenue fell 5.7% from the prior year.

Fourth quarter 2019 GAAP gross margin was 55.1%, 10 basis points lower than the third quarter of 2019, but even with margin reported in the fourth quarter of 2018. Our GAAP operating income was $30.7 million compared to $30.0 million reported in third quarter of 2019 and $33.1 million reported in the fourth quarter of 2018.

Fourth quarter 2019 non-GAAP gross margin was 55.5%, 10 basis points lower than both the third quarter of 2019 and the fourth quarter of 2018. Our non-GAAP operating income was $50.8 million compared to $51.4 million reported in the prior quarter and $46.6 million reported in the fourth quarter of 2018.

Let's review our operating expenses. Our GAAP operating expenses were $61.2 million in the fourth quarter compared with $63.1 million in the third quarter of 2019 and $51.5 million in the fourth quarter of 2018. Our non-GAAP fourth quarter 2019 operating expenses were $41.8 million, down from the $42.5 million we spent in the third quarter of 2019, but up from the $38.7 million reported in the fourth quarter of 2018.

On both the GAAP and a non-GAAP basis, fourth quarter 2019 litigation expenses were $991,000 compared with a $692,000 expense in Q3 2019 and a $409,000 expense in Q4 2018. The differences between GAAP and non-GAAP operating expenses for the quarters discussed here are stock compensation and income or loss from an unfunded deferred comp plan.

Fourth quarter 2019 stock compensation expense, including $574,000 charged to cost of goods sold was $18.7 million compared with $21.3 million recorded in the third quarter of 2019.

Switching to the bottom line. Fourth quarter 2019 GAAP net income was $32.4 million or $0.70 per fully diluted share compared with $0.64 per share in the third quarter of 2019 and $0.61 per share in the fourth quarter of 2018.

Q4 2019 non-GAAP net income was $48.4 million or $1.04 per fully diluted share compared with $1.08 per share in the third quarter of 2019 and $0.99 per share in the fourth quarter of 2018. Fully diluted shares outstanding at the end of Q4 2019 were 46.5 million.

Now let's look at the balance sheet. As of December 31, 2019, cash, cash equivalents and investments totaled $458.5 million compared to $422.0 million at the end of the third quarter of 2019. For the quarter, MPS generated operating cash flow of about $61.0 million compared with Q3 2019 operating cash flow of $72.4 million.

Fourth quarter 2019 capital spending totaled $8.7 million. Accounts receivable ended the fourth quarter of 2019 at $52.7 million or 29 days of sales outstanding compared with the $58.3 million or 31 days reported at the end of the third quarter of 2019 and the $55.2 million or 33 days reported in the fourth quarter of 2018.

Our internal inventories at the end of the fourth quarter of 2019 were $127.5 million, down from the $135.6 million at the end of the third quarter of 2019. Days of inventory fell to 155 days at the end of Q4 2019 from 163 days at the end of the third quarter of 2019.

Before turning to our outlook for Q1 2020, I would like to remind everybody of our long-term non-GAAP financial model, which has been largely unchanged for the past 5 years. First, we target to grow revenue in a rate that is 10 to 15 percentage points greater than our peers. In a year where the market is expected to grow between 5 to 8 percentage points, we believe that MPS should be able to grow annual revenue from 15% to 20%.

Second, we target quarterly gross margin to grow by 10 to 20 basis points sequentially. Third, to ensure continued growth, we target increases in our R&D and SG&A investment at 50% to 60% of the annual revenue growth rate. Finally, we expect to return 30% to 40% of the company's annual free cash flow to shareholders. This long-term financial model is an important tool in setting expectations for accelerated revenue growth and providing operating leverage while allowing for a proper level of business reinvestment.

I would now like to turn to our Q1 2020 outlook. We are forecasting Q1 2020 revenue in the range of $161 million to $167 million. We also expect the following: GAAP gross margin in the range of 55.1% to 55.7%. Non-GAAP gross margin in the range of 55.4% to 56.0%. Total stock-based compensation expense of $18 million to $20 million, including approximately $600,000 that would be charged to cost of goods sold.

GAAP R&D and SG&A expenses between $58.4 million and $62.4 million. Non-GAAP R&D and SG&A expenses to be in the range of $41.0 million to $43.0 million. This estimate excludes stock compensation and litigation expenses. Litigation expenses to be in the range of $1.5 million to $2.5 million as NPS prepares for an upcoming trial, which is set to begin at the end of March. Interest income is expected in the range -- to range from $1.5 million to $1.7 million before foreign exchange gains or losses.

Fully diluted shares to be in the range of 46.2 million to 47.2 million shares. Finally, we are pleased to announce a 25% increase in our quarterly dividend to $0.50 per share from $0.40 per share for shareholders of record as of March 31, 2020.

In conclusion, we will continue executing on our strategy and winning market share. I will now open the phone lines for questions.

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Operator^ (Operator Instructions) And our first question comes from Jeremy Kwan with Stifel, Nicolaus.

Jeremy Lobyen Kwan^ Congrats on the strong results and outlook, especially in a challenging environment. I guess my first question, regarding -- you mentioned about not having sufficient inventory in hand to meet all the immediate demand you're seeing, is there a way you can kind of quantify what's kind of being left on the table? And is there a chance to capture this maybe later on in the coming quarters?

Michael R. Hsing^ All these products, which is design (inaudible) and our customers have upside, there is -- many of us -- many of them, they told us. So we believe, okay, these are -- these sockets are difficult to change. And they're not -- it can change month by month. And those volumes still will be with us.

Bernie Blegen^ Yes. We're not trying to identify a risk factor with regard to our ability to execute against expectations. We're just saying that it would be imprudent for us to allow our investors to believe that there is even more upside beyond that because we may have some constraints with regard to inventory.

Michael R. Hsing^ Yes, our inventories, we involve a few thousand products. And very difficult to predict, which was the ramp ahead of -- which ones to ramp first. And so that causes a lot of problems for our planning and also for our shipments. We're now doing partial shipment.

Jeremy Lobyen Kwan^ Great. That's helpful clarity. And I guess my follow-up would be, Bernie, you mentioned entering the high-performance analog market with the high-precision data acquisition group, can you give us more details about this, maybe you or Michael, maybe what initial application is going to go after first and how do you plan to compete in this market and maybe your sales strategy? Do you need more distribution partners? Or is this something that you can leverage your e-commerce platform?

Michael R. Hsing^ The initial one is in -- these initial market segments there in the communications and as well as medical applications. And we don't have a long-term strategy. I think through our Internet -- through our e-commerce and we tried to push everything through e-commerce.

Operator^ And our next question comes from Alessandra Vecchi with William Blair.

Alessandra Maria Elena Vecchi^ Congratulations on a wonderful quarter. Just on 48-volt, you talked about the new product introductions in 2019 and I believe you guys said on the last earnings call that you'd be seeing some revenue in Q1, can you just update us on that and how we should think about the total revenue opportunity there as we look into 2020 and 2021?

Bernie Blegen^ Yes. I don't think that we guided, per se, on giving an exact revenue outlook for Q1 with beginning of 48-volt. But we said that it would be in 2020. And right now, it's -- everything is tracking pretty much along our expectations. So what's really exciting is that I think that it validates our strategy to have gone into 48-volt and to enjoy and participate in many of the opportunities there it brings us.

Alessandra Maria Elena Vecchi^ Okay, that's helpful. And then I apologize if I missed it, but Bernie, did you give us a little bit of clarity in terms of by segment in Q1. What segments maybe you thought would be the strongest sequentially.

Bernie Blegen^ Yes. Again, I think the broader question there is what's going to be -- what is the revenue drivers looking like. And at this point, I think it's a continuation of more of what we've been seeing recently. So for example, the compute and storage market is very well positioned for growth in the early part of the year. Likewise, communication, we believe that there's also a significant opportunity for growth, particularly in Q1. When you look at -- oh, I should make 1 asterisk on computing, notebooks, which are -- we report in computing, are seasonal. And coming out of Q4, they tend to have a seasonal decline, which we are anticipating as well. But when you look at storage or cloud computing, I think that they were very well positioned. And then after that, if you look at consumer again, that still has not hit a steady state or show any signs of being healthy. And again, consumer is also very seasonal, and it's normal to expect a decline from Q4 to Q1. And then when you look at Industrial, a lot of that was revenue performance, particularly in the second half of the year. It reflected inventory builds on the part of certain of our customers who are anticipating trade restrictions. And so that area may fall off in Q1. In automotive, that tends to go either on the plateau or when it fits designed in your new revenue opportunity, there's a spike.

Alessandra Maria Elena Vecchi^ Okay. Just on automotive, some other semiconductor companies have alluded to sort of a bottoming out improvement there. So are you seeing a similar situation? I know it depends on what model you're designed into and whatnot, but do you feel like the worst is behind you?

Michael R. Hsing^ I think that we are too small to call the industry. We are growing to all these greenfield markets and the leasings that we say that isn't end of the world. All this is the beginning of the world. It's the beginning in the world for MPS.

Operator^ Our next question comes from Michelle Waller with Needham.

Michelle Waller^ Congrats on the results. So I guess the first one for me, in terms of the next-generation gaming consoles launching in 2020, could you guys walk us through what the ramp is expected to look like for MPS. Is it only a back half driver? Or do you think you'll see some meaningful uptick in 2Q? And from a gross margin perspective, how should we think about the impact of corporate gross margins during that ramp?

Michael R. Hsing^ Are you talking about gaming, particularly?

Michelle Waller^ Yes. And specifically, yes.

Michael R. Hsing^ Gaming is not a major part of our business. And that is all into the 1 product, is in a consumer segment, and it is in a share, the similar CPU copower. And so the business is very lumpy. And -- but we treat this very opportunistically. And our customers really like our solutions, and we will support them when the demands come.

Bernie Blegen^ And we probably expect to see a similar ramp as we did in 2017.

Michelle Waller^ Okay. That's helpful. And then for my follow-up, you guys mentioned previously that your dollar content opportunity with the Whitley server platform increased to $70 from $50 in the Purley platform. I'm just trying to figure out -- I know this is a bit further off, but with the equal stream platform that's expected to launch in 2021, how do you guys see your dollar content opportunity changing generation over generation? Or just any color you can give there would be helpful.

Bernie Blegen^ On the dollar content, we don't -- we haven't seen an opportunity to expand beyond what we currently are getting on the V14. But then again, the specs are not entirely finalized. So if it turns out that the space of the power requirements are materially different from what V14 is, there might be an opportunity for pricing leverage.

Operator^ Our next question comes from Matt Ramsay with Cowen.

Joshua Louis Buchalter^ This is Josh Buchalter on behalf of Matt. Congrats on the results in a tough environment. I guess the first question was, if we think about your inventory commentary from last quarter, are there any couple of items in particular that you could point to that drove the change in your thought process from 3Q to 4Q? And then also, is there any margin impact from bringing on the new 12-inch fab and your sort of what sounds like capacity constraints?

Michael R. Hsing^ Well, we're talking about margins. And if you were 12-inch fabs, okay, every time we're bringing up a fab is and not -- we will have a very immediate impact for the margin improvement. All these product -- these products that are from new fab is always a year or 2 years down the road. We -- in terms of which segments of where our inventory is tight and, again, it's actually across the board.

Joshua Louis Buchalter^ Got it. And I guess, in the beginning of the call, you mentioned several tier 1 companies launching with your design wins. Were there any, I guess, if you could rank order 1 or 2 that you're most excited about heading into 2020.

Michael R. Hsing^ These are, we said it and Bernie said at the beginning of the call, so okay, these are things that were -- these are the few things that we achieved in the 2019. And all of these will generate a significant revenue in 2020.

Bernie Blegen^ Yes, and it's not restricted to any 1 end market segment, it's actually very broad-based to the level of the customer engagement that we're receiving from Tier 1s.

Operator^ And our next question comes from Rick Schafer with Oppenheimer.

Richard Ewing Schafer^ I'll echo everyone else's congratulations on another monolithic quarter, another great quarter. I just had a maybe question. On Coronavirus, since it's a topic, is your -- you guys have 3 of your 4 production foundries in China, so I'm just curious, Michael or

Bernie, if you're seeing any signs of supply disruption? Or do you expect to see any signs once guys just start coming back to work next week.

Michael R. Hsing^ All the fab, as far as we know, they are all open. They are all operating. And they're in a really tight conditions, okay?

And all the assemblies, same things, okay. And so far and really hasn't disrupted our supply.

Bernie Blegen^ And again, Rick, it's a very early stage to really fully appreciate or understand how any of our businesses will be impacted.

Richard Ewing Schafer^ Sure, sure. I understand. So maybe a follow-up, if I could. Just on your auto bus, I know you guys secured one of the, I think, the #1 Tier 1 auto supplier a few months ago. I'm just curious where we stand on securing the #2 Tier 1 auto supplier. And as part of your answer, I'm curious, I mean, from after you signed number 1, have you seen -- is it too soon to have seen any noticeable uptick in design activity? And maybe also just a comment on China in general. I know -- I'd be interested. I know that it was kind of a slow year for China auto, they basically canceled the design here, I think, last year or the model year. I'm curious kind of what your expectations are for China this year, what you're seeing?

Michael R. Hsing^ Well, okay. Overall, everybody told us, like, all those will not be a good year, okay? But from the NPS side, we are looking pretty good in fall of 2020. And all these #1 and #2 and #3, all those and we are deeply engaged in that we see all the activities that we the more than we can handle it.

And now we have to pick and choose.

Operator^ And our next question comes from Ross Seymore with Deutsche Bank.

Unidentified Analyst^ This is [Melissa] on behalf of Ross. Congratulations on the really solid quarter. I know you guys don't guide out more than 1 quarter. But I guess, from a high-level perspective, now that we're coming out of this industry downturn, what are your expectations for returning to either seasonal or even above seasonal growth? Is this moderated by what -- by your inventory constraints? And how are you thinking about the slip of the recovery from here?

Michael R. Hsing^ Well, you call it industrial out of the downturn came. And as you said -- as Bernie said earlier, so we will grow above the industrial market, okay? Plus what's your upturn and about 10% -- 15% to 20%. So we committed on that.

Unidentified Analyst^ Okay, great. And then does the inventory constraints, is that kind of restricting that growth prospect? Or do you think you can still kind of hit that target?

Michael R. Hsing^ We tried to -- and I as we couldn't -- as we said earlier, we cannot maximize it because our customers are pulling in those

-- pulling the requirements, okay? And so we have to keep them on line up and we have the partial shipment. And that's -- our inventory is in a very low stage, okay?

Unidentified Analyst^ Got it. And then the last one for me is your computing and storage segment has been driving really strong growth and I was just curious when you look into 2020, how are you thinking about this shape of that business? And in particular, are you worried about any risk of inventory digestion of lumpy buying? Or do you think that it's really strong secular growth that's driving the strength?

Bernie Blegen^ Yes. When you look at 2019, I think that first half of the year was an anomaly where the hyperscales were trying to digest excess capacity. And so I would see, with the V14 haven't been just recently rolled out a return to a more normalized adoption process.

Operator^ (Operator Instructions) And our next question comes from Tore Svanberg with Stifel.

Tore Egil Svanberg^ Congratulation, again. Very nice results. First question on inventory being tight. I mean you're at 156 days. So how tight is it? I mean I know you want to run a little bit higher than that, but it doesn't seem alarmingly low either. So maybe you could just elaborate a little bit on that.

Bernie Blegen^ I think we're at 155 days right now. And if you were to look at sort of the industry standards, we're probably in at about the midpoint range of what people might expect. There's 2 things though that differentiate us. The first is the diversity of the number of products that we maintain and then the second is that we build inventories ahead of when we sell them. And as a result, because we're growing at a rate that is 10 to 15 percentage points faster than the industry that puts more pressure on us to have more inventory available in an earlier stage. So it's as much a risk management decision with the level we carry. And I think that we've said previously that we're more comfortable with inventory levels between about 160 and 180 days.

Michael R. Hsing^ Yes. For the stagnant companies, inventory, yes, is very predictable. For the growth company and we have a particular for NPS, we have -- it is not thousands, we have hundreds of projects and that they are taking off. And some of those faster, other ones the slowest, how do we pick on those? Very difficult to call.

Tore Egil Svanberg^ Well, it's a good problem to have. Second question, and I always ask you this, Michael, if you could give us an update on your e-commerce business. We've noticed that the website keeps changing. So if you could update on those, that would be great.

Michael R. Hsing^ The e-commerce side, okay, other than MPS website, e-commerce and we're still learning from that one, okay. But our product to sell to the third party e-commerce site is doing really well. And so as a result of our learning and we're changing it. You've seen that on our website. And so far, we can't give you the significant number yet, okay?

But our views at 2020, end of 2020, I think that they will move some needles.

Tore Egil Svanberg^ Great. So at least, you're now seeing that the traffic really moving in the right direction, it sounds like.

Michael R. Hsing^ Yes. The key is the traffic. But yes, your key is the traffic. So we can -- I can give you analogies in a, we believe again, a year ago, we believe that there's a lot of fishing in the Pacific Ocean. So we dropped the fish in the middle of Pacific Ocean, we didn't comment anything. And our learning, we're fishing what kind of fish, where are they? We're a lot more targeted. So we went through -- we have gone through that phase, okay? We're not a lot more targeted now.

Tore Egil Svanberg^ Very good. Make sure you have enough date. Last question on the e.Motion business, if you could also update us there, including, obviously, your system-level motor products.

Michael R. Hsing^ Yes. So the model is that the intended is just not selling the models motors and intended to provide a convenience for our customers for the initial ramp. So okay, we -- those business at the very beginning, and I go through, we see quite a few orders from our Internet and then, typically, those customers are going very slow. And I mean, that -- their project takes a year and 1.5 years and it -- to ramp. It's not like they're selling a silicon piece, okay? And usually models for the guys that takes about 3 or 4 years. And in terms of e.Motion, we have -- I don't know what -- Bernie, maybe you can say that, okay, $20-some million this year, more than $20 million -- last year, $20-some million. This year, we're going to keep up a similar growth rate. And that -- so we'll be -- certainly would be a $30 million or $40 million.

Bernie Blegen^ I think that we're comfortable in saying that it can be a $30 million or $40 million business here in the next few years. I think, though, that Michael makes a very good point as far as the length of time between adoption and when you actually generate revenue, many of those applications, almost have characteristics similar to automotive.

Operator^ And I'm showing no further questions at this time. I'd like to turn the call back to Bernie Blegen for any closing remarks.

Bernie Blegen^ Thank you. I'd like to thank you all for joining us for this conference call and look forward to talking to you again during our first quarter 2020 conference call, which will likely be in April. Thank you, and have a nice day.

Operator^ Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect. Everyone, have a great day.