



## Himax Technologies, Inc. Q3 2017 Unaudited Financials and Investor Update Call

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**Operator:** Opening and standard introduction.

**Greg Falesnik:** Thank you, operator. Welcome everyone to Himax's third quarter 2017 earnings call. Joining us from the company are Mr. Jordan Wu, President and Chief Executive Officer, and Ms. Jackie Chang, Chief Financial Officer. After the company's prepared comments, we have allocated time for questions in a Q&A session. If you have

not yet received a copy of today's results release, please email [greg.falesnik@mzgroup.us](mailto:greg.falesnik@mzgroup.us), or access the press release on financial portals, or download a copy from Himax's website at [www.himax.com.tw](http://www.himax.com.tw).

Before we begin the formal remarks, I'd like to remind everyone that some of the statements in this conference call, including statements regarding expected future financial results and industry growth, are forward-looking statements that involve a number of risks and uncertainties that could cause actual events or results to differ materially from those described in this conference call. Factors that could cause actual events or results to differ materially from those described in this conference call include, but are not limited to, general business and economic conditions, the state of the semiconductor industry; market acceptance and competitiveness of the driver and non-driver products developed by Himax; demand for end-use application products; the uncertainty of continued success in technological innovations; as well as other operational and market challenges and other risks described from time to time in the Company's SEC filings, including those risks identified in the section entitled "Risk Factors" in its Form 20-F for the year ended December 31, 2016 filed with SEC in April, 2017.

Except for the Company's full year of 2016 financials, which were provided in the Company's 20-F and filed with the SEC on April 12, 2017, 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.

I will now turn the call over to Ms. Jackie Chang – the floor is yours.

### **Q3 2017 Results**

**Ms. Jackie Chang:** Thank you Greg and thank you everybody for joining us. Our outline for today's call is: first, I will review Himax's consolidated financial performance for the quarter on both GAAP and non-GAAP basis. The non-GAAP financials exclude share-based compensation and acquisition-related charges. I will then review operating expenses. Finally, I will conclude with the fourth quarter outlook. Jordan will then provide a brief update on the status of our business, after which we will take questions.

Our 2017 third quarter revenues and GAAP earnings per diluted ADS came in at high end of our guidance while gross margin and non-GAAP earnings per diluted ADS both exceeded guidance. For the third quarter, we reported net revenues of \$197.1 million, an increase of 29.9% sequentially and a decrease of 9.6% year-over-year. Gross margin was 25.5%, up 1.7% sequentially, outperforming the guidance by 0.7%. GAAP earnings per diluted ADS were 2.1 cents, compared to the guidance range of 1.3 to 2.5 cents. Non-GAAP earnings per diluted ADS were 5.2 cents, compared to the guidance range of 3.0 to 4.2 cents.

Revenue from large panel display drivers was \$54.9 million, up 5.4% sequentially and down 23.7% year-over-year. Large panel driver ICs accounted for 27.9% of our total revenues for the third quarter, compared to 34.4% in the second quarter of 2017 and 33.0% a year ago. As opposed to the original guidance of 10% sequential growth, our large panel driver business grew just mid-single-digit as one of our Chinese customers deferred some shipment to Q4. The sector's rebound from the first half was driven primarily by stronger sales in TV market. The year-over-year decline was caused by phase-out of certain customers' old models. We are pleased with our current engineering collaboration and design-in activities with large panel customers across China, Taiwan and Korea. Such activities will lead to further rebound in future sales momentum.

Revenue for small and medium-sized drivers came in at \$87.2 million, up 24.5% sequentially but down 12.2% year-over-year. The product segment accounted for 44.2% of total sales for the third quarter, as compared to 46.1% in the second quarter of 2017 and 45.5% a year ago. Sales into smartphones rebounded strongly, up more than 30% sequentially, but still declining 36.0% year-over-year. The strong smartphone driver IC sales were driven by customers' replenishment of inventories after a lackluster first half. Shipment of 18:9 displays driver ICs to panel makers for tier-1 end customers also contributed to the strong rebound. The year-over year decline in the third quarter was mainly the result of a shrinking addressable market for pure TFT-LCD driver ICs for smartphones, a significant portion of which is being replaced by TDDI and AMOLED technologies as we highlighted in previous earnings calls. The good news is that our TDDI solutions have started some shipment in the third quarter and are expected to start ramping in Q4. Jordan will elaborate on this a bit later.

Our small and medium-sized driver IC revenue for automotive application went up single digit sequentially and more than 20% year-over-year. The quarterly revenue now reached more than \$20 million, a historical high and accounting for over 15% of the total driver IC revenue. Driver IC sales for tablets were also up strongly, increasing over 25% sequentially but declining 6.8% year-over-year due to weak overall market demand in the product segment.

Revenues from our non-driver businesses were \$55.0 million, up 85.9% sequentially and up 17.5% versus last year. Non-driver products accounted for 27.9% of total revenues, also a record high, as compared to 19.5% in the second quarter of 2017 and 21.5% a year ago. The sequential and year-over-year increase was due primarily to WLO product shipment to a leading customer as well as certain one-off customer reimbursements related to our AR goggles business. The revenue increase was offset by the discontinuation of LCOS and WLO shipments to one of our major AR device customers who decided to end the product's production as we reported before. Excluding the above-mentioned one-off customer reimbursements, which totaled \$13.3 million, the sequential increase would have been lower but still at a high level of 40.9%.

Our GAAP gross margin for the third quarter was 25.5%, up 170 basis points from 23.8% in the second quarter of 2017 and down 10 basis points from 25.6% for the same period last year. The sequential margin improvement was a result of a more favorable product mix, which was due mainly to our WLO shipments starting July, 2017 and the one-off customer reimbursements as I mentioned earlier.

Now let's take a look at operating expenses. GAAP operating expenses were \$47.0 million in the third quarter, up 26.6% from the preceding quarter and up 16.2% from a year ago. The significant sequential expense increase, on top of rising R&D expenses, was caused by \$6.1 million of RSU expense. The RSU expense was assumed to be \$3.0 million in our guidance. The \$3.1 million higher RSU represents lower EPS of 1.5 cents. As an annual practice, we reward employees with an annual bonus at the end of September which always leads to a substantial increase in the third quarter GAAP operating expenses compared to the other quarters of the year. This year, the RSU grant totaled \$6.5 million, out of which \$6.1 million was vested immediately and expensed in the third quarter. The remainder will be vested equally at the first, second and third anniversaries of the grant date. Excluding the RSU charge, our third quarter operating expenses were \$40.9 million, up 10.2% from the previous quarter and up 31.1% from the same quarter 2016. The significant year-over-year increase was primarily the result of rising R&D expenses in the areas of 3D sensing, WLO, TDDI, and high-end TV as well as the annual merit increase. In addition, NT dollar appreciation against the US caused our salary expense to increase around \$0.9 million as we pay the bulk of our employee salaries in NT dollars.

GAAP operating margin for the third quarter was 1.7%, down from 7.0% for the same period last year and up from -0.6% in the previous quarter. The sequential improvement was due to gross profit increase which was mainly driven by WLO shipments and the one-off customer reimbursements mentioned earlier. The year-over-year decline was, however, a result of higher operating expenses and lower sales.

Third quarter non-GAAP operating income was \$10.2 million, or 5.2% of sales, down from 11.5% for the same period last year and up from -0.3% a quarter ago.

GAAP net income for the third quarter was \$3.7 million, or 2.1 cents per diluted ADS, compared to GAAP net loss of \$0.6 million, or 0.4 cents per diluted ADS, in the previous quarter and GAAP net income of \$13.6 million, or 7.9 cents per diluted ADS, a year ago.

Third quarter non-GAAP net income was \$9.0 million, or 5.2 cents per diluted ADS, compared to non-GAAP net loss of \$0.3 million, or 0.2 cent per diluted ADS, in the previous quarter and non-GAAP net income of \$21.3 million, or 12.4 cents per diluted ADS, a year ago.

Turning to our balance sheet, we had \$151.6 million of cash, cash equivalents and marketable securities as of the end of September 2017, compared to \$153.4 million at the same time last year and \$185.9 million a quarter ago. We paid out a dividend of \$41.3 million during the quarter. In addition to the cash position, restricted cash was \$147.2 million at the end of the quarter, up from \$107.2 million in the preceding quarter and up from \$138.0 million a year ago. The restricted cash is mainly used to guarantee the Company's short-term loan for the same amount. We continue to maintain a very strong balance sheet and operate as a debt-free company.

As of September 30, 2017, our inventories were \$130.1 million, down from \$147.7 million a quarter ago and decreased from \$169.4 million at the same time last year. The lower inventory was a result of increased shipments in the quarter. Accounts receivable at the end of September 2017 were \$181.7 million as compared to \$208.4 million a year ago

and \$163.2 million last quarter. DSO was 98 days, as compared to 95 days a year ago and 96 days at end of the last quarter.

Net cash inflow from operating activities for the third quarter was \$16.9 million as compared to an inflow of \$2.9 million for the same period last year and an outflow of \$1.2 million last quarter. The sequential increase was mainly due to higher profit, and better working capital situation.

Capital expenditures were on track with the plan at \$10.2 million in the third quarter of 2017, versus \$1.9 million a year ago and \$11.9 million last quarter. The third quarter capex consisted mainly of capacity expansion for WLO production line and ongoing payments for the new building's construction. As reported in the last few earnings calls, we are increasing capex right now to enlarge our WLO capacity located at the current headquarters to meet certain anchor customer's strong and urgent demand. We are also constructing a new building to house further WLO capacity, active alignment equipment, next generation LCOS production line, and additional office spaces. As part of our 3D sensing total solution, extremely high precision active alignment is required to assemble optics on top of laser. We mentioned in earlier earnings calls that we have partnered with a world leading equipment vendor to develop a dedicated active alignment solution of our own.

As we reported in the previous earnings calls, the capex budget will be funded through our internal resources and banking facilities if needed.



As of September 30, 2017, Himax had 172.1 million ADS outstanding, little changed from last quarter. On a fully diluted basis, the total ADS outstanding are 172.4 million.

**Q4 2017 Guidance:**

For the fourth quarter of 2017, we expect revenue to be down around 4% to 10% sequentially. We reported a one-off customer reimbursement of \$13.3 million in the third quarter which will not repeat in the fourth quarter, thus causing a sequential decline. Excluding the one-off reimbursements, Himax expects the fourth quarter revenue to be down around 3.5% to up 3.0% sequentially. Gross margin is expected to decline around 1%, depending on our final product mix. GAAP earnings attributable to shareholders are expected to be in the range of 13.0 to 15.0 cents per diluted ADS based on 172.5 million outstanding ADSs. Non-GAAP earnings attributable to shareholders are expected to be in the range of 13.2 to 15.2 cents per diluted ADS based on the same number of ADSs.

The above earnings guidance includes the disposal of an investment, netting 12.0 cents in earnings per diluted ADS. As many of you have already seen in our PR issued on September 26<sup>th</sup>, we reached an agreement with a buyer to dispose of a direct investment which was made over 2007 to 2008. The investment involves a China-based operation providing display driver IC backend processing covering wafer bumping, chip testing and packaging. Himax's initial investment amount of \$8.96 million represented a minority stake of 14.46% in the investee company. Total proceeds from disposal are \$32.00 million with a pre-tax gain of \$23.04 million. Gain after tax is estimated to be \$20.74 million, representing a contribution of 12.0 cents GAAP net income per diluted ADS. The

transaction is subject to relevant government approvals with closing expected to be no later than the end of the fourth quarter, 2017.

I will now turn the call over to Jordan.

**Mr. Jordan Wu:**

### **4Q17 Outlook**

Thank you, Jackie.

Despite the decline in the first half in our business, we delivered solid results in the third quarter, achieving both top and bottom line growth across all three major product categories. One of the highlights of our third quarter business is the joint announcement with Qualcomm to unveil our 3D sensing total solution. The announcement detailed the two companies' collaboration in the development and commercialization of high resolution, low power active 3D depth sensing solutions for the Android smartphone ecosystem. 3D sensing is a game-changing opportunity for Himax. It will be our biggest growth engine for the next few years. With that, now let me give you some details behind our guidance and trends that we see developing in our businesses.

### **Display Driver IC Business**

#### **LDDIC**

Our large display driver IC business rebounded in the third quarter from the trough of the first half. We expect the momentum to carry forward into the fourth quarter and next year as China continues to ramp new advanced generation LCD fabs and 4K TV penetration is still on the rise globally. Being a market leader in both areas, we will benefit from the

resulting market expansion. At the moment, due to tight foundry capacity, we are not able to fulfill some rush orders. This would affect our growth in the fourth quarter. We expect a moderate sequential revenue increase for large display driver ICs in the fourth quarter. Looking into the future, we are working with major panel makers on the development of next generation 8K TVs. 8K TV will likely take off as early as 2020 with Tokyo Olympics, which has promised to broadcast 8K programs.

## **SMDDIC**

In our last earnings calls, I discussed how full-screen 18:9 displays are becoming a trend and how we expect higher TDDI penetration in smartphones going forward. Both of these trends held true and continued to accelerate in the third quarter. Our 18:9 display driver ICs are expected to contribute to 25% of our smartphone display driver IC revenue in the fourth quarter, of which FHD+ 18:9 shipments will double.

In terms of our progress in TDDI, I am pleased to announce that we have started some small volume shipment of our new generation TDDI ICs in the third quarter. We now boast a comprehensive product portfolio supporting both full screen 18:9 and traditional 16:9 aspect ratios. We expect our design-wins of HD+ TDDI for smartphone to make meaningful contribution to revenue in the fourth quarter. Our FHD+ TDDI solutions adopt industry leading interlaced output design which requires less space for the customer's panel routing and therefore enables super-slim bezel for the customer's panel design. We have on-going design-in activities with many of the Chinese tier-1 smartphone brands and most of the panel makers in China, Japan and Korea. We expect some of them to start mass production in the first quarter of 2018. In summary, we are looking to ship a few millions units of TDDI ICs during the fourth quarter and seeing strong growth

starting 2018. TDDI has higher ASP and better margin than traditional driver IC with less competition. Hence, we expect the shipment of TDDI ICs will lead to margin improvement of our small and medium panel driver ICs starting 2018.

Now I will talk about AMOLED business. AMOLED is set to become mainstream in the global smartphone market in the future with penetration potentially reaching as high as 50% by 2020. We have joint development projects with many major Chinese OLED panel makers and have delivered 18:9 product samples to some of them starting the second quarter. With Chinese smartphone brands' AMOLED adoption forecast to reach 18% in 2017, Chinese panel makers have committed tremendous capital to build nine brand new OLED fabs by 2019, and are in full speed to pull forward the mass production schedule. Once Chinese panel makers start mass production, we believe OLED driver IC will be one of the long-term growth engines for our small panel driver IC business.

We expect driver IC sales for automotive application to grow around 20% sequentially and close to 35% year over year, far surpassing market average, as some of the major design-wins from prior years started going into mass production. Still more panels are going into vehicles, with the number of units expected to increase from 135 million in 2016 to 200 million in 2022. We have engaged all of the major automotive panel manufacturers worldwide for long-term partnerships and secured many of their key projects pipelined for the next few years.

Going into the fourth quarter, due to seasonality and smartphone OEM customers' inventory adjustment to accelerate the product transition from 16:9 to the new full screen 18:9 design, we expect small and medium-sized driver IC revenue to be flat sequentially.

## **Non-Driver Product Categories**

The non-driver IC business segment has been our most exciting growth area and a differentiator for Himax in the past few years. Now let me share some of the progress we made in the last quarter, as well as future growth opportunities.

## **3D Sensing Total Solution**

First, I will touch on our 3D sensing total solution. We have always said 3D sensing is among the most significant new features for the next generation smartphone. We are excited that Apple has pioneered the 3D sensing technology on iPhone X and is paving the way for smartphone to become a major AR platform. In the Android market, we are seeing leading players also aggressively looking to adopt 3D sensing. Judging by their current development activities, we expect some of China's leading smartphone names to launch flagship models with 3D sensing during the first half of 2018.

While 3D sensing can have a wide range of applications across smartphone, IoT, automotive, AR/VR, robotics, etc., our current target market is primarily the smartphone. SLiM™ (Structured Light Imaging Module), our turn-key total solution, has already achieved the performance, size, power consumption, and costs suitable for smartphones. I cannot over-emphasize the importance of a total solution approach in 3D sensing as it reduces the customer's integration complexity to a minimum and is essential for most of the Android OEMs. The Qualcomm/Himax solution, with Himax being the product owner of the total SLiM™ module, is state-of-the-art in its technological sophistication and the only true 3D sensing total solution available for the Android market right now. 3D algorithm, projector and receiver are the three fundamental building blocks of 3D sensing.

Our SLiM™ total solution brings together Qualcomm's industry leading 3D algorithm with Himax's advanced diffraction optical element (DOE) design and mass-production-proven wafer level optics for the projector and cutting-edge NIR sensors with superior quantum efficiency for the receiver. To complete our turn-key solution for the Android market, we have put together an A team by partnering with a few top players in their respective industry, covering laser, NIR camera lens, IR filter, semiconductor foundry and module assembly. This strong alliance will ensure that our SLiM™ 3D sensing total solution will be an accountable and competitive total solution for customers' volume ramping.

The majority of the key technologies inside the SLiM™ total solution is developed and supplied by Himax ourselves. These critical technologies include, on the projector end, DOE and collimator utilizing our world leading WLO technology, a tailor-made laser driver IC, and high precision active alignment for the projector assembly; and on the receiver end, a high efficiency near-infrared CMOS image sensor. Last but not least, Himax also developed an ASIC by incorporating Qualcomm's algorithm for 3D depth map generation. The fact that all of these critical components are developed in-house puts us in a unique leading position. It represents a very high barrier of entry for any potential competition and a much higher ASP and profit margin for us. While we prefer to offer a total solution, we can also provide the aforementioned individual technologies separately to a small number of select customers who possess in-house 3D sensing integration capabilities so as to best accommodate their specific needs.

We are seeing very strong demand for the SLiM™ total solution amid the Android smartphone market. We are tightly focusing on just a few top tier smartphone makers,

with whom we are in close collaboration right now. We, together with our target customers, are aiming to launch 3D sensing smartphones during the first half of 2018.

Our own SLiM™ solution and production capability will be ready for mass production and shipment by the end of the first quarter of 2018 with an initial capacity of 2 million units per month. The initial capacity is part of our Phase I investment of \$80 million. We will ramp as needed to meet our customers' launch timetable and will soon announce Phase II expansion as I will discuss in a moment. Given that we are offering highly integrated solutions with ASPs much higher than those of individual components, by the time we start shipping our total solutions, they will be a major contributor to both our revenues and profit, consequently creating a more favorable product mix for us.

## **WLO**

In the last earnings calls, we reported that this year's capex will be significantly higher than usual. We also reported the urgent addition of new WLO capacity to meet the rush demand of a leading customer. This new capacity is located in our existing headquarters in which we retrofitted space to make room for the new equipment. We are pleased to report that the project is going smoothly as planned. We have started mass production and shipment to the above mentioned customer during the third quarter. We expect shipment to accelerate to the same customer into the fourth quarter and beyond. In parallel, we are working on several new development projects with the said customer for their future generation products. We are very excited about the partnership and the significant growth opportunities these projects represent.

Now, let me move on to other WLO business updates. WLO is one of the key technologies enabling 3D sensing, AR goggle devices, and many other applications. At present, 3D sensing is the top priority of our WLO business. Levering on our exceptional design know-how and mass production experience in WLO technology, we are able to produce the world's most compact optics required of 3D sensing while achieving superior performance. In addition to 3D sensing, we also have ongoing collaborations with customers in developing wave-guide for AR glasses and micro displays using our WLO technology.

### **New Building**

Now let's move on to the other major capex project of this year, construction of a new building. The progress has been good to date and everything is proceeding according to schedule. The new building, located near our current headquarters, will house additional 8" glass WLO capacity and the new active alignment equipment that I just mentioned. It will also provide the extra office space we desperately need. The new building will be completed and ready for personnel and equipment move-in at around the new-year period of 2018.

### **Phase II Expansion**

As reported before, among all of the components in our 3D sensing total solution, the only two items requiring our own major capital expenditure are the WLO production line and the active alignment equipment. The two items are not outsourced because they require highly differentiating manufacturing know-how and are critical factors of our competitiveness.



Judging from the strong 3D sensing demands from the existing leading WLO customer and new Android OEMs, we are getting customers' input to finalize Phase II capex for additional capacity in 2018. While the plan is yet to be finalized, the scale of the investment would likely substantially exceed the Phase I capex of \$80M. Unlike the Phase I investment where majority of the capex is going to land and building, the Phase II investment will be exclusively for the enlargement of our WLO and active alignment capacity. The Phase II capacity will still be located in the same new building. In fact, the new building has sufficient room to house capacity much in excess of the Phase II expansion. We will formally announce the Phase II expansion once we finalize the plan.

As Jackie mentioned earlier, the capex budget for Phase I and Phase II expansion will be funded through our internal resources and banking facilities, if so needed.

### **CMOS Image Sensor**

Now on to our CMOS image sensor business update. We continue to make great progress with our two machine vision sensor product lines, namely, near infrared ("NIR") sensor and Always-on-Sensor ("AoS<sup>TM</sup>"). Our NIR sensor is a critical part in the SLiM<sup>TM</sup> total solution which I discussed earlier. Our NIR sensors' overall performance is far ahead of those of our peers in 3D sensing application. We currently offer low noise HD, or 1 megapixel, and 5.5 megapixel NIR sensors and are planning to add more to further enrich our product portfolio. Our NIR sensors deliver superior quantum efficiency in the NIR range, especially over 940nm band which is critical for outdoor applications.

On the AoS product line, armed with Emza's machine-vision algorithm, we are working with major consumer electronics and home appliances OEMs to add "people sensing"

capabilities into their products where our WiseEye™ system detects human presence reliably with extremely low power consumption to enhance user experience. Following one major global brand's adoption in their high end TV models in the first quarter of 2017, we expect several new projects will enter mass production in 2018, especially in the TV market.

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

## **LCOS**

I will now update the LCOS business where our main focus areas are AR goggle devices and head-up-displays (HUD) for automotives. Our list of AR goggle device customers covers many of the world's biggest tech names. We continue to see heavyweight companies allocating major R&D resources and budgets to bring the new products into the market. We are committed to provide the best technology to support them in the effort. In addition to AR applications, we are pleased to report that we are making great progress in developing high-end HUD for automotives. Our technology leadership in this space has little competition. LCOS represents a significant long term growth opportunity for us.

For non-driver IC business in the fourth quarter, Jackie just reported third quarter one-off customer reimbursements of \$13.3 million which will not repeat in the fourth quarter, thus causing a sequential decline of 20% for our non-driver revenue, yet an increase of close

to 20% for the same period last year. Excluding the reimbursements, the non-driver revenue would be up 10% sequentially, where WLO would grow around 20%.

That concludes my report for this quarter. Thank you for your interest in Himax. We appreciate you joining today's call and are now ready to take questions.

OPERATOR TO QUEUE QUESTIONS

Jordan's closing remarks

As a final note, Jackie Chang, our CFO, will maintain investor marketing activities and continue to attend investor conferences. We will announce the details as they come about. Thank you and have a nice day!