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Q2 2023 Himax Technologies Inc Earnings Call

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PRESENTATION

Operator

Hello, ladies and gentlemen, welcome to the Himax Technologies, Inc. Second Quarter 2023 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. You may begin.

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

Welcome everyone to the Himax Second Quarter 2023 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 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 e-mail HIMX@mzgroup.us, 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. A list of risk factors can be found in the company's SEC filings, Form 20-F for the year ended December 31, 2022, in the section entitled "Risk Factors", as may be amended.

Except for the company's full year of 2022 financials, which were provided in the Company's 20-F and filed with the SEC on April 6, 2023, 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 would now like to turn the call over to Mr. Eric Li. Eric, the floor is yours.

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

Thank you, Mark. Thank you everyone for joining us.

My name is Eric Li, Chief IR/PR Officer at Himax. On today's call, I'll first review Himax's consolidated financial performance for the second quarter 2023, followed by our third quarter 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 an IFRS basis.

Challenging business conditions due to ongoing macro headwinds persisted during the second quarter, yet we continued to execute successfully with gross margin surpassing the guidance range while both revenues and EPS landed at the upper end of guidance range issued on May 11, 2023.

Second quarter revenues registered $235.0 million, a decrease of 3.8% sequentially, yet at the upper end of our guidance range. This was attributable to improved order momentum particularly in the automotive DDIC, large display driver IC and the non-driver business. Gross margin came in at 21.7%, a decrease from 28.1% of last quarter, but above our guidance range of 20% to 21% due to a favorable product mix. As we previously reported, Q2 gross margin was impacted significantly by a one-time expense related to the strategic termination of certain high-cost foundry capacity agreements in addition to price erosion related to destocking. Q2 profit per diluted ADS was 0.5 cents at the upper end of the guidance range of -2.9 cents to 0.6 cents.

Revenue from large display drivers came in at $45.4 million, a decrease of 14.3% sequentially, yet above our prior guidance. Monitor IC sales surpassed our prior guidance, up single digit sequentially, driven by our clients' proactive pull forward in preparation for the Q2 sales festivals and the recovery of gaming display. Notebook sales notably outperformed our guidance, thanks to strong shipments to key customers. TV IC sales declined as expected as customers suspended pull-ins, having already replenished their inventory over prior two consecutive quarters. Large panel driver IC sales accounted for 19.3% of total revenues for the quarter compared to 21.7% last quarter and 22.0% a year ago.

Moving on to our small and medium-sized display driver segment, revenue was $150.3 million, a slight decline of 2.9% sequentially. Smartphone and tablet driver sales increased mid-teens and single digit, respectively, in second quarter as we saw a recovery in business momentum, particularly in TDDI products. Q2 automotive driver sales decreased single digit sequentially, but outperformed our guidance of a low teens decline as clients resumed order replenishment for both traditional DDIC and TDDI. Automotive driver business was still our largest revenue contributor with around 30% of total sales in the second quarter.

We are particularly confident in our automotive TDDI growth potential, backed by hundreds of design-wins already secured, significantly ahead all our peers, and among these design-wins, only a small portion has commenced mass production. With the design win projects under our belt, we believe we can continue to grow our market share in automotive TDDI in addition to our already dominant position in traditional DDICs where we have a 40% global market share. Small and medium-sized driver IC segment accounted for 63.9% of total sales for the quarter compared to 63.3% in previous quarter and 64.5% a year ago.

Second quarter non-driver sales also exceeded guidance with revenue of $39.3 million, up 7.9% from a quarter ago. The better-than-expected sales performance was a result of higher shipment for Tcon and CMOS image sensor. Despite the slight sequential decline in Tcon sales in second quarter, it surpassed guidance of a low-teens decline, bolstered by a better-than-expected shipment of monitor and automotive Tcon. Tcon business represented over 9% of our total sales in the second quarter. Lastly for WLO, notably during the quarter, we commenced volume production to one leading North American customer for their new generation VR devices to enable gesture control. Non-driver products accounted for 16.8% of total revenues, as compared to 15.0% in the previous quarter and 13.5% a year ago.

Our operating expenses for the second quarter were $53.2 million, an increase of 4.3% from the previous quarter and 1.2% from a year ago. The sequential increase was mainly a result of increased R&D expenses. Yet amidst prevailing macroeconomic headwinds, we remain focused on strict cost controls. Our second quarter operating expenses include the amortized expenses for annual bonus grants made in prior years of $6.4 million as compared to $6.5 million in previous quarter and $7.4 million from a year ago. As a reminder, we grant annual bonuses to employees at the end of September each year, including RSU and cash award. A portion of those bonuses is immediately vested and recognized in the third quarter with the remainder equally vested in 3 tranches on the first, second and third anniversaries of the grant date and recognized on a straight-line basis over the vesting period of each tranche. Second quarter after-tax profit was $0.9 million or 0.5 cents per diluted ADS compared to $14.9 million or 8.5 cents per diluted ADS last quarter.

Turning to the balance sheet. We had $219.5 million of cash, cash equivalents and other financial assets as of June 30, 2023, compared to $461.6 million at the same time last year and $223.8 million a quarter ago. Second quarter operating cash inflow was approximately $1.7 million as compared to an inflow of $66.4 million in Q1, primarily due to $51.0 million income tax paid during Q2, an illustration of our continuous effort to deplete inventory for the past few quarters. We had $43.5 million of long-term unsecured loans as of the end of second quarter, of which $6.0 million was the current portion.

During the third quarter, we have made a payment of $83.7 million for annual dividend to shareholders. Further, we expect to pay out a total of around $30 million for employee bonus awards comprised of around $9.3 million for the immediately vested portion of this year's award and $21.0 million for vested awards granted over the last 3 years. Despite the substantial employee bonus payout, we still expect to generate positive operating cash flow in Q3, again, due to the ongoing destocking process across major product lines.

Our quarter-end inventories as of June 30, 2023, were $297.3 million, markedly lower than $335.2 million last quarter. Accounts receivables at the end of June 2023 was $239.0 million, down from $252.2 million last quarter and down from $371.0 million a year ago. DSO was 90 days at the quarter end as compared to 93 days last quarter and a year ago. Second quarter capital expenditures were $2.9 million versus $2.8 million last quarter and $2.5 million a year ago. The second quarter CapEx was mainly for our IC design business.

As of June 30, 2023, Himax has 174.4 million ADS outstanding, unchanged from last quarter. On a fully diluted basis, total number of ADS outstanding for the second quarter was 174.7 million.

Now turning to our third quarter 2023 guidance. We expect third quarter revenues to be flat to decline 7.0% sequentially. Gross margin is expected to be around 30.5% to 32.0%, depending on the final product mix. The third quarter profit attributable to shareholders is estimated to be in the range of 1.5 to 6.0 cents per fully diluted ADS.

As we have done historically, we will grant employees' annual bonus, including RSUs and cash awards on or around September 30 this year. The third quarter guidance for profit per diluted ADS has taken into account the expected 2023 annual bonuses, which, subject to Board approval, is now assumed to be around $10.5 million, out of which $9.3 million or 4.2 cents per diluted ADS will be vested and expensed immediately on the grant date.

As a reminder, the total annual bonus amount and the immediately vested portion are our current best estimates only and the actual amounts could vary materially depends on, among other things, our Q4 profit and the final Board decision for the total bonus amount and its vesting scheme. As is the case for previous years, we expect the annual bonus grant in 2023 to lead to higher third quarter operating expenses compared to other quarters of the year. In comparison, the annual bonus for 2022 and 2021 were $39.6 million and $74.7 million, respectively, of which $18.5 million and $24.8 million vested immediately.

I will now turn the call over to Jordan to discuss our Q3 outlook. Jordan, the floor is yours.

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

Thank you, Eric.

The prevailing sentiment in the consumer electronics market for semiconductor remains sluggish. Customers continue to exercise caution towards panel procurements, limiting our visibility into the second half for consumer products. However, we see improving business momentum in the automotive sector, our largest sales contributor, where a healthy rebound from the first half weakness appears to be underway. As a reminder, the global automotive market experienced a severe downturn throughout the first half of the year as major Chinese automakers cut back production and implemented strict cost control measures due to intensified EV price competition, adversely impacting our first half sales. Now looking ahead with renewed momentum in the automotive market, we believe the stage is set for a sales rebound as we approach the end of the year, supported by more favorable product mix, improved cost structure and normalized inventory level which should also lead to improved gross margin.

In terms of gross margin, for the third quarter, we expect substantial improvement from the Q2 trough, which was primarily related to the one-time early termination expense to foundry partners as we reported last quarter. I would like to stress again how this early termination decision was part of a crucial operating strategy for us. By sacrificing margin last quarter, we now have added flexibility where new wafer starts are no longer bound by minimum fulfillment requirements and high wafer costs set during the severe foundry capacity shortage period. Furthermore, we can now leverage diverse foundry sources for optimal operational efficiency and much improved cost structure, thereby maintaining our product competitiveness.

Favorable product mix shift is also a key factor contributing to our expected Q3 gross margin expansion. This is predominantly driven by increased automotive sales as discussed earlier, thanks to a robust recovery in the Chinese automotive market leading to order resumption from customers. Notably, our automotive sales for traditional DDIC, TDDI and Tcon are all set to enjoy decent double-digit sequential growth in the third quarter and, collectively, are expected to represent almost 45% of our total sales. As a reminder, all these automotive products have a better than corporate average margin profile.

Moving on to inventory destocking. Our inventory depletion is progressing nicely with Q3 inventory level on track for meaningful reduction. At this point, we are comfortable in our overall inventory level, thanks to our continuous effort to destock for several quarters. In addition, the remaining stocks are comprised of IC products which have a solid customer design-in base and long expected lifetimes. We now expect that our inventory will normalize near historical average levels by the end of the year. While the macroeconomic environment still presents some headwinds for us, given the expected strength in automotive sales, improved operating flexibility and cost structure, in addition to our commitment to expand our presence in high value-added areas such as Tcon, OLED and AI, we expect second half sales and gross margin to improve from the first half and believe we are well positioned for long-term sustainable revenue growth.

With that, I will now begin with an update of the large panel driver IC business. Our third quarter 2023 large display driver IC revenue is projected to be down single digit sequentially. We expect TV IC business to be down high-teens quarter-over-quarter due to leading end brand's stringent production control measures amidst soft market. Notebook IC sales are expected to increase by a decent double digit sequentially, predominantly from rush orders from one leading brand. Meanwhile, monitor IC sales are set to increase single digit sequentially, continuing the customers' restocking momentum we saw last quarter.

Turning to the small and medium-sized display driver IC business. Despite continuing uncertainty in consumer electronics, with improved visibility and demand in the automotive market, Q3 revenue is expected to be flat or slightly up sequentially. Our automotive driver IC business is poised to increase by decent double-digit sequentially on a strong uptick in both TDDI and traditional DDIC. However, smartphone and tablet sales are both projected to decline double digit. The sequential growth of automotive DDIC business is fueled by a resumption of customer orders across the board following several quarters of inventory correction.

Automotive TDDI business also resumed its growth trajectory in the third quarter, driven by increasing production of customers' new vehicles after an unexpected second quarter disruption. The automotive recovery has been further bolstered by supportive governmental policies, especially in China and the U.S. to incentivize new vehicle purchases. Given the rapid adoption of TDDI in new-generation vehicles, where we have already secured well over 300 design wins and a number of new design-in projects is still increasing as we speak, we remain confident that we'll continue to enjoy strong growth as our leading market share position remains unchallenged. It is worth noting that automotive TDDI sales will account for over 30% of total automotive sales in the third quarter and are poised to continue to increase.

Let's move on to LTDI, a technology where Himax has been a pioneer in the market. Given the growing global demand for large, panoramic, interactive and intuitive in-car display experiences, we anticipate accelerating adoption of LTDI in the coming years. LTDI is gaining popularity particularly among high-end car models with fancy and/or larger than 30-inch automotive displays. Our integrated solution of LTDI and local dimming Tcon has been adopted by many customers as their standard platform for high-end displays from which a variety of large automotive displays will be developed. This further solidifies our position among customers in the high-end automotive display market. We expect an influx of collaborations, leading to a growing number of projects slated for mass production starting 2024.

As we have mentioned repeatedly, Himax is at the front runner position in automotive display IC market, offering a comprehensive product portfolio covering the entire spectrum of specifications and technologies to address varying design needs, including traditional DDIC, TDDI, local dimming Tcon, LTDI and AMOLED. Having the broadest, one-stop shop offering also drives customer loyalty as evidenced by years of extensive collaboration with panel makers across the globe as well as deep engagement with Tier 1s and OEMs who deeply trust and rely on Himax expertise for their product road map. We are confident that our automotive business will continue to be our primary sales growth engine moving forward.

Next on smartphone and tablet product lines, we continue to see lackluster demand in the market. Currently, a small group of peers are still in the midst of offloading inventory, offering aggressive pricing while enduring losses to deplete their excess inventory. As we near the end of our destocking process, our strategy is to not engage in pricing competition, even at the expense of forfeiting revenues by turning away unprofitable projects. Having said that, we have placed wafer starts for select products starting Q2.

Next for an update on AMOLED. Himax offers both DDIC and Tcon for OLED display and has commenced production for tablet and automotive applications jointly with global leading panel makers. For automotive OLED display, design-in activities are going smoothly with both conventional carmakers and NEV vendors across different continents. Concurrently, we continue to gear up for AMOLED driver IC development by strategically partnering with major Korean and Chinese panel makers of various applications covering smartphone, tablet, notebook and TV. For smartphone AMOLED display driver, amidst a muted smartphone market, we still target to commence production towards the end of 2023.

Now let me share some of the progress we made on the nondriver IC businesses. Starting with an update on timing controller. We anticipate Q3 Tcon sales to decrease single digit sequentially, hampered by reduced shipment for monitors and OLED displays for tablet. For OLED tablet business, our customers are still in the midst of inventory offloading due to muted end market demand. Despite the soft demand environment, we are actively working on the next-generation IC for OLED tablet, aiming to broaden our offering and better position us for when demand returns.

Next, on our automotive Tcon business. We continue to solidify our leadership position, particularly in local dimming Tcon which can improve display contrast while also lowering power consumption. We are encouraged by the growing validation and widespread deployment in both premium and mainstream car models across the globe. Our automotive Tcon business is poised to experience explosive growth with notable sales contribution starting 2024. We expect it to be one of our major growth engines in coming years.

Switching gears to the WiseEye Smart Image Sensing total solution, which incorporates Himax's proprietary ultralow power AI processor, always-on CMOS image sensor and CNN-based AI algorithm. We continue to support the mass production of Dell's notebook along with other endpoint AI applications, including video conference device, shared bike parking, door lock and smart agriculture, among others. We are also focused on strengthening our Intelli-Sensing Module business in an effort to further broaden our customer base and application.

The module offerings, incorporating WiseEye technology, provide clients with a series of highly integrated plug-and-play module boards, which are user programmable, but also loaded with our pre-trained AI models for simple system integration. This can effectively shorten customers' time to market and reduce development cost, making it particularly well-suited for markets featuring high variety and small quantity. Throughout recent quarters, we have received excellent feedback from customers while seeing large increases in projects for various applications. Building on this momentum, we plan to roll out a series of modules that will expand our product offerings to cover more diverse markets and seize upon the vast opportunities presented in endpoint AI.

Over the past few quarters, we have witnessed steady growth in the adoption of our WiseEye products, particularly in home surveillance applications, specifically door lock, doorbell and battery camera. Notably, we are pleased to report a successful collaboration with a leading door lock vendor in China, the largest market globally. The project is slated for mass production starting in the second half of this year with anticipated growth extending to 2024. Our WiseEye solution is also being implemented for automotive applications, where it can intelligently detect the presence, movement or posture of driver or passenger, delivering a broad array of AI use cases inside a vehicle. Such demand is expanding rapidly with global leading car brands for new car models, primarily in application for car owner recognition and keyless access with other new use cases also under development.

Next for an update on our WE2 AI processor where we have engaged global notebook names for their next-generation product development. We have made significant progress in enriching AI features and use cases through collaborations with major CPU and AP SoC players for next-generation smart notebook, surveillance and a host of other endpoint AI applications. The WE2 processor offers further advancements in inference speed and ultralow power, maintaining superior power efficiency compared to our already industry-leading first-generation AI processor, WE1. Furthermore, in context aware AI, WE2 enables more detailed computer vision object analysis, such as real-time facial landmark, hand landmark and human pose skeleton, among others at extremely low power consumption. This enables sophisticated human expression detection for smart notebook and broader AIoT applications.

Having established a leading position in ultralow power AI processing and image sensing for endpoint AI applications, we are firmly committed to the WiseEye product line's ongoing development and growth. By leveraging broad ecosystem partners and customers, we aim to maximize market reach and explore potential applications. We believe that our WiseEye AI business will serve as a multiyear structural growth driver for Himax.

Lastly, for an update on our optical-related product lines. Himax is one of the few companies in the world that can offer a diverse range of optical products, including WLO, 3D Sensing and LCOS for the development of immersive technologies and the realization of the metaverse. Himax is well-positioned to capitalize on the growth of this nascent industry. As our technologies are vital for facilitating immersive content, evidenced by the growing list of AR/VR goggle device engineering projects with leading customers across the board.

First on WLO update. We recently commenced for the production of our WLO technology to a leading North American customer starting in the second quarter for their new generation VR devices to enable 3D gesture control. We expect a decent shipment for this customer in the second half in preparation for the upcoming seasonal shopping sales.

On LCOS, Himax's state-of-the-art Color Sequential Front-lit LCOS microdisplay technology was one of the most high-profile demos at the Display Week 2023 in May and successfully captured the attention of numerous tech giants. Through years of strenuous development, our Color Sequential Front-lit LCOS has achieved exceptional and industry-leading illumination in full RGB color, along with a groundbreaking tiny form factor, ultra lightweight and a wide degree field of view. These features make our LCOS microdisplay, particularly well suited for next-generation AR goggles, outperforming other competing technologies, mainly MicroLED. A growing number of engineering engagements are proceeding nicely with leading tech names. We are confident our Color Sequential Front-lit LCOS can be one of the most promising technologies that meets the rigorous requirements to enable AR goggles.

The introduction of the latest mixed reality device of a leading tech giant exhibited a significant advancement for the whole metaverse ecosystem. It illustrates how the metaverse and immersive technologies continue to evolve, are increasingly accessible, and may gradually become a more integral part of our everyday live in the future. We believe, given our expertise in optical related technologies including hundreds of patents in AR/VR and 3D, customers can leverage our product suite to develop immersive experiences for a variety of futuristic and mainstream products in their metaverse applications. We continue to strengthen our optical-related technology suite while forging partnerships with global technology leaders to strategically secure a distinct position in the space and create an additional diverse long-term revenue stream. For nondriver IC business, we expect revenues to decline double digit 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 we are now ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will be coming from Jerry Su of Credit Suisse.

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

Jordan, I just want to ask, you have previously noted that the second half revenue is likely to improve from first half. So judging from the guidance you provided already for the third quarter, does that imply that the fourth quarter revenue should recover from the third quarter trough? And what are the drivers behind that? That's the first question.

And then in terms of the automotive, I think you have mentioned about a lot of the new products in this area. But I want to ask about what is the pricing trend you are seeing for the automotive driver IC or timing controllers? And how does that compare with the other product lines?

And then maybe on the wafer pricing side, as you had already terminated your long-term agreement with foundry partners in the second quarter. How should we think about wafer cost into the second half? Can you benefit from some of the renegotiation or the wafer foundry price reduction to help your margin? Those are my 3 questions.

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

Jerry, yes, I think there is a good likelihood, the Q4 where we'll see a further recovery from the trough in Q3. However, as a disclaimer, we are very confident on the continuous growth of automotive sector in Q4. However, in the consumer sector, the Q4 visibility still remains quite low. So it really depends on the outcome of how the market is going to develop for the consumer products. But in our current projection, yes indeed, second half is likely to be better than the first half and Q4 is hopefully going to recover from the trough in Q3. That's the first question.

The second question, really, there are quite a few questions surrounding automotive sector. I think you mentioned pricing trend and specifically, pricing trend for automotive sector compared to those of other markets. I mean, Himax does enjoy a very nice leading position with dominating market share in the automotive sector. And inevitably, we are seeing competition both internationally and coming from China. And certainly, for competitors, one of the approaches they will take for this relatively new market for them is to undercut our price. But I mean, in that end, you also asked a question about our cost structure. I think certainly, I will elaborate a little bit on that in a few minutes. But certainly, we are committed to continue to improve our cost through various means, including diversifying our foundry base as we reported earlier, by terminating certain long-term agreements that are not favorable to us, our long-term competitiveness. So yes, we will certainly be prepared to compete on pricing by improving our cost structure vigorously.

Having said that, I think automotive sector compared to consumer markets has a much higher entry barrier for newcomers because of its very different ecosystem or supply chain. Here we talk about not just panel makers and end customers, also OEM, also Tier 1s play a very, very important role. And also, we have geographical diversity, which is certainly very, very different from any of the consumer markets. Here, you have the U.S. market, Japanese market, Korean, European and certainly China market, which are all really quite different, and they are dominated by very different players. And also these very different names, which dominate different markets, they partner with sometimes rather different Tier 1 players, too. So you're talking about a much more complex and diverse ecosystem players for IC vendors to cover. And I think we do have a very clear advantage being the early mover and also enjoying the leading market share.

And also, as you are aware, automotive market replacement of any part is a lot harder compared to consumer products, right? So we feel, yes, there are price competition and customers do try to undercut our price, but that doesn't mean we always have to meet their price to make the competitiveness. We do enjoy a better position and very, very often customer will still work with Himax, even having very aggressive prices on hand from our competitors. So we are not taking competition lightly, but we are still confident across different product segments in automotive market, namely DDIC, TDDI, timing controller, OLED and LTDI. We are going to lead the market and this is evidenced by the fact that our customer engagement and design win projects under our belts far larger compared to any of our peers. So yes, there are price competition, but we remain quite confident in any foreseeable future for our leading position to be unchallenged.

And wafer price, namely cost structure. For strategically reasons, we did and still do have a slightly larger inventory level than normal, particularly for DDIC products. But we're not worried about that because, again, we are secured by a lot of design wins and with those projects or products expected to enjoy a very long lifetime. But we are approaching the end of our inventory destocking process even for DDIC. And with our new wafer starts, certainly, we will certainly negotiate typically spot deals, volume for price kind of arrangement with our foundry vendors. And so, I think you can expect, at least, the latest starting from about end of Q1 or Q2 of next year, you'll see our DDIC cost structure will see a major improvement because of new wafer starts, that is likely to see better pricing.

And certainly, foundry diversification, I mentioned earlier, is a key area that we are exploring. And we are not just diversified our foundry in Taiwan. We also diversified into China, where China, as we know, is the biggest market in the world for automotive market. And the country does favor local production. And for that reason, we are diversifying into China as well. And our moving to China for foundry service has been most welcomed by Chinese foundry players because they all know Himax is the leading player in this market. So there are various measures that we are taking to hopefully lower our cost and also to strengthen our supply chain for automotive market.

I hope that answers your question, Jerry.

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

Yes, very clear.

Operator

(Operator Instructions) And our next question will come from Donnie Teng of Nomura.

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

I have only 2 questions. The first one is regarding to the automotive drive IC. So I think you have made a very clear comment on the EV market recovery in China in the second half and likely customers start to rebuild some of the automotive driver IC inventory. But recently, like some of the leading auto IDM companies or IC design companies mentioned about some slowdown in terms of some kind of automotive IC demand into the second half. So I'm just wondering if you could give us some color in terms of the end market, do we have like a majority of the market in China or we still have some exposure to the overseas markets? So that's the first question.

And second one is that I think you have mentioned about the cost structure will be improved into the first half next year. I think we have a very good progress in terms of the gross margin recovery already in the third quarter. But in terms of a normalized gross margin, considering the cost structure improvement, could you kindly give us some idea is like, for example, where is the normalized gross margin is compared with like the COVID period in 2021 and 2022?

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

Donnie, the first question, the simple answer is, given our market share, you should not be surprised that our customer base, in terms of OEMs, covers the whole world, not just China. We have mentioned in DDIC, our market share is about 40%. In TDDI, we believe our market share is even higher than that. Just that is a relatively new market, so market statistics are not particularly mature. So we are not talking about that number out loud, but we believe, based on our internal count, our market share should be higher than that. And then in local dimming timing controller, our market share is even higher than TDDI. Again, based on internal count, we believe it is probably 60% or higher. So at LTDI, we are likely to be the pioneer with the first mass production of the whole world expected to start from this quarter. So we do enjoy the leading market share in literally every single technology area for automotive market. So our end customer base does cover the whole world, all major continents and all major markets.

Now you talk about other IC vendors, their view on the second half. I think there could be a difference between us and those where there is a panel maker market in between for us, in between ourselves and the Tier 1 while in their case, they may not be the same. Now, so our first half, so I believe, our first half, the first quarter and second quarter, our automotive revenue probably were more hampered compared to those. And our customers are just coming back and trying to restock and catch up for our supply, which otherwise should have been made in the first half. And more specifically, I'll give you some color, TDDI and Tcon are well positioned to enjoy very strong growth, very decent double-digit growth, not just quarter-over-quarter, but also [second half over first half](corrected by company after the call) and also this year over last year, okay. I repeat, for automotive area, in TDDI and Tcon, both are relatively new markets where we have a leading position, and they are in a very strong growing stage. So we expect to enjoy the decent double-digit growth not just quarter-over-quarter, but also second half over first half and year-over-year for this year. And also, I can pretty much say the same for next year too. I think we have good confidence in that because they are relatively new markets.

However, for DDIC, while the second half, while we reported third quarter is expected to see a strong rebound for the second quarter with second half also expected to enjoy a double-digit growth over first half. However, for DDIC, year-over-year, we are likely to see a decline. We are going to see a decline, DDIC. And given that DDIC is still the biggest component of our overall automotive business, so fiscal year '23 for overall automotive business, we are still likely to see some decline over last year. I don't know if I'm confusing you guys, but I believe I made it quite clear. So because DDIC is being replaced by TDDI and also, I talked about governmental policies to incentivize new purchases from China and the U.S., right. And those incentives are provided primarily to EVs, which are predominantly new design-in models. And given that they are new, they tend to use TDDI and in many cases, local dimming Tcon as well.

So the replacement of TDDI over traditional DDIC, honestly, is probably quicker than we anticipated last year. The pace of replacement is faster. But that is not bad news for us because that means on a per panel basis, our content is higher. And as I mentioned earlier, we do enjoy the even stronger market share compared to DDIC. So I think because of this reason, TDDI and Tcon, I think we feel quite confident that next year of our automotive business will start to see a decent growth from this year again. Although this year, our overall automotive business is likely to see some decline from last year, not a severe decline, but some decline.

Your second question is about our cost and margin profile, I believe. I think I can say in the long term, I mean, as a reminder, the intention is not to provide our long-term gross margin guidance, right, just give a flavor of how we believe our gross margin trend is going to be like as we look at the longer-term horizon. I think it is probably difficult for us to see the same level of very high gross margin during COVID at this peak. We're talking about well over 50%. Honestly, it is probably difficult to see in the coming years. However, whether our gross margin will return to the pre-COVID period when we typically had some 24%, 25% kind of gross margin. I don't think so. I'm not that pessimistic either.

And I think there are a lot of reasons to explain that, but I will emphasize on Himax specifically in our own situation. I think we feel good about our going through a structural change in terms of our product mix and overall company profile. We said earlier in my prepared remarks that our automotive market is likely to account for almost 45% of our total sales this quarter. This was unheard of, whether it's during COVID or pre-COVID, our automotive market at the time was at best 10-plus percent of our total sales. Now this high percentage certainly comes from 2 factors. One, automotive has been growing very fast, and the automotive market for display is likely to outgrow other markets in the coming years. So that is very good news for us.

Certainly, that 45% high number is also the result of a very sluggish consumer market, right, which pushed down other product contributions. But in any case, in the long term, our automotive market contribution is likely to be much, much higher than previously. So that is what I say, fundamental change. And the automotive market does enjoy not just higher, but also more stable and more predictable gross margin compared to other markets. So again, having a much higher exposure to automotive market in the next few years, I think is a very good news for Himax.

And we are also investing aggressively in a few new areas. Our automotive market covers not just driver IC, but also timing controller, right. So that I've mentioned and also, our WiseEye products is in still very early stage, but we expect to double our revenue for the coming years, and that enjoys the best gross margin among all our product lines. And for example, I'll give another example, e-paper is turning into color version and with a fast-growing market potential, and we have a good and major exposure over there as well. So these new markets are likely to drive our gross margin up in the long term.

What I cannot tell with a similar degree of certainty is consumer market, where really there's a poor visibility, not just for the rest of the year, but also into next year. Having said its poor visibility, it doesn't mean it's necessarily bad forever, right. So at some point, we certainly hope it will recover. But for now, I think, at least for Himax, visibility for automotive market is quite good. And for WiseEye is quite good as well. So I believe that will improve our long-term margin profile significantly.

I hope that answers your question, Donnie.

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

Yes.

Operator

And one moment for our next question. And our next question will be coming from Tiffany Yeh of Morgan Stanley.

Tiffany Yeh ***Morgan Stanley, Research Division - Research Associate***

I have 3 questions. My first question is relating to the pricing side. As the management mentioned earlier in the prepared remarks and in the Q&A section that smartphone and tablets market are seeing some pricing erosion. And I'm just wondering, what's the current pricing environment for like non-auto, Tcons and large display driver ICs like TV? Are we seeing like severe pricing competition now in the market? This is my first question.

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

Okay. A quick answer. I think we have seen the worst. And now this market is actually stabilizing. The worst being at a time when everybody suffers from overstock. And as we are nearing, I would say, nearing the end of destocking process throughout the whole industry, I think pricing has now become healthier pricing environment. Certainly, that is my general comment. And specifically, I think TV is certainly stabilizing, for IT, being notebook and monitors are also stabilizing. Automotive market also is holding up. Even tablet, I think, is stabilizing quite nicely. I mean, from our point of view, the weakest spot for now remains to be smartphone, where we mentioned in our prepared remarks that there are still a small group of our peers, which is still going through aggressive destocking process. But hopefully, towards the end of the year or early next year, that will also come to an end.

But I think I say we have gone through the worst because inventory position is healthier. But certainly, we are still suffering from low visibility throughout the whole industry. So what is going to detect our margin profile for non-automotive markets, I think not just for Himax, but throughout the whole industry, the end market demand is still sluggish. So the end customers are definitely going to demand aggressive pricing from us, while our foundry partners, because of low utilization, they are not really enjoying good profitability either. Some of our foundry partners are actually suffering from some losses already.

So can we get more aggressive pricing from our foundries? Or can we, to help us substantially lower our costs, continue to lower our cost to support our end customers, or can the end customers support a more healthy environment because their market may have started to turn around, that is yet to be seen. We don't know yet. But as a fabless IC design company, our current strategy certainly is not to just for the sake of enlarging our revenue size, to make wafer starts while knowing the new wafer starts maybe loss-making business or unprofitable business. Our strategy is not to do that and not to compete too aggressively on those markets where some of our peers are still going through the destocking process.

So your second question?

Tiffany Yeh ***Morgan Stanley, Research Division - Research Associate***

My second question is, I want to ask about the foundries node side. Are we seeing any specific foundry node that is still in shortage right now?

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

No. I don't think there is any node that is in shortage right now. I'm not too familiar with the very, very advanced nodes like 3-nanometer, 4-nanometer, 5-nanometer. But for the space we are aware of, the answer is no.

Tiffany Yeh ***Morgan Stanley, Research Division - Research Associate***

Okay. And my last question is regarding the technology side. Could you kindly provide us your view on the development of gate on array driver IC on auto in the next few years? Could you also share the current penetration rate of the GoA driver IC on auto?

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

Well, given gate on array driver IC has been a very old thing that's been going around for, I don't know, maybe more than 10 years, well over 10 years, so it's not exactly the theme of the day, so to speak, because customers who can adopt GoA technology has already done so. I'm talking about across different panels, different applications. So gate on array back ages ago, I can't even recall when, was once upon the time hit to guys like Himax because all of a sudden, our gate driver market was disappearing. But now gate driver accounted for very, very like negligible portion of our business already because of the GoA technology, which has been putting in place for many years. So it is not really a theme that we discussed about anymore.

Operator

And I'm showing no further questions. I would like to hand the call over to Jordan for closing remarks.

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

As a final note, Eric Li, our Chief IR/PR 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

Ladies and gentlemen, this concludes today's conference. Thank you for your participation. You may now disconnect.