ASML reports €3.3 billion net sales at 48.2% gross margin in Q2 2020

2020 sales growth expectations unchanged

VELDHOVEN, the Netherlands, July 15, 2020 - ASML Holding N.V. (ASML) today's Investor Call – 2020 second-quarter results.

Peter Wennink

Welcome everyone, thank you for joining us for our Q2 2020 results conference call. First of all, I hope all of you and your families are healthy and safe. Before we start our normal quarterly results review, I would like to provide a brief update on the COVID-19 situation.

Thanks to the commitment, engagement and creativity of our people, we managed the quarter very well and this translated into growth in both revenue and profitability in the quarter. Roger will provide more details on the results.

Although we experienced some challenges early in the quarter around supply delays and increased absenteeism, we did not encounter any new disruptions due to COVID-19. We continue to operate with special measures in place around isolation and contamination protocols to ensure the safety of our employees and to reduce risk of operational disruption. Even though this created some initial inefficiencies and production delays, operations capabilities are largely back to normal.

Regarding transportation logistics and customer support, we were able to continue to secure flights to meet customer shipment requirements and we have managed to support our customers in this challenging environment. We have significantly increased the capability of our teams in the field to more independently support the customer and continue to deploy more novel remote diagnostic and augmented reality support. Maturity of this remote technology has accelerated throughout this COVID period and we expect to deploy even more of this in the future.

In summary, we have been able to successfully navigate through the current environment and our operations capabilities are largely back to normal. But as COVID-19 is not yet behind us, we will remain vigilant to ensure the safety of our employees while providing the best possible customer support. Thanks again to our people and everyone in our supply chain, who did an outstanding job servicing our customers during this challenging time.

Now, I would like to turn to our normal quarterly results process.
Before we begin the Q & A session Roger and I would like to provide an overview and some commentary on the second quarter, as well as provide our view of the coming quarters.
Roger will start with a review of our Q2 financial performance with added comments on our short-term outlook. I will complete the introduction with some additional comments on the current business environment and on our future business outlook.

Roger if you will.

Roger Dassen
Thank you Peter and welcome everyone.

I will first review the second-quarter financial results and then provide guidance on the third quarter of 2020.

Net sales came in at 3.3 billion euros, we executed quite well considering the risks in the COVID-19 environment, translating to strong growth of more than 35 percent over Q1.
We shipped 9 EUV systems and recognized revenue on 7 systems in this quarter.
Taking into account the additional approximately 260 million euros of revenue from the net two systems we didn't recognize in Q2, this would hypothetically have resulted in revenue of around 3.6 billion euros and a growth of around 50 percent.
Similar to Q1, some systems were expedited for shipment without factory acceptance testing in Q2, we expect to recognize revenue on these systems at site acceptance in the second half of the year. We shipped 9 EUV systems in the quarter with 4 systems not receiving factory acceptance testing, meaning 5 systems recognized revenue upon shipment. For the 2 systems that shipped in Q1 but did not receive factory acceptance testing before shipment, we were able to complete customer site acceptance tests and recognize revenue this quarter, bringing the total to 7 EUV revenue systems in Q2.

Net system sales of 2.4 billion euros was again more weighted towards Logic at 62 percent, with the remaining 38 percent from Memory. Although Logic remains very strong, Memory has been growing over the last three quarters as a percentage of system sales.

Installed Base Management sales for the quarter came in at 887 million euros. This brings the total of Installed Base revenue in the first half to around 1.7 billion euros.

Gross margin for the quarter was 48.2 percent, a significant improvement over Q1 primarily due to DUV mix and an improvement of the EUV installed base gross margin.

On operating expenses, R&D expenses came in at 567 million euros and SG&A expenses came in at 131 million euros. The effective tax rate was higher (18.5 percent) based on a one-off tax assessment recorded in Q2. Net income in Q2 was 751 million euros, representing 22.6 percent of net sales and resulting in an EPS of 1.79 euros.

Turning to the balance sheet, ASML paid 565 million euros in dividend or €1.35 per ordinary share in Q2, together with the interim dividend of 1.05 euros per ordinary share paid in Q4’19 this resulted in a total dividend for 2019 of 2.40 euros per ordinary share.

We ended last quarter with cash, cash equivalents and short-term investments at a level of 4.4 billion euros, which is 300 million euros higher than Q1.

Moving to the order book, Q2 system bookings came in at 1.1 billion euros, including 461 million euros from three EUV systems. Order intake was balanced between market segments with both Logic and Memory at 50 percent. Logic demand continues to be strong with Memory increasing as a percentage of bookings over the past three quarters.

With that I would like to turn to our expectations for the third quarter of 2020.

We expect Q3 total net sales of between 3.6 billion euros and 3.8 billion euros. We expect our Q3 Installed Base Management sales to be around €850 million euros, which is driven by strong demand for field upgrades and growing service revenue, with a more meaningful contribution from EUV service.

Gross margin for Q3 is expected to be between 47 percent and 48 percent, which is a little below Q2 primarily due to DUV mix, with fewer immersion systems.
We have previously highlighted a number of levers that could positively impact gross margins in the second half. These levers being a richer mix of DUV, more immersion less dry, primarily driven by the memory recovery, growing EUV service revenue and improved immersion margins from our NXT:2050 system. These levers remain and provide the opportunity to achieve 50 percent gross margin in Q4.

The expected R&D expenses for Q3 are around 545 million euros and SG&A is expected to come in around 140 million euros. Our estimated 2020 annualized effective tax rate is still expected to be around 14 percent.

Finally, I would like to talk about capital allocation and working capital. Our capital allocation policy remains unchanged. In the next years, we expect to generate a significant amount of free cash flow. Cash that will not be required to support the future growth of our business, will be returned to our shareholders, in a combination of growing dividends and share buybacks. Regarding investments in our business, we plan to have capex at levels previously communicated in support of future technology and required expansions. Regarding working capital, we are working our way through a transition period. We come from a period where contracts did not include down payments and actually provided extended payment terms for customers given the maturity curve that our EUV tools were on and are moving into a direction where we ask for down payments of EUV tools, reflecting the long lead times and early supply chain commitments that ASML has to enter into. This means a temporarily higher level of working capital in 2020, with a plan to significantly reduce this level in 2021. All in all, we expect to see a significant increase in the generation of free cash flow in the course of the second half of this year. Once this occurs and the risk profile for our entire ecosystem has returned to acceptable levels, then we will resume the execution of share buyback, in line with the plans that we have communicated earlier this year, 6 billion euros over 3 years.

With that I'd like to turn the call back over to Peter.

Peter Wennink
Thank you, Roger.

As Roger has highlighted, we had a strong quarter with over 35% growth in revenue and improved profitability. In this challenging macro-economic environment, we saw growth in both Logic and Memory markets, which is a reflection of our customers' drive to innovate and continue to invest in future technology nodes. With significant work from home and remote learning activities continuing, segments such as data center and communication infrastructure continue to be strong. Demand for consumer related electronics, for example smartphones, may be under some near-term stress due to the economic impact from COVID. Our customers indicate they see continued strength in end markets requiring advanced nodes and this is reflected in our stable demand. For 2020, our growth expectations that we indicated at the start of the year are largely unchanged despite the disruptions caused by the worldwide COVID induced crisis. We therefore expect a year of double-digit growth in sales and profitability.

In Logic, customers continue to ramp advanced technology nodes, 7 and 5 nanometer, in support of the build-up of the digital infrastructure, driving end market applications such as 5G, AI and high-performance compute requiring leading edge equipment, which have longer lead times and qualification schedules. We expect Logic demand to remain healthy which continues to drive demand for EUV systems as well as our other products.

In Memory, customers are continuing to indicate that they are seeing signs of recovery driven by healthy demand in data centers and expectations of improved demand in consumer electronics. Increasing lithography utilization levels support this view and with this continued trend in mind it is understandable that we see additional demand in the second half of the year. This is supported in our bookings, with Memory increasing as a percentage of bookings over the past three quarters.

Sales to China continue to grow and accounted for 23 percent of our systems revenue this quarter. This is driven by demand from both Logic and Memory customers in China and we expect sales growth from the China region this year. Regarding changes to the US export rules that went into effect at the end of June, we expect minimal impact to our business. Regarding the impact of recent US restrictions, it is difficult to determine how near term dynamics will evolve but when you look at the end market demand and the growing digital economy, with secular growth drivers like 5G, AI and high performance compute, the demand for semiconductors for these products will continue and it will fuel future innovations. Wafers and products to support this technology and innovation will be produced somewhere in the world and it will certainly require advanced lithography.

On our Installed Base business, we still expect significant growth this year. First half of the year we realized revenue of around 1.7 billion euros, and we expect a similar level of business in the second half of the year. Services business will continue to scale as our installed base grows and EUV will contribute in a more meaningful way to service revenue as these systems run more wafers in volume manufacturing. We expect significant demand for upgrades, as customers utilize upgrades to increase capacity and improve imaging and overlay performance.

On EUV, this technology has now entered the realm of high-volume manufacturing and is an integral part of our core operational activities as evidenced by the large EUV share of our sales in Q2.
We have successfully implemented the improvements to the modular vessel we discussed last quarter. This vessel is designed to deliver higher availability. With 9 shipments this quarter, we have shipped 13 systems in the first half of the year. As COVID-related transportation and support risks are now lower, we plan to resume the normal qualification process, including factory acceptance testing, meaning we expect to recognize revenue at shipment on all systems in Q3. We plan to be back on track with our cycle time reduction plan in Q3 and feel comfortable about our capacity to produce and ship double digit numbers of EUV systems per quarter. We are therefore still targeting a revenue of around 4.5 billion euros on 35 systems this year. On EUV margins, after more than a decade of investments in EUV, we are well on track to improve profitability in both systems and service. EUV service margins are expected to break even in the second half of the year and EUV system gross margin is on track to meet or exceed the 40 percent target for the year.

We are still planning a capacity of 45-50 systems next year. This is planned within our existing factory footprint by reducing cycle time in our factory to around 20 weeks by the end of this year. We currently have a backlog of 54 EUV systems with 28 system orders for 2021 delivery, covering over half of this capacity and we expect orders to continue in the second half of the year in support of 2021 demand. Understandably, customers are currently reviewing how COVID will impact the global economy and as we proceed through the second half of this year, we will have a better view of how this ultimately translates to their technology ramp plans next year.

In our DUV business, we shipped the first NXT:1470 system to a customer. This is the first dry NXT system, building on the NXT immersion platform, with significant improvements in matched machine overlay and productivity, helping our customers to deal with the increasing cost of complexity when introducing new nodes. The higher output per fab area from an NXT system also maximizes fab capacity and therefore customer profitability.

Our Applications business shipped the first-generation multi-beam inspection system, eScan 1000, targeted for 5 nanometer nodes and beyond. The eScan 1000 demonstrated successful multi-beam operation simultaneously scanning with nine beams. The eScan 1000 will increase throughput up to 600 percent compared to single e-beam inspection systems targeted for in-line defect inspection applications.

In summary, although the macro-environment provides some challenges, we see stable demand and a strong second half. Our 2020 sales growth expectations are largely unchanged from the beginning of the year. We expect Logic demand to continue to be healthy, with an expected Memory recovery in the second half and we expect a continuation of the significant growth in our Installed Base business as already seen in the first half of the year. Meaning, we still expect double digit growth in sales and profitability in 2020.

Although we of course do not yet know the full impact of COVID on the global GDP and how this will translate to end market demand in the coming year, the COVID crisis taught us that the expanding digital economy with secular drivers such as 5G, AI and high performance compute provides significant opportunities over the long term. Our 2025 growth trajectory is therefore still very much intact.

With that we would be happy to take your questions.