Magnachip Semiconductor
Prepared Remarks for Q4 2020 Investor Conference Call
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Thank you for joining us to discuss Magnachip's financial results for the fourth quarter ended December 31, 2020. The fourth quarter earnings release that was filed today after the stock market closed can be found on the Company's investor relations website. A telephone replay of today's call will be available shortly after completion of the call and the webcast will be archived on our website for one year. Access information is provided in the earnings press release.

Joining me today are YJ Kim, Magnachip's chief executive officer, and Young Woo, our chief financial officer. YJ will discuss the Company's recent and annual operating performance and business overview, and Young will review financial results for the quarter and the year and provide guidance for the first quarter of 2021. There will be a Q&A session following the prepared remarks.

During the course of this conference call, we may make forward-looking statements about Magnachip's business outlook and expectations. Our forward-looking statements, and all other statements that are not historical facts, reflect our beliefs and predictions as of today and therefore are subject to risks and uncertainties as described in the Safe Harbor statement found in our SEC filings.

During the call we also will discuss non-GAAP financial measures. The non-GAAP measures are not prepared in accordance with generally accepted accounting principles but are intended to illustrate an alternative measure of Magnachip's operating performance that may be useful. A reconciliation of the non-GAAP financial measures to the most directly comparable GAAP measures can be found in our fourth quarter earnings release available on our website under the investor relations at www.magnachip.com. I now will turn the call over to YJ Kim. YJ?

YJ Kim

Hello everyone. Thank you for joining our call today!

Magnachip's Q4 results exceeded our expectations, capping off one of the most challenging years for any of us. During Q4, demand for Magnachip's products remained robust driven by a strong ramp in 5G. More importantly, we were able to secure more supplies from foundry partners for OLED products, as well as from our internal Fab 3 for the power products. We achieved $142.9 million in revenue and 40 cents in non-GAAP EPS. The revenue increased 14.5% sequentially and 15.9% Year over Year (YoY), and it surpassed the mid-point of our Q4 2020 guidance by approximately $11 million.

There is no doubt that 2020 has presented its share of unique challenges: such as the COVID-19 pandemic, unstable global economy, and geopolitical uncertainties. Nevertheless, for Magnachip, 2020 was a remarkable year of structural transformation. Among the highlights are:

1. Our adjusted operating income and Adj EBITDA increased 36.7% and 29.3% from 2019, respectively. The revenue decreased 2.6% YoY due mainly to our exit from the non-auto LCD business. If we compare apples-to-apples, our 2020 revenue grew 2.7%.
2. GAAP gross profit margin of 25.3% represented a 290-basis point increase from 2019 as we improved the product mix.
3. We successfully closed the sale of our foundry business and Fab 4 for the total cash proceeds of $350.6 million, and we used $227.4 million to fully redeem the 6.625% Senior Notes due 2021. This action significantly strengthened our balance sheet. Our stockholder's equity turned positive to reach $345.6 million at the end of 2020, versus a negative $15 million in 2019.
4. We laid out our 2020 through 2023 strategic initiatives and key metrics under MX 3.0 and launched a new brand identity underscoring our fresh start as a pure-play standard products company.

It is with my profound gratitude for the dedication and tenacity of every Magnachip team member that I share the extraordinary accomplishments in 2020.

Now let's move to a detailed review of our product business, starting with the OLED Business.

During the Q4, our OLED DDIC revenue of $80.4 million set a new historical quarterly record. It surpassed the previous revenue high of $78.3 million recorded in Q3 of 2019, representing a 19% sequential increase and a 19.4%

increase YoY. For 2020, despite the 8% decline in global smartphone shipments, our OLED revenue grew 6.5% YoY to reach a new high of $284.6 million, marking the third consecutive year of achieving record annual revenue.

Let me address a couple of highlights for Q4 as well as fiscal 2020.

First, the momentum in 5G smartphones, especially with High Frame Rate (HFR) OLED DDIC grew stronger in Q4. We were awarded 8 new design wins in Q4, and all of them were 5G and HFR models. The revenue from 5G smartphones accounted for about 20% of the total OLED revenue in 1H 2020, 40% in Q3, and it reached approximately 70% in Q4, representing over 40% of our total 2020 OLED revenue.

Second, the demand for our products in a key model launched by a Korean smartphone OEM continued to increase in Q4. This key model boasts the flagship features at a desirable price point and has been gaining solid ground. In addition, the strong design momentum with smartphone OEMs based in China during Q3 drove a healthy revenue growth in Q4. During the fourth quarter, 12 new smartphone models with our chips were launched. We are encouraged by the continued adoption of our distinctive solutions by multiple end customers worldwide.

In reviewing the OLED business in 2020, our outstanding performance is a testament to the laser-focused execution of the innovative product road maps. As a case in point, our OLED design activities hit new records in 2020: We secured 38 new OLED DDIC design-wins in 2020 to reach 54 cumulative design-wins, compared to 21 new design-wins and 34 cumulative design-wins in 2019. In 2020, about 60% of the 54 cumulative design-wins were derived from the 5G and HFR smartphone models.

2020 was also marked as a year of building a solid foundation and strengthening product lineups to accelerate OLED penetration into other applications. Although we can't comment on our customers' specific plans, I can tell you that our engineering team has been very busy throughout the year engaging with the customers to develop new products in emerging technologies and applications such as OLED TV, Micro LED TV and OLED Automotive. I am happy to report that each project is moving well as planned. I look forward to updating you on the key milestones of these projects in the future.

Now, let's turn to the Power Business.

Power revenue in Q4 2020 came in at $46.9 million, up 0.4% sequentially, and up 23.9% YoY. Q4 Power revenue outperformed our expected growth of 15-20% YoY, due to the strong demand for our premium Power products including Power IC.

For the whole year of 2020, our Power revenue in 2020 was $166.5 million. It was down 5.6% YoY. Our Power revenue was significantly impacted by COVID-19 during the 1H of 2020, but it demonstrated an impressive resilience in the 2H of 2020 despite the capacity handicap caused by the power outage at our Fab 3. In fact, our 2H 2020 revenue was an all-time-half-year high since we started our Power Business in 2007.

Now, let me highlight key takeaways for our Power Business for Q4 as well as 2020.

For Q4 2020, our Power IC products continued to deliver healthy growth, driven by series of design-wins in a wide range of TV models and computing applications. Power IC revenue crossed the $10 million annual revenue threshold in 2020, and it is expected to grow over 35% in 2021. Power IC is one of the premium product families that carries a high gross profit margin, and we will continue to strive to expand this product group by targeting adjacent applications and new customers. We had three key design wins with our power IC products: two from laptop and one from SSD-related applications.

In reviewing the Power business in 2020, we started to re-establish Fab 3, our 8-inch wafer fab for power discrete semiconductors. While Fab 3 capacity will gradually increase from 2021 as we install new tools, we plan to add about 40% incremental capacity for our standard power product by the end of 2022 compared to the 2020 level. Owning a dedicated power discrete fab also plays a critical role in supporting automotive customers.

Underpinned by the sharpened R&D focus and go-to-market strategy, our Power Business introduced a series of new product families that are gaining good initial traction. The total number of new products released in 2020 more than doubled the total number for 2019, and the business pipeline of these new products is expanding. Demand for our power products remains strong, and our Fab 3 is running at full capacity.

Before I conclude the business review, let me take a few minutes to comment on the demand and supply situation. According to OMDIA market research data, the overall OLED smartphone shipment in Q1 will be down 17% from Q4 as Q1 being seasonally low. Against this backdrop, the demand for our OLED products is still relatively strong.

As it is well publicized, the overall semiconductor demand started to increase from the second half of last year, which caused supply constraints especially with our 28-nm external foundry partners. While we are leaving some demand in Q1 unmet due to supply constraints, we are working closely with our strategic customer and our foundry partners to address supply constraints, and we expect the supply situation to improve later in the quarter.

As we look at our current quarter, the demand at most of our end-markets remains very healthy against the typically low season. As we improve our supply situation, we expect to continue executing on our pure-play products strategy.

In closing, we are proud of our solid performance in Q4, and the strategy that the BOD and management set out in early 2019 has positioned the company for long-term success. During the last year, we entered MX 3.0, an exciting new chapter for growth, with a sharpened focus as a pure-play standard products company, renewed energy, and a clear mission of empowering our customers. Under MX 3.0, we set long-term financial targets that we would like to achieve by 2023. While we recognize the path will not always be a straight line, the exciting opportunities ahead of us only reinforce our confidence in our growth outlook towards 2023.

Lastly, we plan to host an Analyst Day on April 20, 2021. Our Board is committed to maximizing shareholder value, and is evaluating various options including, a holistic review of our capital allocation strategy, our target liquidity position, and our ongoing distribution framework. We recognize that the company may currently have excess liquidity. We plan to address, among other things, a comprehensive plan for our near-term capital allocation, our liquidity, leverage policy and our ongoing shareholder distribution on or before the upcoming analyst day.

Now I will turn the call over to Dr. Woo and come back for the Q&A session.

Young Woo:

Thank you, YJ, and a warm welcome to everyone on the call. Let's start with key financial metrics for fiscal 2020 and Q4.

Revenue in 2020 was $507.1 million, down 2.6% from 2019. The slight decrease was due primarily to the exit of non-auto LCD business despite the recovery from COVID 19 and 5G smartphone growth in the later part of 2020.

Display business was $299.1 million, down 3.1% from 2019. As a reference point, the non-auto LCD revenue accounted for approximately $34.5 million in 2019 and $7.9 million in 2020. Our 2020 OLED revenue set another all-time record in terms of annual revenue, representing outstanding growth three years in a row.

Turning now to Power business, revenue of $166.5 million was down 5.6% from 2019 due primarily to the impact from COVID-19 in the 1H of 2020 and Fab 3 power outage in Q3.

For the year, we made great improvement in profitability in 2020. The gross profit margin improved 290 bps year over year, and adjusted operating income margin increased to 8.2% from 5.8% in 2019. Adjusted EBITDA represented 10.4% of total revenue in 2020, compared to 7.9% in 2019. Our non-GAAP diluted earnings per share from continuing operations was 73 cents in 2020, up from 25 cents in 2019.

Now turning to Q4 results.

Total revenue in Q4 was $142.9 million, up 14.5% from Q3 and up 15.9% from Q4 a year ago. Revenue from the standard products business was $129.6 million, up 11.4% from Q3 and up 14.4% from the same quarter a year ago. Both sequential and YoY increase was driven mainly by strong demand in our OLED products especially for 5G and HFR OLED DDIC.

Display revenue in Q4 was $82.7 million, up 18.9% from Q3 and up 9.6% YoY. Adjusting for the non-auto LCD business, it was up nearly 20% YoY. Power revenue in Q4 was $46.9 million, up 0.4% sequentially and up 23.9% YoY. The significant increase YoY was due to higher demand for premium power products such as high-end MOSFETs, primarily for TV and industrial applications, and our Power IC products.

Gross profit margin in Q4 was 26.9%, up 400 basis points from Q3. As a reminder, gross profit margin in Q3 was negatively impacted by 3 percentage-points due to two unusual items in connection with the delayed recovery from the power outage of Fab 3 and the Display's excess inventory charge related to the U.S. Government's export restrictions to Huawei. Our gross profit margin also expanded 220 basis points from Q4 a year ago due primarily to product mix improvement.

Turning now to Operating Expenses. Operating expenses, including $4.4 million one-time termination charges related to the voluntary resignation program in Q4, were $29.3 million or 20.5% of total revenue as compared to 20.3% in Q3 and 20.1% for the same quarter a year ago. SG&A in Q4 was $12.6 million as compared to $12.9 million in Q3 and $13.8 million in Q4 last year. R&D in Q4 was $11.6 million as compared to $12.5 million in Q3 and $11.0 million in Q4 last year. Stock compensation charges included in operating expenses were $1.9 million in Q4, $2 million in Q3, and $4.1 million in Q4 2019.

Adjusted Operating Income in Q4 was $15.4 million, up from $8.8 million in Q3 and up from $10.1 million in Q4 a year ago.

Adjusted EBITDA in Q4 was $18.6 million, up from $11.7 million in Q3 and up from $12.8 million in Q4 a year ago.

Net income in Q4 was $66.6 million as compared with $273 million in Q3 and $23.4 million in Q4 a year ago. As we noted during the last earnings call, the sharp increase in Q3 was due to the recognition of gain on sale of the Foundry business and Fab 4. YoY increase in net income was due to the recognition of income tax benefits of $47.1 million in Q4 primarily from recognizing differences between GAAP and cash tax expense of $43.9 million. We were able to recognize such benefits based on the historical trend of taxable income in recent years and our increased confidence in forecasted taxable income based on growth opportunities as a pure-play products company after the sale of the Foundry Services Group business and Fab 4.

Our GAAP diluted earnings per share in Q4 was $1.45, as compared with $5.89 in Q3 and 54 cents in Q4 a year ago.

Our non-GAAP diluted earnings per share from continuing operations in Q4 was 40 cents, up from 14 cents in Q3 and up from 17 cents in Q4 last year. The difference between our GAAP and non-GAAP EPS was primarily due to the elimination of the one-time recognition of differences between GAAP and cash tax expense of $43.9 million and the elimination of the non-cash foreign currency gain of $13.3 million.

There were 47.1 million diluted weighted average number of shares outstanding in Q4.

Now moving to the balance sheet:

Cash was $279.9 million at the end of Q4. This compares to $542.1 million at the end of Q3 and $151.7 million at the end of 2019.

In Q4, we used $227.4 million to fully redeem the 6.625% Senior Notes due 2021 and paid a withholding tax of $20.5 million as we explained during the last earnings call.

Accounts receivable, net totaled $64.4 million, an increase of 11.5% from Q3. Our days sales outstanding for Q4 was 41 days.

Inventories, net totaled $39.0 million, an increase of 16.1% from Q3. Our average days in inventory for Q4 was 34 days.

CAPEX was $19.7 million in Q4. CAPEX of $36.1 million in 2020 included approximately $20 million of one-time investments, which is in line with the previously disclosed CAPEX plan. The $20 million also included certain one-time spending to ensure the safe management of our Fab 3, which is connected to employee health, in executing the recovery plans from the power outage in Fab 3 during the 2H 2020.

Now, let me give you a brief update on the voluntary resignation program. The total cash cost of $8.8 million have been fully paid including statutory severance and termination benefits. The program is expected to result in estimated annual cost savings of approximately $4.2 million, which will help our plan to reduce our adjusted OPEX level below 18% of revenue by 2023.

Now moving to the first quarter guidance

The COVID-19 global pandemic is not behind us and continues to reduce our forward visibility. While actual results may vary, Magnachip currently anticipates for Q1 2021:

- Revenue to be in the range of $119 million to $124 million, including about $10 million of the Transitional Fab 3 Foundry Services.
- Gross profit margin to be in the range of 25% to 27%.

With that, I will turn the call over to So-Yeon.

So-Yeon Jeong

Thank you YJ and Young. So, operator, this concludes our prepared remarks, and we will now open the call for questions.

So-Yeon Jeong – Closing Remarks

Thank you! This concludes our fourth quarter 2020 earnings conference call. Please look for details of our future events on Magnachip's Investor Relations website. Thank you for joining us today!