



## Himax Technologies, Inc. 3Q 2016 Unaudited Financials and Investor Update Call

<b>Conference Details:</b> Confirmation #: 99322894 Call Length: 1 hour Lines: 100 Conference Date: 11/10/16 Conference Start Time: 8:00 a.m. EST Pre-Record Message: No Moderator: Greg Falesnik	<b>Participant Dial-In Numbers:</b> TOLL-FREE: 1-866-444-9147 TOLL/INTERNATIONAL: 1-678-509-7569 CONFERENCE ID: 99322894
<b>Moderator/Speaker Dial-In Numbers (for Greg Falesnik, Jordan Wu, Jackie Chang and Penny Lin):</b> Leader Dial in 1 720 634 2980 Leader Dial in - Toll Free 1 855 842 5904 Leader Passcode: 29519799  <b>Direct URL to Live Call Console</b> <a href="http://www.leaderview.com/leaderview/la.jsp">http://www.leaderview.com/leaderview/la.jsp</a> Conference ID number: 99322894 Web PIN: 1069	<b>Replay Dial-In Numbers:</b> TOLL-FREE: 1-855-859-2056 TOLL/INTERNATIONAL: 1-404-537-3406 From: 11/10/16 EST To: 11/17/16 at 11:59 p.m. EST Replay Pin Number: <b>99322894</b>

**Operator:** Opening and standard introduction.

**Greg Falesnik:** Thank you, operator. Welcome everyone to Himax's third quarter 2016 earnings call. Joining us from the company are Mr. Jordan Wu, President and Chief Executive Officer, and Ms. Jackie Chang, Chief Financial Officer. After the

company's prepared comments, we have allocated time for questions in a Q&A session. If you have not yet received a copy of today's results release, please email [greg.falesnik@mzgroup.us](mailto:greg.falesnik@mzgroup.us), or access the press release on financial portals, or download a copy from Himax's website at [www.himax.com.tw](http://www.himax.com.tw).

Before we begin the formal remarks, I'd like to remind everyone that some of the statements in this conference call, including statements regarding expected future financial results and industry growth, are forward-looking statements that involve a number of risks and uncertainties that could cause actual events or results to differ materially from those described in this conference call. Factors that could cause actual results include, but are not limited to, general business and economic conditions, the state of the semiconductor industry; market acceptance and competitiveness of the driver and non-driver products developed by Himax; demand for end-use application products; the uncertainty of continued success in technological innovations; as well as other operational and market challenges and other risks described from time to time in the Company's SEC filings, including those risks identified in the section entitled "Risk Factors" in its Form 20-F for the year ended December 31, 2015 filed with SEC in April, 2016.

Except for the Company's full year of 2015 financials, which were provided in the Company's 20-F and filed with the SEC on April 13, 2016, the financial information included in this conference call is unaudited and consolidated, and prepared in accordance with US GAAP accounting. Such financial information is generated internally and has not been subjected to the same review and scrutiny, including internal auditing procedures and external audits by an independent auditor, to which

we subject our annual consolidated financial statements, and may vary materially from the audited consolidated financial information for the same period. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

I will now turn the call over to Mr. Wu. Jordan – the floor is yours.

### **Q3 2016 Results**

**Mr. Jordan Wu:** Thank you Greg and thank you everybody for being with us for our earnings call, on which we will detail results from the third quarter of 2016, and provide our fourth quarter 2016 guidance and outlook. Our CFO, Jackie Chang, will give further specifics on our financial performance after my overview.

We are pleased to begin by saying our revenues, gross margin and EPS for the quarter were in line with our reiteration of guidance on September 29, 2016. For the third quarter, we reported net revenues of \$218.1 million, at high end of our guidance, with a gross margin of 25.6%. Third quarter GAAP earnings per diluted ADS came in at 7.9 cents and non-GAAP earnings per diluted ADS were 12.4 cents, also meeting the high end or exceeding our guidance.

The third quarter revenues of \$218.1 million represented an 8.5% sequential increase and a 31.7% increase year-over-year. Both the sequential and year-over-year growth was due to continual growth momentum across all our major product lines, driven by large panel driver IC sales benefiting from our leading market share

in China and in 4K TV, better-than-expected smartphone driver IC sales and accelerating AR/VR related business from our leading US customer.

Revenue from the large panel display drivers was \$72.0 million, up 6.6% sequentially, and up 42.6% from a year ago. Large panel driver ICs accounted for 33.0% of our total revenues for the third quarter, compared to 33.6% in the last quarter and 30.5% a year ago. As opposed to original guidance of double-digit sequential growth, our large panel driver business grew just mid-single-digit due to a certain customer's short-noticed shipment adjustment of its monitor products. Without the last minute change, we could have achieved double-digit sequential growth that we guided. Despite the lower than expected sales mentioned above, our large panel products actually enjoyed more than 40% year-over-year growth thanks to strong demands from Chinese and Taiwanese panel customers during the quarter. In China, our driver IC business for large panel grew more than 70% year-over-year during the quarter. In comparison, worldwide large-size TFT-LCD panel shipments declined around 6% in the same period. It is especially worth highlighting that our engineering collaboration and design-in activities with large panel customers across China, Taiwan and Korea all remain robust and we expect these trends to continue into the next year.

Revenue for small and medium-sized drivers came in at \$99.3 million, up 9.6% sequentially and up 17.8% from the same period last year. Driver ICs for small and medium-sized applications accounted for 45.5% of total sales for the third quarter, as compared to 45.0% in the previous quarter and 50.9% a year ago. Sales into

smartphones came in better than guided to achieve low-single-digit growth sequentially and up more than 20% year-over-year, as we fulfilled some of the surging rush orders of late from Chinese end customers through securing additional capacity from our supply partners. The strong rebound of our smartphone driver IC business this year came from our long-standing leading market share in China where our end brand customers are performing strongly. Automotive and tablet applications were also contributors to the segment and continued solid momentum, growing double digit during the third quarter both sequentially and year-over-year.

Revenues from our non-driver businesses were \$46.8 million, up 9.0% sequentially and up 52.1% from the same period last year. Non-driver products accounted for 21.5% of total revenues, as compared to 21.4% in the previous quarter and 18.6% a year ago. The sequential growth was led by the LCOS and WLO shipments for AR applications. Other product lines such as timing controller, touch panel controller and ASIC also enjoyed sequential growth. The performance of LCOS and WLO increased several folds year-over-year thanks to shipments to our major AR customer. The year-over-year growth was partially offset by the decline of programmable gamma OP, power management IC, and CMOS image sensors. We expect, however, the LCOS and WLO shipments to slow down starting fourth quarter 2016. We remain positive on the long-term prospect of these two product lines, judging by the numerous customers we have engaged, many of which the world's biggest tech names, and the busy engineering activities going on with such customers right now. I will elaborate further a bit later.

Our GAAP gross margin for the third quarter was 25.6%, down 50 basis points from 26.1% in the previous quarter and up 380 basis points from the same period last year. We have been able to maintain a relatively strong margin this year mainly thanks to a more favorable product mix in small and medium-sized driver ICs, increased LCOS and WLO shipments for AR applications and certain engineering fees from AR/VR new project engagements. Gross margin improvement remains one of our business focuses.

In summary, we are pleased with the overall performance of the third quarter 2016.

Jackie Chang, our CFO, will now provide more details on our financial results. After Jackie's presentation, we will discuss about the fourth quarter guidance and insight on our business, markets and strategies going forward.

Jackie.....

**Ms. Jackie Chang:** Thank you, Jordan. I will now provide additional details for our third quarter financial results.

GAAP operating expenses were \$40.4 million in the third quarter of 2016, up 32.2% from the preceding quarter and up 4.9% from a year ago. The significant sequential increase was caused by the \$9.2 million 2016 RSU grant we have traditionally expensed in the third quarter, which was considered in our guidance. As an annual practice, we reward employees with an annual bonus at the end of September each year which always leads to a substantial increase in the third quarter GAAP operating

expenses compared to the other quarters of the year. This year, the annual bonus compensation including Restricted Share Units, or RSUs, and cash payouts totaled \$12.0 million, out of which \$9.2 million was vested immediately and expensed in the third quarter. The remainder will be vested equally at the first, second and third anniversaries of the grant date. Excluding the RSU charge, our third quarter operating expenses were \$31.2 million, up 2.0% from the previous quarter and down 8.2% from the same quarter 2015.

GAAP operating margin for the third quarter of 2016 was 7.0%, up from -1.5% for the same period last year and down from 10.9% a quarter ago. The GAAP operating income decreased 30.2% sequentially, but increased 721.5% year-over-year. The sequential decline was mainly a result of the higher RSU expense to compensate the team for the much improved profitability of the year.

Third quarter non-GAAP operating income, which excludes share-based compensation and acquisition-related charges, was \$25.1 million, or 11.5% of sales, up from 1.6% for the same period last year and up from 11.1% a quarter ago. The non-GAAP operating income increased 12.1% sequentially and 835.7% from the same quarter 2015.

Our GAAP net income for the third quarter was \$13.6 million, or 7.9 cents per diluted ADS, compared to \$19.8 million, or 11.5 cents per diluted ADS, in the previous quarter and GAAP net loss of \$2.3 million, or 1.4 cents per diluted ADS, a year ago. GAAP net income increased 683.1% year-over-year due to higher revenue and much improved gross margin, but declined 31.3% from the previous quarter due to the \$9.2

million 2016 RSU charge in the third quarter. Non-GAAP net income actually increased 5.7% sequentially.

Third quarter non-GAAP net income was \$21.3 million, or 12.4 cents per diluted ADS, compared to \$20.2 million last quarter and \$1.7 million the same period last year. Non-GAAP EPS exceeded our 10.0 to 12.0 cents guided range.

Turning to our balance sheet, we had \$153.4 million of cash, cash equivalents and marketable securities as of the end of September 2016, compared to \$126.0 million at the same time last year and \$179.3 million a quarter ago. We made a cash RSU payment of \$9.2 million and a dividend of \$22.3 million during the quarter. On top of the above cash position, restricted cash was \$138.0 million at the end of the quarter, same as the preceding quarter. The restricted cash is mainly used to guarantee the Company's short-term loan for the same amount. Himax continues to maintain a very strong balance sheet and remains a debt-free company.

Our inventories as of September 30, 2016 were \$169.4 million, down from \$177.7 million a year ago and down from \$186.7 million a quarter ago. The lower inventory was a result of increased shipments in the quarter. Accounts receivable at the end of September 2016 were \$208.4 million as compared to \$168.0 million a year ago and \$187.9 million last quarter. DSO was 95 days at the end of September 2016, as compared to 89 days a year ago and 90 days at end of the last quarter.

Net cash inflow from operating activities for the third quarter was \$2.9 million as compared to an inflow of \$14.1 million for the same period last year and an inflow of

\$13.1 million last quarter. The year-over-year decrease was a result of higher receivables although net profit actually increased. The sequential decrease in cash flow was mainly due to increased receivables from higher sales and a decrease in accounts payable as more payments made at the end of the quarter. We expect a significant operating cash inflow in the fourth quarter and for the full year.

Capital expenditures were \$1.9 million in the third quarter of 2016 versus \$2.6 million a year ago and \$1.7 million last quarter. The capital expenditure in the third quarter consisted mainly of purchases of R&D related equipment.

As of September 30, Himax had 172.0 million ADS outstanding, little changed from last quarter. On a fully diluted basis, the total ADS outstanding are 172.4 million.

I will now turn the floor back to Jordan.

#### **Q4 2016 Outlook**

**Mr. Jordan Wu:** Thank you, Jackie.

We delivered solid results to achieve both top and bottom line growth during the first three quarters of the year as our driver and non-driver business segments both performed strongly.

We have increased market share in our core driver IC business this year and continue to solidify our leading position through technology advancement and

customer engagement. With the most comprehensive product portfolio in the industry, we will further capitalize on our strong position in display drivers to lead the market in major new technology trends, including higher display resolution, AMOLED and in-cell TDDI. Equally important, Himax has many unique technologies and solutions for AR, VR and IoT applications with exciting long-term growth potential. For our LCOS micro display and WLO products, which are integral parts of the eco-system for the booming AR sector, we continue to increase new project engagements with many heavyweight customers worldwide. We remain committed to our long-term strategy to diversify our product and customer base with innovative technologies.

With that, I will now provide our fourth quarter guidance, followed by a more detailed outlook.

**Q4 Guidance:**

The fourth quarter is typically a low season for the semiconductor industry. For the fourth quarter of 2016, we expect revenue to be down 4% to 9% sequentially. Gross margin is expected to be slightly down% sequentially, depending on our final product mix. GAAP earnings attributable to shareholders are expected to be in the range of 8.5 to 11.0 cents per diluted ADS based on 172.4 million outstanding ADSs. Non-GAAP earnings attributable to shareholders are expected to be in the range of 8.7 to 11.2 cents per diluted ADS based on 172.4 million outstanding ADSs.

In providing the above earnings guidance, we have assumed a 14.0% income tax rate for 2016, calculated based on exchange rate of NTD 31.5 against the USD, which is also the exchange rate as of beginning of November 2016.

#### **Q4 2016 Outlook**

Now let me provide you with some details behind our guidance and trends that we see developing in our businesses.

Our **large panel driver IC** business has grown from Chinese panel customers' rapid capacity ramping and rising 4K TV penetration this year. For this quarter, we anticipate our large panel driver IC revenue to increase high single digit year-over-year, but to decline mid single digit sequentially due to one single customer's inventory adjustment. Despite the temporary demand slowdown, our leading position in this segment remains intact. Our large panel customers are increasingly demanding a total solution from IC vendors in addition to their constant request for better IC solutions to support their high-end and high-resolution products. On top of our unique offerings of technology solutions for advanced features required of high end TVs, our capability to provide a total solution covering driver ICs, timing controllers and PMICs especially positions us very well in the 4K and 8K display markets. For example, to handle the massive amount of video data, 8K TVs require higher speed interface, advanced driving and video processing technologies, as well as highly integrated timing controllers with sophisticated functions. We believe our technology strength and total solution capability are significant differentiators against our competitors and will further solidify our leading position as the industry migrates to 8K TVs. We are one of the pioneers in product development of 8K TVs with our Chinese and Korean panel customers and are already shipping small volume to a leading Korean panel maker.

The other segment within our driver business is ICs used in **small and medium-sized panels** for applications including smartphones, tablets and automotives. While the market demands remain strong, fourth quarter sales for smartphones are likely to decline mid single digit sequentially due to the foundry capacity constraints. However, the sales of smartphone DDICs will still grow close to 30% year-over-year, driven by Chinese end brand customers' strong shipment growth this year. On the AMOLED front, we are collaborating closely with leading panel makers across China for AMOLED product development. This positions us well for the coming growth of new AMOLED panel shipment expected from these customers starting late 2017. We have seen wider adoption of AMOLED panels, now almost exclusively supplied by Samsung, for smartphone brand customers' flagship models. This trend has prompted all leading Chinese panel makers to ramp up their investments in AMOLED manufacturing and accelerate their timetable for the mass production of AMOLED panels. We believe AMOLED driver ICs will be one of the critical growth engines for our small panel driver IC business starting the end of 2017.

Among driver ICs used in small and medium-sized panels, the most noteworthy category in recent years is automotive applications. We expect continued solid momentum in Q4 with revenues expected to grow double digit sequentially and close to 50% year-over-year. With numerous tier 1 automobile brands as our indirect end customers, we have successfully engaged all key panel manufacturers and module houses worldwide for long-term partnerships and command a leading market share in this segment. To address the growing demand of larger automotive displays with higher resolution and built-in on-cell or in-cell touch screen feature, we continue to develop advanced solutions to enable new automotive display applications and

provide our customers with the most comprehensive solutions in the industry. As such, we anticipate the strong growth will likely continue into the next few years. Driver ICs used in tablets will continue to grow double digit in Q4, following Q3's strong momentum, thanks to shipments for several leading brand customers in the US and Korea and the holiday season impact. Overall, we expect the small and medium-sized driver IC segment to increase sequentially by low single digit in the fourth quarter.

For the past few years, the **non-driver** business segment has been our most exciting growth area and a differentiator for Himax. New product developments continue to evolve and gain traction. While we are more positive than ever on the long-term growth prospect of our non-driver businesses, we anticipate near-term headwinds with about 20% sequential decline in our non-driver revenues for the fourth quarter. Sales of timing controllers and CMOS image sensors will deliver strong growth in the fourth quarter, but those of WLO and LCOS micro displays and, to a lesser extent, touch panel controllers and ASIC chips will decline sequentially. I will now highlight some of the non-driver product lines.

First, our touch panel controller product line. We have seen significant traction in customer adoption and design wins of our on-cell solutions. Notably, a leading Chinese smartphone maker is featuring our solution in its newly-launched flagship tablet. More importantly, we are one of the pioneers in offering TDDI solutions and are in partnerships with essentially all of the display makers of state-of-the-art pure in-cell touch panels for joint technological development. We are seeing the use of in-cell display with TDDI rapidly becoming the preferred choice for smartphone brand

customers' next generation mid-to-high end models. Also, the increasing adoption of AMOLED panels has pushed TFT-LCD panel makers to turn to pure in-cell TDDI panel development for thinner display designs. On top of the very busy design-in activities for TDDI solutions with Korean, Chinese and Taiwanese panel customers, we are also aggressively developing new products and strengthening our team to expand our product portfolio and get ourselves ready for the anticipated strong growth in this segment. TDDI will be a major growth engine for our small panel business starting early 2017, which will also boost our corporate gross margin over time.

I will now turn to the LCOS and WLO product lines. Our LCOS and WLO businesses have grown strongly through the first nine months of 2016 mainly due to shipments to one of our leading AR device customers. We were recently informed by the AR customer to reduce future shipment of the current generation device to a minimum, and instead, to focus on the joint-development of future generation devices. We therefore expect our LCOS and WLO sales to decline in the fourth quarter, as well as over the next few quarters in 2017. We are not particularly worried about the short-term headwind as the said major customer is more committed than ever in the long-term development of the AR product concept, which is viewed as a new computing platform and that Himax remains a critical partner to the customer in its AR efforts. Equally important, while the revenues from LCOS and WLO may subside over the next few quarters, they will come from a much more diversified customer base. Quite a few of our other customers are expected to bring their AR products to the market starting next year, although we still don't expect large volumes from the early generation products of these customers. Not only will we see more diversified

revenue stream from multiple customers, our list of customers continues to expand and it now covers some of the world's biggest tech names. Such customers usually come to us for tailored solutions and pay for such developments. This is clear evidence for our undisputed leadership position in the industry. Having invested in related technologies for over 15 years, we are uniquely positioned as the provider of choice for micro display and related optics, both of which are critical enablers to AR devices. With little competition, we are currently working with over 30 customers on various current and future generation AR devices using LCOS micro display and/or WLO. Our increasing design engagements cover not only leading companies mentioned above, but also niche AR players which bring in innovative product ideas.

In addition to many AR devices under development, our WLO technology is also being adopted to enable new things such as 3D scanning, which can in turn be used in a wide variety of industries such as consumer, industrial, IoT, AI, medical, automotive and military. Some customers even come to us with novel bio-medical product ideas. Our customer base for this business is extremely diversified, again covering literally all of the most well-known tech names throughout the world, many of them leading end brand players or semiconductor platform solution providers. Himax is one of the very few players in the market with WLO technology and the one possessing the most proven mass production track record with expertise ranging from design and high yield production to cost and quality controls. We are very happy with our current development progress in this area.

With respect to the expansion plan for our next generation LCOS and WLO production lines, we are pleased to report that we have proceeded in line with our

schedule. We plan to complete it around the end of 2017 or early 2018. The new production lines will enable higher end product design and offer far better product quality for mass production of our next generation LCOS and WLO product lines that we expect will lead the industry in the future generation of related products. This investment will be financed through our internal resources and existing bank facilities, if needed.

We continue to make great progress with our new smart sensor areas by collaborating with certain heavyweight partners, including a major e-commerce customer, leading consumer electronics brands and a heavy-weight international smartphone chipset maker. By pairing a DOE integrated WLO laser diode collimator with a near infrared CIS, we are offering the most effective total solution for 3D sensing and detection in the smallest form factor, which enables easy integration into next generation smartphones, AR/VR devices and consumer electronics. Similarly, the ultra-low-power QVGA CMOS image sensor can also be bundled with our WLO lens to support super low power computer vision to enable new applications across mobile devices, consumer electronics, surveillance, drones, IoT and artificial intelligence. We will report business developments in these new territories in due course. Regarding other CIS products, we maintain a leading position in laptop applications and will increase shipments for multimedia applications such as surveillance, drones, home appliances, consumer electronics, etc.

And that concludes our non-driver business discussion.

Thank you for your interest in Himax. We are now ready to take questions.

**OPERATOR TO QUEUE QUESTIONS**

**Jordan's closing remarks**

As a final note, Jackie Chang, our CFO, will maintain investor marketing activities and attend future investor conferences. We will announce the details as they come about. Please contact our IR department and/or Greg Falesnik if you are interested in speaking with the management. Thank you and have a nice day!