AIXTRON SE

Analyst Earnings Conference Call

Q1 2017 Results
April 2017

Prepared Remarks

Kim Schindelhauer, CEO

Charles Russell, CAO

Dr. Bernd Schulte, COO

The spoken word applies

Slide 1, 2 – Operator & Forward-Looking Statements

Operator

Good morning, ladies and gentlemen, and welcome to AIXTRON's Q1/2017 results conference call. Please note that today's call is being recorded. Let me now hand you over to Mr. Guido Pickert, Director of Investor Relations & Corporate Communications at AIXTRON, for opening remarks and introductions.

Guido Pickert

Director of Investor Relations & Corporate Communications

Thank you, operator. Let me start by welcoming you all to AIXTRON's Q1/2017 results conference call. Thank you for attending today's call.

My name is Guido Pickert, Director of Investor Relations at AIXTRON SE. I'd like to welcome our CEO Kim Schindelhauer as well as our CAO Charles Russell and COO Dr. Bernd Schulte.

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.

As with previous results conference calls, I trust that all participants have our results presentation slides, page 2 of which contains the usual SafeHarbor statement. I will therefore not read it out loud, but would like to point out that it 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.

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 Kim Schindelhauer, AIXTRON's CEO for opening remarks.

AIXTRON

Slide 3, 4 – Q1 Important Events, Guidance

Kim Schindelhauer

CEO

Ladies and Gentlemen, on behalf of AIXTRON's Executive Board, let me welcome you to the presentation of our Q1/2017 results. My name is Kim Schindelhauer. I am the CEO of AIXTRON since March 1st. I am with the company since 25 years, initially as member of the Executive Board and for the last 15 years as Chairman of the Supervisory Board. It is a pleasure to be back on the Board in an operational function and together with my colleague on the Executive Board, Dr. Bernd Schulte, I will guide AIXTRON into the next phase after the non-successful takeover by Fujian Grand Chip last year.

Bernd will give you an update on our technology portfolio and the expected developments in 2017.

Also with us today is our Chief Accounting Officer Charles Russell, who has been with the company for more than a decade. He is responsible for accounting and financial reporting within AIXTRON. Charles will go through the results with you and answer your related questions.

Before that, let me highlight some key results from Q1. SLIDE 3.

With an order intake of 61.9m Euros in Q1 we had another strong quarter. We have booked revenues of 53.6m Euros and an EBIT of -12.7m Euros. Included in this number are extraordinary write downs in the amount of 6.6m Euros which results in an adjusted EBIT before extraordinary write downs of -6.1m Euros. This gives us confidence to achieve our previously communicated 2017 guidance for revenues and orders.

Longtime low inventory levels of 49.9m Euros and as well as reduced operational and Capex spending led to a Free Cash Flow of 33.3m Euros and to the group cash position of 193.6m Euros. A significant improvement compared to prior quarters.

Charles will go into more details on this.

I would like to share some additional important events in Q1 with you.

We received a purchase order from a large Asian display manufacturer for an OVPD deposition R&D tool, due for delivery in Q4/2017. This is an important milestone in our OLED development program.

Furthermore, the delisting from NASDAQ and the deregistration from the SEC were completed.

As of March 20th, AIXTRON was again included in the TecDAX share index of which we were excluded in December for the first time due to the low free float during the pending takeover transaction.

In addition, the U.S. Class Action suit against AIXTRON was dismissed.

Turning to SLIDE 4.

Based on our Q1 results and order intake, we reiterate our full year 2017 guidance given in February 2017 with revenues and an order intake between 180 and 210 million Euros for fiscal year 2017.

We continue to expect an improvement of the free cash flow in 2017 compared to 2016 and to achieve a positive EBIT for full year 2018.

Let me now give you some background to the previously mentioned write downs in Q1. To explain our position, I have to ask you to follow me for a second:

AIXTRON has a wide portfolio of enabling Technologies for highly diversified applications. Each application has a group of customers or a very large single customer. Each application is a completely separate market and is not competing with each other at all.

This unique market position AIXTRON has, to deliver equipment for complex material deposition into different applications and/or markets, by building on the same core know how, provides unusual growth opportunities for the company.

The negative side of this unique situation is that for each of these future applications, significant R&D funding is required. And the absolute amount of R&D is rising as well.

One solution would be to focus on less application and spend less R&D to make the company profitable rather quickly.

It is unquestionable that the deposition of complex materials will be the future and AIXTRON will be the only company to focus its entire know how towards that and support the relevant customers and market as per their requirements.

We made the decision to continue our activities in these future markets but with a more focused approach. We will organize our portfolio for future technologies and transfer them it into defined independent units. For each unit we will select technology partners at an early stage of the development to provide the required resources. These partnerships, which could be investments in R&D as well as joint ventures, will focus on the specific requirements needed.

This year, we will review all development programs and select solution in order to focus our R&D spending. This will lead to a sustainable profitability and growth of the group in the following years.

As the first step of focusing our R&D spending, we froze our product development for III-V-Materials for future generation logic chips (TFOS). This led to an extraordinary write down of assets in the amount of 6.6m Euros. We will not spend further R&D until a firm timeline for the introduction of this material application has been set and a partner was found to cover the required developments expenses.

We are of course fully committed to support our customers to introduce TFOS materials to the market once this will happen.

At this point; let me now hand you over to Charles who will give a detailed overview of Q1 results.

Slide 5, 6, 7, 8 – Key Financials Q1/2017, P&L, Cash Flow, Balance Sheet

Charles Russell

Chief Accounting Officer

Thank you Kim and hello to everyone.

Turning to slide 5, let me start by saying that Q1 was in many ways a reasonable quarter thanks largely to a very strong order intake at 61.9m Euros which was up 39% on the 44.4m Euros we generated in the same quarter last year. This year-on-year growth means that we ended the first quarter with a solid order backlog totaling 85.9m Euros. We also improved profitability compared to the first quarter last year despite a 6.6m Euro write off we decided to make for our assets in the area of our Three-Five-on-Silicon or TFOS activities. Also on the positive side, we generated a Free Cash Flow of 33.3m Euros largely because of reductions in working capital. However, earnings remained negative in the first quarter with net income coming in at -13.5m Euros.

Moving to the next slide, let me take you through the income statement for Q1.

Total revenues recorded during the first quarter of 2017 of 53.6m Euros, were up from 21.4m Euros in the same period last year. We also improved our gross margin by 10 pps from 15% in Q1 last year to 25% in Q1/2017 and it would have been 27% had we not written off 1m Euros of TFOS inventory assets in the first quarter.

Operating expenses totaled 26.4m Euros in Q1/2017 which were higher than Q1/2016 mainly due to higher R&D expenses including a 5.6m Euro write down related to our TFOS activities. Otherwise R&D spending would have been at a normal level of 14.1m Euros.

EBIT for the first quarter came in at -12.7m Euros which was an improvement over the -14.7m Euros of Q1/2016. If we exclude the 6.6m Euro write down, the improvement was more pronounced with adjusted EBIT coming in at -6.1m. The net result for Q1/2017 was -13.5m Euros which was a slight improvement over the -15.5m Euros in the first quarter last year.

As you can see – the fourth quarter of 2016, with around half of 2016 annual revenues, was an extraordinary quarter both in terms of revenues and earnings which therefore makes it difficult to compare.

Moving to slide 7, which shows our cash flow statement for the first quarter.

We had a particularly good quarter in terms of cash flows due to in large part a strong positive operating cash flow of 34.6m Euros mainly resulting from collections of accounts receivable and an increase in advance payments from customers for new orders. The overall result was that we generated a total cash flow of 33.6m Euros in Q1 2017. As a consequence our cash balances have increased from 160.1m Euros at the end of last year to 193.6m Euros at the end of Q1/2017.

Turning to the next slide – our Balance Sheet

AIXTRON continues to have a solid balance sheet with equity of 356.7m Euros, cash of 193.6m Euros and no debt.

I want to elaborate on two things, inventories and customer advance payments. Firstly, inventories which at 49.9m Euros were a clear reflection of the good work we are doing around inventory management. Secondly, advance payments from customers increased by to 30.5m Euros as of March 31, 2017 compared to 26.1m Euros at the end of last year, reflecting the strong order intake recorded in Q1/2017.

Now let me hand you over to Bernd who will talk about our technology portfolio on slide 9.

Slide 9 – Technologies

Dr. Bernd Schulte

COO

Thank you Charles and a warm welcome to everybody.

As mentioned before – we had a good quarter with strong orders, backlog and revenues. And we have reached an important milestone for our OVPD technology for the deposition of organic material with the order we have secured.

In Q1, Gartner has confirmed what we have already anticipated: We have been the global number one supplier for MOCVD Equipment in 2016 with a 55% market share.

On our last conference call I mentioned that AIXTRON technologies are enablers for mega tech trends including the move to renewable energy and the electrification of transportation. Both of which require higher amounts of semiconductor components and in many cases new materials to make those components possible. To that add 5G mobile connectivity, autonomous driving and the Internet of Things all of which require millions of sensors and other semiconductor products. As I said before, our deposition technologies will be strong enablers of these future semiconductor products which will represent a solid demand for us.

In order to benefit from these mega tech trends we need to stay close to our customers to be ready with our technology when our customers need them. As usual in new and complex technologies, some of this timing is not fully clear yet.

We are committed to supporting our customers once a firm timeline has been announced. However, in case such technology roadmaps are not firming up we have to be tough on ourselves how to focus our internal resources. This is exactly the situation with TFOS. We are convinced these materials will be required in the future but we are not sure exactly when they will penetrate the market. Against this background, we made the decision to freeze our activities in this area with one-time costs this year and savings expected in

2018. As soon as we see progress on the market side we can intensify our efforts, however, only if the market pays for it.

This is a first example how we want to focus our R&D spending going forward. In the next steps we are evaluating potential partnerships to strengthen the position of our product portfolio as Kim described. These activities are one of our major focus areas this year and we will give you more information on our progress in future conference calls.

With that I thank you for your attention and we are now looking forward answering your questions.

Guido Pickert

Director of Investor Relations & Corporate Communications

Thank you, Kim, Charles and Bernd.

Operator, we'll now take the questions.

Q - David Mulholland - UBS - Analyst

Firstly, obviously, good to see some action on the cost side of the business but I wonder if you could just give us some guidance on -- now that you've paused the investment in TFOS, what should we expect in terms of R&D or even total OpEx for the full year? And then secondly, bookings trends continue to be quite strong in Q1. How do you see the pipeline through the rest of the year? Can we carry on at these levels or I guess how do you see the outlook for bookings in Q2, Q3?

A - Kim Schindelhauer

To the TFOS situation on the full year basis, we are planning with a saving of EUR 9 million to EUR 10 million. Bernd, maybe you can say something to the other part of the question?

A- Bernd Schulte

The ordering levels are quite solid right now and in short term and we are seeing this potentially continuing. However, in our business, the possibilities to look further ahead than one quarter is quite difficult. In general, as Kim mentioned, we have confirmed our guidance, and with that, mathematically you can see that we are relatively positive going forward.

Q - David Mulholland - UBS - Analyst

Great. And maybe one quick follow-up on the OLED side. Obviously, I know you probably can't specify who the customer is, but is it fair to assume that this is someone that's already active in OLED display? And could you possibly just give us a bit of background, had you gone through the full process with this customer at your own site last year that then led to this order? Maybe just a bit more color on the strength of the relationship with the Asian OLED display manufacturer?

A- Bernd Schulte

You can be sure that is a customer who is already engaged in OLED manufacturing. And I think we have been mentioning in previous calls that this program goes through 3 major stages. So this is the second stage where we, with the customer together, target to prove the feasibility for high-volume manufacturing. It's for high-volume manufacturing but on a smaller substrate size level. The first step was showing the feasibility of the technology in general. Now we are at the second step. And of course the third step would be doing this all together on higher volume manufacturing and a larger substrate size.

Q - Jürgen Wagner - MainFirst Bank AG - Analyst

Now post the R&D on the project freeze in TFOS, what would be a breakeven sales level in 2018? And the second question, what is your view on the GaN LED market, particularly in China? There is some reports that the competitive pressure increased. Or do you see an improvement in the market?

A- Bernd Schulte

Indeed, there are certain movements in the competitive situation in China. You probably have heard that Chinese MOCVD suppliers are in the process of getting qualified with Chinese customers. What we are hearing from the market, that they may step forward and are now even taking orders on a significant level and you can imagine that this changes the landscape quite significant in the market, in particular, when you consider that Chinese competitors have an even more aggressive pricing behavior than in the past.

So we are focusing our product portfolio in areas where we can play our unique selling points, and as such, we can achieve reasonable margins for our products. We are definitely looking in particular in the area of LED in China, but also elsewhere, in particular on specialty LED applications, where high yield performances are acknowledged. We are also seeing good opportunities and good development in the area of red-orange-yellow LEDs in China.

A- Charles Russell

In terms of a breakeven, if you look at the quarter that we have just reported, we have an adjusted EBIT of EUR 6.1 million negative and a gross margin of 25%. In Q1, we've had some low-margin sales, as we previously said in the Q4 conference call about AIX R6. We have to get the remainder of those out of the pipeline, then the margin should improve slightly. I would think a breakeven is somewhere around EUR 65 million every quarter.

Q - Jürgen Wagner - MainFirst Bank AG - Analyst

Okay. And that is the level also for next year to look at?

A - Kim Schindelhauer

Well, that might change if we consider any further actions on our R&D spending.

Q - Jürgen Wagner - MainFirst Bank AG - Analyst

But at the moment?

A - Kim Schindelhauer

Based on the current situation that is correct.

Q- Gunther Hollfelder - Baader-Helvea - Analyst

First question is on the AIX R6 sales. So for the inventory sales, has this now been completed with the first quarter or do you expect additional sales later this year?

A- Charles Russell

We still have additional sales to clear from backlog during the remaining quarters of this year. And then I hope we should be done with the AIX R6 inventories. So you could expect that the margins in the subsequent quarters may still be (rather) depressed by that.

Q- Gunther Hollfelder - Baader-Helvea - Analyst

Okay. You also mentioned the situation in China, and you're focusing increasingly on, for example, red-orange-yellow LEDs. So given, let's say, less strategic importance for

Thomas Swan and the Showerhead technology going forward, is there any potential here for to lower cost here from this perspective?

A- Bernd Schulte

We continue to regard the showerhead technology as a very important part of our product portfolio. In general, the showerhead technology in terms of manufacturing cost of the product is not much different to our planetary. What I tried to say is, we are looking into areas where we can use our strength of our products and there where the market acknowledges those strengths and pays for it. That could include the planetary but the Showerhead as well.

Q- Gunther Hollfelder - Baader-Helvea - Analyst

Okay. And then the last question on the memory CapEx environment. Last year, your sales were mainly related to CVD systems and for the NAND flash market. We've recently seen a recovery also in DRAM related CapEx. So do you have any visibility or do you expect a recovery of your DRAM related like LED sales here this year?

A- Bernd Schulte

We expect a slight improvement but not a big improvement in terms of QXP ALD sales for DRAM. The good news is we're seeing still this very healthy momentum for flash-memory to continue and we are seeing very good inquiry levels from our customer for the CVD tools to continue at least for the first half of the year

Q- Gunther Hollfelder - Baader-Helvea - Analyst

And business for your QXP tool, would this be triggered by a new process node or what would be a trigger to get more sales related to the QXP?

A- Bernd Schulte

This would be triggered, number one, of course, being qualified with further films at various customers; also when our existing customers increase their investment into DRAM. Sooner or later, this is going to happen.

Q- Thomas Becker - Commerzbank - Analyst

Just a quick one with respect to the positive EBIT you are targeting for 2018. So is this based on the current, let's call it, TFOS restructuring measures, or is this already anticipating more to come? And the second question is with respect to cash. You had quite a healthy cash level and you mentioned in Q1 that inventories are at a 10-year low level. So let's say, given the reversal in the next quarter as more normalization, I guess, what you think will be the cash level at the end of the year? What's your target there?

A- Charles Russell

In terms of the cash, the guidance we have given is that our free cash flow will be better than 2016, but given that 2016 was minus EUR 40 something million and we're plus EUR 34 million at the moment, I think we will be considerably better than last year. I wouldn't like to give a guidance to the cash balance at the end of the year because that depends on the timing of sales, timing of collections. The inventories that we still have for AIX R6 should reduce over the next few quarters. So on the basis that other things stay the same and that may or may not be the case, then you would expect the inventory levels to stay roughly the same or perhaps, even improve slightly, but it depends on whether we get a large number of orders or whether we're making things in advance for customers perhaps for OLED or others.

The EBIT for 2018, we don't expect to be in the same structural position in 2018 that we are now, so it's based on the assumption that in 2018, we have a different structure, but we're not entirely sure what that is at the moment because we are looking for partners and we need to agree those structures with the partners. So we think on our best estimate that we will be breakeven or profitable next year, but we can't say definitively what the structure is.

Q- Thomas Becker - Commerzbank - Analyst

Okay. So this means that what you have done to TFOS is not, let's say, the only thing which will happen then going forward. So your positive EBIT is also based on other measures to come to be announced?

A- Bernd Schulte

Yes, this is what Kim Schindelhauer said.

Q- Thomas Becker - Commerzbank - Analyst

Okay. Last question from my side is, would you rule out that given the order you received for your OLED program, that the OLED program per se is still under evaluation? So would you, let's say, rule out that the same thing like which happened to TFOS could happen to OLED as well, or is this now in the safe zone, after you again received admittedly probably small order for OLED?

A- Bernd Schulte

Generally, we always consider and evaluate our technologies, so we never rule anything out. But it has been an important step and if we can continue the pace and if we find the appropriate financial model to go forward, this is exactly what we are working on within the next months and we will keep you updated as soon as we can be more definitive in the actions we will take.

Q- Charles Lepetitpas - Natixis S.A - Analyst

I had just one question. I understand that your 2018 guidance on EBIT value is based on finding new partners for your technology parts for you. I wonder whether you have already found one of several of these partners or not yet, and if you expect to find such partners during the next quarter?

A - Kim Schindelhauer

We are definitely looking for partners. We do not have any concrete partners yet, but there are a lot of interesting scenarios and we will evaluate them as they come along. And then I think for 2018, when we will have more clarity on structure than today. Because I think, as we all know from the P&L, a major item is really the R&D spending for future technologies. We don’t want to give up these technologies, but we also don't want to continue losses as said before. However, we have some interesting ideas and we will execute them going forward.

Q - David Mulholland - UBS - Analyst

Just a quick follow-up. On the receivable side obviously, a very low level in Q1, sitting on the balance sheet and you mentioned part of that was due to work internally on managing the cash flow of the business, but is this a sustainable level? Have something fundamentally changed on the kind of agreements you are doing with customers in payment terms? Or is this at a temporary level and things normalize in Q2?

A- Charles Russell

With MOCVD, we do see the advanced payments from customers with the order and that's different from most semiconductor equipment manufacturers. So AIXTRON has in the past always had relatively low receivables days. I think it's around 50 at the end of March 2017 and that has been the sort of normal level over the past decade.

Q - David Mulholland - UBS - Analyst

Okay. So to summarize, you would say it's still quite sustainable at this level?

A- Charles Russell

The receivables days, yes.

Guido Pickert

Well then, thank you very much to all listeners and questioners for your questions. Have a good day, and we will be still available for further questions, if you have any. Bye bye.