Earnings preview Sept 25, 2024

MU: End market weakness to be offset by circuit breakers

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At the earnings call today we expect MU management to sound incrementally more negative than they were at the August investor meetings. We expect a round of estimate cuts on the Street as management likely walks back its FY25 expectation of strong momentum and sequential margin improvement. We expect a **negative reaction** in the aftermath of the earnings call. We are cutting our Fy25 estimate to $35bn/$5.74, well below consensus estimates. We believe the Street does not appreciate the duration of the slowdown in end demand, which few saw coming 3 months ago. Our checks show downstream OEM/ODMs have been selling DRAM contracts back into the channel, indicating they do not foresee a quick recovery.

But after an initial negative reaction, we expect **circuit breakers** to kick in. We anticipate help from two very different sources. The first source of help – the **US Fed**. A week ago, we applied our insights from the semis market to macro data and came to the conclusion that the Fed needed to do something drastic (link). We think the Fed did just that. In cutting the Fed fund rate by 50bps and suggesting another 150bps worth of cuts through 2025, thus taking the rates into the neutral territory, the Fed is offering to open the flood gates of liquidity, with the predictable effect of pushing up consumer demand over time.

The second source of help - **Samsung**. Yes, Samsung. Our view is that the DRAM situation has gotten bad enough for Samsung to start curtailing output, thus reducing oversupply in the channel.

While we are not clear on the timing of the circuit breakers, after an initial pullback we expect the stock to **head up**. We are cutting our $120 PT established in July. We think our **new PT of $110**, based on 19x to our reduced Fy25 eps, is a realistic goal.

While we expect management to continue pushing the case for AI/HBM, we do not expect the AI premium to return to the stock. We expect Street's elevated AI-driven price targets to come down. We note in passing that we called peak earnings for MU in early July and cut our price target (link). A few days later the stock began its sharp decline, along with the rest of its AI cohort.

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Street positioning: The Street appears somewhat **at ease** going into the earnings call tonight, secure in the belief that the ~40% slide in the stock from its July high may have priced in the lowered Nov quarter outlook that MU management provided at the August investor conferences. But should the Street be at ease? A quick look at the **timing** of events shows that MU management warned investors **after** the slide, not before. In our view, MU's slide in July was in response to a general loss of patience investors expressed with **AI-related** stocks. Meanwhile, MU management's warning in August was related to renewed weakness in the traditional **non-AI** end markets. The question remains – has the stock sufficiently discounted management's incremental negativity?

Our short answer – probably not: If the non-AI weakness is temporary, i.e. lasts only for a quarter, we suppose the negativity is priced in. But what if at the earnings call today, management indicates weakness in PC/smartphone/consumer sectors extend beyond the Nov quarter and into the **Feb quarter**? Could a pick-up in demand from the AI-related Blackwell HBM shipment be enough to offset weakness in the traditional sectors? We note that the preponderance of DRAM bits goes into non-AI end markets (>90%); for AI demand to offset non-AI weakness is harder than many expect. **Furthermore,** doesn't the very fact that Blackwell has been delayed, if only for a few months, suggest that the memory sector's supply/demand calculation made earlier in the year may lead to oversupply of bits allocated to HBM? The additional months of bit production with no Blackwell to ship into adds to the oversupply in the channel.

What happened in July? Within just a month of the previous earnings call, MU management goes from 'momentum is strong' and 'sequential gross margin improvement' to warnings of 'weak demand' and 'weak pricing'. Something happened in July that spooked MU management and jolted them into lowering elevated expectations into out-quarters they had set in late June.

Our checks into the supply chain reveal that management had good reason to sound the alarm. Typical **buyers** of DRAM- OEM/ODMs and disti- began **selling DRAM contracts** to reduce their purchase commitment. That's not a sign of robust future demand.

Signs of distress out of Samsung shows that this is not a MU-specific problem. An abrupt lowering of guidance at FedEx indicates that the slowdown is not limited to the memory sector; FedEx spoke of a slowdown in industrial shipment between their B2B customers. We believe there was a general weakening of consumer and industrial demand here in the US and in Asia in July/Aug, which may not have been anticipated by market participants, and which we believe is not dialed into consensus estimates for semis. Weakness in Europe was reported by several IT players at the June quarter earnings calls.

Our checks into the traditional non-AI supply chain:

Cut back in PC outlook for the year: The two pillars of enthusiasm evident at Computex in early June appear to have fallen flat. Expectations of 40mn unit sales of AI PC have vanished. With very little traction seen at QCOM's models, the PC sector seems to have given up hopes for an uplift to ASP from AI PCs. Hopes of a refresh cycle from Microsoft o/s upgrade too have vanished. Expectation of mid-single digit growth three months ago, we think have fallen back to **flat** growth, with overall PC units this year no better than at pre-pandemic levels going back to 2019.

Cut back in Smartphone outlook: Whereas the Street was expecting mid-single digit unit growth a quarter ago, those hopes have come down to now no better than **flat,** in our view. This implies a 30-50mn unit cut back versus expectation a few months ago. The chief culprits 1) a general pull-back in financing of smartphone supply chain in China and 2) push-out in launch of AI apps in AI-enabled smartphones from early Q4 to end of year. Not just with Apple, but it now turns out with Android as well, the arrival of AI applications is going to be no earlier than Christmas season. This essentially means that the smartphone vendors have pushed AI hopes out of Cy24 and into Cy25.

General weakness in consumer goods: The TV sector shows incremental weakness, perhaps in the aftermath of the Olympics. During the mid-Autum holiday in China, rather than the usual **2 days**

of production slowdown, LCD panel manufacturers in China shut down production lines for **2 weeks**. Samsung suspended production of its LED production line, a key component of worldwide LCD TVs. We note that recent reports of headcount reduction at Samsung mentioned cutbacks at its TV and smartphone divisions in addition of the memory division, indicating a general slowdown in consumer demand.

Downstream systems vendors trim DRAM contracts**:** 1) Over the past 1-2 months, our checks show PC/server OEMs sold DDR4 contracts they were holding, we suppose in response to weakening end demand and falling DRAM pricing. 2) Our checks show that distis have been selling lpDDR4 contracts in response to lowered expectations from smartphones. 3) Even in the gaming segment, we believe GDDR contracts were sold, interestingly some by NVDA itself.

What does the selling of contracts by downstream players mean? We think it means that the traditional buyers of contracts may be seeing prolonged weakness in end markets.

The Fed (and PBoC) to the rescue: A week ago, we applied our insights from the semis market to economic macro data and come to the conclusion that the Fed needed to do something drastic (link). We think the Fed did just that. In cutting fed fund rate by 50bps and suggesting another 150bps worth of cuts through 2025, thus taking the rates into the neutral territory, the Fed is offering to open the **flood gates of liquidity** to boost demand. China's PBOC too announced a stimulus package this week to promote lending.

The Fed's SEP projection published last week includes the expectation for GDP. If the Fed is right in assessing that rate cuts will be enough to maintain Cy25 GDP at 2%, flat to Cy24, then they are implying a few quarters of above-normal economic growth next year. If they are right in their assessment, then the memory market should see green shoots re-emerge and end demand to right itself some time in Cy25.

Samsung to the rescue? Our view is that the situation may have gotten bad enough for Samsung to start curtailing DRAM output. The first (and easily reversible) step in that direction would be to **cut back packaging** DRAM dies and allow completed wafers to go into wafer inventory. Rather than go for market share, Samsung may change tactics and act to prevent further slide in profitability. Whereas it would be too much to expect falling DRAM price to bounce upwards, the potential action hopefully brings channel supply into better balance with weakened demand, thus turning the **second derivate of memory price positive**. We expect DRAM fab utilization to continue unchanged at full capacity.

We are cutting our FY25 rev/eps/gm estimate to $35bn/$5.74/35%, **well below consensus** estimate $38bn/$8.7/42.6%. We think gross margin may have peaked out at the Aug/Nov levels. We do not expect tailwinds to overall margin from AI shipment. By the time Blackwell ships in volume in MU's 2Fh25 we expect memory vendors to have aligned bit supply and TSV packaging capacity to HBM end demand, thus diluting pricing power. We expect the November soft patch in non-AI segments to extend into the Feb quarter. We do not expect management to be able to guide to the timing of a turn-around in bit demand. Our **$110PT is based on 19x** to Fy25 eps.

Net/Net: We are cutting our Fy25 estimate well below consensus estimates. We believe the Street does not appreciate the duration of the slowdown in non-AI end demand. We expect MU management to sound incrementally more negative than they were at the August investor meetings. We expect a round of estimate cuts on the Street as management likely walks back its FY25 expectation of strong momentum and sequential margin improvement. We expect a **negative reaction** in the aftermath of the earnings call.

But after an initial pull back, we expect circuit breakers to kick in, and for the **stock to head up**. We anticipate help from two sources – macro help from the US Fed and sector-specific tailwind from production cutback at Samsung. We think our **reduced PT of $110** is a realistic goal.

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