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# EDITED TRANSCRIPT

Q2 2021 Himax Technologies Inc Earnings Call

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**Eric Li** *Himax Technologies, Inc. - Chief of IR/PR Officer*

## CONFERENCE CALL PARTICIPANTS

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**Jonathan Doherty Lopez** *The Vertical Trading Group, LLC, Research Division - Research Analyst*

**Mark Schwalenberg** *MZ Group S.A. - Partner*

## PRESENTATION

### Operator

Hello, ladies and gentlemen. Welcome to the Himax Technologies, Inc. Second Quarter 2021 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Mr. Mark Schwalenberg from MZ Group.

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### Mark Schwalenberg *MZ Group S.A. - Partner*

Welcome everyone to Himax's second quarter 2021 earnings call. Joining us from the company are Mr. Jordan Wu, President and Chief Executive Officer; Ms. Jessica Pan, Chief Financial Officer; and Mr. Eric Li, Chief IR/PR Officer.

After the company's prepared remarks, 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 e-mail [himx@mzgroup.us](mailto:himx@mzgroup.us). Access the press release on financial portals or download a copy from Himax's website at [www.himax.com.tw](http://www.himax.com.tw).

Unless otherwise specified, we will discuss our financial results based on non-IFRS measures. You can find the related reconciliation to IFRS on our website.

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, the effect of the COVID-19 pandemic on the company's business; general business and economic conditions and the state of the semiconductor industry; market acceptance and competitiveness of the driver and non-driver products developed by the company; demand for end-use application products; reliance on a small group of principal customers; the uncertainty of continued success in technological innovations; our ability to develop and protect our intellectual property; pricing pressures, including declines in average selling prices; changes in customer order patterns; changes in estimated full year effective tax rate; shortage in supply of key components; changes in environmental laws and regulations; changes in export license regulated by Export Administration Regulations, EAR; exchange rate fluctuations; regulatory approvals for further investments in our subsidiaries; our ability to collect accounts receivable and manage inventory; 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, 2020, filed with the SEC as may be amended.

Except for the company's full year of 2020 financials, which were provided in the company's 20-F and filed with the SEC on March 31, 2021, 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 Mr. Eric Li. Eric, the floor is yours.

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**Eric Li Himax Technologies, Inc. - Chief of IR/PR Officer**

Thank you, Mark, and thank you everybody, for joining us. My name is Eric Li, and I'm the Chief IR/PR Officer. Joining me are Jordan Wu, our CEO; and Jessica Pan, our CFO.

On today's call, I'll first review the Himax consolidated financial performance of the second quarter 2021, followed by the third quarter 2021 outlook. Jordan will then give an update on the status of our business, after which we will take questions.

Our second quarter revenues and gross margin were both at the upper range of the guidance issued on May 6, 2021, and EPS exceeded the guidance. Revenue, gross margin and EPS, again, all reached all-time highs in the second quarter of 2021.

For the second quarter, we recorded net revenue of \$365.3 million, an increase of 18.2% sequentially and an increase of 95.3% compared to the same period last year. The sequential increase was at the upper range of the guidance of an increase of around 15% to 20% quarter-over-quarter. Gross margin was 47.5%, at the upper range of the guidance of 45.5% to 47.5%, and a significant 7.3 percentage points improvement from the 40.2% of the first quarter 2021.

Non-IFRS profit per diluted ADS was 62.4 cents, exceeding our guidance of 54.2 cents to 60.2 cents. IFRS profit per diluted ADS was 62.3 cents, exceeding our guidance of 54.0 cents to 60.0 cents. Revenue from large display drivers was \$85.4 million, up 22.2% sequentially and up 43.7% year-over-year, with sales growing through all 3 major product areas, namely TV, monitor and notebook. Both monitor and notebook IC revenues delivered decent sequential increases, thanks to continuous home working and distant education demands.

TV revenues were up an impressive double-digit quarter-over-quarter, mainly due to strong shipment of high-end TV products including those to a world-leading end customer as we indicated in the last earnings call. Large panel driver IC accounted for 23.4% of total revenues for this quarter compared to 22.6% in the first quarter of 2021 and 31.8% a year ago. Small- and medium-sized display drivers saw continued strong momentum with revenue of \$230.6 million, up 13% sequentially and up 133.4% year-over-year.

Automotive segment delivered more than 22% sequential increase in Q2, the highest growth among the 3 segments in the small- and medium-sized driver IC business.

TDDI for tablet was up more than 30% sequentially, a continuation from the high base last quarter, while smartphone TDDI posted low single-digit sequential growth. Small- and medium-sized segments accounted for 63.1% of total sales for the quarter compared to 66.1% in the previous quarter and 52.8% a year ago.

The second quarter smartphone sales came in better than expected with revenue reaching \$83.9 million, up more than 200% compared to the same period last year. The smartphone segment represented around 23% of our total sales in Q2. Our smartphone TDDI sales were still capped by severe capacity constraints and, as we explained before, we continued to strategically allocate more capacity to tablet TDDI at the expense of smartphone shipments as we were the major supplier in the tablet TDDI market.

Sales of traditional smartphone DDICs grew nicely as expected with seasonal demand. As mentioned several times before, traditional smartphone DDICs are quickly being replaced by TDDI and AMOLED.

Our tablet revenue continued to break sales records reaching \$85.3 million in Q2. Tablet sales grew 17% sequentially and doubled year-over-year, reflecting strong market demand from home working and online learning as well as our market share gains.

Tablet revenue accounted for more than 23% of our total sales in the second quarter, slightly above our smartphone IC business in weighting. While our tablet TDDI sales continued an uninterrupted growth streak since the product's initial mass production in the first

quarter of 2020, our shipments were still limited by ongoing industry-wide capacity shortage. The accelerated growth, however, illustrated our market leadership in non-iOS tablet market and TDDI's increasing penetration in the tablet market. Revenue of traditional discrete driver IC for tablet was flat sequentially in the second quarter as the market continued to be quickly replaced by TDDI.

Our second quarter driver IC revenue for automotive amounted to \$53.3 million, up 22.1% sequentially and more than doubled year-over-year, while demand continued to outpace the supply. Automotive driver IC business accounted for around 15% of total revenue in the quarter. As we predicted in the last earnings call, we expect our automotive shipments to grow quarter-over-quarter in 2021 and into the next year. Jordan will elaborate on this in a few minutes.

Second quarter revenue for our non-driver business was \$49.3 million, up more than 40% sequentially and up more than 70% year-over-year. Tcon business registered a remarkable growth of over 60% sequentially, up more than 130% year-over-year. Non-driver products accounted for 13.5% of total revenue as compared to 11.3% in the first quarter of 2021 and 15.4% a year ago.

Gross margin for the second quarter was 47.5%, up from 40.2% of the previous quarter and greatly increased from 21% of the same period last year. Our non-IFRS operating expenses for the second quarter were \$39.3 million, a little changed from the previous quarter, but up 5.7% from a year ago, mainly because of increased salary.

Reflecting higher sales and better gross margin, non-IFRS operating income was \$134.3 million or 36.8% of sales versus 27.5% of sales in the last quarter. Again, both operating income and operating margin reached historical highs.

Non-IFRS after-tax profit was \$109.1 million or 62.4 cents per diluted ADS, a new record high and greatly up from \$67.1 million or 38.4 cents per diluted ADS of the last quarter.

Turning to the balance sheet, we had \$270.4 million of cash, cash equivalents and other financial assets as of June 30, 2021, compared to \$107.1 million in the same time last year and \$245.8 million a quarter ago. The higher cash balance was derived mainly from \$85.2 million of operating cash inflow during the quarter, offset by the \$59.6 million cash outflow for refundable deposits made for purpose of securing foundry capacity.

Restricted cash was \$112.1 million at the end of Q2 compared to \$114.8 million a quarter ago and \$164 million a year ago. The restricted cash was mainly used to guarantee the short-term secured borrowings for the same amount. We had \$55.5 million of long-term unsecured loans as of the end of Q2, of which \$6 million was current portion.

Our quarter-end inventory as of June 30, 2021, were \$134.2 million, up from \$114.9 million last quarter and down from \$161.5 million a year ago. Compared to the prior year, our inventory remains at a lower level as customers request finished goods delivery as soon as they are available, reflecting the prolonged supply-demand imbalance. As the overall semiconductor is unlikely to have sizable capacity increases anytime soon while demand far outpaces supply, we anticipate a similar level of inventory position in the next few quarters.

Accounts receivable at the end of June 2021 was \$329 million, up from \$289.1 million last quarter and up from \$206.1 million a year ago due to higher sales. DSO was 88 days at the quarter end, as compared to 101 days a year ago and 84 days at the end of last quarter.

Now turning to the cashflow for the quarter, net cash inflow for operating activities amounted to \$85.2 million as compared to an inflow of \$60.3 million last quarter, and an outflow of \$9.2 million for the same period last year. Investing activities saw a net cash outflow of \$58.2 million during the second quarter, mainly because of a net increase of \$59.6 million in refundable deposits that we made during the second quarter for the purpose of securing foundry capacity. Also, as part of investing activities, second quarter capital expenditures were \$1.4 million versus \$2 million last quarter and \$0.7 million a year ago. The second quarter CapEx was mainly for R&D-related equipment for our IC design business.

We declared an annual cash dividend of 27.2 cents per ADS during the second quarter, totaling \$47.4 million and equivalent to 100% of last year's net profit. The dividend was paid out on July 12, 2021. As before, our dividend was determined primarily by prior year's profitability. Our decision to pay out full net profit of last year demonstrated the management's strong confidence for our business

prospects. As of June 30, 2021, Himax has 174.3 million ADS outstanding, little change from last quarter. On a fully diluted basis, the total number of ADS outstanding was 174.7 million.

Now turning to our third quarter 2021 guidance. For the third quarter, we expect further revenue growth from the already high level of Q2 2021. Gross margin should see another uptick and could reach another quarterly high. For the third quarter, we expect revenue to increase 13% to 17% sequentially. Gross margin is expected to be in the range of 50.5% to 52%, depending on the final product mix.

With the increases of revenue and margin, we anticipate net profit should increase substantially in third quarter. Non-IFRS profit attributable to shareholders is expected to be in the range of 75.0 cents to 81.0 cents per fully diluted ADS. The third quarter IFRS profit attributable to shareholders is estimated to be in the range of 63.0 cents to 69.0 cents per fully diluted ADS.

Similar to our usual practice, we will grant RSUs on or around September 30 for this year for employees' share-based compensation. The third quarter guidance for IFRS profit per diluted ADS has taken into account the expected 2021 RSU grant, which, subject to Board approval, is now assumed to be around \$75 million, out of which \$26.3 million or 11.8 cents per diluted ADS will be vested and expensed immediately on the grant date.

As a reminder, the total RSU amount and the immediately vested portion are our current best estimates only and could vary materially depending on, among other things, our Q4 profit and the final Board decision for the total RSU amount and its vesting scheme.

As the case for previous year, the RSU grant in 2021 will lead to higher third quarter IFRS operating expenses compared to other quarters of the year. In comparison, the 2020 RSU totaled \$5 million, out of which \$4.8 million was vested immediately. Needless to say, our estimated total RSU amount is significantly higher than those of the prior years due to anticipated record high profit for this year. This is an illustration of our appreciation to the team for their hard work. This also demonstrates our confidence in our long-term growth prospects.

I will now turn the call over to Jordan. Jordan, the floor is yours.

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**Jordan Wu Himax Technologies, Inc. - Founder, CEO, President & Director**

Thank you, Eric. The semiconductor industry continues to go through a severe foundry shortage, especially in the mature process nodes where we are mainly anchored. With foundries running at more than full capacity, while demand shows no indication of abating, the long-lasting unaddressed supply-demand balance remains.

In view of the foundry shortage and anticipated growing demand for the foreseeable future, we have entered into strategic agreements with foundry partners to cover both our short-term and long-term needs. We are in the process of entering into further such agreements as we speak, with some of them involving new foundry partners, leaving nothing untried to expand our capacity pool.

Likewise, across various product lines, we are entering into strategic agreements with customers who wish to secure their IC supplies. Some of them are indirect customers who don't necessarily source ICs directly from us, but still wish to enter into supply deals with us to ensure that their direct vendors, mostly panel makers in our case, will get their desired supply quantities from us. All such contractual arrangements will help boost our future growth prospects and improve earnings visibility.

Notwithstanding all these efforts, demand continues to outpace supply, and we believe the imbalance could last well into 2022. However, we are on track for more accessible capacity to grow our business quarter-by-quarter this year. Looking further ahead, we expect to also secure more capacity for 2022 as compared to this year. We will provide more details as they become available.

With that, now let us start with an update on the large panel driver IC business. For the third quarter, large display driver IC revenue is projected to increase more than 30% sequentially with all the 3 major product lines set for further growth.

In Q3, we expect both monitor and notebook businesses to post double-digit growth, benefiting from remote work and online schooling trends. For TV segment, we expect over 20% sequential growth in Q3, anchored by higher-end and larger-sized TVs, despite the slight

dip in the worldwide TV shipments anticipated for the second half. While demand remains resilient for us, supply still falls well short of demand fulfillment.

As consumers spend more time indoors and the number of connected devices per household is rising steadily, we are seeing more demand for advanced displays such as higher resolution TV, higher refresh rate monitor and ultra large-sized, high aspect ratio curved view displays. We continue to lead the high-end TV and gaming monitor markets by offering major panel makers and end customers total solutions of our driver ICs and advanced Tcons together.

In addition, we are also working on next-generation notebook DDICs, shooting for high-end and low power consumption features to enhance our product portfolio and market share gains.

Now let's turn to the small- and medium-sized display driver IC business. In the third quarter, revenue is expected to increase by low-teens sequentially at around 70% year-over-year, driven by persisting demand for tablet and automotive segments, while sales for smartphones are expected to see single-digit decline.

In Q3, the automotive driver business is set to grow by more than 30% sequentially and more than 150% year-over-year, once again showing the highest growth among the 3 segments in the small- and medium-sized driver IC business.

In early 2020, foreseeing the foundry shortage, we secured a long-term agreement with our strategic foundry partner to enlarge our capacity, specifically for the automotive application. While the capacity accessible to us is still far behind customer demands right now, we have been able to grow our shipment and sales amidst the prevailing shortage, especially for automotive ICs. As for the tablet market, we remain committed to allocating capacity in favor of tablets over smartphone to strengthen our leading position in the tablet driver market.

For the third quarter, we expect tablet sales to grow by mid-teens and smartphone sales to be down single digit compared to the previous quarter, reflecting our capacity allocation decision. Again, we are unable to meet all customer demands due to tight foundry capacity.

Now let's review each of the 3 major product segments within the small- and medium-sized display driver IC business. Sales growth for tablet IC business is expected to expand into the third quarter, thanks to robust consumer demand, driven by unprecedented stay-at-home lifestyle.

Tablet sales are expected to account for the highest proportion of all the product lines in Q3, benefiting from the proactive adoption by all leading non-iOS tablet names of our TDDI solutions. It's worth highlighting that we are the dominant tablet TDDI player in non-iOS market, taking more than 60% market share.

Himax continues to lead in the next generation tablet TDDI technology by offering state-of-the-art solutions for higher frame rate, higher resolution, larger screen size and more accurate active stylus designs. We are glad to report that recently, we started mass production for the world's first 12.4-inch WQXGA super high-resolution tablet with a leading end customer. In addition, we successfully piloted our tablet TDDI solution for the fast-expanding education tablet, a market with great potential. For the third quarter, we expect tablet TDDI sales to grow mid-teens. Revenue of traditional DDIC for tablet is expected to increase high single digits sequentially.

Next, a quick update on smartphone driver. The worldwide smartphone market confronted a short-term headwind from the recent spreading of the pandemic in the Southern Asia. However, our demand for smartphone still far surpasses supply. Limited by the total accessible capacity, we continue to strategically allocate capacity in favor of tablet over smartphone, as we mentioned before. Consequently, we anticipate our smartphone sales to be down single digit in Q3.

Looking ahead at our smartphone TDDI lineups, we are undertaking new design developments supporting higher frame rate, ultra slim bezel and higher resolution features. We expect successful engagement with key customers in the coming quarters. Discrete drivers for smartphone, running at relatively low volume, are expected to grow strongly with seasonal demand for the third quarter.

Now turning to the automotive sector. As I just mentioned, we expect strong growth for automotive IC business in Q3 on the backdrop of severe global IC shortage for the automotive market. With the rising volume for EV and anticipated proliferation of autonomous driving, the displays for automotive market will grow in not only volume but also chip size and sophistication.

As a world-leading automotive driver supplier who commands well over 30% of the global market, we are leading the charge in answering to such demands. We continue to work closely with panel suppliers, Tier 1 players and car makers for their future generation display designs. The most prominent among the new technologies for automotive display is TDDI, which is especially critical for large size and free form displays. Himax is the pioneer in the world of automotive TDDI development, having started the first-generation TDDI mass production as early as the second quarter of 2019. Taking advantage of the first-mover position and our long-standing close engineering collaboration with Tier 1 customers, we further upgraded our design. And now, our Gen 2 TDDI for automotive has officially entered into mass production in this quarter with its dominating design-win coverage across literally all display makers, numerous Tier 1 players and leading car manufacturers across all automotive markets.

The number of awarded projects is already in the dozens and still growing quickly as we speak. We expect the TDDI volume to expand exponentially starting from this quarter.

Aside from providing comprehensive coverage to address varying design needs, most important of all, our product portfolio adheres to the demanding standards of quality and reliability required of automotive products. Our early engagement with customers and mass production experience will prove invaluable for our long-term competitiveness. Also during the third quarter, we are again pioneering in the launch of the leading-edge LTDI, or large display touch and driver integration, solution that incorporates sophisticated multi-chip system design and is essential for very large-sized, stylish, curved automotive displays in a customers' upcoming first launch in vehicles. With these new technologies unleashed, we expect our automotive driver business to enjoy phenomenal growth for the next few years.

Next for an update on AMOLED. As AMOLED technology is embraced in the high-end display market, Himax is highly devoted to this area covering smartphone, wearable, tablet and automotive areas. Our successful collaboration with BOE Varitronix, a subsidiary of BOE, the world's largest TFT LCD player, on flexible AMOLED driver and Tcon for the automotive application is expected to be in mass production commencing in the fourth quarter this year. We are also excited about the significant progress in other fields with major China panel makers and will update the status when appropriate. Capacity shortage is expected to continue across all business segments in our small- and medium-sized driver IC business. Our shipping quantity will be constrained by capacity shortage during the third quarter.

Now let me share some of the progress we made on the non-driver IC businesses. Let's start from the timing controller. For the third quarter, we anticipate mid-teens sequential growth in Tcon sales. While also still limited by accessible capacity, we are optimistic about long-term growth prospects of the Tcon business with strong demand coming from some of the high-value products such as 4K, 8K TV, gaming monitor and low-power notebooks. Looking further ahead, we are particularly excited about the potential for automotive Tcon, which incorporates our leading-edge local dimming feature that coupled with mini-LED backlight, enables thousands of dimming zones for superior display contrast comparable to that of AMOLED. Our industry-leading local dimming Tcon already won numerous project awards from OEMs and Tier 1s. We believe Tcon segment will continue to be one of the growth drivers for our non-driver business.

Next, on WLO update. In the third quarter, we will continue to support an anchor customers' legacy product and anticipate sales to remain flat sequentially, which will still help sustain WLO factory utilization. WLO technologies continue to play an important role in enabling future generation optical applications. As a leader in the diffractive optics field, we keep on collaborating with worldwide tech giants and OEMs, where we are fully involved in optical-related innovation and development of ToF 3D sensing, AR glasses and other applications in a wide range of different fields.

Next, a quick update on 3D sensing. Our proprietary 3D decoder IC has been broadly acknowledged in the leading e-payment ecosystems in China since its initial mass production in the second half of 2020. Our 3D decoder IC provides high-performance decoding capability for high-precision face recognition and is particularly popular in areas such as door lock and industrial access control, where privacy is a major concern. We expect more design win awards and growing volumes throughout the year.



Now switching gears to the WiseEye smart sensing solution. To maximize market visibility and explore potential applications, we continue to push forward with two WiseEye business models, namely total solution and discrete component. Let's start with an update on WiseEye total solution. Our WiseEye total solution implements ultra low-power computer vision AI that aims at endpoint devices with constraints in processor resource and power consumption.

In addition to the design win for a mainstream application from a leading tech name that we reported last quarter, we are pleased to report new awards during the second quarter from utility meter, battery camera and panoramic video conferencing applications. Some of these applications are expected to enter into mass production beginning in the fourth quarter of 2021.

We continue to work on various new solutions, covering a wide variety of applications, including doorbells, surveillance, smart city, health care, agriculture and many other AIoT devices with joint efforts from multiple algorithm partners in different domains, including Himax owned subsidiary, Emza. We are at the forefront of delivering cutting-edge ultralow-power smart image sensing solution to the edge AI market.

For WiseEye key component business model, we reinforced our go-to-market strategy by intensively participating in leading AI partners' infrastructures and ecosystems. Following the successful collaboration with Google's TensorFlow Lite for microcontrollers and Microsoft Azure, we also joined Arm AI Partner Program and tinyML Foundation in an attempt to reach out to more diverse AI communities.

More recently, we teamed up with online store Digi-Key in addition to SparkFun that we announced before to showcase our edge device components and easy-to-use development tools for developers to conveniently access our WiseEye solution.

Hundreds of evaluation boards and development kits have been purchased online and distributed to add developers across the globe. We've extended outreach to various AI channels. We have received priceless feedback from numerous users for different application demands that never occurred to us. We are excited about the business progress and are confident that WiseEye will play a key role in the non-driver segment looking ahead into 2022 and beyond.

For non-driver IC business, we expect revenue to increase low single digits 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.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Your first question comes from the line of Donnie Teng of Nomura Securities.

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### **Donnie Teng *Nomura Securities Co. Ltd., Research Division - VP & Analyst of Greater China Semiconductor and Technology Research***

I have 2 quick questions. The first one is the gross margin trend. So I think Jordan has mentioned multiple times that foundry capacity, particularly for driver IC, may not be easily resolved, maybe in the coming 1 to 2 years, but our gross margin in third quarter has been already surpassed 50% level. So just wondering, in the real business practice, would the further increased gross margin in the future will have some negative impact to our customers? And we may think that the gross margin to be relatively stable from fourth quarter and beyond? So that's the first question.

And the second one, is that I remember in early days that we have some meaningful sales exposure to smartphone aftermarket for maintenance, right? So I'm curious about whether that market still enjoy very high gross margin at the current time point?

And how would the situation in the coming 1 to 2 quarters, as you can see that the smartphone demand in third quarter, particularly like in China is still not quite strong. Thank you.

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**Jordan Wu Himax Technologies, Inc. - Founder, CEO, President & Director**

Thank you, Donnie. Your first question about gross margin trend that our guidance for Q3 has been over 50% and whether, I guess, your question is whether it can continue to go up or at least sustain at this high level. And whether such high level of gross margin will be negative to customers. I think certainly, gross margin enhancement is always our number one priority, at least among the top priorities. So we have to try everything we can to drive our gross margin higher.

But having said that, at the end of the day, gross margin can only be determined by the market, i.e., the demand supply situation. And I think needless to say, the fact that our gross margin is so high is partially, very importantly attributable to the fact that the foundry capacity is very tight, and it's pretty much a seller's market. So that is not deniable.

Having said that, I think our customers, arguably, do have the capability to absorb high costs coming of the driver IC because after all, driver IC still accounts for a pretty low portion of their total cost. Even if you look only at their material costs, driver IC is definitely not among the top items, not even close.

So if you are a panel maker, and you're sitting on multiple fabs, each one costing you billions of dollars to build. And driver IC, while the price is coming up, you still need to have driver IC, otherwise, you simply cannot run your factory.

And the last thing you want to see is to see your factory sitting idle, right? The depreciation charges is going to kill you. So I think whether driver IC's upward price trend will jeopardize the panel industry for its additional cost burden, I would argue the impact can only be marginal because, again, our cost accounts for a pretty small portion of their total cost, the importance of driver IC technically and business-wise are critical for panel makers.

So in fact, we actually mentioned briefly in our prepared remarks, we are seeing the overwhelming demand from our customers and in many cases, direct customers as well as indirect customers, to try to enter into long-term supply arrangements with us because I think they recognize it's very important and the capacity tightness is not going away anytime soon. So, but again, at the end of the day, our gross margin is determined by demand and supply. All we can do is to take advantage of the current situation, which is probably favorable to us. And also, I think, quite importantly, we are trying to take advantage of this situation and try to reposition and improve our competitiveness for the longer term. So for example, by entering into such agreements with direct and indirect customers, we get to kind of "cherry-pick", I wouldn't say cherry-pick, we tend to pick the customers and products that we prefer over others because at the end of the day, our foundry capacity is limited, i.e., our resources are limited. So we need to allocate our resources. We need to better utilize our resources to our best advantage. That includes short-term advantage, i.e., pricing, gross margin, profitability, et cetera. And longer-term advantage, which is higher-end products, better customers, higher entry-level markets, et cetera. And I think we are doing quite well in achieving this, which may not show in our immediate results, but I think in the long term, it can be quite important for us. So hopefully, that will be something that will help sustain our gross margin, hopefully, for the longer term.

And your second question is about some of our sales exposure to smartphone's maintenance market in China. Indeed, we are one of the players in that market. That market certainly is relatively smaller compared to the mainstream brand name first-hand market. And also the volatility is higher. It goes up and down more dramatically than the other mainstream market, ditto for gross margin as well. And so when there's a slowdown, it tends to go faster and vice versa. When there's a pickup, it tends to go faster as well. So we try to, as we mentioned earlier, right, the capacity pool for our smartphone TDDI and tablets TDDI is the same one.

So with this, we have to and we do try to allocate our capacity to satisfy both the short-term needs and our long-term needs. Long-term needs meaning regardless of short-term gross margin, there are certain markets we simply need to support and maintain and for the long-term benefits of our customers and ourselves. But certainly, we do look at the short-term gross margin trend as well in making such allocation decision. And as you can expect, when the maintenance market goes down, when it goes down more dramatically than the other market, then we may actually allocate more resources to mainstream smartphone market and certainly tablet market as well. And I think that's pretty much, in the very short term, what we are doing a bit right now.

**Operator**

Your next question comes from the line of Jon Lopez of Vertical Group.

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**Jonathan Doherty Lopez *The Vertical Trading Group, LLC, Research Division - Research Analyst***

Hi, thank you for taking the question. I have two, if I could. The first one, I guess, is more of a clarification. Can you just comment or confirm for this year, for 2021, are you receiving a higher allocation of wafers in aggregate from your foundry partners? Do you have more wafers this year than you did in 2020?

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**Jordan Wu *Himax Technologies, Inc. - Founder, CEO, President & Director***

Yes. We did. We do.

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**Jonathan Doherty Lopez *The Vertical Trading Group, LLC, Research Division - Research Analyst***

Okay. Great. That's helpful. And I know it's early, but as you're having conversations for 2022, is your expectation the same? Do you expect to get more wafers in '22 versus '21?

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**Jordan Wu *Himax Technologies, Inc. - Founder, CEO, President & Director***

Again, we do. Jonathan, I have to put a disclaimer in that easy answer. The answer is yes, we do, but not by a great deal, so marginally, I cannot comment on how much exactly percentage for us. The fact is that the industry, overall, there is simply no new major capacity expansion this year and next year or even second half 2023, right? So it will be a miracle if we claim that we are going to up our capacity by like a lot, right, whether it's this year or next, next year.

But we mentioned in our prepared remarks that we made the early move early last year, specifically for automotive display driver IC, which is rather separate from the rest of the driver ICs in technology. So in early last year, when the COVID-19 was hitting the world and the global automotive demand is coming down to the toilet, we actually took the opportunity and struck a pretty good deal for a long time with our foundry partners, strategic foundry partner to secure (inaudible). Having said that, we're very happy because we did get to secure pretty decent growth for this year and next year. But it turns out the amount was still far less than actually the demand when the demand started to pick up towards the end of last year, and certainly very much into this year and as we can foresee next year.

So while our capacity increases specifically for automotive, in a pretty satisfactory portion, but the demand is still far outpacing supply. And we expect to see a good capacity increase for large panel when we enter into next year and to some extent, this year as well. And this is important. This is very important because and it's not easy because based on our internal estimates, while the display driver IC demand for large panel will grow this year and the next few years because of a few factors, namely the panels are still growing bigger and the resolution is, on average, is still rising. And also, you are getting more and more percentage of high-end large panels, for example, high refresh rates, right? 120 hertz or even 240 hertz. Some design requires more sophisticated design, i.e., larger IC per panel. So we believe the demand in terms of wafer area will increase.

We actually, based on internal estimates, the supply can actually decrease somehow. So it has been our strategy to proactively enlarge our capacity where we can with the foundry capacities, specifically for our large panel. And I think we did achieve some success. So that is how you get to see, for example, this quarter, whether it's on a sequential basis or year-over-year basis, our large panel is doing quite well. And I think, moving into next year, I think we are quite hopeful that some of this new capacity will contribute to our further growth for large panel.

Small- and medium-sized, I talked about automotive already, so now the only large area left untouched is TDDI for smartphone and tablet. That is a difficult area because again, it's so full and it's so much in shortage right now, so it is honestly quite difficult to get more capacity. And actually, way before the pandemic, we were suffering from shortage already. So we've been trying everything we can to try to get more capacity. But the fact is that before pandemic, there was already a shortage. And the shortage -- we continue to suffer from shortage till now and foreseeable future into next year.

We have entered into agreements with foundry partners to hopefully at least sustain at the current level or hopefully increase a little bit. But I don't think our accessible capacity for TDDI, small panel, will see a major increase this year or even next year, 2023, because of new buildings of fabs, 2023, hopefully, we are up to see a new addition to us.

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**Jonathan Doherty Lopez** *The Vertical Trading Group, LLC, Research Division - Research Analyst*

I see. Okay. So sorry, if I could summarize, it sounds like you're comfortable that you'll have more large panel access to large panel capacity in '22. It sounds like you're a little less sure on smartphone and on tablet. And I guess my follow-up there is that seems a little counterintuitive to me just given aren't most of your large panel products produced on 8-inch foundry processes? Or sorry, on 8-inch wafers where capacity is ostensibly maybe a little less available?

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**Jordan Wu** *Himax Technologies, Inc. - Founder, CEO, President & Director*

Yes, it is counterintuitive. Jonathan, you're absolutely right. Well, before that a small correction, yes, we expect to do better in large panel, also in small panels automotive business.

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**Jonathan Doherty Lopez** *The Vertical Trading Group, LLC, Research Division - Research Analyst*

All right. Sorry.

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**Jordan Wu** *Himax Technologies, Inc. - Founder, CEO, President & Director*

Yes. Now it's counterintuitive, but I think, in the case of automotive, for example, it's purely 8-inch, and we just move faster than anyone else because we have extensive discussions with OEMs, Tier 1s and panel makers, and we understand we could foresee there will be outbursts of demand, while nobody seemed to be ready for it. So we get to agreements, we just got prepared.

And for other large panels, it's a combination of 8-inch and 12-inch. Some of the capacity increase for next year, and in fact, this year as well actually a lot of certain new building of capacity in China, which are 8-inch -- which are 12-inch, sorry, which are 12-inch. And there will be certain 8-inch new capacities accessible to us, which involves foundry partners that we didn't have a business relationship with on the foundry side. So it's a newly developed foundry partner. And yes, there are situations which are specific to us. But I think you are right. 8-inch overall is much harder to expand compared to 12-inch.

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**Jonathan Doherty Lopez** *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Understood. I'm sorry, I have one other quick one. And you could make the answer relatively quick. I don't know how much you'll be able to say, but there's been some discussion recently of a large Korean customer potentially looking to outsource some of their OLED DDIC needs. I'm wondering if that's something that you would think is possible? And is something that you would potentially look to participate in?

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**Jordan Wu** *Himax Technologies, Inc. - Founder, CEO, President & Director*

The answer is yes. But I'm afraid that I certainly can't elaborate much more than that. But that is definitely a possibility and we are definitely interested, subject to terms and conditions and other stuff.

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**Operator**

Your next question comes from the line of Jerry Su of Credit Suisse

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**Jerry Su** *Crédit Suisse AG, Research Division - Director*

I think my line just got cut off earlier. So the first question is on the third quarter large driver IC guidance. I think you mentioned that 30% revenue growth. I'm just wondering what is the growth rate for the monitor and notebook? Because I think in the press release or prepared remarks, you only mentioned double-digit growth. And then TV is seeing 20% growth. So just want to double check on this.

And then the second question is related to the competitive landscape. I think, in China there is -- I think the China government and also there's a lot of factories they're trying to ramp up or increase the domestic usage or supply of the driver IC. How do you think about their potential threat to Himax or to the existing players in the next 1 to 3 years?

**Jordan Wu Himax Technologies, Inc. - Founder, CEO, President & Director**

Thank you, Jerry. I guess your first question is about the Q3 growth, specifically for monitor and notebook, is that right?

**Jerry Su Crédit Suisse AG, Research Division - Director**

Yes.

**Jordan Wu Himax Technologies, Inc. - Founder, CEO, President & Director**

Very strong, actually sequentially. Let me see, both monitor and notebook are in the range of above 50% growth sequentially. A combination of better capacity, accessibility and certainly some price hike. And both sectors, we are, again, our resources are limited, and we are constrained by foundry shortage so we have to allocate our products to certain products that we choose, right? So in the case of monitor, we are very much in favor of gaming monitor, which tend to be high end and high refresh rates and high resolution and so on. And in the case of notebook, it's primarily on certain low-power models and we're actually quite excited about the notebook market, needless to say the present surprise for everybody because of the COVID, where I don't need to repeat that.

And I think we have intensive discussions with end customers, and they seem to be still pretty upbeat about the demand for the next few years, regardless of the pandemic having been kind of cooled down in most of the world. And also because of the pandemic and the change in people's lifestyle, notebook now people are demanding better features and larger screens and better cameras and faster refresh and so on and so forth. So we are, for example, we are moving towards more high-end FHD or even eDP 1.4, such high-end features are being some of them are being designed-in, some of them are still being discussed, developed together with our customers and end customers. So notebook is something that we are actually quite excited about.

Your second question, I suppose, is around local competition for I actually talked about briefly when answering Jonathan's questions. That in China, there are certain new constructions of fabs, which actually we quite welcome. We're actually one of the earliest customers. And we have entered into supply agreements with them. And for the current demand and for our future demand as well. And we pay a lot of attention to their expansion plans. So we are actually one of their earliest customers, and we believe we are certainly one of their larger customers for discrete driver ICs.

Having said that, so we actually welcome they are building new fabs for the industry. And we are actually pushing them to go faster. Unfortunately, as we are all aware, these days, the lead time for new tools for fabs for foundries is actually getting longer and longer, and certainly, our Chinese foundry partners they are no exception to this problem. So we are in discussions about their expansion plan and timetable and certainly, we want to make sure we are part of their plan.

Having said that, certainly, the foundry partner being Chinese and backed by the government, they certainly have to support their local customers, i.e., our Chinese competitors. However, I think as I said earlier and repeatedly that we are hoping to reposition ourselves so that we get to do more higher-end products with higher entry barriers. So I think that is kind of the differentiation we try to make against our Chinese peers, who tend to still be in, for example, low-end TV and low-end smartphone areas, where in comparison, tablet and monitor notebooks and certainly automotive are much harder for them. So I think yes, there's always a threat and Chinese competition has always been a threat for decades for us. But I think, right now, I guess, we are more worried about foundry constraints than Chinese competition because I think we see, still some differentiation against local competitors and so do our customers. I think they would also position people like Himax against their Chinese supplier for different kinds of products.

**Operator**

This concludes our Q&A session. I will now turn the call back over to Jordan.

**Jordan Wu Himax Technologies, Inc. - Founder, CEO, President & Director**

As a final note, Eric Li, our Chief IR Officer, 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.

**Operator**

Again, this concludes today's conference call. Thank you for participating. You may now disconnect.

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