Magnachip Semiconductor

Prepared Remarks for Q4 2021 Investor Conference Call

February 16, 2022

So-Yeon Jeong

Thank you for joining us to discuss Magnachip's financial results for the fourth quarter ended December 31, 2021. 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 Shinyoung Park, our chief financial officer. YJ will discuss the Company's recent and annual operating performance and business overview, and Shinyoung will review financial results for the quarter and the year and provide guidance for the first 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 fourth 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!

For the fourth quarter, the demand and signals from our customers remained strong across the board; however, severe supply constraints continued to significantly limit our OLED revenue potential, which was partially offset by our stronger Power business. We reported $110.3 million in revenue and 31 cents in non-GAAP diluted EPS. Our revenue decreased 13.1% sequentially and 22.8% Year over Year (YoY) as a result of the supply constraints.

The shortage was felt most severely for 28nm 12-inch wafers where we have been producing most of our new OLED products, winning numerous designs, and rapidly expanding market share in the past few years. Case in point, the revenue from 28nm products grew 80% to $174million in 2021 from $97 million in 2020, representing 90% of total OLED revenue in 2021 as compared to 34% in 2020. The success of our 28nm product line has been and we expect will continue to be one of the critical growth enablers for us. Unfortunately, a severe shortage of 28 nm OLED wafers adversely affected our OLED business as a major limiting factor, adding tremendous pressure to an already difficult supply environment. Fortunately, we enhanced our supply chain for additional 28nm capacity last year, which we expect will start to come online in the later part of this year.

Looking at the full year, while our revenue for 2021 declined 6.5% YoY due to the wafer supply shortage, partially offset by outstanding growth in our Power business, I am very pleased that we delivered solid profitability for the full year 2021.

- Gross profit margin reached 32.4%, representing an increase of 710 bps from 2020.
- Adjusted Operating Income margin increased to reach 11.8% of total revenue from 8.2% in 2020.
- Adjusted Net Income was 10.8% of total revenue, versus 5.6% from the year before, and
- Adjusted EBITDA also grew to $70.7 million from $52.9 million in 2020.

2021 has certainly presented its share of unique challenges for us; however, our team steadfastly pressed forward with our plan to achieve not only healthy profitability but also critical milestones to fuel future growth, upon which I will elaborate shortly. I deeply appreciate every Magnachip team member for their unwavering commitment and dedication. I am most grateful that we could achieve solid results while protecting and safeguarding our employee health and safety amidst the global COVID-19 pandemic.

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

Our OLED revenue in Q4 was $37.7 million, down 31.8% sequentially, and down 53.1% from our historical record revenue level in Q4 2020. Against severe supply constraints, we have been protecting our profitability by strategically focusing on high value, high margin design activities, including the newly launched flagship smartphone model of a major smartphone OEM. Also, revenue from 5G smartphones and high frame rate products continued to grow to represent over 93% of our 2021 OLED revenue.

Turning to the full year review, OLED revenue was $192.8 million, down 32.3% YoY as we unfortunately had to forego some demand. Our demand was more than 50% higher than what we shipped in 2021. However, I am pleased to report some critical milestones that we achieved.

1. <u>We have successfully broadened our customer base</u> to include a top-tier panel maker outside Korea. Initial revenue is expected to start in the later part of this year. We are well aligned with top-tier panel makers in the world and positioned to benefit from increasing OLED adoption in multiple countries.

2. <u>We enhanced our supply chain for additional 28nm manufacturing capacity</u>, which is expected to come online in the later part of this year. In addition, we are in discussions with our foundry partners regarding a multi-year supply agreement in order to secure long-term capacity. We have also been working on MOUs and supply

agreements with key customers, some of which have already been signed.

3. We are expanding into new areas: We have successfully commenced initial mass production of OLED TV DDIC during the fourth quarter, and we continue to expand our large display OLED TV business by addressing NextGen premium TVs with MicroLED technology. We used to have over 30% market share in TV applications with LCD DDIC during peak times before we strategically de-focused from this business a few years ago. In addition, we are also expanding our OLED DDIC product lineup for automotive display applications.

In summary, our OLED business is winning new customers and expanding into newer applications. The demand from our current customers is strong. In fact, we are getting numerous RFQs from Korean panel makers, although supply constraints continue to be the gating factor. With additional supply capacity expected beginning in the later part of this year, we are very optimistic about the rejuvenated growth in our OLED business in the coming years.

Now, let's turn to the Power Business.

Power revenue in Q4 came in at $58.2 million, which was slightly lower than our record revenue in Q3 2021, and a solid quarterly revenue growth of 24.2% YoY. The overall demand for our IGBT, MV MOSFET and BatteryFET products in the industrial and wireless applications remained strong. Especially, our IGBT products for solar inverter demonstrated solid traction in Q4, bolstered by growing interests in alternative energy.

For full year 2021, our Power business delivered a record-high revenue of $227.8 million, an increase of 36.8% YoY, driven by solid demand across most of our product families coupled with increased internal capacity resulting from our timely investment in Fab 3. Clearly, we are approaching our target ahead of our plan, and we are working to further improve Fab 3 capacity. Shinyoung will provide more details shortly.

One notable highlight for 2021 is the exciting momentum we are seeing in premium power products. Our premium product group grew remarkably in 2021 to $117.1 million from $82.5 million a year ago. SJ MOSFET not only maintained its solid position in Korea TV markets but also expanded into PC power, lighting and other industrial applications. Power IC revenue grew over 60% YoY since the first penetration into SSD-related applications in 2020. IGBT revenue grew significantly driven by strong demand for renewable energy.

Our go-to-market strategy, efficient R&D and timely investment in Fab 3. led us to achieve record quarterly revenues three quarters in a row during 2021 and also accelerated development and introduction of new products.

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.

Before I turn the floor over to Shinyoung, I will take a few minutes to comment on our capital allocation plan. Given our current business condition, our near-term cash use is focused on three areas:

1. We target to maintain $100 million+ cash on the balance sheet. This is mainly for working capital, but it also reflects our customers' desire to see a solid cash balance.
2. As we have already demonstrated, we are committed to shareholder return. In December 2021, our board authorized a $75 million Stock Repurchase program.
3. The remainder of the cash on our balance sheet will be allocated for flexible optionality. At the present time, we believe that supply is the fundamental limiter of our potential growth. Therefore, enhancing our supply chain is currently deemed one of the imminent capital allocation options. Possible options include but not limited to securing additional 28nm manufacturing capacity and locking in multi-year long term supply agreements, which typically require strong commitments from us and our customers including prepayments. We are also expanding additional manufacturing capacity at Fab 3 for our Power business to address continuously increasing demand.

In conclusion, we are expanding our customer base and penetrating new applications. Our ability to supply is anticipated to improve in the later part of this year. While our near-term outlook is still being challenged by persisting supply constraints, we expect OLED revenue to be flat to slightly up in 2022 compared to 2021, with significant growth coming during later part of the year. As a whole company, we expect a modest revenue increase in 2022 driven by the OLED recovery as well as decent growth in our Power business. 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 the full year 2021 and Q4.

Revenue in 2021 was $474.2 million, down 6.5% from 2020. The decrease was due primarily to a decrease in revenue from our mobile OLED DDIC products stemming from a continued severe supply shortage, which was offset in part by strong revenue growth from our Power business.

Display business revenue was $205.3 million, down 31.3% from 2020, whereas Power business revenue was up 36.8% from 2020 to $227.8 million. Power business revenue growth was driven by solid demand across most product families coupled with increased internal capacity resulting from our timely investment in Fab 3.

Despite the decline in revenue year-over-year due mainly to the global shortage in manufacturing capacity, gross profit margin in 2021 improved 710 bps year-over-year to reach 32.4%, which flowed through to non-GAAP metrics of Adjusted Operating Income, Adjusted Net Income and

Adjusted EBITDA, all of which improved year-over-year, as highlighted by YJ earlier. Our non-GAAP diluted earnings per share was $1.09 in 2021, up from 73 cents in 2020.

Now turning to Q4 results.

Total revenue in Q4 was $110.3 million, down 13.1% from Q3 and down 22.8% from Q4 a year ago. Revenue from the standard products business was $99.5 million, down 15.2% from Q3 and down 23.2% from the same quarter a year ago. Both the sequential and YoY decrease was driven mainly by a significant decrease in revenue from our OLED products due to the previously mentioned supply shortage.

Power revenue in Q4 was $58.2 million, down 1.1% sequentially but up 24.2% YoY despite the fact that Q4 usually is a seasonally soft quarter. The significant increase YoY was due to strong demand across most product families as well as from the increased internal capacity at our Fab 3.

Gross profit margin in Q4 was 35%, down 170 basis points from Q3 but up 810 basis points from Q4 a year ago. The year-over-year increase was attributable to an improved product mix, combined with an increase in average selling price under a favorable pricing environment, and a higher utilization rate of Fab 3. In Q3 2021, gross profit margin was favorably impacted by the shipment of certain products that were manufactured at a lower cost in the previous quarter. The higher gross profit margin combined with the higher revenue resulted in a significant improvement in all profitability metrics in Q3.

Turning now to Operating Expenses. SG&A in Q4 was $13.3 million, as compared to $12.6 million in Q3 and $12.6 million in Q4 last year. R&D in Q4 was $12.2 million, as compared to $12.3 million in Q3 and $11.6 million in Q4 last year. Stock compensation charges included in operating expenses were $1.6 million in Q4, $1.9 million in Q3, and $1.9 million in Q4 2020.

In Q4, our operating income of $63.9 million 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 in cash in December 2021 and the remaining $19.2 million is expected to be received by the end of March 2022. This remaining portion was recorded as other receivables on our balance sheet as of December 31, 2021.

Adjusted Operating Income in Q4 was $14.4 million, down from $22.7 million in Q3 and down from $15.4 million in Q4 a year ago. Adjusted EBITDA in Q4 was $18.1 million, down from $26.4 million in Q3 and down from $18.6 million in Q4 a year ago. The sequential decline in these non-GAAP metrics was primarily attributable to the higher-than-usual gross profit in Q3 as explained above.

Net income in Q4 was $53.6 million as compared with $10.8 million in Q3 and $66.6 million in Q4 a year ago. The sharp sequential increase in Q4 in 2021 was due primarily to the recognition of income from the $70.2 million reverse termination fee discussed earlier. As a reminder, net income in Q4 2020 was favorably impacted by the recognition of income tax benefits of $47.1 million, primarily from recognizing differences between GAAP and cash tax expense of $43.9 million.

Our GAAP diluted earnings per share in Q4 was $1.12, as compared with 23 cents in Q3 and $1.45 in Q4 a year ago.

Our non-GAAP diluted earnings per share in Q4 was 31 cents, down from 42 cents in Q3 and down from 40 cents in Q4 last year. The difference between our GAAP and non-GAAP EPS in Q4 this year was primarily due to the elimination of income from the $70.2 million reverse termination fee and related professional service fees, expenses, and income tax effect in connection with these non-GAAP adjustments relating to the contemplated merger transaction of the Company that was terminated in December 2021.

There were 47.7 million shares outstanding in Q4, calculated on a diluted weighted average basis.

On December 21, 2021, our board authorized the repurchase of up to $75M of the Company’s stock, and as an immediate step, we entered into a $37.5M Accelerated Stock Repurchase agreement and received an initial delivery of 994,695 shares under the agreement. Our stock buyback under the Accelerated Stock Repurchase agreement is expected to be completed by the end of March 2022.

Now moving to the balance sheet:

Cash was $279.5 million at the end of Q4. This compares to $276.3 million at the end of Q3 and $279.9 million at the end of 2020. During Q4, we received $51 million out of the $70.2 million reverse termination fee and spent merger-related expenses of about $14 million. We also used $37.5 million of our cash to enter into the Accelerated Stock Repurchase program that I just mentioned.

Accounts receivable, net totaled $51 million, a decrease of 3% from Q3. Our days sales outstanding for Q4 was 42 days.

Inventories, net totaled $39.4 million, an increase of 1.5% from Q3. Our average days in inventory for Q4 was 50 days.

CAPEX was $18.8 million in Q4. CAPEX of $32.2 million in 2021 included approximately $17 million of one-time investments for our Fab 3, which came in lower than the previously disclosed CAPEX plan as a result of our cost reduction efforts in negotiating better pricing terms. As YJ mentioned earlier, while we are approaching our target capacity at Fab 3 ahead of our plan, the demand for our power products has been outstripping our internal capacity. In 2022, we will invest about $8 million for special CAPEX to further improve Fab 3 capacity with an expected payback period of less than 2 years. Excluding this special capex, our normalized CAPEX for 2022 is expected to be at around 4% of total revenue.

Now moving to the first quarter guidance

Our near-term outlook is still being challenged by persisting supply constraints. While actual results may vary, looking into the next quarter, which typically presents seasonal softness, Magnachip anticipates Q1 2022 to be the bottom and currently expects:

- Revenue to be in the range of $102 million to $108 million, including about $9 million of Transitional Fab 3 Foundry Services.
- Gross profit margin to be in the range of 34.5% to 36.5%.

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 fourth quarter 2021 earnings conference call. Please look for details of our future events on Magnachip's Investor Relations website. Thank you for joining us today!