MagnaChip Semiconductor
Prepared Remarks for Q2 2020 Investor Conference Call
July 30, 2020

So-Yeon Jeong

Thank you for joining us to discuss MagnaChip's financial results for the second quarter ended June 30, 2020. The second 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 the 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 operating performance and business overview, and Young will review financial results for the quarter and provide guidance for the third quarter. 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 discussion 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 second 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! First of all, I would like to welcome both So-Yeon Jeong, our head of IR and Dr. Young Woo, our CFO, to their first earnings call at MagnaChip. Both will play important roles as MagnaChip opens a new chapter as a pure-play standard products company. I also want to acknowledge changes in our Board of Directors. Semiconductor veteran Mr. Camillo Martino was named Chairman in June, and Ms. Liz Chung of Microsoft Korea joined our newly expanded board in July.

During the second quarter, our team executed well and delivered excellent results. In keeping with our commitment to safety of our employees and continuity of services to our customers, we demonstrated our ability to be resilient to the impact of the COVID-19. We continue to take further steps to mitigate potential risks related to the health and safety of our employees and to the supply chain management.

Key non-GAAP financial metrics exceeded our expectations:

- Revenue for the combined businesses came in above the high end of the guidance range due to strong demand in our Power and Foundry businesses. Gross margin surpassed expectations, driven by improved product mix and higher fab utilization.

- Non-GAAP diluted earnings per share from continuing operations was 13 cents as compared to 3 cents in Q1. On a sequentially flattish revenue, our bottom line improved due to higher gross margin.

- For the 5th consecutive quarter, we generated operating cash flow. In Q2, the cash flow from operations was $36 million. At the end of the second quarter, our cash balance increased to $192.8 million, marking the highest level since the IPO in March 2011.

In addition to delivering outstanding financial results, our team has made substantial progress with the pending sale of the Foundry business and Fab 4. I am comfortable with our progress to-date, and we are working diligently to complete the remaining tasks to close this transaction. These tasks are mostly related to separating the shared R&D infrastructure and building: We are separating the IT systems, reestablishing a new IT infrastructure and a new Quality and Reliability Assurance (QRA) lab for the continuing business, relocating our OLED test and development center, and transferring Power process R&D capability from Fab 4 to Fab 3. I am proud of, and thankful, for what our team has accomplished during the quarter. Based on the progress we've made so far, we are now slightly ahead of our internal schedule, and anticipate that the transaction will likely close in the third quarter instead of our previous estimate of the September-October timeframe.

Now, let's take a closer look at the continuing business starting with the Display:
During the second quarter, we completely exited all non-auto LCD DDIC business as a part of our strategic efforts to improve profitability and sharpen focus. As a reference point, we have reported approximately $6 million of non-auto LCD revenue as recently as Q1. If we use an apples-to-apples comparison, our Q2 Display business revenue would have been 2.7% down from Q1 had we adjusted for this change.

COVID-19 negatively impacted the global smartphone market during Q1 and extended into Q2, but we performed relatively well compared to the market during the first half of 2020. According to the market data, global smartphone market declined about 20% year-over-year during the 1st half of 2020, but our OLED DDIC business was up 12.4% in the 1st half. The above-market performance was due in part to the accelerated launch schedule from some of our customers.

Our Q2 OLED DDIC revenue was $67 million, down 3.9% sequentially and down 8.3% year-over-year. Let me highlight 4 key takeaways for our Display business.

Firstly, regarding our new product launches… On our Q1 earnings call in May, we said we expected smartphone makers using our OLED drivers to launch 18 models in the 1st half, 10 models being scheduled to launch in Q2. Actually, 12 models were launched, bringing the total launch of 20 new smartphone models in the first half.

Secondly, regarding customer design wins… We won 8 new OLED DDIC design wins in Q2, including 5 based on the 28-nm manufacturing process. Our 28-nm products feature notable reduction in chip size and power consumption and continue to demonstrate strong design momentum in this growing product family.

Thirdly, regarding advanced features in 5G phones… We are expanding our high frame rate (HFR) OLED DDIC product line. We launched five HFR OLED DDIC products to date, and all of these now support 144Hz for FHD+ displays and 120Hz for QHD+ displays. Faster display response time is vital to full-featured 5G smartphones, and we are well positioned to capitalize on the booming 5G smartphone industry. Our revenue from 5G smartphone accounted for about 20% of the total OLED revenue in 1H 2020.

Finally, regarding diversification … We continue to diversify the OLED business into Automotive applications. During the second quarter, we taped out our first OLED Automotive product. Leveraging our strategic alignment with major OLED panel makers, we plan to expand our design wins for Automotive displays.

Looking ahead, while quarterly revenue may fluctuate, we remain excited about the long-term outlook for the OLED market trend and our unique position. Recently, we experienced an upswing in demand for our OLED products. This recent increase in demand is outstripping our supply capability in Q3 because of insufficient lead time. The standard lead time for our OLED products is 2.5 to 3 months.

Now, let's turn to the Power business. The total annual Power semiconductor market is approximately $45 billion, which presents us with a tremendous opportunity for longer term growth.

It is important to note that today our manufacturing process R&D was centralized in our main Fab 4 facility to support both our Fab 4 and Fab 3. With the closing of the pending Foundry transaction, Fab 3 will become as the dedicated fab for our Power business. Currently, critical product development and sizable production for Power are conducted at Fab 4. Therefore, we will now be transferring all of our Power process R&D to Fab 3 and plan to equip the fab to continue supporting our customers seamlessly. We also strengthened our Power business leadership recently by hiring a 35+ year veteran of power semis as the General Manager. Our Power business remains an essential part of our longer-term growth and diversification strategy.

Now let's talk about our Power business in Q2:

1. Power revenue experienced a strong rebound from Q2 as China showed some signs of recovery from the global pandemic. The revenue came in at $39.8 million, up 20% sequentially and down 16.7% year-over-year. We saw a pent-up demand for our MV

MOSFET products driven by the increased popularity of personal transportation such as e-bike and e-motorcycles in China.

2. We are seeing growing momentum with our Power IC product line. Our Power IC for one of the applications in the solid-state drive is gaining traction at a global memory company, and we are expanding our Power IC lineup to serve notebook PC and smartphone applications in addition to TV applications.

3. During Q2, we saw design-in and design win activities across MV MOSFET, BatteryFET, Super Junction MOSFET and Power IC product lines addressing a wide range of applications. We are encouraged by a growing design pipeline in Power business.

Turning to the Foundry Services Group:
Foundry Services Group revenue was $95.8 million, the highest recorded revenue on 8-inch lines since the IPO. Revenue was up 11% sequentially and up 31% year-over-year, driven by the surge in demand for work-from-home related products, as the result of the COVID-19 pandemic.

Now, let's talk about our strategic transition:
The sale of our Foundry business and Fab 4 allows us to transform into a streamlined, pure-play products company focused on the attractive Display and Power markets. While we can't be immune to the risk of macroeconomic conditions, we are fundamentally resetting

our business model, and I would like to share with you our key goals that we are targeting to achieve by 2023:

First, **profitable revenue growth.** For Display, we will ride on the continued global adoption of OLED panels by smartphone makers as well as the proliferation of new OLED applications. For Power, we will focus on premium products and penetrating new high-growth segments such as the Automotive market. While we improve our financial performance in existing businesses, we may also consider inorganic growth options that are synergistic and EPS accretive if the right strategic opportunity presents itself. We plan to grow at a double-digit CAGR from 2020 to 2023.

Second, **gross margin**. For Display, we exited the lower margin non-auto LCD business. We will capitalize on this as we launch new products in emerging display applications. For Power, through a combination of reestablishing our R&D center, increasing our manufacturing output in Fab 3 and leveraging external foundry services, we will drive a more favorable premium product mix. Considering all of this, we plan to consistently achieve above 30% gross margin in a few years.

Third, operating expenses. The continuing operations are currently carrying some stranded costs, which may take some time to unwind. As a streamlined standard product company, we will right-size OPEX and exercise financial discipline.

Collectively, these initiatives will bring a significant improvement to our operating income. As I mentioned during our last earnings call, our goal is to first reach a 10% adjusted operating income level of the standard product business and then to continue to improve thereafter.

By the end of first quarter of 2021, we should be largely freed of approximately $21 million in annual interest expenses, which will substantially benefit our net income.

We are not stopping here. These goals are important milestones in our continuous journey towards profitable growth. Today, we shared with you some financial benefits of the new MagnaChip. Once the pending transaction closes, we will be able to share more financial metrics. We also plan to host an Analyst Day in the future and present strategic initiatives to illustrate how we will get there.

In summary, we delivered better-than-expected financial results while accelerating the closing schedule of the pending Foundry business sale. We will continue our execution to deliver a successful close and strengthen our business foundation for profitable growth. We remain well positioned to navigate through this challenging time, and as the industry environment improves, we will emerge stronger and capitalize on attractive market trends.

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

Young Woo:

Thank you, YJ, and hello everyone. It is nice to meet you over the phone. I am very excited and honored to join MagnaChip and to drive its transformation with a great team, and I look forward to engaging with our key shareholders.

Before I go into the financial review, I would like to reiterate that we believe segregating the transitional Fab 3 foundry services revenue from the continuing operations revenue provides investors with a better understanding of our core business results.

Revenue in Q2 from continuing operations, without transitional Fab 3 foundry services, was $109 million, down 1.6% from Q1 and down 17.5% from Q2 a year ago, which was primarily due to COVID-19 that negatively impacted the global smartphone market. Both sequential and year-over-year decline was also attributable to the strategic exit of non-auto LCD DDIC business, which accounted for $6.3 million in Q1 2020 and $9.6 million in Q2 2019.

Display revenue in Q2 was $69.2 million, down 10.8% quarter-over-quarter and down 17.9% year-over-year. The decline in the Display business was in part due to the above-mentioned exit of non-auto LCD business. Power revenue in Q2 was $39.8 million, up 20% quarter-over-quarter and down 16.7% year-over-year. The sequential improvement in the Power business was due to a solid rebound in the China market.

Non-GAAP combined revenue from both the continuing and discontinued operations in Q2 was $204.7 million, which exceeded the high-end of the guidance range. It was up 3.9% sequentially and flattish with the same quarter a year ago. The sequential improvement was attributable to the increased revenue from our Power business and the discontinued operations, which offset the decline in the Display business.

Before I go into the gross margin detail, I would like to remind you that when the business is labeled discontinued and the assets are classified as held-for-sale, all depreciation and amortization corresponding to those assets stops. Therefore, GAAP gross profit from our discontinued operations and non-GAAP combined gross profit from total operations in Q2 benefitted from this accounting treatment by approximately $2 million during the second quarter.

Gross profit margin in Q2 from continuing operations, without transitional Fab 3 foundry services, was 29.5%, up 3.2 percentage points from Q1 and up 5.5 percentage points from Q2 a year ago. The sequential increase in gross profit margin was due primarily to improved product mix and higher fab utilization. The year-over-year improvement was primarily attributable to a reserve of $2.2 million related to a legacy display product that was recorded in Q2 of 2019.

Non-GAAP combined gross profit margin from continuing and discontinued operations in Q2 was 30.8%, which exceeded the high-end of the guidance range. It was up 5.5 percentage points sequentially and up 9.4 percentage points with the same quarter a year ago, as a result of improved product mix and higher fab utilization. Gross profit margin in Q2 also benefited from the above-mentioned accounting treatment relating to the assets classified as those held-for-sale effective March 31, 2020.

Turning now to Operating Expenses in Q2._Operating expenses from continuing operations were $23.5 million or 21.6% of revenue from continuing operations without transitional Fab 3 foundry services as compared to $23.2 million or 20.9% in Q1 and $22.9 million or 17.3% for the same quarter a year ago. Q2 operating expenses included $1.5 million of stock based compensation charges. SG&A in Q2 was $12.4 million as compared to $12.1 million in Q1 and $11.1 million in Q2 2019. R&D in Q2 was $11.1 million as compared to $10.5 million in Q1 and $11.8 million in Q2 last year.

Adjusted Operating Income for continuing operations in Q2 was $10.1 million, up from $7.3 million in Q1 2020 and up from $9.4 million in Q2 a year ago.

Adjusted EBITDA for continuing operations in Q2 was $12.7 million, up from $9.9 million in Q1 2020 and up from $12 million in Q2 a year ago.

On a GAAP basis, our earnings per share for continuing operations was 34 cents, up from a LOSS per share of 89 cents in Q1 2020 and up from a LOSS per share of 25 cents in Q2 2019.

Our non-GAAP diluted EPS for continuing operations in Q2 was 13 cents, up from 3 cents in Q1 and up from 11 cents in Q2 last year. The difference between our GAAP and non-GAAP EPS was primarily due to the elimination of the non-cash net foreign currency gain of $8.5 million.

<u>Now moving to the balance sheet of the continuing operations.</u>
Cash was $192.8 million. This compares to $157.3 million at the end of Q1. As you recall, our interest payments occur in the first and third quarters of the year. We generated net operating cash flow of $36.0 million in Q2. This represented the 5th consecutive quarter of net positive operating cash flow.

Once the pending transaction closes, we intend to de-lever and strengthen the balance sheet. The transaction-related tax exposure is estimated to be up to 15% of the net cash proceeds of $344.7 million from the transaction.

Accounts receivable was down 20% from Q1. The decrease in accounts receivable in Q2 was attributable to the timing of payments from certain customers. Our days sales outstanding for Q2 was 41 days.

Inventories was up 22.6% from Q1, due primarily to meet an anticipated increase in customer demand for our standard products. Our average days in inventory for Q2 was 54 days.

CAPEX was $5.5 million in Q2 as compared to $3.4 million in Q1.

Let me give you more details on our CAPEX plan.

1. For 2020, we have some unusual moving parts: We will support both the continuing and discontinued operations with necessary investments. In addition, we will also start to reestablish the process R&D in Fab 3, build the QRA lab and relocate OLED test and development center as YJ mentioned earlier. Lastly, we are in the process of separating the IT systems and establishing a new IT infrastructure to support the continuing business after the sale. This will require a one-time investment of $21 million. With that, we expect the total CAPEX for 2020 to be around $35 million.

2. For 2021, we plan to complete the reestablishment of Fab 3. Once completed, our Fab 3 will have dedicated R&D capability, be equipped to seamlessly assume the critical projects, and support the growing demand for our power products. This special investment, which is estimated to be around $22 million, will allow us to pursue a revenue potential that equates to a payback period of less than 3 years. With that, the total CAPEX for 2021 is anticipated to be flattish from 2020.

<u>Now moving to Q3 Guidance</u>

On July 20, our Fab 3 facility in Gumi, South Korea experienced a temporary power outage for approximately 9 hours and 15 minutes. We are nearly fully operational in our Fab 3 facility as of today. The accident caused damage to our work-in-process wafers with an estimated total cost of up to approximately $2.3 million. The related impact to our revenue from continuing operations is expected to be negligible.

The COVID-19 global pandemic and escalated trade tension are rapidly evolving situations and reduce our forward visibility. While actual results may vary, MagnaChip currently anticipates for Q3 2020:

- Revenue from the continuing operations to be in the range of $118 million to $124 million, including $9.5 million to $10 million of the Transitional Fab 3 Foundry Services at cost. We want to remind you that we exited non-auto LCD DDIC business in Q2.
- Gross profit margin from continuing operations to be in the range of 25% to 27%
  - Without the estimated power outage impact, gross profit margin from continuing operations would have been in the range of 27% and 29%

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 second 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!
