Himax Technologies, Inc. Q1 2017 Unaudited Financials and Investor Update Call

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Moderator/Speaker Dial-In Numbers (for Greg Falesnik, Jordan Wu, Jackie Chang and Penny Lin): Leader Dial in (toll free) 1-855-842-5904 Leader Dial in (international) 1-720-634-2980 Leader Passcode: 29519799 **Direct URL to Live Call Console** http://www.leaderview.com/leaderview/la.jsp Conference ID number: 6717220 Web PIN: 1069	**Replay Dial-In Numbers:** TOLL-FREE: 1-855-859-2056 TOLL/INTERNATIONAL: 1-404-537-3406 From: 05/11/2017 EDT To: 05/18/2017 at 11:59 p.m. EDT Replay Pin Number: 6717220

Operator: Opening and standard introduction.

Greg Falesnik: Thank you, operator. Welcome everyone to Himax's first quarter 2017 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, or access the press release on financial portals, or download a copy from Himax's website at 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, 2016 filed with SEC in April, 2017.

Except for the Company's full year of 2016 financials, which were provided in the Company's 20-F and filed with the SEC on April 12, 2017, 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.

<u>Q1 2017 Results</u>

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 first quarter 2017, as well as provide our second quarter

2017 guidance and outlook. Our CFO, Jackie Chang, will give further specifics on our financial performance after my overview.

Our 2017 first quarter revenue, gross margin and GAAP earnings per diluted ADS all met our guidance for the quarter. For the first quarter, we reported net revenues of $155.2 million with a gross margin of 23.1%. First quarter GAAP earnings per diluted ADS were 0.8 cents.

The first quarter revenues of $155.2 million represented a decrease of 23.7% sequentially and 13.9% year-over-year. I will go through the issues causing the revenue decline below.

Revenue from large panel display drivers was $59.3 million, down 12.4% sequentially, and down 9.8% from a year ago. Large panel driver ICs accounted for 38.2% of our total revenues for the first quarter, compared to 33.3% in the fourth quarter of 2016 and 36.4% a year ago. The decline was due to fewer working days in China and Taiwan and phase-out of certain customers' old models. In addition, the scale 5.6 earthquake that struck Tainan in early February also somehow impacted some of our customers' productions and therefore our driver IC shipment. In spite of the lukewarm sales, our engineering collaboration and design-in activities with large panel customers across China, Taiwan and

Korea all remain robust. Such activities will lead to future rebound in sales momentum.

Revenue for small and medium-sized drivers came in at $66.6 million, down 33.2% sequentially and down 16.1% from the same period last year. Driver ICs for small and medium-sized applications accounted for 42.9% of total sales for the first quarter, as compared to 49.0% in the fourth quarter of 2016 and 44.1% a year ago. Sales into smartphones declined 37.8% year-over-year and 49.6% sequentially. The substantial decline in our smartphone driver IC sales was caused mainly by weak sentiment in the China market which is still loaded with excess inventory built up at the end of last year. Another negative factor for our small panel driver IC sales is the shrinking addressable market for pure TFT-LCD driver ICs for smartphone cause by increasing in-cell and AMOLED display adoption. The revenue from automotive applications declined about 9.0% from the last quarter but was up around 12.0% year-over-year. Our driver ICs used in tablets also declined around 33.0% sequentially and 8.0% year-over-year for weak overall market demand in the product segment.

Revenues from our non-driver businesses were $29.3 million, down 18.8% sequentially and down 16.7% from the same period last year. Non-driver products accounted for 18.9% of total revenues, as compared to 17.7% in the fourth quarter of 2016 and 19.5% a year ago. The sequential decline was primarily caused by lower LCOS and WLO shipments as one of our major AR customers decided to discontinue its production, as we reported before. To a much lesser extent, lower sales of touch panel controllers and ASIC chips also contributed to the sequential decline. This decline was partially offset by the increased sales of CMOS image sensors and NRE income from ASIC projects.

The first quarter operating expenses increased rather significantly which our CFO will report in a minute. In light of the promising new business opportunities around the corner, we will continue to invest heavily in R&D and customer engineering regardless of the prevailing unfavorable business conditions. We are aware that this will hit our short-term bottom line, but we believe such investment is extremely important and will bring in very handsome return in the next few years. The second quarter operating expenses are budgeted to increase about 7% sequentially and 20% year-over-year. Of the operating expenses, R&D will see the most significant increase, to be up around 10% sequentially and 28% year-over-year. WLO is to account for some 50% of the increased R&D expenses. For the additional WLO capacity prepared for ramping in the second half which we announced last quarter, there are heavy pre-ramp expenses such as equipment bring up, sampling, and other related engineering efforts. About 30% of the additional R&D expenses will be TDDI related where the team is expanded in preparation for the expected design-ins with smartphone end customers. The remaining 20% of the incremental R&D will be expensed for high-end TV and structured light related R&D. Our confidence on our strong growth prospects is also evidenced by the unprecedented heavy CAPEX plan for 2017, which I will elaborate a bit later.

Jackie Chang, our CFO, will now provide more details on our financial results. After Jackie's presentation, we will further discuss our 2017 outlook and second quarter guidance.

Jackie……

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

Our GAAP gross margin for the first quarter was 23.1%, up 400 basis points from 19.1% in the fourth quarter of 2016, and down 310 basis points from 26.2% for the same period last year. Our GAAP gross margin for the fourth quarter of 2016 was lower due to a one-time, non-cash inventory write-down totaling $12.0 million, on top of the $2.7 million originally estimated for the quarter. Excluding the additional inventory write-down, our gross margin for the first quarter would have been down 190 basis points from 25.0% in the fourth quarter of 2016. The sequential and year-over-year decline was due to unfavorable product mix and margin decline in large-panel driver ICs and non-driver product segments

Jordan just talked about our increased expenses. GAAP operating expenses were $34.3 million in the first quarter of 2017, up 7.1% from the preceding quarter and up 7.3% from a year ago. The sequential increase was primarily the result of an increase in R&D expenses while the year-over-year increase was due to higher salary expenses.

GAAP operating margin for the first quarter of 2017 was 1.0%, down from 8.4% for the same period last year and down from 3.4% in the previous quarter. The GAAP operating income decreased 77.1% sequentially and 89.6% year-over-year. The sequential and year-over-year decrease was a result of lower sales, lower gross margin and higher expenses in the quarter.

First quarter non-GAAP operating income, which excludes share-based compensation and acquisition-related charges, was $2.1 million, or 1.3% of sales, down from 8.7% for the same period last year and down from 3.6% a quarter ago. The non-GAAP operating income decreased 71.8% sequentially and 86.8% from the same quarter in 2016. Again, the sequential and year-over-year decrease was a result of lower sales, lower gross margin and higher expenses in the quarter.

Our GAAP net income for the first quarter was $1.4 million, or 0.8 cents per diluted ADS, compared to $4.4 million, or 2.6 cents per diluted ADS, in the previous quarter and GAAP net income of $13.1 million, or 7.6 cents per diluted ADS, a year ago. GAAP net income decreased 89.6% year-over-year and 69.3% from the previous quarter.

First quarter non-GAAP net income was $1.7 million, or 1.0 cent per diluted ADS, compared to $4.8 million last quarter and $13.5 million the same period last year.

Turning to our balance sheet, we had $199.5 million of cash, cash equivalents and marketable securities as of the end of March 2017, compared to $168.0 million at the same time last year and $194.6 million a quarter ago. On top of the above cash position, restricted cash was $107.4 million at the end of the quarter, down from $138.2 million in the preceding quarter and down from $180.5 million a year ago. The restricted cash is mainly used to guarantee the Company’s short-term loan for the same amount. We continue to maintain a very strong balance sheet and remain a debt-free company.

Our inventories as of March 31, 2017 were $148.3 million, down from $182.8 million a year ago and down from $149.7 million a quarter ago. Accounts receivable at the end of March 2017 were $167.7 million as compared to $173.0 million a year ago and $191.0 million last quarter. DSO was 97 days at the end of March 2017, as compared to 87 days a year ago and 87 days at end of the last quarter. The increase of DSO was due to higher revenue proportion of driver IC sales for large panel customers who tend to have longer credit terms.

Net cash inflow from operating activities for the first quarter was $5.5 million as compared to an inflow of $21.5 million for the same period last year and an inflow of $47.2 million last quarter. The decrease in cash inflow was a result of lower profitability and higher working capital.

Capital expenditures were $2.0 million in the first quarter of 2017 versus $2.2 million a year ago and $2.2 million last quarter. The capital expenditure in the first quarter consisted mainly of capacity expansion for WLO and LCOS product lines and purchases of R&D related equipment.

As of March 31, 2017, Himax had 172.0 million ADS outstanding, unchanged 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.

Q2 2017 Outlook

Mr. Jordan Wu: Thank you, Jackie.

The factors causing our slow first quarter will remain in the second quarter. However, looking ahead into the second half, we believe our overall financial performance will be resilient. We are positive on DDIC business outlook because of expected shipments for certain customers' 4K TV models and TDDI products. Various areas of the non-driver IC businesses are also expected to contribute to the improvement of our overall financials from second half of this year.

Before we detail the prospect for 2017, we thought it's important to update the status of our CAPEX plan and highlight our progress in 3D scanning technology, which is a major reason why we embarked on this aggressive CAPEX plan. We believe 3D scanning is one of the most significant new applications for the next generation smartphone. The view is echoed by many industry researchers. We are seeing strong demand for 3D scanning products from multiple top name customers who are either collaborating with us or engaging us for advanced stage discussion, thanks to our absolute technology leadership. Our SLiM™ product line is the state of the art total solutions for 3D sensing and scanning based on structured light technology. We offer fully integrated structure light modules with vast majority of the key technologies inside also provided by ourselves. These technologies include advanced optics utilizing our WLO technology, laser driver IC, high precision active alignment for the assembly of laser projector, high performance near-infrared CMOS image sensor and, last but not least, an algorithm chip for 3D depth map generation. While we prefer to offer total solution, we can also provide aforementioned individual technologies separately to selected customers so as to accommodate their specific needs. Of the above technologies, the two items requiring CAPEX for us are advanced optics built using our in-house WLO production line and active alignment for which we develop a solution jointly with an international, world leading semiconductor equipment house. The remaining items are all outsourced for manufacturing and therefore do not require our own CAPEX.

As indicated previously, this year's CAPEX will be significantly higher than usual. In the last earnings call, we reported the urgent addition of new WLO capacity to meet the near term demands of certain customers. This new capacity is located in our existing headquarters in which we retrofitted certain space to make room for the new equipment. We are pleased to report that the project is going smoothly as planned. Major ramp of the new WLO capacity is scheduled to start from the third quarter. Now moving on to the other major CAPEX project of this year, construction of a new building, again the progress is good and the schedule is well under control. The new building, located nearby our current headquarters, will house additional 8” glass WLO and the next generation 12” wafer LCOS production lines, as well as provide the extra office space that is desperately needed. The new building will be completed and ready for personnel and equipment move-in by early 2018. To give you an update for the CAPEX plan, we have budgeted $80.0 million for 2017 for the new WLO capacity and the new office/fab construction, covering equipment, land, building, facilities and clean rooms. Of the total budget, around $60.0 million will be paid out during the year with the remaining in the next year.

The CAPEX budget for 2017 and the dividend for the year of 2016 will be funded through our internal resources and banking facilities.

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

Q2 2017 Guidance:

For the second quarter of 2017, we expect revenue to be down around 5.0% to flat sequentially. Gross margin is expected to be around flat sequentially, depending on our final product mix. Operating expenses will increase significantly as mentioned earlier. GAAP earnings attributable to shareholders are expected to be in the range of -1.0 to 0.0 cents per diluted ADS based on 172.5 million outstanding ADSs.

Q2 2017 Outlook

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

Large panel driver IC revenue for the second quarter will decline around 10% sequentially due to phase-out of certain customers' old models. Certain earlier misses of customer new design-in projects will affect our Q2 and possibly Q3 business. Nevertheless, we have secured new design-wins, particularly in 4K TV, to resume our larger-sized driver IC business growth in the fourth quarter. Looking forward, 4K TV penetration is still on its way up and Chinese panel customers will keep on ramping new advanced generation fabs over the next few years, including a brand new Gen 8.5 and another Gen 8.6 fab starting the second half of 2017. We remain the market leader in the large panel driver IC business in China and will be a major beneficiary from China's capacity expansion.

The other segment within our driver business is ICs used in **small and medium-sized panels** for applications including smartphones, tablets and automotive. Second quarter sales for smartphones are likely to experience slight decline on weak China market demand, end customers' continued inventory adjustment and higher TDDI and AMOLED adoption. Furthermore, the new 18:9 screen design is slowing down the demand for the existing 16:9 models. We believe our smartphone business will recover sequentially in the third quarter. Not only do we expect to secure more design-wins from 18:9 display, we also expect our customers to replenish inventories after the lackluster first half of the year. We remain mindful of the trend that higher in-cell panel and TDDI adoption will reduce the addressable market for smartphones using traditional TFT-LCD driver ICs. We are confident that our TDDI solutions and business will start to contribute in the third quarter. We will elaborate on this in the non-driver IC business discussion. On AMOLED display, we have started to deliver product samples to our customers in the second quarter. Our customer base for AMOLED covers many leading panel makers across China. We believe AMOLED driver IC will be one of the long-term growth engines for our small panel driver IC business.

Driver ICs used in automotive application has been the best performing product category in recent years. We are seeing solid momentum in the second quarter with revenue to grow around 15% sequentially and over 50% year-over-year. Being the market share leader 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 secured many of their key projects pipelined for the next few years. To address the growing IC demand out of larger automotive displays and more displays per vehicle, we continue to develop advanced technologies including IC solutions for on-cell and in-cell touch screens. Finally, our driver ICs used in tablets will stay around flat sequentially in the second quarter. Overall, we expect the small and medium-sized driver IC segment to increase sequentially by around low-single-digit in the second quarter.

For the **non-driver IC** business segments, we continue to experience near-term headwinds as we mentioned in the previous earnings call and expect mid-single-digit sequential decline in our non-driver revenues for the second quarter. Sales of CMOS image sensors will deliver double-digit growth in the second quarter, while those of WLO and touch panel controllers will decline sequentially. I will now highlight some of the non-driver product lines.

First on the touch panel controller product line, in spite of new design-wins of our discrete touch solutions and volume shipment of several projects featuring our on-cell solutions to Chinese and Korean smartphone brand customers, the touch controller IC revenue will decline in the second quarter due to increasing TDDI adoption. As mentioned earlier, the 18:9 screen format is increasingly popular among major smartphone players, especially for their mid-to-high end models. Being a front runner of TDDI solutions for 18:9 displays, we will benefit from the new trend. I mentioned earlier that to address the fast growing TDDI demand and to catch up with customers' request for fast product ramp, we have allocated further R&D and customer engineering resources to this important new product area. With comprehensive joint development engagements covering many leading panel makers, we are confident that we can leverage our long-standing and widespread relationships with panel makers to be a market leader for TDDI.

With regards to WLO, we expect revenue in the second quarter to decline due to discontinuation of shipment to one of our leading AR device customers. At present, 3D scanning is the top priority of our WLO business. Our goal is to provide total solutions with the performance, size, power consumption and costs all suitable for smartphone and tablet applications. Alternatively, for selected customers we can also provide individual key components upon their requests. Judging by the ongoing close collaboration and discussion with multiple leading end device makers, we have strong reasons to believe that the 3D scanning solutions will bring us explosive revenue growth when the new feature gets adopted by smartphones. Apart from smartphone and tablet, we expect the adoption of 3D scanning to widely spread over to various applications such as industrial, IoT, AI, medical, automotive, military, surveillance and drone. We will expand our technology roadmap to cover more applications in due course.

Now on the CMOS image sensor business update, we continue to make great progress with our two machine vision sensor product lines, namely near infrared ("NIR") sensor and Always-on-Sensor ("AoS™"). Our NIR sensor is a critical part in the structured light 3D scanning total solution. Similar to WLO, we can supply NIR sensor as an individual component for both mobile and non-mobile applications. Our NIR sensors' overall performance is far ahead of those of our peers. We currently offer low noise HD and 5.5 megapixel NIR sensors with superior quantum efficiency in NIR band while operating at excellent power consumption.

Our AoS solutions provide super low power computer vision to enable new applications across a very wide variety of industries.

The ultra-low power, always-on vision sensor is a powerful solution capable of detecting, tracking and recognizing its environment in an extremely efficient manner using just a few milliwatts of power. In April, we announced a strategic investment in Emza, an Israeli software company dedicated to developing extremely efficient machine vision algorithms. The investment enables us to provide turn-key solutions to meet customers' increasing appetite for ultra-low power. With Emza's machine-vision algorithms, we can transform AoS sensor from a pure image capturing component to an information analytics device that can be easily integrated into smart home and security applications as well as smartphone, AR/VR, AI and IoT devices.

For the traditional human vision segments, we expect mass production of several earlier design wins for notebooks and increased shipments for multimedia applications such as car recorder, surveillance, drone, home appliances, and consumer electronics, among others, during the second quarter.

I will now turn to the LCOS product line. LCOS revenue will be flat sequentially and down year-over-year due to discontinuation of shipment to one of our leading AR device customers. We expect revenue for LCOS to come from a more diversified customer base starting later in 2017. We are seeing heavyweight companies allocating major R&D resources and budgets in their new push for

AR goggle devices. Having invested in related technologies for over 15 years, we believe our LCOS is the technology of choice with little competition. Our list of customers continues to expand and it now covers many of the world's biggest tech names. In addition to AR application, we are pleased to report that we are making great progress in developing high-end head-up-display for automotive applications. This represents a significant long term growth opportunity for us. We will report business development in this territory in due course.

In summary, we are seeing ongoing weakness in the China smartphone market and temporary slowdown of our large-sized driver IC business, which will likely lead to a mild sequential decline in revenue in Q2. Regardless of the soft market condition, we continue to commit our R&D on our strategic growth areas. Likewise, CAPEX will be at an unprecedented high level to capture the tremendous growth opportunities where we have a significant leadership. Last but not least, I'd like to emphasize that, as excited as we are on the prospect of non-drive IC products and notwithstanding driver IC's short term pressure, driver IC has been a core part of our business and will remain so in any foreseeable future. Our technology strength, total solution capability and long term customer relationships in driver IC business remain intact. We are confident that our driver IC will resume growth starting the fourth quarter.

Thank you for your interest in Himax. We appreciate you joining today's call and 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!