AIXTRON SE

Analyst Earnings Conference Call

Q1/2018 Results
April 2018

Prepared Remarks

Executive Board

Dr. Felix Grawert

Dr. Bernd Schulte

Finance & Administration

Charles Russell

The spoken word applies

Slides 1, 2 – Operator & Forward-Looking Statements

Operator

Good morning, ladies and gentlemen, and welcome to AIXTRON's Q1/2018 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 welcoming you all to AIXTRON's Q1/2018 results conference call.

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.

As the operator indicated, this call is being recorded by AIXTRON and is considered copyright material. As such, it cannot be recorded or re-broadcast without express permission. Your participation in this call implies your consent to this recording.

Please note that our SafeHarbor statement on page 2 of our results presentation applies throughout this conference call. You may also wish to have a look at our latest IR presentation, which includes additional information on AIXTRON's markets and its technologies, and is available on our website.

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 Dr. Bernd Schulte for opening remarks.

Bernd?

Slide 3 – Q1/2018 Important Events, Guidance

Dr. Bernd Schulte

Executive Board

Many thanks Guido, and welcome from my side as well. Let me start by giving you an overview of the key developments in Q1 before handing over to Charles Russell, our VP Finance and Administration, who will lead you through the financials. This will then be followed by my colleague on the AIXTRON Executive Board Dr. Felix Grawert who will discuss how we manage the operational challenges today and ahead of us. I will then do a wrap up before handing over to you all for Q&A.

Let me start by saying that we had a strong first quarter and as a result we can certainly confirm the 2018 full year guidance we gave at the end of February and I will give you more details to this guidance at the end of the call.

We have a strong foundation with a robust line of products as well as a resilient, cost effective and flexible business model which enables us to benefit from the current strong market environment as Felix will explain to you later.

Secondly, we have gone through a successful reorientation of our technology portfolio and now have a durable and focused product portfolio in growth areas such as specialty LEDs, Lasers and Power Electronics.

Thirdly, we have a comprehensive technology and product development roadmap in which we:

1. Continue to improve the performance of our opto-electronics MOCVD systems
2. We are currently enhancing our SiC Power offering to make it the most productive solution in the market for volume manufacturing.
3. We are developing disruptive technologies in the OLED area as well as next generation carbon materials such as graphene, all of which have significant end market opportunities, and will support our growth in the medium and longer term.

Let's now return to Q1 which was our strongest start to the year since 2011. Our business enjoys a positive momentum with strong interest for our full range of products but in particular for our manufacturing solutions for the production of lasers such as vertical cavity surface emitting lasers (VCSELs) for 3D sensing and optical datacom applications. This is reflected in the higher than originally expected order intake in Q1, which at 79m Euros was 27% ahead of the same quarter last year and 20% ahead of the previous quarter.

The quarter was strong in terms of revenues which came in at roughly 62m Euros which was 16% ahead of the same quarter last year. In terms of profitability we were both EBIT and net income positive in the first quarter with EBIT of close to 8m Euros and a net profit of slightly above 12m Euros. Both were ahead of the same quarter last year when AIXTRON was loss making. This earnings increase is largely a reflection of an improved product mix and a very strong gross margin performance which reached 43% in the quarter supported to a certain degree by lower US-Dollar denominated revenues. This was above the 39% we achieved in the previous quarter and the 25% we achieved in Q1/2017. As the product mix varies quarter to quarter and order behavior can be lumpy, this gross margin profile will also fluctuate going forward.

At this point; let me now hand you over to Charles for a more detailed overview of the Q1/2018 numbers.

Slides 4-7 – Key Financials Q1/2018, P&L, Cash Flow, Balance Sheet

Charles Russell

Finance and Administration

Thanks Bernd and hello to everyone.

Turning to slide 4, Q1 represented a very good start to the year with an order intake of 79m Euros, up 20% on the previous quarter and 27% up on the 62m Euros we generated in the first quarter last year.

Consequently, we ended the quarter with an equipment backlog of 115m Euros, up 6% on the year-end backlog and 31% ahead of the previous year.

This gives us good visibility for the remainder of the year.

The positive development is mainly due to the strong demand for equipment used for laser applications such as VCSELs and optical datacom.

We were profitable in the first quarter both at an EBIT and net income level.

This was largely driven by increased sales and a good product mix producing a 43% gross margin.

EBIT for the quarter was 8m Euros, compared with a loss of 13m Euros in the comparable period in 2017.

Net income in the first quarter was 12m Euros, the increase over EBIT being because we recognized 5m Euros of deferred tax assets.

Moving to the next slide, let me go into more depth on the income statement.

Total revenues recorded during the first quarter of 2018 were 62m Euros, up from 54m Euros in both Q4 and Q1 2017.

Compared with previous quarters, the mix of sales was much higher in Europe.

38% of our sales were in Europe this quarter compared with 8% in the year ago period and 13% in Q4 2017.

We also had a favorable product mix.

Gross margin improved from 25% in Q1 last year to 43% in this quarter which reflects the sales mix and the absence of R6 sales which we had in Q1/2017.

Operating expenses of 19m Euros were less than the 26m Euros in the same quarter last year.

Selling and Administration expenses are more or less in line with the normal run rate in previous quarters.

The major change is in the R&D expense which is lower because of last year's sale of the Memory business and the freezing of developments in TFOS.

We are now clearly focused on development for Opto and Power and OLED.

As a result of increased sales volumes, increased margins, and lower operating expense, EBIT for the first quarter was a profit of 8m Euros - a significant improvement over Q1/2017.

Because of the transition from losses to profitability, we have capitalized 5m Euros of deferred tax assets, giving an overall tax credit in the quarter of 4m Euros. This being a transition effect only.

Consequently, the net result for Q1 was 12m Euro profit.

Moving to slide 6, which shows our cash flow statement.

As expected, largely because of an agreed payment related to the sale of our ALD/CVD product line, we were cash flow negative in the first quarter.

Receivables DSO also increased from 33 to 43 days, which is a short term timing effect related to the high level of sales in the month of March.

Operating cash flow was minus 21m Euros in contrast to the previous periods where cash flow was strongly positive.

We do expect the operating cash flow to be positive for the year.

Cash at the quarter end was 223m Euros compared with 246m Euros at year end.

Turning to the next slide – our Balance Sheet.

The principal changes in AIXTRON's balance sheet since year end reflect the increased levels of business.

- Inventories have increased because of increased orders.
- Receivables have increased in line with sales.
- Equity has increased because of the profit.

And, as expected, liabilities reduced because of payments related to the Memory business sale.

Now let me hand you over to Felix who will give you some operational insights.

Dr. Felix Grawert,

Executive Board

Thank you Charles.

In the last earnings calls we have provided you a comprehensive perspective on the markets and on the strategy for our core markets in Opto and Power. This time, we would like to discuss some operational topics that are important for us.

Our numbers and guidance reflect a strong uptake in revenue and orders in the MOCVD business. Our manufacturing model is very well capable of digesting this upswing. It is based largely on outsourced in-deliveries and pre-assemblies from our suppliers. It focuses the in-house work mainly on production planning, orchestration of the assembly work performed on our shop floor and test of the assembled tools. Thus, we are not running into capacity constraints with respect to our own staff.

However, we have to manage an overall tightening of supply and part availability along the semiconductor equipment supply chain. In order to do so we monitor this very closely and – where needed – pre-order long lead items ahead of time to be able to serve customer demand and to avoid running into limitations for our output. We do not expect risks regarding our inventory level as it has a small effect compared with the inventory attributable to tools which are built to customer orders. Thus, we think we are well set to deliver the tools according to our customers' demand.

Furthermore, we will need to install a significantly larger number of tools with our customers in the field, especially in the 2nd half of 2018. Our service team has been sized to cope with the installation level of 2017, such that the increased output calls for additional installation capacity this year. As we do not want to provide this only via an increased headcount – some may be needed – we have started a service and installation efficiency program targeted at reducing the installation time per tool. Efficiency gains are a more elegant way to boost output, especially in boom times that we are seeing now.

Finally, the growing number of customers in the Power Electronics and automotive industry as well as some of the laser customers ask for different and higher quality standards. We also address this topic with a dedicated quality initiative.

In summary, I think we are well equipped to manage these operational challenges as we have the right manufacturing model and the set of initiatives in place to address them.

Let me also briefly comment on our OLEDs business, APEVA, which addresses a 50 Billion US-Dollar end market opportunity by 2021 with their OLED display technology.

The project is progressing as announced in the February Earnings call: our Gen2 tool is being set up and tested in a facility in Asia and will soon be installed at a customer's facility in order to qualify the technology for mass production. Discussions with a Joint Venture Partner are intensively ongoing, but have not been concluded yet.

With that, let me hand you back to Bernd for a wrap-up.

Slide 8 – 2018 Wrap-Up and Guidance

Dr. Bernd Schulte

Executive Board

Thank you Felix.

Before we finish the presentation, let me summarize the main operational points we've presented to you today and then give you our perspective on the broader business issues we are addressing in the months ahead.

In summary; Q1 was solid with strong revenues, higher than expected orders and margins which gives us increasing confidence for this year. We are addressing the operational topics coming along with the strong business and therefore do not see limitations to deliver as desired.

Based on these results, we confirm our 2018 full year guidance given in February 2018 shown on slide 8.

We expect revenues and order intake in the range of 230 to 260 million Euros, and an EBIT margin between 5% and 10% of revenues. However, due to positive development of the business, we expect revenues and EBIT margin to be close to the top end of their guided ranges. Gross margin is expected to be between 35% and 40%. A positive Operating Cash Flow for the year is also expected.

With that I'll pass you back to Guido before we take some questions.

Guido Pickert

Investor Relations & Corporate Communications

Thank you, Bernd, Felix and Charles.

Operator, we'll now take the questions.

Uwe Schupp – Deutsche Bank

Two questions from my side. Firstly, again on the guidance and the implied €50 million for the second quarter. Question would be – whether you saw this €50 million as kind of core scenario from today's perspective? Or are you just trying to be conservative as possible in order to start rebuilding a track record? Or what is really behind this, in other words, are you expecting a serious slowdown in the VCSEL demand because of current nervousness in the market versus potential build- out scenario for 2019 devices coming to the market?

Secondly, on the gross margin, could you help us understand a little bit better what your thinking behind your gross margins scenario really is? We heard you saying that you're expecting sales and also EBIT being at the upper end. Why wouldn't that necessarily be the case for the gross margin?

And I heard Bernd that, you indicated that there will be always some fluctuation. But if there would be fluctuation in the coming quarters, wouldn't that also imply that given the higher end of the EBIT margins, that there is also some relief on the OpEx line as well? So just some background around that would be appreciated.

A - Bernd Schulte

Coming to the €50 million calculated order intake, which is required to exactly hit the €260 million. We have to see €50 million as the required shippable order intake for this year.

We are seeing a continued interest in terms of inquiries for various kinds of applications, not just VCSELs, but also others MOCVD applications. So for us it is a reasonable and realistic statement to say that we are close to the upper end of the guidance.

We always have to evaluate what is doable in terms of our production, and what customers are able to take into their facilities within this year. This led us to stick with our guidance, however, to refine it to the upper end.

Second to your question about gross margin. We had a very good quarter with 43% which was higher than the guided gross margin. Q1 was a particularly strong quarter for several reasons.

Charles mentioned that we had at a relatively high sale into euro-based orders. So we had a lower effect from the exchange rate. Secondly, we had a very good product mix with higher margin products and elements such as final acceptances. This could vary, because going forward we expect to ship more LED related orders, which by nature have a lower gross margin due to the competitive environment. So that leaves us to say we are between 35% and 40% of gross margin in the average for the entire year.

Uwe Schupp – Deutsche Bank

That's very clear. Just to follow up on the first point. So the €50 million is not your basic core guidance in terms of Q2 orders, but, the number of orders that would be shippable for this year and the rest would potentially be for next year?

A - Bernd Schulte
Yes, exactly. And this is for equipment only. In the chart where we've explained this bit. We are assuming typically around €10 million for after sales, which would come on top of this for the order intake.

Veysel Taze – ODDO BHF
If you look at Q1 - the Opto part was very strong, but the rest of the business, as indicated in the LED space, it will not be a year like last year. Can you explain a little bit on the Power and the LED part, the trajectory between the quarters, what we can expect for the rest of the year, because in Q1 seems to be very, very weak on LED and Power part?

A - Bernd Schulte
Let me comment on the LED part. Orders for LEDs are in general quite lumpy. Typically, these orders come from China and are coming in the amount of 5, 10, sometimes more systems per order. As such, we're seeing quite high fluctuation from quarter-to-quarter for the different applications. As you quite rightly see that effect for Q1 was low, it doesn't mean it will not be different in the future.

Veysel Taze – ODDO BHF
And on the Power...

A - Bernd Schulte
And for Power Electronics, it's a growing market from a relatively low level at the moment. Most of our customers are in the phase of sampling to their customers, and we are not in the phase where customers are really strongly ramping into high-volume manufacturing. This is not yet to be expected for system shipments earlier this year. We expect this growth to kick in maybe next year or beyond.

Veysel Taze – ODDO BHF
Just follow-up on Mr. Schupp's question. On the order momentum in Q2, I mean we are now end of April, so would you say that you could already see in April a slowdown, or would you say the pace has been still okay? And also considering from the semiconductor companies what we heard up to now in the early season was okay, no preproduction in Q2. So for the iPhone X 3D sensing modules, it looks like there will be still capacities for Q2 needed or so. Colors around the laser momentum and on the order momentum into Q2, in general, would be very helpful.

A - Bernd Schulte

We are not guiding on next quarter's order intake. However, let me say that, we've seen very healthy inquiry levels from the market for systems and our sales team is very active. Please also keep in mind, that we're not just selling VCSEL tools. We have a broad range of product in different applications. Seeing that Q1 was very strong for laser doesn't mean that our order intake in the next quarter has to come down. Even though that there are rumors and gossips in the market that there is some slowdown in VCSEL demand for certain end applications.

Veysel Taze – ODDO BHF

And then on another LED customer of yours, OSRAM which I am not following. I was thinking that they might invest in new capacity seen in Germany as well. I don't know if you could comment on OSRAM. But did this not happen? That was kind of expectations also for first half to see some LED demand coming from this customer. What happened on this side?

A - Bernd Schulte

You're quite right, we are not able to comment on specific customers. Please accept that we cannot make a statement. But I would suggest you may ask OSRAM directly.

Veysel Taze – ODDO BHF

Okay, yes. Fair enough. And on the service business in Q1, it was €12 million quarterly revenues. Is that a reasonable level for the rest of the year? Because it's a stable business or were there some extra one-offs or something?

A - Bernd Schulte

Well, we have typically in the range between €10 million to €12 million after sales business. This is a very typical range here.

Andrew Gardiner – Barclays

I was interested in some of the comments you made, Felix, regarding the supply chain and the potential tightness of certain components across the semi equipment chain. And just sort of comparing that to how you're framing to 2018 guidance.

Are you suggesting now that €260 million, the top end of that range, regardless of where orders may be in the next three months or so, that really is a sort of a physical limit, not perhaps so from your manufacturing standpoint, but just in terms of sourcing its components, and so it wouldn't be prudent for us to be thinking of revenue beyond that, just from sourcing point of view?

A - Felix Grawert

No, that was not quite the message. So the message was, first of all, we will be close to the top of our revenue guidance. That was the first message. And the message I was giving regarding the operational topics was that we **do not have** limitations with respect to output, neither with respect to our manufacturing capabilities nor with respect to our supply base. But rather, that we are managing this very carefully in order to be able to deliver according to our customers' requirements and to the guidance that we had given. And we have this on our radar and therefore we are able to ship despite the strongly increased outputs. That is the message.

A - Bernd Schulte

Maybe, Andrew, let me add on here. I think Felix's presentation was just to say the opposite of what you are referring. We have been asked of where our limits are and please keep in mind that 6, 7 years ago when we had the LED boom, we were shipping 100 to 150 reactors per quarter. The capability of our very flexible manufacturing concept allows us to ramp as needed by the market. Of course, there are always challenges while ramping. But giving credit to our operational team - we are able to manage those challenges.

Andrew Gardiner – Barclays

Understood. I certainly appreciate on your side, your people, you clearly have that capacity. As you suggested, you've demonstrated that in the past. I was interested in the tightness of the supply chain and how much room for flexibility you have, if you are catering to some interesting markets at the moment, if orders were indeed there over the next quarter so, what is the theoretical revenue number for this year that you could deliver?

A - Felix Grawert

It is being monitored and managed, so the message to you is that whatever orders comes, it will be shipped.

Andrew Gardiner – Barclays

Okay. Fair enough. So another one just on Opto. What are your lead customers? IQE has been pretty clear about their sort of ordering and installation pattern, I think we can assume that they've taken a reasonable number of revenues you are recognizing in the quarter.

I was wondering beyond that, elsewhere within the Opto space, can you give us a sense as to regionally, where the shipments are? There're a lot of noises about Taiwanese or Chinese customers trying to ramp their own capabilities in this area, perhaps initially R&D, but ultimately for commercial volumes. Can you give us sort of a comment on the breadth of demand that you're seeing there?

A - Bernd Schulte

So for Optoelectronics application, we have a very broad stretch from the regional perspective. So we're seeing orders, request, et cetera, and sales into Europe. You mentioned one customer, but also the United States, Taiwan, as well as China. They are on different levels. So as far as we can see, different level of qualifications with end customers. But definitely, the interest and our business goes into a very broad regional space.

Janardan Menon - Liberum

Just to go back to your potential peak revenues for the year, again, maybe I ask it one last time in a different way. If theoretically you were to take orders of, let's say, another 70 million of equipment orders in Q2. Would it - is it theoretically possible that you would exceed €260 million of the revenue for the full year this year?

A - Bernd Schulte

In principle, I think this is what Felix tried to mention. From what we see in terms of orders, which is a reasonable assumption, we have no concerns that we can serve these orders and shipments this year.

Janardan Menon - Liberum

Understood. And then just moving on to your OLED business, can you just give us an update? You did give us quite a bit of an update on your capital markets day recently. But are we still on track that if the customer is happy with the way the Gen2 system is going, we're looking in order for a larger development system by the end of the year? And if so, would that also be included in your order trend or because it's a development system, will you keep it out of that?

A - Felix Grawert

As mentioned, the status is unchanged, yet making good progress since we last met and also since the last earnings call in February. The Gen2 tool has been set up and is being tested. And we expect this tool to be moved in the customer facility. You know, it's about the tool to pass the qualification and for that it will be thoroughly tested. Based on those tests, the customer will make his decision.

Janardan Menon - Liberum

And if it is a decision for another system, would that be included in your order book in the same half year, if does comes in the second half?

A - Bernd Schulte

We have not considered such an OLED system order in our order guidance of €230~260m, whatever size it might be.

Janardan Menon - Liberum

Understood. And just lastly, can you give us on guidance for your tax rate going forward? You took a tax benefit in the quarter, but what should we be modeling as an ongoing tax rate for the business?

A - Charles Russell

I think an ongoing tax rate for the business you should be modeling somewhere in the range 15% to 20%. Because we have tax to pay in some of the other countries apart from Germany and we also have to pay some tax in Germany. So 15% to 20%, maybe at the lower end of that range.

Juergen Wagner – Main First
A follow-up on OLED. You have two discussions on this with your customer that you said is progressing well. And the second one is with your potential joint venture partner, and how is this going? And when should we expect a decision?

A - Felix Grawert
This discussion is also progressing well, but not concluded yet. Such joint venture discussions need to cover many aspects. And these aspects, if you really want to fully argue everything out - that simply takes some time. This is why it continues. We do not want to forecast now when it is concluded, it will be done when both sides have achieved an excellent win-win result that makes this business together successful.

Juergen Wagner – Main First
But you could serve this follow-up R&D order with your customer without having concluded joint venture talks, is that right? Or do you have a Plan B thing, and you do it on your own or?

A - Felix Grawert
There is no dependency of the operational follow-on order on having concluded the joint venture discussions. However, for the longer term, the objective is to close the joint venture and come together with a partner. But it's not a limiting factor for anything in the near term.

Juergen Wagner – Main First
Okay. And the second question, as you mentioned in your prepared remarks, VCSEL is driving sales closer to €260 million this year. How much of that revenue number will be VCSEL equipment?

A - Bernd Schulte
We do not specify this in detail. What we have said is that we had very good Opto related sales in Q1. Together with our strong order intake in Q1, which was dominated by laser applications, we have the confidence that we'll be closer to the upper end of the guidance. But we do not give a breakdown of the applications. We will share this for the year end results in February next year.

Guenther Hollfelder – Baader Helvea
Just some follow-up questions. One on the order intake dominated by Opto. You disclosed that Opto sales accounted for around 70% in the first quarter. It was similar in the order intake level that was what you were indicating?

A - Bernd Schulte
It's not far away.

Guenther Hollfelder – Baader Helvea
And given the size of the orders and the number of tools, can you comment on what was the largest order you had in the first quarter and then how many tools it was? It's to get an idea how this structure is behind this large order number.

A - Bernd Schulte
We mentioned before in the previous call. In laser, you have a different order behaviors than in LED. Laser, typically, customers order smaller/single-digit numbers of tools. Sometimes they order one by one, others maybe up to five. This is the maximum we have seen so far in terms of individual orders.

Guenther Hollfelder – Baader Helvea
Then one follow-up on your comments on the gross margin in second quarter. If you're saying this higher share of Opto also in the order intake, shouldn't this positively impact on the gross margin continued then in the second quarter or other shipments more in the second half of the year?

A - Bernd Schulte
The point that I try to make is that we will see fluctuations quarter-to-quarter. It depends where the majority of shipments into what applications are going. As Q1 was strongly influenced by shipments into the lasers business, we had a very favorable product mix. Therefore, with the 43% we've been clearly above our guided range.

Nevertheless, by saying that we will stay within the guided gross margin range, you can assume that there will be quarters with lower gross margins than in the first quarter. That's all we want to say. So don't expect 43% for the rest of the year. There will be quarters where we will be below that.

Guenther Hollfelder – Baader Helvea
And the last question on the OLED follow-up question. What's your visibility regarding the timing of the OLEDs tool being moved to the customer's facility? Is there a technology trigger or is it more timing?

A - Felix Grawert
It is essentially a technology trigger. As we mentioned in the February earnings call, the tool is being set up and tested, and it's tested together with our customer, as mentioned before. And when these tests and modifications reach a certain maturity level that is then a technical trigger point for the tool to move into the customer's facility.

Malte Schaumann – Warburg
My questions have been answered.

Guido Pickert
This concludes our Q1-2018 results conference call. We are looking forward welcoming again to our next result conference call for H1 on July 26. Thank you very much.