



Himax Technologies, Inc. Q2 2018 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 2018 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, 2017 filed with SEC in March, 2018.

Except for the Company's full year of 2017 financials, which were provided in the Company's 20-F and filed with the SEC on March 28, 2018, the financial information included in this conference call is unaudited and consolidated, and prepared in accordance with IFRS 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 Results

Ms. Jackie Chang: Thank you Greg and thank you everybody for joining us. Our outline for today's call is: first, review of the Himax consolidated financial performance for the quarter, followed by the third quarter 2018 outlook. Jordan will then provide an update on the status of our business, after which we will take questions. We will review our financials on both IFRS and non-IFRS basis. The non-IFRS financials exclude share-based compensation and acquisition-related charges.

Our second quarter 2018 revenues and gross margin met our guidance while IFRS earnings per diluted ADS exceeded our guidance. For the second quarter, we reported net revenues of \$181.4 million, an increase of 11.4% sequentially and an increase of 19.5% year-over-year. Gross margin was 23.0%, up 0.5% sequentially. IFRS earnings per diluted ADS were 1.2 cents, better than the guidance range of 0.0 to 1.0 cent per diluted ADS.

Revenue from large display drivers was \$60.6 million, up 2.2% sequentially, and up 16.3% year-over-year, driven by increasing 4K TV penetration and Chinese panel

customers' ramping of new LCD fabs. Large panel driver ICs accounted for 33.4% of our total revenues for the second quarter, compared to 36.4% in the first quarter of 2018 and 34.4% a year ago.

Revenue for small and medium-sized display drivers came in at \$89.3 million, up 24.5% sequentially and up 27.5% year-over-year. The driver ICs for small and medium-sized applications accounted for 49.2% of total sales for the second quarter, as compared to 44.0% in the first quarter of 2018 and 46.1% a year ago. Sales into smartphones were up 54.3% sequentially and up 42.5% year-over-year. The growth was driven by accelerating TDDI shipments and the anticipated smartphone makers' inventory replenishment for new product launches. Jordan will elaborate on this a bit later.

Our driver IC revenue for automotive applications recorded another historical quarter, up 15% sequentially and more than 35% year-over-year. The quarterly revenue reached \$28.7 million, accounting for more than 19% of our driver IC revenue. We are happy with the strong momentum in this space.

Revenues from our non-driver businesses were \$31.5 million, down 1.1% sequentially but up 6.4% versus last year. Non-driver products accounted for 17.4% of total revenues, as compared to 19.6% in the first quarter of 2018 and 19.5% a year ago. The sequential decline was mainly due to reduced NRE income. The year-over-year increase was driven mainly by WLO shipment. We expect WLO shipment to continue to rebound strongly in the second half. Jordan will elaborate on this a bit later.

Our IFRS gross margin for the second quarter was 23.0%, up 50 basis points from 22.5% in the first quarter of 2018 but down 80 basis points from the same period last year. The sequential increase was due mainly to improved product mix.

Our IFRS operating expenses were \$41.3 million in the second quarter of 2018, up 3.6% from the preceding quarter and up 11.3% from a year ago. The year-over-year increase was primarily the result of rising R&D expenses in the areas of 3D sensing, WLO, TDDI, and high-end TV, as well as annual merit increase.

IFRS operating margin for the second quarter of 2018 was 0.3%, up from -0.6% in the same period last year and up from -2.0% in the prior quarter. The sequential and the year-over-year increase was both a result of revenue increase but offset by increased operating expenses.

Second quarter non-IFRS operating income was \$0.8 million, or 0.5% of sales, up from -0.3% for the same period last year and up from -1.8% a quarter ago.

IFRS profit for the second quarter was \$2.0 million, or 1.2 cents per diluted ADS, compared to IFRS loss of \$2.8 million, or 1.6 cents per diluted ADS, in the previous quarter and IFRS loss of \$0.7 million, or 0.4 cents per diluted ADS, a year ago. The sequential increase was a result of higher sales and better gross margin.

Second quarter non-IFRS profit was \$2.3 million, or 1.3 cents per diluted ADS, compared to a loss of \$2.6 million, or 1.5 cents per diluted ADS last quarter and a loss of \$0.3 million, or 0.2 cents per diluted ADS the same period last year.

Turning to our balance sheet, we had \$126.7 million of cash, cash equivalents and other financial assets as of the end of June 2018, compared to \$185.9 million at the same time last year and \$151.9 million a quarter ago. The cash position dropped \$25.2 million due primarily to (1) capex of \$17.7 million, (2) cash outflow of \$2.8 million from operations, and (3) Emza investment of \$3.5 million. On top of the above cash position, restricted cash was \$147.0 million at the end of the quarter, as compared to \$147.0 million in the preceding quarter and \$107.2 million a year ago. The restricted cash is mainly used to guarantee the Company's short-term borrowings for the same amount.

As of June 30, 2018, our inventories were \$142.1 million, down from \$148.0 million a quarter ago and down from \$147.7 million at the same time last year. Account receivables at the end of June 2018 were \$176.3 million as compared to \$164.5 million a year ago and \$166.6 million last quarter. DSO was 93 days at the end of June 2018, as compared to 97 days a year ago and 92 days at end of the last quarter.

Net cash outflow from operating activities for the second quarter was \$2.8 million as compared to an outflow of \$1.2 million for the same period last year and an inflow of \$2.3 million last quarter.

Capital expenditures were \$17.7 million in the second quarter of 2018 versus \$11.7 million a year ago and \$18.6 million last quarter. The second quarter capex consisted mainly of ongoing payments for the new building's construction, WLO capacity expansion and installation of active alignment equipment to support our 3D sensing

business. Other capex, primarily for design tools and R&D related equipment for our traditional IC design business, is around \$2.5 million during the quarter.

We declared an annual cash dividend of 10 cents per ADS during the second quarter, totaling \$17.2 million, which has been paid out on July 31. Our dividend is determined primarily by the prior year's profitability. Our decision to pay out 61.7% of last year's net profit demonstrated our continued support for our shareholder base and strong confidence in the near term outlook for our newly increased capex and the overall long-term growth prospects.

The capex budget for 2018 and the dividend for the year of 2017 will be funded through our internal resources and banking facilities, if so needed. Jordan will elaborate a bit later.

As of June 30, 2018, Himax had 172.1 million ADS outstanding, unchanged from last quarter. On a fully diluted basis, the total ADS outstanding are 172.5 million.

Q3 2018 Guidance:

For the third quarter of 2018, we expect revenues to be around flat sequentially. Gross margin is expected to be around 22.5%, depending on our final product mix. IFRS earnings attributable to shareholders are expected to be around -1.0 cent per diluted ADS based on 172.5 million outstanding ADSs. Non-IFRS earnings attributable to shareholders are expected to be around 1.5 cents per diluted ADS based on 172.5 million outstanding ADSs.

As we have done in the past, our third quarter IFRS earnings per diluted ADS guidance has taken into account our expected 2018 grant of restricted share units, or RSUs, to the team at the end of September. The 2018 RSUs, subject to our Board approval, is now assumed to be around \$4.5 million, almost all of which, or 2.1 cents per diluted ADS, will be vested and expensed immediately on September 30th, the grant date. In comparison, the 2017 RSUs totaled \$6.5 million, out of which \$6.1 million was vested immediately. The grant of RSUs would lead to higher third quarter IFRS operating expenses compared to the other quarters of the year.

I will now turn the call over to Jordan.

Q3 2018 Outlook

Mr. Jordan Wu:

Thank you, Jackie.

Before I discuss about our business outlook, I would like to highlight that our bottom line has been substantially affected by the major increase of R&D expenses since some two years ago when we decided to invest heavily into a number of new areas, something we brought to the market's attention repeatedly before. We believe our operations will be out of the trough starting from the fourth quarter, initially driven by the anticipated ramping of the new foundry for the TDDI product line and, thereafter, shipment of 3D sensing products next year. 3D sensing, in particular, will represent a paradigm shift in our business when it starts to achieve a broader market adoption. With that, now let me give

you some insights behind our guidance and trends that we see developing in our businesses.

Display Driver IC Business

LDDIC

Our large display driver IC business recorded low-single-digit growth in the second quarter due mainly to our Chinese panel customers' ongoing capacity expansion, a more favorable product mix driven by the market's 4K TV demands and shipment to a new panel customer who recently started ramping up their first fab. Looking into the third quarter, while the Chinese domestic market is relatively slow for reasons such as weak currency, the western markets, especially the US, remain robust. We see single digit growth for the third quarter as we continue to benefit from Chinese panel customers' capacity expansion and ramping of new fabs. However, foundry capacity shortage remains an issue. While we are making good progress in adding new capacity into our pool, the ultimate ramping schedule will depend on how fast our panel customers can go through their customer qualification, something all our major customers are working very hard on.

Looking into the future, with the 2020 Tokyo Olympics approaching and more Gen 10.5 fabs coming online to enable very large screen 8K TVs, many TV manufacturers are rushing to introduce consumer-grade super high end products with 8K resolution. Capitalizing on our 4K TV success, we are strongly positioned for this emerging market opportunity.

SMDDIC

Turning to the small and medium-sized display driver IC business. The trend for full-screen, 18:9 display is already fully in place for smartphone with phone makers now aggressively adopting such screens for 2018 and 2019 models even for mid-end and entry-level products. Our comprehensive TDDI product portfolio positions us well to support this trend. We are pleased that both our FHD+ and HD+ TDDI ICs enjoyed significant growth during Q2, with revenue and shipment volume both more than tripled during the quarter, despite being able to fulfill just a fraction of orders amid severe foundry capacity shortage. Capped by the very limited capacity, our Q3 TDDI shipment will likely see some 10% decline from that of the second quarter. TDDI's foundry capacity shortage is even more challenging than that of the large display driver IC. To capture the TDDI opportunity, we have been working very hard to source and qualify additional foundry capacity. We are on track to complete the porting of our existing products into another foundry vendor and start mass production toward early fourth quarter. The addition of the new foundry capacity will substantially grow our TDDI revenue starting from Q4 with further growth expected throughout 2019. In parallel, to further widen our reach, we are working on new designs based on additional foundry partners' processes which, however, will only be ready next year. We expect TDDI penetration will reach 40% in 2019 which represents an enormous growth opportunity for Himax. TDDI has more than double the ASP of the traditional driver IC with better margins. It will change our product mix for smartphone display driver IC and make a very significant contribution to our growth going forward. Looking into the third quarter, sales for smartphones are likely to decline around 40% sequentially as the TDDI shipment is constrained by capacity shortage and the traditional discrete driver IC is being quickly replaced by TDDI and AMOLED.

In automotive segment, we continued to have new projects going into mass production which were design-wins of the prior years. During the second quarter, sales into automotive sector already accounted for more than 19% of our total driver IC sales and close to 16% of our total revenues. On top of the world's first TDDI projects for automotives during the first quarter, our team further successfully added AMOLED design-wins during the second quarter. We have achieved a distant number one market share position thanks to our superior product quality, service and stable delivery. Q3 revenue in this segment is set to grow around 20% sequentially.

For third-quarter small and medium-sized driver IC business, we expect revenue to decline mid single digit sequentially.

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. Now let me share some of the progress we made in the last quarter, as well as our views on future growth opportunities.

3D Sensing Solutions

Since we announced 3D sensing as one of Himax's long term growth initiatives in 2017, 3D sensing, led by Apple's iPhone X, is gradually becoming a new industry trend as major Android smartphone makers beginning to integrate it into flagship models, although most of such projects are still in development stage. Leading Android smartphone makers are exploring various 3D sensing technologies, namely structured light, active stereo camera (ASC) and, to a lesser extent, time-of-flight (ToF), trying to strike a good balance of cost, specifications and application. More software players are

entering the ecosystem to develop 3D sensing applications beyond the existing applications, namely facial recognition, online payment and camera performance enhancement. Being a leading player in the 3D sensing space, Himax is in partnership with several leading smartphone names to enable their 3D sensing by providing optics, projector or total solution, depending on the customer's needs and their in-house capabilities. The projects we are involved in cover all the three types of 3D sensing technologies mentioned above. These efforts will facilitate a broader adoption of 3D sensing on Android smartphone starting 2019. Our goal is to ensure that the smartphones backed by Himax 3D sensing technology will deliver the industry's highest standard in all of 3D depth accuracy, indoor/outdoor sensitivity, power consumption, size, data security and eye safety.

Now, let me go through the progress we have made in structured light and ASC 3D sensing businesses and our approaches.

SLiM™, our structured light 3D sensing hardware total solution which we jointly announced with Qualcomm in last August, targets premium smartphone market. The Qualcomm/Himax solution brings together Qualcomm's industry leading 3D algorithm with Himax's cutting-edge design and manufacturing capabilities in optics, NIR sensors, and ASIC, as well as our unique know-how in 3D sensing system integration. It is by far the highest quality 3D sensing total solution available for the Android market right now. At present, we are working with customers who are targeting to bring new 3D sensing applications to smartphone, on top of facial unlock and online payment. We are now targeting the end of the year or early 2019 for shipment to the customers for their product launch in first half 2019, although the actual shipment date will ultimately be dictated by

end customers. Another noteworthy update is that our SLiM™ total solution can work on Qualcomm's high end mobile platforms now, as opposed to being limited to only the premium Snapdragon platform when we first launched the technology, thereby lowering the total cost barrier of 3D sensing.

Our ASC 3D sensing solution, targeting mass market smartphone models, achieved a significant milestone during the second quarter. While structured light 3D sensing offers outstanding depth precision for its complex projector design, ASC 3D sensing can also enable facial recognition with a simpler projector. While it is somehow constrained by its limited depth precision, it is a lower cost alternative for face authentication and enjoys better software readiness since it is built on the existing dual camera ecosystem. We are already working with top tier smartphone makers and leading platform partners concurrently on multiple projects. Early shipment is targeted to begin toward the end of the year with major ramp in 2019, although, again, the actual shipment date will ultimately be dictated by the end customers. We expect more design-wins in the coming months. It appears that ASC 3D sensing, with its cost advantage and the existing dual camera ecosystem, has a better chance of accelerating 3D sensing adoption for facial recognition on Android smartphone market during 2019.

WLO

As anticipated, the shipment volume to our WLO anchor customer for the second quarter was a lot higher versus that of the first quarter and our WLO capacity utilization improved subsequently. We expect the shipment for the second half to increase significantly versus that of the first half. The overall 2018 shipment will increase considerably year-over-year. Meanwhile, we are encouraged by the progress of our new R&D projects with

the said customer for their next generation products centering around our exceptional design know-how and mass production expertise in WLO technology. We are very excited about the significant growth opportunities of these projects.

While 3D sensing is the top priority of our WLO business at present, we also have engineering collaboration with select world-class technology leaders to develop wave-guide for AR glasses and micro displays using our advanced WLO technology. We expect to kick off new R&D projects during the third quarter.

Capex

Now some update on our capital expenditure. We announced the increase of the Phase I capital expenditure budget, which is on top of our regular capex for the IC design business, from \$80 million to \$105 million in early 2018. The majority of the Phase I investment is going to land and building, new equipment for the WLO anchor customer, and an initial capacity of 2 million units per month for 3D sensing. Of the \$105 million budget, \$33 million has been paid out in 2017, followed by \$17.5 million made in the first quarter 2018 and another \$15.2 million in the second quarter. The payment for the remaining \$39.3 million is to be made throughout the rest of 2018. With the anticipation of broader 3D sensing adoption in 2019, we expect to further expand production capacity towards the end of the second half. Kick-off timing and amount of the Phase II investment is still being evaluated, depending on the customers' projected volume and timetable.

As we mentioned in the previous earnings calls, the capex budget will be funded through our internal resources and banking facilities. We have more than sufficient banking

facilities with favorable cost for such capex budget and will start to draw down some of them in Q3.

CMOS Image Sensor

In the last earnings call, I reported Himax has been working with an industry leading fingerprint solution provider to develop an under-display optical fingerprint product in the last two years, targeting smartphones using OLED displays. Himax provides a customized low-power image sensor in the solution. I am pleased to announce that the solution has entered into mass production with a major Android smartphone OEM for their new flagship model with shipment expected in the coming months. The CMOS image sensor used in the solution will have a notably higher ASP than the company's traditional display driver IC products.

On other 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"). NIR sensor is a critical part for both of our structured light and ASC 3D sensing solutions. We expect significant growth in our CMOS image sensor business as 3D sensing shipment gets started. On the AoSTM product line, the acquisition of Emza enables Himax to be uniquely positioned to provide ultra-low power imaging sensing solutions, leveraging Himax's industry leading super low power CIS design and Emza's unique AI-based computer vision algorithm. We are pleased with the status of engagement with leading players in areas such as connected home, smart building and security, all of which new frontiers for Himax.

For traditional human vision segments, we see strong demands in laptop and increasing shipment for multimedia applications such as car recorders, surveillance, drones, home appliances, and consumer electronics, among others.

LCOS

I will now give an update on the LCOS business where our main focus areas are AR goggle devices and head-up-displays (HUD) for automotives. While AR will take a few years to fully realize its market potential, we have seen many companies, be the top name multinationals or new start-ups, invest heavily to develop the ecosystem -- applications, software, operating system, system electronics, and optics. We are slated to kick off another AR goggle project with tailor-made micro display for a tier-1 tech name during the third quarter. In addition, we continue to make great progress in developing high-end holographic head-up display for automotives. Timing for such revenue contribution would be 2019 the earliest.

For non-driver IC business, we expect revenue to increase around 15% sequentially in the third quarter driven by WLO shipment

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 continue to attend investor conferences. We will announce the details as they come about. Thank you and have a nice day!