



Himax Technologies, Inc. Q2 2019 Unaudited Financials and Investor Update Call

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Operator: Opening and standard introduction.

Maili Bergman: Welcome everyone to Himax's second quarter 2019 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 HIMX@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, 2018 filed with SEC in March, 2019.

Except for the Company's full year of 2018 financials, which were provided in the Company's 20-F and filed with the SEC on March 28, 2019, 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 Maili and thank you everybody for joining us. In today's call we will first review the Himax consolidated financial performance for the second quarter, followed by the third quarter 2019 outlook. Jordan will then give 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 2019 revenues, gross margin and EPS all met our guidance issued on May 9th. For the second quarter, we recorded net revenues of \$169.3 million, an increase of 3.7% sequentially and a decrease of 6.6% year-over-year. As expected, our smartphone segment recorded a significant sequential growth while automotive business declined amidst worldwide sluggish car sales. The TV sales were also hit by the falling panel prices caused by the display industry's oversupply situation. Gross margin was 19.5%, down 310 basis points sequentially due to less favorable product mix. IFRS loss per diluted ADS were 3.0 cents, in line with the guidance range of 2.0 to 3.5 cents. Non-IFRS loss per diluted ADS were 2.8 cents, in line with the guidance range of 1.8 to 3.3 cents.

Revenue from large display drivers was \$59.3 million, down 15.3% sequentially, and down 2.2% year-over-year. Clouded by weak demand and oversupply, our panel customers have been over-stocked since last year. Our large panel driver ICs experienced lower shipments and pricing erosion in the second quarter as a result. Large panel driver ICs accounted for 35.0% of our total revenues for the second quarter, compared to 42.9% in the first quarter of 2019 and 33.4% a year ago.

Revenue for small and medium-sized display drivers came in at \$81.7 million, up 20.9% sequentially but down 8.5% year-over-year. The segment accounted for 48.3% of total sales for the second quarter, as compared to 41.4% in the first quarter of 2019 and 49.2% a year ago. The sequential revenue increase was mainly from smartphone and tablet sales. Both segments saw stronger shipments to a more diversified customer base in Q2. On year-over-year basis, sales for all small and medium-sized business segments declined except for smartphone TDDI.

Sales into smartphones were up 60.9% sequentially and flat year-over-year. The strong sequential increase came from high TDDI shipment off a low base and strong shipment of traditional discrete driver IC to a major Chinese smartphone maker. On a year-over-year basis, our TDDI shipment doubled as our shipment was capped last year by capacity constraint. However, sales of the traditional DDICs declined by close to 40% from last year. We expect sales for traditional discrete driver ICs in smartphone segment to decline significantly in the second half of 2019 as its addressable market is being quickly replaced by TDDI and AMOLED. Display drivers for tablet and other consumer products were up 23.7% sequentially through shipment to a leading end customer and white box market on

the backdrop of a shrinking global tablet market. Year-over-year sales of this segment declined 17.9%.

Our driver IC revenue for automotive application was down 10% both sequentially and year-over-year as car sales remained weak across all major markets worldwide. The \$25.6 million sales for the second quarter accounted for 18.2% of our total driver IC revenue. We expect this downward trend to continue in 2H19.

Revenues from our non-driver businesses were \$28.3 million, up 9.8% sequentially but down 10.1% from last year. Non-driver products accounted for 16.7% of total revenues, as compared to 15.7% in the first quarter of 2019 and 17.4% a year ago. The sequential increase was mainly due to higher timing controller and CMOS image sensor sales offset by lower WLO shipment. On a year-over-year basis, CMOS image sensor enjoyed some growth, while other major products, including WLO and timing controller, experienced decline.

The gross margin for the second quarter was 19.5%, down 310 basis points sequentially and down 350 basis points from the same period last year, both a result of product mix. We anticipated the sequential decline and highlighted three reasons in the last earnings call. Firstly, our large panel driver IC business experienced pricing pressure caused by industry wide TV panel oversupply and high material cost. Secondly, the gross margin of the WLO business fell because of reduced shipment per an anchor customer's demand which led to lower capacity utilization. Finally, the significant sequential increase of TDDI for low-end market and certain traditional discrete driver IC for smartphones also led to lower overall gross margin.

Our IFRS operating expenses were \$38.9 million in the second quarter, down 3.4% from the preceding quarter and down 5.8% from a year ago.

IFRS operating margin for the second quarter was -3.5%, down from 0.3% in the same period last year and down from -2.1% in the prior quarter. The sequential decrease was primarily a result of lower gross margin. The year-over-year decline was a result of lower sales and gross margin.

Second quarter non-IFRS operating loss was \$5.5 million, or -3.2% of sales, versus non-IFRS operating income of \$0.8 million, or 0.5% of sales, for the same period last year and down from -1.8% a quarter ago.

IFRS loss for the second quarter was \$5.2 million, or 3.0 cents per diluted ADS, compared to loss of \$2.3 million, or 1.3 cents per diluted ADS, in the previous quarter and IFRS profit of \$2.0 million, or 1.2 cents per diluted ADS, a year ago.

Second quarter non-IFRS loss was \$4.8 million, or 2.8 cents per diluted ADS, compared to non-IFRS loss of \$2.0 million, or 1.1 cents per diluted ADS last quarter and non-IFRS profit of \$2.3 million, or 1.3 cents per diluted ADS the same period last year.

Turning to the balance sheet, we had \$122.4 million of cash, cash equivalents and other financial assets as of the end of June 2019, compared to \$126.7 million at the same time last year and \$108.2 million a quarter ago. The cash position increased \$14.1 million from last quarter due primarily to increased unsecured borrowings of \$37 million, offset by capex

of \$5.7 million and cash outflow of \$17.7 million from operations. On top of the cash position, restricted cash was \$164.3 million at the end of the quarter, the same as the preceding quarter and up from \$147.0 million a year ago. The restricted cash is mainly used to guarantee the secured short-term borrowing for the same amount. We had \$77 million unsecured short-term loan at the end of Q2 versus \$40 million a quarter ago. As reported in the last earnings call, further loan was made to finance the land payment.

Our inventories as of June 30, 2019 were \$188.5 million, slightly down from \$189.3 million a quarter ago and up from \$142.1 million a year ago. Accounts receivable at the end of June 2019 were \$176.2 million, little changed from last quarter and a year ago. DSO was 96 days at the end of June 2019, as compared to 93 days a year ago and 97 days at end of the last quarter. As highlighted in the last earnings calls, in response to capacity shortage of foundry and certain packaging material, we had to keep the inventory level higher than usual last year. Given the prevailing uncertain market conditions and ease of foundry capacity, we have started to control our inventory level from the first quarter 2019. More sizeable reduction in inventory will be seen starting the third quarter.

Net cash outflow from operating activities for the second quarter was \$17.7 million as compared to an outflow of \$2.8 million for the same period last year and an outflow of \$22.1 million last quarter. The increased outflow year-over-year was mainly due to additional inventory buildup and lower profit.

Second quarter capital expenditures amounted to \$5.7 million, versus \$17.7 million a year ago and \$6.3 million last quarter. The investment in design tools and R&D related equipment for our traditional IC design business amounted to \$1.7 million in the quarter.

The remaining \$4.0 million was for the ongoing payments for the new building's construction and WLO capacity expansion. Third quarter capex is budgeted to be around \$33 million including the payment of \$27.7 million for the land purchase which was deferred from the second quarter. By the end of Q3 we will have concluded substantially all the capex payments for the new land, building and 3D sensing project with just \$1 million left to be made in the fourth quarter.

Before concluding my report of the second quarter results, I would like to provide an update on dividend information. We typically make annual cash dividend payment at approximately the middle of the year based on the prior year's profitability. Our Board of Directors has decided that we will not pay cash dividend in 2019. The decision was made with full consideration of Himax's 2018 financial results as well as 2019 operations and capital requirement.

As of June 30, 2019, Himax had 172.1 million ADS outstanding, unchanged from last quarter. On a fully diluted basis, the total ADS outstanding are 172.6 million.

Q3 2019 Guidance:

For the third quarter, we expect revenue to decrease around 2% to 7% sequentially. Gross margin is expected to be around flat sequentially, depending on our final product mix. IFRS loss attributable to shareholders are expected to be in the range of around 3.5 to 5.5 cents per diluted ADS based on 172.6 million outstanding ADSs. Non-IFRS loss attributable to shareholders are expected to be in the range of 3.3 to 5.3 cents per diluted ADS based on 172.6 million outstanding ADSs.

This year, we will not issue restricted share units (RSU) to employees in September like previous years. Thus, our third quarter guidance has not assumed any RSU expense in the third quarter 2019. RSU is part of our share-based compensation plan which we usually reward employees with an annual bonus at the end of September. In 2018, the RSU grant totaled \$3.9 million, out of \$3.8 million was vested immediately and expensed in the third quarter. The remainder was vested equally at the first, second and third anniversaries of the grant date. The decision of not issuing RSU in 2019 was made with full consideration of Himax's 2019 financial results and operational requirement.

I will now turn the call over to Jordan.

2019 Outlook:

Mr. Jordan Wu:

Thank you, Jackie.

Before I discuss our business outlook for the third quarter, I would like to comment on overall industry trends that are currently impacting our businesses. As we mentioned last quarter, market conditions have been challenging and we do not see them improving in the near-term. Uncertainty in the global economy continues to overshadow the marketplace, where we are seeing softness in all industries that consume display. This combined with prevailing industry-wide capacity oversupply, has led to severe pricing and cost pressure for panels, which has directly affected our sales and margin.

Against the backdrop of an unfriendly market environment, we have faced multiple challenges that have had an adverse effect on our overall financial performance over the past twelve months. First, the large display driver IC and small/medium driver IC markets experienced chip-on-film (COF) and wafer capacity shortages, respectively. The severe shortages significantly affected our ability to fulfill customer orders in the back half of 2018, which not only impacted our 2018 sales but also jeopardized our ability to win new projects with customers at the time. While these constraints were resolved towards the end of 2018, we are still suffering from the repercussions of the loss of new projects as we did not get to take part in the mass production of those projects, many of which started in the second or third quarter this year.

Second, beginning earlier this year, there has been a major pullback in demand for our DDICs as panel makers, facing an industry-wide overcapacity and uncertain economic outlook, cut back their production and, in the meantime, attempt to lower the DDIC inventory which they built earlier to address the IC shortage concern. The combination of these two factors has negatively impacted our performance in the second half of 2018 as well as full-year 2019. Separately in the smartphone segment, new model opportunities, which we count on to boost our new generation TDDI product shipment, have been limited so far in 2019 due to a slow smartphone market.

In summary, while we expect strong TDDI growth in 2019, its contribution to our overall sales will be offset by decreases in large panel and automotive DDICs, which have been negatively impacted by the unfavorable market environment.

Notwithstanding the current business headwinds, we are committed to the long-term strategy of achieving a balanced portfolio of DDIC and non-DDIC products. Looking forward, we believe that as a market and technology leader in DDIC, we are positioned well to regain market share in both large and small/medium display segments where we have seen major new project opportunities emerging with our customers. At the same time, we are working towards capitalizing on the unique non-driver technologies where we have invested heavily in the last few years, particularly 3D sensing and ultra-low power smart sensing. I will elaborate on some of those areas in a moment.

Last but not least, while we are making good progress in the development of strategic technologies, we have kept R&D expenses approximately flat compared to last year. These include next generation display driver technology for 8K TV and AMOLED, 3D sensing for both mobile phone and non-mobile phone applications and the ultra-low power smart sensing solutions. We are committed to our overall strategy and continue to invest in technology to drive our long-term growth. Now let me give you further insights behind our Q3 guidance.

Display Driver IC Business

LDDIC

As usual, let us start with the large-panel driver IC business update. During Q2, our business, and the overall market, remained weak due to panel overcapacity and high inventory on the backdrop of an uncertain global economy. Panel makers have reduced production output, resulting in decreased demand and price erosion for our DDIC products. We expect these trends will continue into Q3 and the remainder of 2019.

Another major factor affecting our large display driver IC business is the material costs. Although COF demand has started to show signs of relaxation, the supply remains tight and prices in Q3 remain high. The overall outlook of our LDDIC business for the second half of 2019 has reversed since our last report due to the reasons mentioned above. We now expect our third quarter revenue in the large display driver IC segment to decrease sequentially by high-teens with lower gross margin. Based on the information currently available, it is unlikely that overcapacity and weak demand in the large panel will change in the near future. As a result, we expect revenue to decline further in 4Q19 for this segment with continued margin pressure. Despite the short-term weak outlook, we are making good progress securing new design wins from our existing customers. We expect to return to growth starting Q1 2020.

On technology development, 8K TVs will continue to hold a small share in the TV market because 8K content and transmission technology are still early in its lifecycle. But 8K TVs remain a strategic area for Himax and are expected to boost demand for higher LCD driver ICs and timing controller contents.

SMDDIC

Now let's turn to the small and medium-sized display driver IC business, beginning with an update on our smartphone segment. The global smartphone market is expected to decline in 2019. On the one hand, we are pleased with the strong TDDI growth in the second quarter driven by a more diversified customer base and enriched product portfolio. On the other hand, the speed of growth of TDDI has not been to our satisfaction and we are concerned that the TDDI market is maturing while at the same time experiencing rapid

ASP erosion caused by increased competition. Moreover, sluggish smartphone demand and shorter product cycles have led to our slower-than-expected inventory reduction.

For the third quarter, we expect TDDI shipment to be down by low single digits and revenue to decline by high single digits from the previous quarter due to ASP erosion. As Jackie mentioned earlier, we have taken more aggressive action to control inventory levels and adjust for the weak market environment. We expect a further reduction in inventory level in the third quarter.

As highlighted in the previous earnings call, we remain the industry leader in developing next generation TDDIs solutions such as MUX6, dual gate and high screen refresh rate TDDIs. We have already begun new design-ins with major smartphones names but do not expect these to make a meaningful contribution to our sales until 2020. Increased competition in TDDI market combined with accelerating AMOLED display adoption will limit our TDDI growth for smartphone application in Q3 and the remainder of 2019.

I mentioned in the last earnings call that we could potentially start shipping TDDI chips for the tablet market in 2019. We expect to see a small revenue contribution during Q4 of this year with a number of leading end customers. Furthermore, we are the industry leader in TDDI with active stylus by partnering with the world's top brands for pen tablets and interactive pen displays. We were pleased to have begun shipments during Q1 of our TDDI for automotive display to a leading panel customer for a prominent auto manufacturer. The initial volume started small but the pipeline for next year's mass production looks promising. While both segments are smaller than smartphone in terms of volume, they enjoy better margin and growth opportunities for our TDDI solutions in the near future.

As expected, our traditional discrete driver IC sales into smartphone increased strongly in Q2 as our design-win with a major Chinese smartphone maker went into production during March and a significant shipment took place in Q2. Despite this rebound, we are seeing the traditional discrete driver ICs' addressable market being quickly replaced by TDDI and AMOLED in smartphone. As a result, we expect traditional discrete driver ICs for smartphone to decline substantially in the third quarter of 2019 and beyond.

Combining shipments of TDDI and discrete smartphone driver, our Q3 sales into the smartphone market is expected to decrease by around 10% sequentially.

A major development we are seeing is increased utilization of OLED display designs for smartphones, triggered by increased AMOLED capacity and under-display fingerprint sensing technology which is currently only applicable with AMOLED displays. Although we expect this trend to negatively impact the demand for TDDI and corresponding ASP's, we have been collaborating closely with leading panel makers across China for AMOLED product development. While we don't expect revenue contribution anytime soon, we do believe AMOLED driver ICs will be one of the long-term growth engines for our small panel driver IC business.

In the automotive display segment, the market has been depressed by declining new car registrations, particularly in China. We continue to face weak demand and expect Q3 sales to be flat sequentially. Looking forward, against the backdrop of a feeble car market, the penetration of displays into vehicles is maturing. Therefore, we don't expect the same kind of growth that we enjoyed in the past several years in the automotive segment. However,

we will continue to lead this space by bringing new technologies to market including TDDI, AMOLED and local dimming timing controller. We believe such new technologies will help rejuvenate the industry and bring our automotive sales back to a growth trajectory.

Our tablet and consumer electronics businesses represented around 12.4% of our total sales in the second quarter. As the overall markets remain weak, we expect tablet business to decrease by more than 30% in the third quarter mainly due to a major end customer's inventory adjustment. As mentioned earlier, we have started to provide OEMs with samples for our world leading in-cell TDDI that supports the use of active stylus for tablet during the first quarter. We will report progress in due course. Combining tablet and consumer electronics businesses, we expect sales to decrease by around 25% sequentially in the third quarter.

For third-quarter, revenue for the small and medium-sized driver IC business is expected to decrease by around 10% sequentially.

Non-Driver Product Categories

Now let me share some of the progress we made on the non-driver IC businesses in the last quarter.

3D Sensing Business

First on 3D sensing business update. We continue to participate in most of the smartphone OEMs' ongoing 3D sensing projects covering structured light and time-of-flight (ToF). As I reported earlier, in the past, our structured light-based 3D sensing total solution targeting Android smartphone's front-facing application was unsuccessful due to high hardware cost,

long development lead time, and the lack of killer applications. Since then, we have adjusted our structured light-based 3D sensing technology development to focus on applications for non-smartphone segments which are typically less sensitive to cost and always require a total solution. We teamed up with industry-leading facial recognition algorithm and application processor partners to develop new 3D sensing applications for smart door lock and have started design-in projects with certain end customers. Separately we are collaborating with partners who wish to take advantage of our 3D sensing know-how to automate traditional manufacturing and thereby improve its efficiency and cost. A prototype of the cutting-edge manufacturing line is being built on our premises and we believe this project can represent a major step forward in our alternative 3D sensing applications. We are still in the early stage of exploring the full business potential for structured light 3D sensing technology but believe it will be applicable in a wide range of industries, particularly those demanding high level of depth accuracy.

On ToF 3D sensing, we have seen increasing adoption of world-facing solutions to enable advanced photography, distance/dimension measurement and 3D depth information generation for AR applications. Very recently, thanks to ToF sensor technology advancement, some OEMs are also exploring ToF 3D for front-facing facial recognition and payment certification. As a technology leader in the 3D sensing space, we are an active participant in smartphone OEMs' design projects for new devices involving ToF technology by offering WLO optics and/or transmitter modules with our unique eye-safety protection design.

WLO

Next is some discussion on our WLO business. As anticipated, the second quarter WLO revenue declined sequentially due to reduced shipment to our anchor customer as per their lower seasonal demand. The sequential shipment decline led to lower capacity utilization and therefore negatively impacted our Q2 gross margin. That being said, our shipments to the anchor customer in the first half of 2019 recorded a nice growth from last year. Furthermore, based on the customer's shipment forecast, we expect the third quarter WLO revenue to rise significantly with the strong momentum expected to carry through the second half of the year.

Our advancements in technology have enabled us to remain an industry leader and an active ecosystem participant for the creation of breakthrough products and technologies. In addition to 3D sensing for smartphone applications, we have various engagements in other markets. For example, the automotive sector is developing as an attractive market with substantial opportunities for our WLO product line in 2D/3D in-cabin optical sensing for driver monitoring/identification and advanced parking assist systems.

WiseEye

Next on WiseEye, our ultra-low power, AI-based, smart sensing solution. During Computex 2019, in partnership with Quanta Computer, the world's largest notebook ODM, we unveiled the world's first human-aware intelligent vision solution for notebooks, WiseEye 2.0 NB. This solution was built on Emza's unique AI-based algorithm as well as Himax's proprietary computer vision processor and CMOS image sensor, all built with ultra-low power design. Emza, based in Israel, is Himax's wholly owned subsidiary and a pioneer specialized in AI-based algorithm for ultra-low power intelligent image sensing. WiseEye 2.0 NB enables seamless integration of sensing user context awareness for an improved

notebook user experience and extended battery life. New product features include, among others, device wake-up when user is present, screen lock when absent, screen dimming when disengaged, and privacy alerts when a second person is identified in the field of view. Additionally, the AI-based always-on sensor can detect user engagement levels, based on presence and face posing, to enable power management of the display and maximize battery life. Since Computex, we have extended our dialogue to most OEMs who are all looking to include AI low power sensors into their platforms. We are targeting their next generation product launches for the 2020 back to school season.

While our focus is currently on notebooks, intelligent ultra-low power human detection and people counting can be widely utilized. In the future, we will expand into the residential security, smart home, smart building, consumer appliances, automotive and industrial segments.

CMOS Image Sensor

On CMOS image sensor business updates. For the traditional human vision segments, we see strong demand in notebooks, where we are one of the market leaders, and increased shipments for multimedia applications such as car recorders, surveillance, drones, home appliances, and consumer electronics, among others. Additionally, we have seen increased shipment and new design-wins in the automotive segment covering before-market solutions such as surround view and rear-view camera.

CMOS image sensor is a critical component in the WiseEye solution I mentioned earlier. We have made a huge effort to combine the capabilities of high quality HD image capturing and ultra-low-power, low resolution visual sensing into one single sensor, the industry's

first with such design. With this 2-in-1 sensor, notebook manufacturers can simplify their product design and save the cost for an additional camera needed for context awareness. The first generation of the 2-in-1 sensors is designed with state-of-the-art stack-die technology to achieve a die size small enough to fit into the industry's next generation ultra slim notebook computers. In addition, our sensor has incorporated an RGB-IR design to enable Windows Hello facial recognition. The new 2-in-1 CMOS sensor will be available by the end of 2019.

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 automotive. In 2018, many AR goggle devices were launched, targeting primarily niche industrial or business applications, with top name multinationals continuing to invest heavily to develop the ecosystem - applications, software, operating system, system electronics, and optics. While AR goggles will take a few more years to fully grow into its market potential, we believe LCOS remains the mainstream technology in this space. Our technology leadership and proven manufacturing expertise has made us a preferred partner with AR goggle device customers for their ongoing engineering projects. In addition, we continue to make great progress in developing high-end holographic head-up displays for high-end automotive. LCOS for both goggle device and HUD enjoy much higher ASP and better gross margin for us and represents a long-term growth driver for us.

For non-driver IC business, driven by strong growth in WLO and CIS, we expect revenue to increase by about 30% sequentially in the third quarter.

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!