



Himax Technologies, Inc. Q2 2017 Unaudited Financials and Investor Update Call

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Operator: Opening and standard introduction.

Greg Falesnik: Thank you, operator. Welcome everyone to Himax’s second 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 events or results to differ materially from those described in this conference call 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 Ms. Jackie Chang – the floor is yours.

Q2 2017 Results

Ms. Jackie Chang: Thank you Greg and thank you everybody for joining us. Our outline for today's call is: first, I will report Himax's consolidated financial performance for the quarter on a GAAP basis and provide supplementary results on a non-GAAP basis, which excludes share-based compensation and acquisition-related charges. Second, I will provide the third quarter outlook. Finally, Jordan will discuss our business and product highlights, after which we will take questions.

Our 2017 second quarter revenue and GAAP earnings per diluted ADS came in at the mid-point of our guidance while gross margin exceeded the guidance. For the second quarter, we reported net revenues of \$151.7 million with a gross margin of 23.8% and GAAP loss per diluted ADS was 0.4 cents.

The second quarter revenues of \$151.7 million represented a decrease of 2.2% sequentially and a decrease of 24.5% year-over-year. I will go through the issues causing the revenue decline below.

Revenue from large panel display drivers was \$52.1 million, down 12% sequentially, and down 22.8% year-over-year. Large panel driver ICs accounted for 34.4% of our total revenues for the second quarter, compared to 38.2% in the first quarter of 2017 and 33.6% a year ago. The decline was due to a temporary slowdown of our large size driver IC business caused by earlier misses of certain customers' new design-in projects as we have reported in last quarter's earning call. We have overcome the engineering hiccup and business will be back on track starting the third quarter. In spite of the lukewarm sales in the first half of 2017, 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 \$70.0 million, up 5.1% sequentially and down 22.7% year-over-year. Driver ICs for small and medium-sized applications accounted for 46.1% of total sales for the second quarter, as compared to 42.9% in the first quarter of 2017 and 45.0% a year ago. Sales into smartphones increased 2.5% sequentially and down 51.5% year-over-year. The less than satisfactory result in the second quarter was caused mainly by weak sentiment in the China market since most brands were preparing for new models based on 18:9 displays, which Jordan will elaborate a bit later, and therefore turned cautious in building inventory for legacy 16:9 displays. In addition, our sales were affected by the shrinking addressable market for pure TFT-LCD driver ICs, a significant portion of which is being replaced by TDDI and AMOLED technologies as we indicated in the previous earnings calls. As Chinese OEM customers began to replenish inventory for the new release in the second half, we have seen strong recovery in third quarter.

Our small and medium-sized driver IC revenue for automotive application increased 15.6% sequentially and 50.6% year-over-year. We are happy with the continuous strong momentum in this space. Our driver ICs used in tablets increased around 8.0% sequentially but declined 13.7% year-over-year for weak overall market demand in the product segment.

Revenues from our non-driver businesses were \$29.6 million, up 0.9% sequentially and down 31.1% versus last year. Non-driver products accounted for 19.5% of total revenues, as compared to 18.9% in the first quarter of 2017 and 21.4% a year ago. The sequential increase was primarily due to NRE contribution. The year-over-year declines were due to discontinuation of LCOS and WLO shipments to one of our major AR device customers who decided to end the product's production as we reported before. To a much lesser extent, lower sales of touch panel controllers and power management ICs also contributed to the year-over-year decline.

Our GAAP gross margin for the second quarter was 23.8%, up 70 basis points from 23.1% in the first quarter and down 230 basis points from 26.1% for the same period last year. The sequential increase was a result of a more favorable product mix and higher NRE. The year-over-year decline was primarily caused by unfavorable product mix and margin decline in the driver ICs product lines.

Now let's take a look at operating expenses. GAAP operating expenses were \$37.1 million in the second quarter of 2017, up 8.1% from the preceding quarter and up 21.4% from a year ago. The sequential and year-over-year increases in the second quarter are in line with the operating expense budget that we reported in the last earnings call. The

sequential increase was primarily the result of rising R&D expenses in the areas of 3D sensing, WLO, TDDI, and high-end TV. The year-over-year increase, on top of the same reasons above, was also caused by the annual merit increases. In addition, NT dollar appreciation against the US caused our salary expense to increase around \$1 million as we pay the bulk of our employee salaries in NT dollars.

GAAP operating margin for the second quarter of 2017 was -0.6%, down from 10.9% for the same period last year and down from 1.0% in the previous quarter. The sequential decline was a result of lower sales and higher expenses in the quarter and the year-over-year decrease was a result of lower sales, lower gross margin and higher expenses.

Second quarter non-GAAP operating loss was \$0.4 million, or -0.3% of sales, down from 11.1% for the same period last year and down from 1.3% a quarter ago. Again, the sequential decline was a result of lower sales and higher expenses in the quarter while year-over-year decrease was caused by lower sales, lower gross margin and higher expenses.

GAAP net loss for the second quarter was \$0.6 million, or 0.4 cents per diluted ADS, compared to GAAP net income of \$1.4 million, or 0.8 cents per diluted ADS, in the previous quarter and GAAP net income of \$19.8 million, or 11.5 cents per diluted ADS, a year ago.

Second quarter non-GAAP net loss was \$0.3 million, or 0.2 cent per diluted ADS, compared to non-GAAP net income of \$1.7 million last quarter and non-GAAP net income of \$20.2 million the same period last year.

Turning to our balance sheet, we had \$185.9 million of cash, cash equivalents and marketable securities as of the end of June 2017, compared to \$179.3 million at the same time last year and \$199.5 million a quarter ago.

On top of the above cash position, restricted cash was \$107.2 million at the end of the quarter, as compared to \$107.4 million in the preceding quarter and down from \$138.0 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.

As of June 30, 2017, our inventories were \$147.7 million, little changed from \$148.3 million a quarter ago and decreased from \$186.7 million at the same time last year. Accounts receivable at the end of June 2017 were \$163.2 million as compared to \$187.9 million a year ago and \$167.7 million last quarter. DSO was 96 days at the end of June 2017, as compared to 90 days a year ago and 97 days at end of the last quarter.

Net cash outflow from operating activities for the second quarter was \$1.2 million as compared to an inflow of \$13.1 million for the same period last year and an inflow of \$5.5 million last quarter. The sequential decrease was mainly due to an income tax payment of \$8.0 million and year-over-year decrease was the result of lower profitability.

Capital expenditures were \$11.9 million in the second quarter of 2017 versus \$1.7 million a year ago and \$2.0 million last quarter. The second quarter capex consisted mainly of capacity expansion for WLO production lines and ongoing payments for the new

building's construction. As reported in the last few earnings calls, we are increasing capex right now to enlarge our WLO capacity within the current headquarters to meet certain anchor customer's strong and urgent demand. We are also constructing a new building to house further WLO capacity, the next generation LCOS production line, and additional office spaces. This is our phase I expansion which is \$80 million as we announced in the last earnings call.

We declared an annual cash dividend of 24 cents per ADS during the second quarter, totaling \$41.3 million, which will be paid out on August 14. Our dividend is determined primarily by the prior year's profitability. Our decision to pay out 81.4% of last year's net profit demonstrates our continued support for our shareholder base and strong confidence in the near term return outlook for our newly increased capex and our overall long-term growth prospect.

The capex budget for 2017 and the dividend for the year of 2016 will be funded through our internal resources and banking facilities, if so needed.

As of June 30, 2017, Himax had 172.0 million ADS outstanding, unchanged from last quarter. On a fully diluted basis, the total ADS outstanding are 172.5 million.

Q3 2017 Guidance:

For the third quarter of 2017, we expect revenues to be up 23.0% to 30.0% sequentially. Gross margin is expected to be up 1% sequentially, depending on our final product mix. GAAP earnings attributable to shareholders are expected to be in the range of 1.3 to 2.5

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 3.0 to 4.2 cents per diluted ADS based on 172.4 million outstanding ADSs.

For the third quarter, of the three product categories, we expect large panel driver IC to increase around 10% quarter-over-quarter; those for small and medium-sized panels to be up by around 20% sequentially; and non-driver IC business is expected to increase around 90% sequentially.

As we have done in the past, our third quarter GAAP earnings per diluted ADS guidance has taken into account our expected 2017 grant of restricted share units, or RSUs, to the team at the end of September. The 2017 RSUs, subject to our Board approval, is now assumed to be around \$3.0 million, almost all of which, or 1.5 cents per diluted ADS, will be vested and expensed immediately on September 30th, the grant date. In comparison, the 2016 RSUs totaled \$12.0 million, out of which \$9.2 million, or 4.3 cents per diluted ADS, was vested immediately. The grant of RSUs would lead to higher third quarter GAAP operating expenses compared to the other quarters of the year.

I will now turn the call over to Jordan.

2017 Outlook

Mr. Jordan Wu: Thank you, Jackie.

Despite the decline in the first half in our business, we anticipate a strong recovery in driver ICs segment and exciting opportunities in the non-driver segments over the

remainder of 2017 and beyond. Looking ahead, we believe our overall financial performance will be resilient. Now let me provide you with some details behind our guidance and trends that we see developing in our businesses.

Display driver IC market

LDDIC

We have a positive outlook on the growth momentum in our large display driver IC business. While global TV shipments may experience 0.4% year-over-year decline, China's share of global TV panel shipments is projected to reach 33% in 2017, compared to 29.5% in 2016. Being a market leader in the large display driver IC business in China, we will capitalize on China's rising market share. Not only have we refreshed our product roadmap and delivered better product costs to our existing and newly added customers, we have also secured new design-wins, particularly in 4K TV, to solidify our growth for the remainder of the year.

Looking forward, 4K TV penetration is still on the rise and Chinese panel customers are still ramping new advanced generation fabs over the next few years, including a brand new Gen 8.5 fab and another Gen 8.6 during the second quarter of 2017. This will help further grow our revenue and market share in the large panel segment in 2018.

SMDDIC

In the small and medium-sized panel segments, our driver IC sales for **automotive** applications have enjoyed over 30% annual growth over the last few years, well surpassing the market average. Still more panels are going into vehicles, with the

number of units expected to increase from 135 million in 2016 to 200 million in 2022. We have successfully engaged literally all of the major automotive panel manufacturers worldwide for long-term partnerships and secured many of their key projects pipelined for the next few years.

The most significant segment in our small and medium-sized panel driver business is ICs used for **smartphones**. Our customers have started to replenish inventories after the lackluster first half and we have added more design-wins for 18:9 displays. Sales into smartphones already rebounded in June and we expect a strong recovery into the third and fourth quarter.

In our last earnings call, I discussed how **18:9 displays** are becoming a trend and how we expect higher **TDDI** penetration in smartphones going forward. Both of these trends held true and continued to accelerate in the second quarter. In order to increase the effective viewing area of the display without enlarging the overall size of the phone, new aspect ratios and bezel-less designs are essential. Most of the brands are now preparing for the change into new displays featuring the so-called FHD+ and HD+ resolutions, which have an aspect ratio of around 18:9 to 21:9. We predicted this market shift and have been working hard to get ourselves ready for this new trend. We have been awarded several important projects for major brands. Many design-in activities are ongoing and we are already starting mass shipments for some of the projects, helping boost our third quarter revenue for the segment.

In terms of our progress in **TDDI**, I reported in the last earnings call that we made further investments into R&D and customer engineering to catch up with our customers'

requests for fast product ramps. I am pleased to report that our FHD+ TDDI solutions have drawn tremendous interests from tier-1 brands and most panel makers in China, Japan and Korea, primarily because our TDDI solutions enable super-slim bezels for customers' panel design. We expect our new FHD+ TDDI solutions to be a significant contributor to our revenues in the fourth quarter and beyond.

Now very briefly on the touch panel controller IC. While the discrete touch panel controller IC is being quickly replaced by TDDI, we expect this product's revenue will in fact grow over 40% in the third quarter as some of the earlier design-in projects featuring our on-cell solutions started volume shipments for Chinese smartphone brands.

Now I will talk about **AMOLED** displays. We have joint development projects with many of the major Chinese OLED panel customers and have delivered product samples to some of them in the second quarter. With Chinese smartphone brands' AMOLED adoption forecast to reach 18% in 2017, Chinese panel makers have committed tremendous capital to build 7 to 10 brand new OLED fabs and are driving at full speed to pull forward the mass production schedule. AMOLED is set to become mainstream in the global smartphone market in the near future with penetration potentially reaching as high as 50% by 2020. Once the Chinese panel makers start to mass produce OLED displays, we believe OLED driver IC will be one of the growth engines for our small panel driver IC business.

Non-Driver Product Categories

The non-driver IC business segment has been our most exciting growth area and a differentiator for Himax in the past few years. Let me share some of the exciting progress we made in the last quarter, as well as future growth opportunities.

3D sensing total solution

First, I will touch on our 3D sensing total solution. We believe 3D sensing is among the most significant new features for the next generation smartphone. Our SLiM™ product line, based on structure light technology, is a state of the art total solution for 3D sensing. Our goal is to provide total solutions with performance, size, power consumption and costs all suitable for smartphones and tablets. We offer fully integrated structure light modules, with the vast majority of the key technologies inside the module also developed and supplied by ourselves. These critical in-house technologies include advanced optics utilizing our world leading WLO technology, laser driver IC, high precision active alignment for the projector assembly, high performance near-infrared CMOS image sensor and, last but not least, an ASIC chip for 3D depth map generation. The fact that all of these critical building blocks are developed in-house puts us in a unique position. We are able to react quickly and tailor our solutions to customers' specific needs. It also represents a very high barrier of entry for any potential competition and a much higher ASP for us. While we prefer to offer a total solution, we can also provide the aforementioned individual technologies separately to select customers so as to best accommodate their specific needs.

Thanks to our absolute technology leadership, our progress made with the fully integrated structure light 3D sensing total solution module is very exciting. We are seeing strong demand for 3D sensing solutions from numerous tier 1 customers. We are in

close collaboration with select leading smartphone makers and partners right now, aiming to bring our total solution to mass production as early as early 2018 to meet our customers' aggressive launch timetables. Moreover, given that we are offering highly integrated solutions with ASPs much higher than those of individual components, by the time we start shipping our total solutions, they will be a major contributor to both our revenues and profit, and consequently create a more favorable product mix for us.

Furthermore, 3D sensing will be a game changing technology for a wide range of applications. The smartphone space is our current focus, however, we believe over time it will be a necessary feature for applications such as AR/VR, industrial, IoT, AI, automotive, robotics, military, surveillance and drones.

WLO

In the last earnings call, we reported that this year's capex will be significantly higher than usual. We also reported the urgent addition of new WLO capacity to meet the rush demand of a certain customer. This new capacity is located in our existing headquarters in which we retrofitted space to make room for the new equipment. We are pleased to report that the project is going smoothly as planned. A major ramp of the new WLO capacity has already started at the beginning of the third quarter and will accelerate throughout the remainder of 2017 and beyond.

Now, let me move on to other WLO business updates. Advanced wafer-level optics (WLO) is one of the key technologies enabling 3D sensing, AR devices, and many other applications. At the present time, 3D sensing is the top priority of our WLO business. Levering on our exceptional design know-how and mass production experience in WLO

technology, we are able to produce the world's most compact optics required of 3D sensing while achieving superior performance. In addition to 3D sensing, we also have ongoing collaborations with customers in developing light-guide for AR glasses and micro displays using our WLO technology.

New Building

Moving on to the other major capex project of this year, the construction of a new building. The progress has been good to date and everything is proceeding according to schedule. The new building, located near our current headquarters, will house additional 8" glass WLO capacity and provide the extra office space we desperately need. The new building will be completed and ready for personnel and equipment move-in by the end of 2017 or early 2018. Its timely completion is particularly critical for our 3D sensing total solution business as it will house the new WLO capacity needed for multiple smartphone customers.

Phase II capex

Judging from our customers' enthusiasm, we are planning to kick-start the phase II capital expansion beyond the phase I's \$80 million mark that we announced earlier much sooner than expected in order to fulfill the strong 3D sensing demand for the next 2-3 years. The phase II capacity will still be located in the new building. In fact, the new building has sufficient room to house capacity much in excess of the phase II expansion. We expect the phase II investment to provide a handsome return and will entrench Himax as top tier customers' 3D sensing go-to supplier for its leading technology and reliable capacity support in this up and coming industry with tremendous growth potential. As reported before, among all of the components in our 3D sensing total solution, the

only two items requiring capital expenditure for us are advanced optics, utilizing our in-house WLO production line, and active alignment for which we have developed a state-of-the-art solution. The two items are not outsourced because they require highly differentiating manufacturing know-how and are critical factors of our competitiveness. We will report a phase II capex plan in due course.

CMOS Image Sensor

Now on to our 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 (“AoSTM”). Our NIR sensor is a critical part in the structured light 3D sensing total solution which I spoke on above. Our NIR sensors’ overall performance is far ahead of those of our peers in 3D sensing applications. We currently offer low noise HD, or 1 megapixel, and 5.5 megapixel NIR sensors and are planning to add more to further enrich our product portfolio. Our NIR sensors deliver superior quantum efficiency in the NIR range, especially over 940nm band which is critical for outdoor applications.

Our AoS solutions provide super low power computer vision, which enables new applications across a 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. We are pleased to report that we already have one major global brand leveraging our AoS in their new high end TV models, which have already hit the market.

For the traditional human vision segments, we see strong demands in notebooks and

increased shipments for multimedia applications such as car recorders, surveillance, drones, home appliances, and consumer electronics, among others.

ASIC

I mentioned earlier that one of the critical elements of our 3D sensing total solution is an ASIC for 3D depth map generation. We are able to develop the ASIC thanks to our unique in-house capability in developing video ASICs for customers. Equipped with the ASIC, our 3D sensing total solution can substantially reduce the power consumed while processing 3D sensing, enhance personal data security, accelerate the 3D depth map generation, and free up a smartphone's processor for other applications. We view this unique capability as a significant competitive advantage. It has been and will continue to be one of our key drivers in the success of our 3D sensing total solution.

LCOS

I will now turn to our LCOS update. Even though the market is still in development stage, we continue to see heavyweight companies allocating major R&D resources and budgets in their push for AR goggle devices. Our list of customers continues to expand and it now covers many of the world's biggest tech names. In addition to AR applications, we are pleased to report that we are making great progress in developing high-end heads-up-displays for automotive applications. This represents a significant long term growth opportunity for us. Our technology leadership in this space has little competition, which is evidenced by our partnerships with tier 1 companies who have launched their AR products with Himax inside, as well as our partnerships with the world's leading AR glasses producers.

That concludes my report for this 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.

Thank you and have a nice day!