Magnachip Semiconductor

Prepared Remarks for Q1 2022 Investor Conference Call

May 3, 2022

So-Yeon Jeong

Thank you for joining us to discuss Magnachip's financial results for the first quarter ended March 31, 2022. The first 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 Shinyoung Park, our chief financial officer. YJ will discuss the Company's recent operating performance and business overview, and Shinyoung will review financial results for the quarter and provide guidance for the second quarter of 2022. 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 first quarter earnings release available on our website under the investors section 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.

To begin, I'd like to quickly touch on our Q1 consolidated results and then give an update on some challenges we are seeing in the broader macro environment. After that I will provide a detailed review of our business segments.

In Q1, we reported revenue of $104.1 million in a severely supply constrained environment. This along with strong gross profit margin generated a non-GAAP EPS of 28 cents, which was an increase of 27% year-over-year. While it is good to see the healthy bottom-line bolstered by improved gross margin, I am still disappointed with these results because it doesn't represent the full potential of this company.

As we approached the end of Q1, we were optimistic that we would begin to see incremental improvements in business conditions for the rest of the year. However, the ongoing lockdowns in China have added new challenges to an already stressed supply chain to both of our businesses. We want to take a cautious stance for the near-term despite recent positive momentum, which I will go over in detail.

Moving onto a detailed review of our Q1 results by product segment starting with OLED:

Our OLED revenue in Q1 was $26.1 million, down 30.7% sequentially, and down 53.1% YoY. As expected, severe shortages in 28nm 12-inch wafer capacity where we produce most of our new OLED products continued to significantly impact our results. However, we remain focused on supporting our existing customers, winning new business and executing on our additional capacity plans to set ourselves up for a strong recovery:

1. First, our dedicated customer support and engineering teams are working closely with the top-tier panel maker in Korea to initiate and support two new OLED Driver IC projects, which we expect to kick off this month.

2. Second, as mentioned last quarter, we successfully broadened our customer base to include a top-tier panel maker outside Korea. In Q1, we worked very closely with this customer and successfully taped out the first project in February. This product is expected to greatly contribute to our revenue in the later part of this year. Further, we have engaged in design-in discussions for additional new projects with this customer.

3. Third, our additional 28nm manufacturing capacity remains on track to come online in the later part of this year. While we expect to go through a typical yield learning curve during the initial phase of the production ramp, we expect yields to improve over 2023. In addition, we are in active discussions with our foundry partners regarding a multi-year supply agreement to secure long-term capacity and expect to have an update for you in a couple of months.

4. Finally, in terms of our new business areas, we successfully ramped mass production of our new OLED TV DDIC product line during the quarter and saw strong revenue growth for the large display OLED TV market. While still small, we are optimistic about the growth potential for this business. For OLED automotive display applications, we added an additional customer design-win during the quarter with a Premium European automaker for their center stack display and the initial mass production is scheduled for the 1st half of 2023 based on our customers' current plan.

In summary, our OLED business is winning new customers and expanding into newer applications. With additional supply capacity expected to ramp up in the later part of this year and progress with our LTA supply agreements, we are very optimistic about the growth in our OLED business in the future, particularly when our newly designed products at the leading Korean customer and new major customer outside of Korea are expected to go into full production with our newly added capacity. For Q2, we anticipate our Display business revenue to be flat to slightly up primarily as capacity level remain about the same.

Now, let's turn to the Power Business.

I am excited to report that we achieved the highest revenue in company history in a single quarter primarily driven by strong demand for our premium power products as well as BatteryFETs products. Our Power Business revenue in Q1 was $64.8 million, up 11.4% sequentially and 20.0% YoY. These results were driven by very strong demand for our premium products, particularly our SJ MOSFET, Power IC and IGBT product lines, which grew 19.5% sequentially and 25.1% YoY to a record high 53.6% revenue mix. In addition, BatteryFETs that support world's leading foldable smartphone, earphones, and tablets demonstrated strong growth. We are extremely excited about the continued momentum and growth in our Power business in key end markets like communication, consumer, industrial and computing all driven by the trend in electrification of everything.

In our SJ MOSFET product line, we are seeing robust demand from TV, PC Power and Lighting applications due to increasing energy efficiency requirements. In Q1, we had strong traction with new designs in TVs and LED Lighting as well as share gains in laptops and gaming. For Power IC, we began ramping shipments of our boost ICs for SSDs for servers and datacenters. In our IGBT product line, revenue grew about 60% YoY driven by our entry into renewable energy end market, particularly solar inverter applications.

Our go-to-market strategy, efficient R&D and timely investment in Fab 3 led us to achieve record quarterly revenue once again and also accelerated development and introduction of new products.

One notable achievement for the quarter was that we successfully expanded the Automotive design pipeline with our new high-performance medium voltage (MV) MOSFET product for Brushless Direct Current (BLDC) motor applications. We received a purchase order for our new 40V MV MOSFET from a tier 1 automotive supplier for major car manufacturers and started mass production in April. We also kicked off more MV products for multiple automotive applications.

This is an additional win aside from the original Automotive Power project that we announced previously. Our original Automotive Power project is progressing well. The qualification and design activities are moving along with the end-customer's schedule. We expect the initial mass production to start in the second half of 2023 based on our customer's current plan.

During the quarter, we also added another new product to our Power supply family with the announcement of a high-performance synchronous boost converter that can be used in a variety of applications, for SSDs, OLED panels and Bluetooth speakers. This boost converter provides strong circuit protection capabilities and allows for smaller PCB board form factors in environmentally-friendly packages.

In summary, we will continue to execute the growth plan of our Power business by strengthening Fab 3 productivity and introducing new products with superior performance and improved cost, which we expect will further drive healthy growth for many years. For Q2, we expect our Power business revenue to be flat to slightly down as a result of back-end capacity constraints due to the China lockdown.

In conclusion, we are expanding our customer base, penetrating new applications and remain focused on executing on our long-term strategy. Despite macro issues and increased uncertainty, which may limit our near-term opportunity, recent developments and critical milestones we have achieved reinforce our confidence and optimism about our long-term growth.

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

Shinyoung Park:

Thank you, YJ, and welcome to everyone on the call. Let's start with key financial metrics for Q1.

Total revenue in Q1 was $104.1 million, down 5.7% sequentially and down 15.4% YoY. Revenue from the standard products business was $94.0 million, down 5.5% from Q3 and down 16.7% from the same quarter a year ago. Once again, both the sequential and YoY decrease was due mainly to a significant decrease in revenue in our Display and OLED business driven by the previously mentioned supply shortage.

However, our Power business in Q1 was very strong and achieved a record revenue of $64.8 million, which represents an increase of 11.4% sequentially and 20.0% YoY. The significant growth was due to strong demand across most product families, particularly our premium products.

Gross profit margin in Q1 was 37.5%, up 250 basis points from Q4 and up over 960 basis points from Q1 a year ago. The year-over-year increase was primarily attributable to an improved product mix, combined with an increase in average selling price under a favorable pricing environment. Sequentially, Q1 benefited by approximately 200 basis points from a timing mismatch of lower cost 12" wafers that was purchased in a prior period and sold in Q1.

Turning now to Operating Expenses. Q1 SG&A was $14.2 million, as compared to $13.3 million in Q4 2021 and $12.6 million in Q1 last year. Q1 R&D was $12.0 million, as compared to $12.2 million in Q4 2021 and $13.4 million in Q1 last year. Stock compensation charges included in operating expenses were $1.6 million in Q1 and the same $1.6 million in Q4 and Q1 2021.

In Q1, our operating income was $12.9 million, compared to $63.9 million in Q4 last year and an operating loss of $2.1 million in Q1 2021. As a reminder, our Q4 2021 results included net gain of $49.4 million that represented income of $70.2 million from the recognition of a reverse termination fee net of professional service fees and expenses incurred in connection with the contemplated merger transaction of the Company that was terminated in December 2021. Of the $70.2 million, we received $51 million cash in December 2021 and $19.2 million was recorded as other receivables on our balance sheet as of March 31, 2022. Subsequently in April 2022, we received $14.4 million and the remaining $4.8 million is expected to be received by the end of June 2022.

Adjusted Operating Income in Q1 was $14.5 million, about flat from $14.4 million in Q4 2021 and up from $10.0 million in Q1 a year ago. Adjusted EBITDA in Q1 was $18.8 million, slightly up from $18.1 million in Q4 last year and up from $13.5 million in Q1 a year ago.

Net income in Q1 was $9.5 million as compared with $53.6 million in Q4 2021 and a net loss of $7.5 million in Q1 a year ago. The sharp sequential decrease was due primarily to the recognition of income in Q4 2021 from the $70.2 million reverse termination fee discussed earlier.

Our GAAP diluted earnings per share in Q1 was $0.20, as compared with $1.12 in Q4 last year and loss of $0.19 in Q1 a year ago.

Our non-GAAP diluted earnings per share in Q1 was $0.28, down from $0.31 in Q4 last year but up from $0.22 in Q1 last year.

There were 46.7 million shares outstanding in Q1, calculated on a diluted weighted average basis.

On December 21, 2021, our board authorized the repurchase of up to $75 million of the Company’s stock, and as an immediate step, we entered into a $37.5 million Accelerated Stock Repurchase (ASR) agreement with JPMorgan Chase Bank, National Association. On March 14, 2022, we completed the ASR program, and repurchased approximately two million shares at an average price of $18.51.

<u>Now moving to the balance sheet:</u>

Cash was $284.9 million at the end of Q1. This compares to $279.5 million at the end of Q4 of 2021 and $290.2 million in Q1 of 2021.

Accounts receivable, net totaled $51 million, about flat from Q4 last year. Our days sales outstanding for Q1 was 44 days.

Inventories, net totaled $36.9 million, a decrease of 6% from Q4 last year. Our average days in inventory for Q1 was 51 days.

CAPEX was $0.9 million in Q1. As disclosed in our previous earnings call, this year, we will invest about $8 million special CAPEX to further improve Fab 3 capacity. Excluding this special CAPEX, our normalized CAPEX for 2022 is expected to be at approximately $20M.

Now moving to the second quarter guidance

Our near-term outlook is still being challenged by persisting supply constraints especially for 28nm 12" wafers. While actual results may vary, looking into the next quarter, Magnachip currently expects:

- Revenue to be in the range of $100 million to $105 million, including about $9.5 million of Transitional Fab 3 Foundry Services.
- Gross profit margin to be in the range of 33% to 35%.

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

So-Yeon Jeong

Thank you YJ and Shinyoung. 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 first quarter 2022 earnings conference call. Please look for details of our future events on Magnachip's Investor Relations website.

Before we end the call, I'd like to officially announce that I will be transitioning out of my role as the Investor Relations advisor for Magnachip. It's been an honor working with this great management team and representing such a wonderful company. Going forward, The Blueshirt Group will serve as Magnachip's Investor Relations advisors and you can find the primary IR lead, Yujia Zhai and his contact information at the bottom of our earnings press release.

Thank you and take care.