

## Q4 2018 Earnings Call

### Company Participants

- Peter T. F. M. Wennink, President, CEO & Chairman of the Management Board

### Other Participants

- Leo de Later, Analyst

### Questions And Answers

#### Q - Leo de Later

Mr. Wennink, ASML showed a good Fourth Quarter. What are the highlights?

#### A - Peter T. F. M. Wennink {BIO 1852674 <GO>}

Yes. The quarter was good. I think we had sales that exceeded our expectations, or at least our guidance. That was because we pulled some system in from Q1 to Q4, which led to a EUR 3.1 billion sales number. Gross margin was good, 48.5%. However, we -- a few days before the results, we reached an initial settlement with Nikon on a year-long IP infringement court case and we settled with them. And we provided (another EUR 30 million) of cost, which actually brings down the gross margin. We charge this to the gross margin, brings it down to 44.3%. Now if we look at that, net income for the quarter, EUR 900 million. And if we take into account the Nikon settlement, EUR 788 million.

#### Q - Leo de Later

Anyhow, you report another record year. How would you summarize 2018?

#### A - Peter T. F. M. Wennink {BIO 1852674 <GO>}

I think 2018 is a very good year. I mean, in 2018, we actually reached our EUR 11 billion target -- almost our EUR 11 billion target that we set for 2020, which is very good. That actually means that net income was EUR 2.7 billion. However, because of the Nikon settlement, we had to take the provision -- or we wanted to take a provision for EUR 130 million, which brings the net income to EUR 2.6 billion. Gross margin, 47%. With the Nikon settlement, that goes down to 46%. But all in all, if you look at this from a financial point of view, very good. Now having said that, I think the biggest achievement is not on the financial ones. The biggest achievements, I think, in 2018 were the technological breakthroughs that we had in EUV, DPV business, application business. So we're very well positioned for further growth in the next couple of years.

#### Q - Leo de Later

Let's have a look at EUV. How are you progressing with EUV?

**A - Peter T. F. M. Wennink** {BIO 1852674 <GO>}

When you think about EUV in 2018, I can tell you anything about technological progress, which I will do. But really the most important here is that it's the acknowledgment of the customers that EUV is there to be used in high volume production. So all our major customers are planning EUV in high volume production. And they're very vocal about this. I mean, in their public statements on the next generation, they talk about EUV, whether it's for N7+, N5, L7, it is EUV. So why is that? And it's actually evidenced by the fact that when we look at our order book, it contains more systems -- more unit systems than our planned shipments for 2019. So that's very good. And why is that? I think it's really because we made some technological breakthroughs. We actually are over 250 watt power in our current systems. It brings us over 145 wafers per hour, where we initially planned 125. We pulled the development of the 3400C in, which gives more transparency and more wafers per hour, over 170 wafers per hour. If you take that all together, that explains the confidence of the customers to say EUV will happen and we're going to put this into high volume production.

**Q - Leo de Later**

Are there already gadgets that have chips that are made on EUV systems?

**A - Peter T. F. M. Wennink** {BIO 1852674 <GO>}

Well you will see the first high-end applications being built with devices and chips that will be made on our EUV systems in the second half of this year. Yes.

**Q - Leo de Later**

Let's have a look at the semiconductor markets. There is considerable uncertainty in the market. What's your take on the semiconductor market at present?

**A - Peter T. F. M. Wennink** {BIO 1852674 <GO>}

Yes. It's undeniable that we have a concern, a certain weakness in the market right now. I think it's primarily driven by the fact that we see certain patches of the economy cooling. China, for instance. We have geopolitical tensions, the fear of trade war. We have local fears like the Brexit. And everything together leads to, I think, a slowing demand for end products, which also reflects on semiconductors. And that's what we have seen. And I think we've seen that trend developing in the second half of 2018. But at ASML, we really notice it very close to year-end, we saw customers coming, both Memory and Logic customers that actually said the market is clearly showing signs of slowing and some weakness. And they decided to push out some of the H1, the first half 2019 shipments, into the second half. That is both for Memory and for Logic customers. And that has happened. Now, if we look at that. And we would split that into the business segments: NAND, there is some overcapacity, it's not a surprise. It was already there also last quarter. We saw the 2D to 3D transition has happened. Yield improvements are clear. There was a lot of investments done over the last two years. So digestion period, that is clear. DRAM. I think DRAM, you very clearly see a slower end demand for bits. That has to do with, for instance, the mobile market is slowing because of the economic situation. You see some slower uptick in the server market. So that is where DRAM demand -- the end demand seems to slow, which will not only happen now. But I think it will continue in Q1 and Q2.

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On Logic, Logic is also a victim, you could say, of some slowdown in the mobile phone space. But if you really look at Logic from our point of view, there's quite a significant growth profile in 2019 for Logic. And as also mentioned by our customers, there's very strong demand for the next-generation chips. So for the N7+ chips, for N5, for N10 and that all needs EUV also and a lot of immersion. So from a Logic point of view, the market is strong for us. Now I'd like to summarize 2019 as follows: if you look at the business segments, I think Memory, 2019 as compared to 2018, were probably just over 20% lower than in 2018. For Logic, however, I think Logic for 2019 as compared to 2018, we see around a 50% increase for the demand for our systems, yes? And on installed base management, it's going to be single digit. Also, because you see a slowdown in the industry. So some of the upgrades that we're currently planning, probably a little bit later. All in all, if you add that up and you compare 2018 and '19, we see growth. 2019 is going to be a growth year.

### **Q - Leo de Later**

Regarding 2019, can you give a sense of the impact of the fire at one of your suppliers, Prodrive, in December last year?

### **A - Peter T. F. M. Wennink {BIO 1852674 <GO>}**

Yes. I mean, that happened in December last year, very unfortunate. At that fire, the work in process and part of the inventory were actually -- they actually were gone. Now that cycle time to start up that production, it was a work in process and to get to an output is about a quarter. So this is why we see about a quarter delay. It's about EUR 300 million of impact that we see in the First Quarter, which we will recuperate largely in Q2. But that's what it is.

### **Q - Leo de Later**

Yes. And how does this translate in ASML's sales First Quarter. But also for the full year?

### **A - Peter T. F. M. Wennink {BIO 1852674 <GO>}**

The full year's going to be very good, really driven by strong Logic demand. The First Quarter will be light and it will be light because, just like I've just mentioned, we have about a EUR 300 million impact of the fire at one of our suppliers, which actually pushes some of those shipments into Q2. One of the reasons for the lightness in Q1 is the pull-in that we saw in Q4 of 2018 of some of our systems that we planned for Q1 and the push-outs that are starting to push to the second half of 2019. Now looking at that and looking at the first half, I think those trends that I just mentioned for Q1, I think they will also be visible in Q2. But we see a very strong correction and uptick in the second half of 2019. So it's going to be a year that is really skewed towards the second half. And I think if you would compare the first half of 2019 with the second half of 2018, it will be a lower number, yes, a lower sales number. And that difference, that reduction in sales, is evenly split between Memory and Logic.

### **Q - Leo de Later**

Has this also -- also with the fact that you report a lower guidance on your gross margin?

**A - Peter T. F. M. Wennink** {BIO 1852674 <GO>}

The gross margin is a reflection of the light sales number, yes? And I think, specifically, there are -- I think there are 3 reasons also. One, of course, lower sales. With this supplier accident that has actually happened, we have to push some of the higher-margin systems to Q2 and beyond. Upgrades, we'd like to use the components to build new systems and we push upgrades to the second half of the year. Those are high-margin products that we planned for Q1, which, of course, are now pushed back. Next to that, of course, lower sales means a lower load in the factory. So the factory utilization is going down. And the third very important item is that we have invested very strongly in our service infrastructure. Our customers will ramp high volume EUV towards the end of the year, in the second half of this year. And that means that the service infrastructure is there and it's a big number. And with very low sales, you have a bigger relative impact of that -- still that service business that is not profitable yet on the gross margin of the First Quarter. We'll see that also in the Second Quarter. But it will recuperate in the second half. In the second half, you'll see a strong improvement of the gross margin because of higher sales, better load, the introduction of high-margin EUV systems. We'll see upgrades coming back because we will then have all the components to do the upgrades. And I think if you add that all together, you will see a gradual improvement of our gross margin from the low levels in Q1 to the end of the year where I strongly believe that we'll exit the year with gross margins which are growing towards the gross margin target of 50% in 2020.

**Q - Leo de Later**

So summarizing your story, it all has to do with temporary business conditions?

**A - Peter T. F. M. Wennink** {BIO 1852674 <GO>}

Yes. I've been with the business more than 20 years and I stopped saying this business is not cyclical. I mean, I've stopped saying that a long time ago. It will always be cyclical. If you look at the very strong capacity additions that we have had over the last couple of years, driven by very strong end demand for leading-edge products. But it's logical that at a certain moment in time when the economic tailwind is suddenly a headwind, that will be some time where we need to do a digestion. And that's happening as we speak. Now that's normal and we have had that before. But you need to really think about what does that mean for the medium; to long-term future of the company. It's very bright. I mean, there's no doubt. And you can listen to our customers, of what the benefits are of the next-generation chips, yes? Those will be significant. So we will keep investing. Even in times of slowdown, we've done this in the past and we'll do it again, we will invest in R&D or even accelerate. We need to pull EUV in. We want to make sure that those high-value products for the customer and for us will be available in 2020 and beyond. So we're going to increase our R&D from EUR 1.6 billion last year to about EUR 1.9 billion this year. And I think it's all driven by the fact that we strongly believe in what we have said at our Capital Markets Day about the prospect and the future of this company. And I think if you look at that and you translate that into our confidence, we translate that confidence into increase our dividend with 50% and I think that, all in all, is a very good thing.

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