

AIXTRON SE

Analyst Earnings Conference Call

Q1 2020 Results

April 30, 2020

Edited Transcript

Executive Board

Dr. Bernd Schulte, President

Dr. Felix Grawert, President

Finance & Administration

Charles Russell

The spoken word applies

Slide 1, 2 – Operator & Forward-Looking Statements

Operator

Good morning and good afternoon, ladies and gentlemen, and welcome to AIXTRON's first quarter 2020 results conference call. Please note that today's call is being recorded. Let me now hand you over to Mr. Guido Pickert, VP of IR & Corporate Communications at AIXTRON, for opening remarks and introductions.

Guido Pickert

Investor Relations & Corporate Communications

Thank you, operator. Let me start by welcome you all to AIXTRON's presentation of our Q1/2020 results. As usual, I'd like to welcome our Executive Board represented by Dr. Felix Grawert and Dr. Bernd Schulte, as well as our VP of Finance and Administration, Charles Russell.

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Please also note that our Safe Harbor statement, which is included in our results presentation, applies throughout the conference call.

This call is not being immediately presented via webcast or any other medium. However, we will place an audio file of the recording or a transcript on our website at some point after the call.

I would now like to hand you over to Bernd Schulte for opening remarks. Bernd?

Slide 3 – Q1 2020 Highlights & Operational Performance

Dr. Bernd Schulte

Executive Board

Many thanks Guido, and let me welcome you to our First Quarter 2020 results presentation. Let me start by giving you an overview of the key developments in the quarter.

We had a solid start to the year with orders in Q1 coming in at 68.8 million Euros which is 28% above the same quarter in 2019, and 15% below the very strong Q4 of last year.

In Q1, revenues came in at 41 million Euros, which is low due to depressed order intake in summer last year and it is slightly below our planning for the quarter as the delivery and the commissioning of some of our tools into Chinese customers were delayed into Q2. That said we do not see, at this point, significant influence on our business from the corona virus. But to be clear – we cannot rule out that an extension of the restrictions that apply worldwide could at the very end also affect our business.

In the first quarter, our other key financials were also largely in line with our plans except the achieved gross margins at 36% which was influenced by the delayed commissioning of a number of tools in China as a result of the pandemic. EBIT ended up being at the low negative side at 1.1 million Euros while free cash flow was at 3.0 million Euros. We finished the quarter with an order backlog of 146.3 million Euros which is 16% over the same period last year and gives us confidence that we can meet our 2020 full year guidance which we communicated to you on our last call.

Despite the pandemic, we continue implementing our strategy, a core part of which involves the renewal of our entire MOCVD product portfolio over the next 18 months. We remain confident about our prospects for two reasons: We do see continued customer interest in our products to further build out critical communications infrastructure, contactless sensing, energy efficient power electronics and innovative displays. Secondly, our focused investments into next generation deposition tools for compound semiconductors and OLEDs will open new market opportunities for our equipment and get our business in the future in an even better position.

At this point, let me now hand you over to Charles for a more detailed overview on the Q1 2020 numbers. Charles?

Slides 4-6 – Q1 2020 Financial Performance

Charles Russell

VP Finance

Thanks, Bernd, and hello to everyone.

Starting on slide 4, our income statement. Total revenue for the quarter at 41 million euros was lower than in recent quarters. This reflects both the generally low order intake in the relevant period of last year and a much lower level of system commissioning in China in Q1 because of the lockdown. These factors resulted both in lower utilization of installation personnel and lower utilization of production. Relative to Q4, the effect of the under-utilization on gross margin was around 5%.

Operating expenses at 16 million euros were less than the 20 million euros in Q4 of 2019.

SG&A expense was 7.5 million euros compared with 6.8 million euros in Q4. The additional expense mainly relates to recruitment and additional IT costs.

R&D expense of 14.4 million euros was 0.6 million euros less than in Q4 because of lower expenses for MOCVD projects.

Net other operating income of 6.2 million euros was higher than the 2.3 million euros in Q4. Q1 income included the reversal 2.9 million euros of impairment provisions against a building in Germany, 1.9 million euros of grants and 1.2 million euros of exchange rate gains.

EBIT was a loss of 1 million euros compared with a profit of 14 million euros in Q4. Net income was also a loss of just under 1 million euros.

Turning to the balance sheet on the next slide.

Inventories of 85 million euros include around 12 million euros of prototypes, both on site at customers and in our facilities.

Receivables of 17 million euros represent 30 DSO (Days Sales Outstanding), the same as at the end of Q4.

Customer deposits increased to 60 million euros in Q1 compared with 51 million at the year end. This reflects the strong order intake.

Moving to slide 6, our cash flow statement

We had free cash flow of 3 million euros in the quarter, which brought our overall cash balance up 300 million euros.

And with that, let me hand you over to, Felix.

Slide 7 – Q1 2020 Business Update & FY 2020 Guidance

Felix Grawert

Executive Board

Thank you, Charles and welcome to you all.

I will give you a short overview of developments within our portfolio, of our approach to handling the pandemic and of our outlook.

Let me first speak about our OLED business APEVA. We are going through the qualification process with our Korean customer and make good technical progress. Some technical challenges have been solved, other topics are still work in progress. The end of the Gen2 project and with this a decision about a follow-on project have come closer. But we are not there yet, and a few months of work are still ahead of us.

In our MOCVD business, we are seeing solid interest around our mini and micro LED solutions – both for large display applications and for small wearable devices like watches. Furthermore, in Optoelectronics we see growing demand for lasers, in particular from telecom applications. In Power Electronics, we see strong interest from multiple market segments – GaN power, GaN RF and Silicon Carbide – which gives us confidence that this market is moving from R&D to large scale volume production.

Let me now give you some background information on how we handle the COVID-19 challenge.

Our production is up and running without interruption or delays. Early on we have enabled many of our employees to work from home. At our premises, we have implemented strict measures such as mandatory wearing of masks, shift work to reduce the risk of entire teams being quarantined, protective measures in our cafeteria, and others. We are working closely with our supply chain to ensure uninterrupted inflow of material for the ongoing production of our products. As part of these activities we have pre-ordered materials for anticipated production capacities in the second half of the year. We continue to serve customers with spare parts worldwide and have created backup solutions for critical cases. In some countries with strict lockdown orders by governments we have obtained the status of “critical infrastructure suppliers” with the help of our customers, and therefore all our branches worldwide are fully operational.

As a result of all this we can confirm and reiterate our guidance for the year 2020 that we have given in on our last call. The Executive Board continues to expect revenues and order intake to be in a range between 260 million and 300 million Euros, a gross margin of approximately 40% and an EBIT margin between 10% and 15% of revenues

for the full year 2020. This expectation is based on a solid order book at the end of the first quarter and a healthy level of customer inquiries particularly around LED based display applications, lasers for optical data transmissions and next generation power electronics.

We have assumed for our budget this year an exchange rate of US-Dollar 1.20 per Euro and that the full results of our OLED business APEVA are consolidated.

With that, I will pass, back to Guido, before we take questions.

Guido Pickert

Investor Relations & Corporate Communications

Thank you very much, Felix, Charles, Bernd. Operator, we will now take questions, please.

Question-and-Answer Session

Charlotte Friedrichs, Berenberg

The first one would be around the order intake. Can you tell us what the spread across the end markets is here in the first quarter?

Dr. Bernd Schulte, AIXTRON

Yes. Thank you for the question. I think the strongest portion of order intake came in for LEDs, LEDs for mini LED and the other display, but not micro LED applications. So this was about, I'd say, around 40%. And the rest was mixed between lasers mainly for telecom and a little also for power electronics including RF applications.

Charlotte Friedrichs, Berenberg

And around the slippages that you mentioned also in your press release this morning, can you give us an idea of what kind of an effect do you expect for Q2? Is it reasonable to assume that basically all of these will come into Q2, or could it maybe take later or some of them may disappear altogether?

Dr. Felix Grawert, AIXTRON

There was a small number of shipment delays in China where customers asked us to amend the shipment date and move it from the first quarter into the second quarter. In addition, a number of final acceptances could not be conducted in China. We now know that China is fully up and running, so these things will be done in the second quarter. They have just moved by one quarter forward.

In the second quarter Europe and the U.S. are most strongly affected by the pandemic. There is a certain chance that again some delays will happen to a couple of tool shipments for European and U.S. customers and potentially also a couple of acceptances with these customers could be delayed. However, these potential delays will be compensated by the catchup from China, so the overall effect should be neutral.

And then finally to be mentioned, shipments as well as acceptances in Europe and the U.S. may shift into the third quarter, but we are confident that we will execute them within the year 2020, so we do not expect it will affect our guidance for the entire year.

Charlotte Friedrichs, Berenberg

Okay, understood. And then my final question would be around sort of the product mix across the year that you expect and sort of tying in with the feedback that you have received from customers on your silicon carbide tool. And also now with

smartphone shipments, perhaps also a bit about the 3D sensing end market, what you're hearing here from customers.

Dr. Bernd Schulte, AIXTRON

As we mentioned in our speech and in our publication, we are seeing a very healthy mix across these different applications. So certainly, we expect this year growth in the area of the very innovative displays, meaning this includes mini LEDs as a backlight solution for LCD, but also fine pitch display for large display solutions and first investments into micro LED displays, as we already mentioned. But we see also a growing demand for power electronics. And with that I mean both gallium nitride and silicon carbide based power electronics, and certainly devices for the telecom infrastructure buildup which we expect gets accelerated due to the current situation. The only thing we still await to come back is capacity demand from 3D sensing. As we mentioned in our last call, this is to be seen when this comes back.

Janardan Menon, Liberum

Just to go back to the previous answer on the LEDs for the display side, on the 40% you said, would the biggest driver there be mini LEDs for backlighting? And I am just wondering, can you give me a feel for how big you think that market could be? Obviously, long ago you had backlighting as a big driver of revenues at one point. I'm just wondering, is this the start of a new trend and do you think that, if this spreads across the LCD market, will this be a material driver of orders for you going forward, or do you think it will remain a contained thing and that growth will be more in the micro LED and other areas?

Dr. Bernd Schulte, AIXTRON

Thank you, Janardan. We see certain demand in particular for the red colored dot, simply because for blue and green there is a lot of installed capacity out there, which has been installed mainly for general lighting applications. But you certainly need as many red colored systems. And also what we're seeing now is that some LED companies who previously have focused on solid state lighting, are now looking into mini LED and fine pitch LED applications and they now want to have in-house supply of red LEDs in addition to green and blue. We are seeing this as a trend driving demand for us as our main market contribution into this this application is the deposition technology for the red color. Whether this is a huge application to continue is to be seen, but in the moment we are definitely enjoying this trend.

Janardan Menon, Liberum

Understood. You have talked about the renewal of your portfolio, how it's -- across the various segments you're renewing it. I was just wondering, would that have a positive impact on gross margin? Is cost reduction of the bill of materials a key part of the

renewal? And if so, when would we start seeing some of that coming in through the numbers?

Dr. Felix Grawert, AIXTRON

Thank you, very good question. Our new products across the different application segments will be released step by step. The new silicon carbide product was released in fall of 2019. Later this year a product for GaN power electronics will follow, followed by products for lasers and red micro LEDs. The portfolio renewal is conducted step by step. Typically, in our industry, when we launch a new product, we first bring out a so-called beta tool to two or three selected lead customers to qualify the product and to gain field experience based on customer feedback. After that phase, we then go into volume production for the broad market. So it's a step by step process. Finally, at the point where we go into volume production and roll out the new product to all customers, we will see the gross margin impact in the P&L. And yes, we introduce these new product generations to significantly increase our competitiveness and of course to gain or maintain market share in our addressed growth markets. The higher performance of these new tools is a value proposition for our customers. We expect this to translate later into an improvement of the gross margin, which you will then gradually see probably within the year of 2021 rather than in 2020.

Janardan Menon, Liberum

Understood, very clear. And lastly just a question on how you expect the revenues to come through. You've started quite low in Q1. You said that's because of the nature of the order intake last year. Is this going to be quite a second half loaded year, or will you see a good snapback in Q2 itself to meet your full year targets?

Dr. Bernd Schulte, AIXTRON

Yes, Janardan, can I just guide you to slide 7 in our results presentation, our guidance slide? There you see the typical pie chart of what we expect, and you see that we need about € 40 million to € 80 million of new system orders in the second quarter, or maybe even early Q3, which are shippable within this year to reach the lower or higher range of the guidance. And I'm glad to say to you that in the moment we're seeing continued healthy discussions with customers and inquiry levels continuing.

So we feel quite confident that we will be in the range with the second half of the year again being stronger than the first half. The only thing which might be a risk is whether our supply chain stays to be as good as it is in the moment. We are quite confident in this. In addition, we have taken the most possible measures from our side that you can take. So this makes us feel quite good about this.

Uwe Schupp, Deutsche Bank

Firstly, on the export licenses please, I remember that this was an issue on some of the previous calls, and I was just wondering whether the situation has improved here. Obviously, the main reason is that there may be a work from home attitude also in the Berlin departments in that particular area in the public sector, and I was just wondering whether this has an ongoing impact on your business.

Secondly, speaking of work from home, is that a warm rain currently for you because of higher demand from customers in the area of data communication?

And then lastly, Felix, just a brief update, please, on your Silicon Carbide program. We are seeing some push outs here and there on the silicon carbide side from Q2 into H2 for various reasons, obviously COVID-19 being not the least one. Just the number of beta customers would be interesting and how you generally judge the level of interest at the current stage.

Dr. Bernd Schulte, AIXTRON

Yes, Uwe, let me start with the first two questions, the export licenses. Honestly, I certainly am not in a position to give you an efficiency rating of the German government.

However, in the moment, we do not have issues with export licenses. This can be simply a timing effect or just the nature of the orders we are currently shipping. In any case - in the moment it's no issue.

And you asked whether the increased demand in data and telecom speed rates can give us a boost in the business. The answer is yes, but it's not immediate. Once there is a decision made for infrastructure investments, then it usually takes a while until our customers place orders and build up new capacity to manufacture the required devices. But overall, my expectation definitely is that it will give us additional tailwinds.

Dr. Felix Grawert, AIXTRON

Let me address your question relating to the silicon carbide program. Some customers have pushed out decisions on the tool technology and their respective ramp up of capacities. We heard throughout the year 2019 that customers were planning to make tool decisions and start the build out of their factories in the fourth quarter of 2019. This has clearly been moved out, I would say, towards the second or third quarter of 2020. This delay of about 6 to 9 months in our customers' tool decisions is a result of a more difficult market environment in particular in the automotive market. We see this as a benefit as this fits our schedule even better.

In terms of the number of beta customers - we have our automated tool on the ground with 4 or 5 customers with whom we are in the qualification phase. We do see a strong and a healthy demand for this tool. And we have orders for the tool from additional customers where we had to decline making them additional beta customers as long as

the qualification phases continue. So we have taken orders for the tool in the manual operated mode, giving the customer the chance to later switch on and add the automation piece of it.

Overall, the delay of customers' tool decisions has helped us because it better fits to our schedule of the qualification of our silicon carbide tool. Nevertheless, we do not see the demand disappearing or even the trend to more efficient power semiconductors reversed. In contrast, we rather see even larger customer expansion plans emerging for the future. We now also see Chinese customers coming into the market that had not been on the radar yet. So the overall outlook is positive.

Veysel Taze, Bankhaus Lampe

The first one would be on some of your comments regarding gross margin. So you said underutilization had an impact on gross margin by roughly 5 percentage points. I was wondering at what revenue level you see them disappear and how that's going to shape up for the rest of the year.

Charles Russell, AIXTRON

So yes, relative to Q4, the underutilization had an effect of 5% on the gross margin. And in terms of what level it would get back to a normal utilization, I think that would be when the revenue is around €55 million.

Veysel Taze, Bankhaus Lampe

Okay. And then on the OpEx, Q1 was flat versus Q4, so around €22 million. Is that something we should model in for the upcoming quarters as well, or some one-offs there?

Charles Russell, AIXTRON

Well, you should not model in a repeat of the exchange gains of €1.2 million or the repeat of the release of the impairment provision of €2.9 million. So there's €4.1 million which is not necessarily repeatable. But otherwise, I think the level of OpEx is pretty representative.

Veysel Taze, Bankhaus Lampe

Okay. And then one question regarding your power business. So in Q1 you had roughly €11 million sales in power. And I was wondering what was the split silicon carbide versus GaN. And then on GaN, a little color around current market momentum or demand momentum. So TSMC seems to have secured some designs. They invested a few years ago. Do you see them investing in new capacities? And how is the investment behavior regarding GaN in China? And then a final question regarding your OLED project. Felix, you mentioned during your presentation that a few months of work was

still to be done, so would you have an update there. Can we expect a decision still in the first half?

Dr. Felix Grawert, AIXTRON

Let me get started with the question on power electronics. Revenues in the first quarter were about 20% gallium nitride, both power and RF combined, and about 20% silicon carbide, so power electronics amounting a total of 40%. We see an increased market momentum. Gallium nitride is now gaining traction. You may look and analyze, for example, across the Chinese smartphone market and see what models have been launched, a significant number of them being based on gallium nitride-based quick chargers. You can open them up and do a reverse engineering or buy the appropriate reports of that. Then you will see who the makers of these are. A big part of that supply chain, some of them are fabless players, pointing then again back to foundries, one name you mentioned, that are producing the devices and who see the demand picking up from. So what you have stated is in fact also what we see, when we look into the market, especially in Asia, and in particular in China.

That being said, the volume ramp, for which in 2019 we have predicted a tipping point coming close, is happening, as customers move from R&D stage to volume ramp, driven by consumers buying the products in electronics stores. With that, we do see orders from customers for capacity and factory expansions coming, for example from established players, one of you had mentioned. And beyond that, we do see quite some momentum from smaller players and startups which are enjoying very healthy financing, both by venture capital and also by government entities in China. So China and Taiwan are real strongholds in this ramp that we see. And of course, we also see that the Western players have become more active. They may not yet be in current smartphone models. But they are, I think, very fast to follow this trend. Overall, the gallium nitride power electronics ramp is now in the early phase.

With that, I would like to switch over to the OLED question. I mentioned earlier on that we are making good progress. We have finished and completed quite a number of development topics. Think about this between us and the customer, an agreed checklist of topics that need to be worked on and the specifications that need to be fulfilled. Some of these points have been fulfilled and agreed that they are closed and done. Some other action items are still open and still need work. I would not want to comment now about the exact timing when that is done. You asked the question, is it going to happen this first half. That would give us two more months precisely from today. Such a timeline would be overoptimistic, you can rather expect a couple more months of work ahead of us.

Jürgen Wagner, MainFirst

I'm sorry to come back to OLED. How much of your order and your revenues guidance for this year is OLED driven?

Dr. Felix Grawert, AIXTRON

Well, it's both within our guidance.

Jürgen Wagner, MainFirst

Yes, but can you quantify, or would you want to quantify?

Dr. Felix Grawert, AIXTRON

No, I would not want to do that.

Jürgen Wagner, MainFirst

But the way it works, if it's further delayed, even if the order comes in Q4, you would still recognize part of it as revenues, is that right?

Dr. Felix Grawert, AIXTRON

I think that would be very difficult if the order came in Q4. With OLED, we are not in the classic business of building tools one by another, but it's large scale system building which we will record, according to the percentage of completion (POC) method. Think about it as a project which lasts 18 months. So after one month, you can record only the percentage of the total that you have completed as revenue. And that would be a relatively small portion of it for one month of work on the GenX system. If an order came, for example, on the 1st of December, within one month it's a very small portion that you can complete.

Malte Schaumann, Warburg Research

Just on OLED again, but could you confirm, or do you like to confirm that there will be a decision within the year 2020, maybe not in the first half but somewhere in the second half at the latest point in time? Would that be right to assume?

Dr. Felix Grawert, AIXTRON

Yes, definitely.

Malte Schaumann, Warburg Research

And then the question is on your current order pipeline. You mentioned that the discussions with the customers are quite healthy. Is that true across the applications, are there areas where you see a certain sort of form of weakness, or are you saying most of the target applications are quite stable and healthy at the current stage?

Dr. Bernd Schulte, AIXTRON

Yes, it is pretty much what I said in the first question. The good things is we're seeing several areas getting high interest. Certainly one is for these new innovative displays,

meaning here the micro LED, mini LED applications. So we definitely see customers are preparing potential demand for production, but also for power, and when we speak about power, meaning both silicon carbide and gallium nitride. Felix just mentioned gallium nitride. And the silicon carbide ramp, we not only have beta customers, we have also existing customers who are ordering tools. And they do continue their capacity ramp more or less as they announced, so that is going on. And we're seeing demand for the telecom build out of infrastructure, which I have mentioned already that we expect not to slow down or maybe even to accelerate due to the current situation where everybody appreciates a high-speed internet connection at home. So these are the main drivers.

And as I said, as expected, the 3D sensing market has not yet returned, and we all know that the cell phone market in the moment is not at its best. However, all the smartphone makers will come out with new models, and I think it's no surprise that all the new models will have a kind of 3D sensing solution built in. So of course, the high-end models are typically not representing high volume sales, but we are seeing that customers in 3D sensing are pretty busy. When that then turns into orders for additional capacity, I told you last time I expect it earliest end of the year, and I think that statement still holds.

Malte Schaumann, Warburg Research

Yes. Okay. So no reason even of change in the recent weeks of the overall pattern. Then final question is on the competitive situation. One of your competitors launched a photonic dedicated tool earlier in the year. Do you see him gaining traction somewhere, or do you feel quite confident, especially when you will launch new tools as well? So any change in the overall competitive environment for your applications?

Dr. Bernd Schulte, AIXTRON

Well, in the moment, I think the situation is unchanged as in the past. Certainly, we are watching also the performance of the new tool of the competitor, which is still in the market but not yet qualified. But eventually it may be qualified, and then we have to judge the situation. But I also want to refer to what we said previously. We don't stand still. We spoke about our new product introduction programs, and that certainly includes next generation of tools for lasers and gallium arsenide-based materials. So we will come out by end of the year, early next year with our next generation tool, and we feel quite confident that we can at least maintain our market share.

Guido Pickert, AIXTRON

With that, we conclude today's call. Thank you very much for listening to our call and participating in the Q&A session. You know where to find us in case you have any follow-up questions. And please all stay healthy. Thank you and good bye.