Himax Technologies, Inc. Q2 2015 Unaudited Financials and Investor Update Call

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Moderator/Speaker Dial-In Numbers (for Adam Holdsworth, Jordan Wu, Jackie Chang and Nadiya Chen): TOLL-FREE: 1-855-842-5904 TOLL/INTERNATIONAL:1-720-634-2980	**Replay Dial-In Numbers:** TOLL-FREE: 1-855-859-2056 TOLL/INTERNATIONAL: 1-404-537-3406 From: 8/7/15 Eastern Daylight Savings Time To: 8/14/15 at 11:59 p.m. Eastern Daylight Savings Time Replay Pin Number: 85580801

Operator: Opening and standard introduction.

Adam Holdsworth: Thank you, operator. Welcome everyone to Himax's second quarter 2015 earnings call. Joining us from the company are Mr. Jordan Wu, President and Chief Executive Officer, and Ms. Jackie Chang, Chief Financial Officer. After the company's prepared comments, we have allocated time for questions in a Q&A session. If you have not yet received a copy of today's results release, please call PCG Advisory Group at 1-646-862-4607, or access the press release on financial portals, or download a copy from Himax's website at www.himax.com.tw.

Before we begin the formal remarks, I'd like to remind everyone that some of the statements in this conference call, including statements regarding expected future financial results and industry growth, are forward-looking statements that involve a number of risks and uncertainties that could cause actual events or results to differ materially from those described in this conference call. Factors that could cause actual results include, but are not limited to, general business and economic conditions, the state of the semiconductor industry; market acceptance and competitiveness of the driver and non-driver products developed by Himax; demand for end-use application products; the uncertainty of continued success in technological innovations; as well as other operational and market challenges and other risks described from time to time in the Company's SEC filings, including those risks identified in the section entitled "Risk Factors" in its Form 20-F for the year ended December 31, 2014 filed with SEC as amended.

Except for the Company's full year of 2014 financials which were provided in the Company's 20-F, filed with the SEC on April 15, the financial information included in this conference call is unaudited and consolidated, and prepared in accordance with US GAAP accounting. Such financial information is generated internally and has not been subjected to the same review and scrutiny, including internal auditing procedures and external audits by an independent auditor, to which we subject our annual consolidated financial statements, and may vary materially from the audited consolidated financial information for the same period. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Before I turn the call over to Mr. Jordan Wu, I would like to inform everyone that Taiwan is at the center of a powerful typhoon, and Himax's management and its facilities are safe and sound. Jordan and Jackie are weathering the storm at their headquarters in Taiwan, and if for any reason there are connectivity issues on this call, Himax will issue a press release with details for an alternative time. Thank you for your understanding.

I will now turn the call over to Mr. Wu. Jordan – the floor is yours

<u>Q2 2015 Results</u>

Mr. Jordan Wu: Thank you Adam and thank you everybody for being with us for today's call. In today's earnings call, in addition to reporting our performance in the second quarter, I will also provide our outlook for the third quarter of 2015 and update our product areas of focus for this year. Our CFO, Jackie Chang, will also provide additional details on our financial performance.

Our 2015 second quarter revenue, gross margin, GAAP and non-GAAP earnings per diluted ADS all met at high end or exceeded our guidance for the quarter. For the second quarter, we reported net revenue of $169.2 million, at high end of our guidance, with a gross margin of 23.8%. Second quarter GAAP earnings per diluted ADS were 5.1 cents and non-GAAP earnings per diluted ADS were 5.4 cents, both exceeded guidance. During our first quarter 2015 earnings call, we mentioned the industry's low visibility, especially in China's smartphone market. Yet, we were able to arrive at top end of our revenue guidance and beat EPS guidance because our driver IC business came in better than expected across all applications. We were pleased to see a snapback during the second quarter from our Chinese branded smartphone end customers. TV, as projected, was another bright spot among driver IC products. We will now review all of our business segments in greater detail.

Our second quarter revenue of $169.2 million represented a 13.9% decrease from the second quarter of 2014 and a 5.5% sequential decrease from the first quarter of 2015.

Revenue from large panel display drivers was $54.3 million, an increase of 6.9% from the second quarter of 2014, and down 5.7% sequentially. Large panel driver IC accounted for 32.1% of our total revenues for the second quarter, compared to 25.9% a year ago and 32.2% in the last quarter. The year-over-year increase in total revenue was a result of market share gain from our Chinese panel customers and accelerated 4K TV shipments during the quarter, yet the sequential decrease was caused by continued weakness in the monitor market.

Revenue for small and medium-sized drivers came in at $82.8 million, down 22.6% from the same period last year and down 4.9% sequentially. Driver ICs for small and medium-sized applications accounted for 48.9% of total sales for the second quarter, as compared to 54.5% a year ago, and 48.6% in the previous quarter. While the overall demands in mobile devices are still trending down, the decline of our small and medium driver IC business was much smaller during the quarter compared to the last quarter. This was mainly because sales from our Chinese branded smartphone end customers, who were trailing behind the competition in the first quarter, rebounded strongly in the second quarter. The growth from Chinese branded smartphone customers was however largely offset by business from our key Korean end customer who was going through product transition during the quarter. Our Chinese end customers are using a multi-branding strategy in new sales channels such as e-commerce and direct sales points to gain market share back in China and exploring the long-awaited export opportunities. Meanwhile, our key Korean customer has decided to strategically increase the weight of AMOLED panels in their smartphone product portfolio. The transition in product development left a gap in our second quarter smartphone driver IC business as we have been its major TFT LCD driver IC outsourcing partner since 2012. We have foreseen this issue and worked on the development of AMOLED driver products. We believe that shipments of AMOLED panel drivers to both Korean and Chinese customers starting the second half of 2015 will help lift our smartphone driver sales going forward. I will elaborate more on Himax's competitive advantages in AMOLED driver ICs a bit later. For driver ICs used in tablets, sales stabilized after 3 consecutive quarters of decline. As for driver ICs used in automotives, revenues remained robust during the quarter.

Revenue from our non-driver businesses were $32.1 million, down 16.8% from the same period last year and down 6.6% sequentially. Non-driver products accounted for 19.0% of total revenue, as compared to 19.6% a year ago, and 19.2% in the previous quarter. Within our non-driver business segment, the main contributors included our timing controllers, programmable gamma OP, touch panel controllers, CMOS image sensors, power management ICs, LCOS microdisplays, WLO, and ASIC services. As we reported in the last earnings call, quite a few of our non-driver business segments were affected by the weakness in the China market, particularly in the smartphone and tablet segments, which resulted in the sequential decline of our non-driver businesses.

Our GAAP gross margin for the second quarter of 2015 was 23.8%, a 40 basis points decrease from 24.2% in the same period last year and down 190 basis points from 25.7% in the previous quarter. As previously guided, the sequential decline was mainly due to unfavorable product mix.

Our GAAP net income for the second quarter of 2015 was $8.8 million or 5.1 cents per diluted ADS, compared to $24.1 million, or 14 cents per diluted ADS, for the same period last year, and $12.6 million, or 7.3 cents per diluted ADS, in the previous quarter. GAAP net income declined 63.4% year-over-year and declined 29.7% from the previous quarter. The year-over-year decline was due to lower sales and gross margin, higher operating expenses, and a one-time investment gain of $8.5 million or 5.0 cents in the second quarter last year. Excluding the one-time investment gain influence, our GAAP net income declined 51.3% year-over-year. The sequential decline was due to lower sales and gross margin in the quarter.

Jackie Chang, our CFO, will now provide more details on our financial results. After Jackie's presentation, we will further discuss our second quarter results and third quarter 2015 guidance.

Jackie……

Ms. Jackie Chang: Thank you, Jordan. I will now provide additional details for our second quarter financial results.

Our GAAP operating expenses were $31.4 million in the second quarter of 2015, up 8.3% from the same period a year ago and up 3.4% from the previous quarter. Operating expenses increased from the second quarter of 2014 due to higher expenses for additional headcount to support new projects, annual salary increases, and an increase in R&D expenses. The quarter-over-quarter operating expense increase reflected increase in R&D expenses. In response to the bearish market sentiment, we have started expense control since the beginning of the year. However, in selective areas, mainly WLO and LCOS, we are still expanding right now. The combined total headcount of the two areas is expected to be up by around 230 during the year.

GAAP operating income for the second quarter of 2015 was $8.9 million or 5.2% of revenue, down 51.9% year-over-year and down 43.3% sequentially. The decline was mainly due to lower sales, decreased gross margin, and higher expenses in the quarter.

Non-GAAP net income in the second quarter was $9.3 million, or 5.4 cents per diluted ADS, representing a decline of 61.8% year-over-year and a decline of 28.5% sequentially. As previously mentioned, excluding the one-time investment gain, non-GAAP net income decreased 49.2% year-over-year.

Our cash, cash equivalents, and marketable securities were $164.5 million at the end of June 2015, down from $172.9 million during the same time last year, and down from $178.8 million last quarter. In addition to our cash position, our restricted cash was $130.0 million at the end of the quarter. The restricted cash is mainly used to guarantee the company's short term loan for the same amount. We continue to maintain a strong balance sheet, and we remind investors that we remain a debt-free company.

Inventories as of June 30, 2015 were $189.6 million, up from $166.3 million for the same period last year and up from $186.1 million last quarter. As mentioned in the last earnings call, we've been expecting customer restocking after the Chinese New Year and yet market demand only picked up by late second quarter, which has resulted in higher inventories. We believe we will be able to lower these inventory levels starting the third quarter of the year. Accounts receivable at the end of June 2015 were $182.3 million, as compared to $199.0 million for the same period last year, and $192.7 million last quarter. DSO was 95 days at end of June 30, 2015, as compared to 92 days the same period a year ago and 97 days at end of the last quarter.

Net cash outflow from operating activities for the second quarter of 2015 was $13.8 million, as compared to cash inflow of $22.9 million for the second quarter of 2014, and cash outflow of $3.7 million for the first quarter of 2015. The widening cash outflow quarter-over-quarter was mainly due to an income tax payment of $9.6 million. Both the year-over-year and sequential declines were mainly due to higher inventory and a decrease in accounts payable at the end of the quarter, offset by lower accounts receivable in the quarter.

Capital expenditures were $2.0 million during the second quarter of 2015 versus $3.8 million for the same period last year, and $1.8 million last quarter. Among other things, we continued to expand our clean room facilities for WLO product line during the quarter.

During the second quarter, we declared our annual cash dividend of 30 cents per ADS, totaling $51.4 million, which was paid out in July. Our dividend is determined primarily by the prior year's profitability. Our decision to pay out 77.5% of last year's net profit demonstrates our continued support for our shareholder base and confidence in our long term profitability.

As of June 30, 2015, Himax had 171.2 million ADSs outstanding, unchanged from the last quarter. On a fully diluted basis, the total number of ADSs outstanding is 172.2 million.

I will now turn the floor back to Jordan.

Q3 2015 Outlook Introduction

Mr. Jordan Wu:

Thank you, Jackie. We started this year with a sluggish first half as a result of weak overall market demands, especially those from China. The recent economic instability in the Euro zone and turmoil in the Chinese stock markets have further worsened the already uncertain demands of consumer electronics overall in the second half. More specifically, weaker demands have led to softening panel prices and lower capacity utilization of panel manufacturers. Pressured by poor market sentiment, our gross margin will decline during the third quarter. However, we remain confident about our new growth opportunities lying ahead. New customers, new design-wins and new TDDI products on smartphone panel, market share gains for our large panel driver ICs, and significant developments in our non-driver businesses should provide strong contribution in the quarters ahead. Furthermore, we believe that our LCOS and WLO businesses will hit an inflection point during the second half of the year, and I will explain such progress on that front shortly.

With that, I will now provide our third quarter guidance, followed by more detailed outlook for the third quarter.

<u>Q3 Guidance:</u>

For the third quarter of 2015, we expect revenue to decline 5 to 9% compared to the last quarter. Gross margin is expected to decline around 1.5% from the previous quarter depending on the final product mix. GAAP earnings attributable to shareholders are expected to be in the range of -1.5 to -0.9 cents per diluted ADS based on 171.9 million outstanding ADSs. Non-GAAP earnings attributable to shareholders are expected to be in the range of 1.0 to 1.6 cents per diluted ADS based on 171.9 million outstanding ADSs.

As we have done in the past, our third quarter GAAP earnings per diluted ADS guidance has taken into account our expected 2015 grant of restricted share units, or RSUs, to our team at the end of September. The grant of RSUs would lead to higher third quarter GAAP operating expenses compared to the other quarters of the year.

Q3 2015 Outlook

Now let me provide you with some details behind our guidance and trends that we see developing in our business segments. In our **large panel driver IC** business, after two strong quarters of shipment in TV application, we are starting to experience shipment slowdowns in TV along with continuous softness in notebooks and monitors. Hence, we will still see sequential decline by low teens in this segment in the third quarter. However, we believe 3Q weakness is a temporary setback. As we have repeatedly stated, 2015 will be a year for our large panel driver IC business to post year-over-year growth amid poor market conditions. We are still gearing up our engineering collaboration and design-in activities with Chinese panel customers, who, despite low market sentiment, are still adding new capacity after years of continuous expansion. The new capacity in China represents further growth opportunities for us with projected shipment growth and market share gains throughout the rest of 2015 and beyond. On top that, sales of 4K TVs are tracking better now than the beginning of the year as Chinese panel customers are embracing the 4K TV market with mid-to-low end models that could stimulate purchase interests. Thus, we remain positive on the outlook of our large panel driver IC business this year and also going forward

The other segment in our driver business are ICs used in **small and medium-sized panels** for applications including smartphones, tablets and automotive. We highlighted in our previous earnings call that we were cautious in our second quarter outlook; however, we experienced a snapback in Chinese customers' smartphone demand due to certain brand end customers' market share gains through new model launches, and change in their marketing strategy and sales channels as mentioned earlier. We therefore exited the second quarter with smartphone sales tracking better than we expected. Despite the muted market demand, panel resolution will continue to get upgraded. We are positive that resolution above HD720, especially FHD, will accelerate from the third quarter and go on for the rest of the year. Our QHD driver IC shipment also started at the end of the second quarter, following the design win with a brand customer as reported in the previous earnings call. Meanwhile, for FHD and beyond, the preferred technology would be LTPS TFT-LCD since it allows higher pixel density and more circuit integration with less power consumption. We are pleased to see more and more Chinese panel makers, following Korean and Japanese players, entered mass production for high resolution panels at their new LTPS facilities aggressively. Such progress means more business opportunities for the next few years for Himax as we have longstanding and solid business relationships with Chinese panel makers. We believe FHD and QHD will account for a growing percentage of our smartphone driver IC revenue starting this quarter.

We discussed on our last call two other areas which we believe will fuel the next growth drive in our small and medium driver IC business, namely AMOLED driver IC and TDDI technology, which integrates driver IC and touch panel controller IC into one.

On the AMOLED driver IC front, we continue to collaborate closely with multiple panel customers in Korea and China, some of which are likely to see meaningful volume late this year. There are few competitors in this marketplace and we are well positioned, having been previously engaged by numerous existing and new AMOLED panel makers in their new panel developments. It is worth mentioning that major Chinese panel makers have announced the building of new AMOLED projects, and we believe Himax is in a good position to be a major beneficiary. We look forward to working with our customers as the market for this technology expands. I will elaborate further on the TDDI opportunity a bit later.

For our driver ICs used in tablets, following three consecutive quarters of decline, the market stabilized in the second quarter and, as previously indicated, may improve in the second half of the year. Our observations remain that the trend for the panels in the mainstream tablet market will be upgraded to 10” and above with higher resolutions, from the once popular sizes of 7” to 9”. This is a favorable trend to the driver IC demand. However, its contribution to our sales will not be significant until 2016.

Among driver ICs used in small and medium-sized panels, the best-performing category in 2015 is for automotive applications. We have successfully engaged key panel manufacturers and module houses for long-term partnerships and secured leading market share in this segment. We anticipate second half sales to grow by high teens compared to the first half, which will also lead to high-teens growth year-over-year. Himax's ICs are well recognized by numerous tier 1 automobile brands globally, thus we are well positioned to take advantage of this growing market which honors its long product life cycle, stable pricing, and higher gross margins when compared with rest of the segments in small and medium panel driver ICs.

So, compared to the previous quarter, our small and medium-sized driver segment will decline low single digit in the quarter sequentially.

For the past few years, our **non-driver** business segment has been our most exciting growth engine. New product development continues to evolve and gain traction, and we remain positive on the long-term growth prospect of our non-driver businesses.

Our touch panel controller product line declined sequentially in the second quarter as we have foreseen in the previous earnings call. As we enter the third quarter, several of our on-cell design-wins will start mass production at multiple major end customers. On top of that, we are also excited about our technological advances and product development progress in the latest pure in-cell technology, where we are one of the pioneers in offering one-chip solutions integrating driver IC and touch panel controller, or TDDI. Driven by leading TFT-LCD makers, the industry is moving towards pure in-cell panels, which remains set to start mass production in the second half of this year. We are in partnerships with essentially all of the leading panel manufacturers, module houses, and OEMs in pure in-cell touch for joint technological development, and feel there is a strong market for these products ahead with fewer competitors.

Our CMOS image sensors experienced a slow first half since 4G smartphone adoption in China remained weak. The lack of smartphone replacement demand hurt the shipments of our high end product offerings. Entering the third quarter, we are pleased to report that we have secured several new customers in the second half mass production pipeline with our 8-megapixel and 13-megapixel sensors.

Regarding our LCOS business, Himax continues to collaborate with industry heavy weights by providing tailor made designs for their head mounted devices, and we remain enthusiastic about the projects in the pipeline. As stated, our LCOS and WLO businesses will hit an inflection point this year as we are gearing up for increasing pilot production shipments now, with expected volume ramping thereafter. We already secured a piece of land which is 5 hectares in size and is conveniently located nearby our headquarter building in Tainan, Taiwan. We have started planning for the construction of a new manufacturing/office facility with first phase investment of approximately $40 million in order to meet customers' desired output. The first phase construction will occupy just around 20% of the newly secured land, leaving plenty of space for future expansion. The investment will be financed through our internal resources and existing bank facilities, if needed. While we remain debt free as mentioned earlier, we do enjoy great support from banks that have provided us with plenty of unutilized facilities. Once started, the construction is expected to be completed in 12-18 months. This progress is sooner than we thought when we last reported. We will report further details in due course.

Furthermore, Himax continues to partner with numerous industry leading players using our industry-dominant wafer level optics, or WLO, for the development of three technologies of the future, namely array cameras, special purpose sensors, and microdisplay wave-guides for head-mounted displays. As our top-tier customers begin to mass produce products embedding these new technologies, Himax, being in the heart of that supply chain, should benefit significantly. However, we would like to remind investors that we believe, like HMD, while WLO can enable cutting edge products, such products are early stage in nature. Himax, along with our partners, are pioneers in these technologies and are committed to bringing them into commercialization.

Overall, we expect our non-driver segment to decline mid single digit sequentially in the third quarter.

Thank you for your interest in Himax. We appreciate you joining today's call and are now ready to take questions.

OPERATOR TO QUEUE QUESTIONS

Jordan's closing remarks

Thank you everyone for taking the time to join today's call. As a final note, Jackie Chang, our CFO, will maintain investor marketing activities and attend future investor conferences in the U.S. We will announce the details as they come about. Please contact our IR department and/or Adam Holdsworth if you are interested in speaking with Management and taking meetings with the Company. On a side note, we have recently redesigned our company website to reflect the new and exciting developments of Himax. Please take some time to explore our product line that we take deep pride in. Thanks again and have a nice day.