Magnachip Semiconductor
Prepared Remarks for Q1 2023 Investor Conference Call
May 3, 2023

Yujia Zhai

Hello everyone. Thank you for joining us to discuss Magnachip's financial results for the first quarter ended March 31, 2023. The first quarter earnings release that was issued today after the market close can be found on the Company's investor relations website. The webcast replay of today's call will be archived on our website shortly afterwards.

Joining me today is YJ Kim, Magnachip's Chief Executive Officer. Shinyoung Park, Magnachip's Chief Financial Officer, is on maternity leave. During Shinyoung's absence, YJ is the Principal Financial Officer of the company. YJ will discuss the Company's recent operating performance and business overview, and I will provide the financial results for the quarter and YJ will provide guidance for the second quarter of 2023. 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 in the investor relations section of our website. With that, I now will turn the call over to YJ Kim. YJ?

YJ Kim

Hello everyone, thank you for joining us today and welcome to Magnachip’s Q1 2023 earnings call. Before we proceed, I want to welcome Gilbert Nathan as an observer of the Company's Board of Directors and ad hoc Strategic Review Committee of the Board. Mr. Nathan is currently the managing member of Jackson Square Advisors as well as the CEO of Keycon Power Holdings. With his extensive experience serving on the Boards of multiple publicly listed companies, we are very pleased to have him join us. Following our annual shareholders’ meeting in May, Mr. Nathan will promptly be appointed as a director on our Board and serve as a member on Magnachip’s Strategic Review Committee. We are pleased to benefit from Mr. Nathan's deep knowledge and expertise in finance and capital markets, as we strive to enhance value for our shareholders.

Moving on to our results. Our Q1 financial performance was within the range of the guidance we provided on our Q4 earnings call. Revenue was $57 million and gross profit margin was 21.2%. As we indicated last quarter, our results are being severely impacted by several macro challenges that I will detail as I discuss each of our 2 main businesses.

Beginning with our Display business. Q1 revenue was $10.8 million, down 62.9% year-over-year but up 43.5% sequentially. These results reflect the continued effects of last year’s supply shortage of 28nm 12-inch OLED wafers that impacted 2nd half 2022 design wins and the ongoing smartphone inventory correction.

End-consumer demand overall continued to be weak, but we have begun to see some market recovery in the Premium Tier, where our display products play. During the first quarter, we saw increased demand from our large Korean panel customer for a leading Korean smartphone model. We also commenced shipments of our OLED products to this customer for two new premium-tier smartphone designs expected to be launched in Q2 by a leading Asian Smartphone OEM and a Global Smartphone OEM.

Further, we remain steadfast in our mission to turn around our Display business and continue to execute our recovery plan during the quarter. I will summarize some of the key Display business recovery initiatives for you…

- **At our new non-Korean Tier 1 panel customer**, last quarter, we completed qualification for the 1st OLED DDIC project. This quarter, we began shipping initial volume and expect to accelerate shipments in the coming quarters.

- In Q1, we also successfully delivered our second OLED DDIC project sample ahead of schedule and mass production is expected in the second half of this year. Our second OLED DDIC offers significant performance and feature upgrades from our 1st DDIC for this customer and we continue to have prospects with many of the leading smartphone OEMs.

- I also recently visited our new panel customer in their multiple sites, as well as our new foundry partner. Our strategic partnerships are stronger than ever. We are in active discussions with them regarding other projects that could tape out later this year and contribute to revenue growth in 2024.

- **At our large panel customer in Korea,** we successfully completed the tape out of a high-end smartphone DDIC project and are now in the evaluation phase. We are targeting to release samples to our Korean customer in Q2, with mass production expected to begin near the end of the year.

- For our automotive OLED project at this customer, the mass production shipment timing we announced last quarter is now expected in mid-May. We are optimistic about securing additional design wins in the upcoming quarters based on our Automotive OLED DDIC.

Moving on to our Power business: Q1 revenue was $40.7 million, down 37.3% year-over-year and down 12.1% sequentially. Similar to last quarter, our Power business continues to be impacted by a weak demand across our end markets, particularly in Computing and Consumer. As a result, we significantly reduced production during the quarter at our internal Fab to normalize inventories, which negatively impacted Fab utilization, which was a primary driver of our lower gross margin during the quarter.

Despite the challenging environment, the core fundamentals of our Power business remain unchanged:

- Despite the market slow down, the blended Power products ASP increased 3.4% QoQ and 26.3% YoY in Q1'23 by improving the product portfolio and focusing on premium markets. Our Premium products continued to maintain its strong product mix and ASPs. In Q1, Premium products represented 64.4% of total Power revenue compared to 53.6% a year ago and Premium ASPs increased 6.4% year over year.

- In addition, we continued our record pace of design activities. In Q1'23, we were awarded over 100 design ins and wins, driven by our strong product portfolio across automotive, industrial and computing applications. While total volumes remain weak during this industry-wide inventory correction, we remain confident that we will see a quick recovery on the other side of this cycle due to these strong fundamentals.

- We also continue to innovate. This week, we announced nine new 600V SJ MOSFET products featuring a proprietary design technology that improves on-resistance and overall system efficiency. In the second half of this year, we will be introducing a full set of next generation products that will have better performance or cost by at least double digit percentage.

- Further, our Power segment's Automotive business continued to make solid progress in various applications within the XEV automotive market. For example, we were awarded multiple design wins with our innovative power products for applications such as Electric Water Pumps, Positive Temperature Heaters, Regenerative Braking Systems, Idle Stop and Go systems and Electric Vehicle Charging Stations with leading EV auto makers across Korea, Japan, China and Taiwan.

Now turning back to our OLED business summary, we continue to focus on executing on the near-term goals that we have set forth with our two major panel customers. We believe our OLED business is bumping along the bottom and is poised to ramp in the 2^{nd} half and expect to deliver revenue growth in 2023. With our cutting-edge OLED products, we are well positioned to make significant strides in the industry once the current environment improves. Looking further ahead, we are highly optimistic about our OLED opportunities, particularly as we make headway internationally into the next major market beyond Korea, where our available foundry capacity is expected to increase few folds over the next few years.

In our Power business, our product design-in/win rate is stronger than ever and we're rolling out next generation power products throughout this year. Looking ahead, the macro environment remains uncertain, however, we believe we hit the bottom in Q1 and we expect gradual improvement going forward as channel inventories are consumed. We expect sequential growth especially in industrial, automotive, and computing segments.

Finally, we recognize our recent market performance and results have been disappointing. However, we want to assure our investors that we remain unwavering in our commitment to drive growth and maximize shareholder value as demonstrated by our decision to bring in fresh perspectives with the addition of Mr. Nathan to our Board. Further, we continue to execute our stock buyback program daily and I am confident that the net purchases across this challenging market will provide accretive returns to our shareholders on the other side of this downturn. Thank you to our shareholders for all of your patience and we appreciate your support as we work towards our goals. I will now turn the call over to Yujia to go over the financials in detail.

Yujia Zhai:
Thank you YJ, and on behalf of Magnachip's CFO Shinyoung Park, I will provide the financial update for Q1.

Total revenue in Q1 was $57 million, down 6.5% sequentially and down 45.2% year-over-year. Revenue from the standard products business was $51.5 million, down 4.3% sequentially and down 45.2% year-over-year.

Revenue from our Display business was $10.8 million, up 43.5% sequentially and down 62.9% year-over-year. Our results continued to be impacted by the wafer supply constraints in our OLED business that impacted our design wins in the second half of 2022 and slow demand for Chinese and Korean top-tier smartphone models as a result of the global downturn in the smartphone market.

Revenue from our Power business was $40.7 million, down 12.1% sequentially and down 37.3% year-over-year. Our Power business continues to be impacted by a weak demand environment across most of our end markets, particularly Computing and Consumer related applications.

Gross margin in Q1 was 21.2%, down from 26.4% in Q4 2022 and down from 37.5% in Q1 last year. The sequential decline in the gross margin was mainly **due to a lower utilization rate of our internal fabrication facility in Gumi in response to the industry-wide slowdown, an inventory correction and higher fab costs.** The year-over-year decrease was primarily due to an unfavorable product mix and a significant drop in the utilization rate of our Gumi fab. As a reminder, gross margin in Q1 last year benefited by 200 basis points from a **one-time, timing** mismatch of lower cost 12" wafers that was purchased in Q4 2021 and subsequently sold in Q1 2022.

We expect our Q2 2023 gross margin will continue to be impacted by lower utilization as well as higher manufacturing input costs such as electricity and wages. Gross margin is expected to improve as we anticipate higher volume and utilization rates in the second half.

Turning now to Operating Expenses. Q1 SG&A was $12.2 million, as compared to $12.6 million in Q4 2022 and $14.2 million in Q1 last year. Q1 R&D was $13.3 million, as compared to $13.7 million in Q4 2022 and $12.0 million in Q1 last year. Stock compensation charges included in operating expenses were $1.1 million in Q1 compared to $1.5 million in Q4 and $1.6 million in Q1 last year. Also included in our OPEX this quarter was a one-time charge of $8.4 million related to early termination subject to our voluntary resignation program that we executed during the quarter. Based on the number of employees that opted for this program, we expect to have annual savings of approximately $3.4 million.

Q1 operating loss was $21.8 million. This compares to an operating loss of $10.1 million in Q4 and an operating income of $12.9 million in Q1 2022. On a non-GAAP basis, Q1 adjusted operating loss was $12.2 million, compared to adjusted operating loss of $8.6 million in Q4 and adjusted operating income of $14.5 million in Q1 last year.

Q1 adjusted EBITDA was negative $7.9 million. This compares to a negative $4.8 million in Q4 and a positive $18.8 million in Q1 last year.

Net loss in Q1 was $21.5 million as compared with a net income of $3.0 million in Q4 and a net income of $9.5 million in Q1 last year.

Our GAAP diluted loss per share in Q1 was 49 cents, as compared with an earnings per share of 7 cents in Q4 and an earnings per share of 20 cents in Q1 last year.

Our non-GAAP diluted loss per share in Q1 was 24 cents. This compares with non-GAAP diluted loss per share of 36 cents in Q4 and an earnings per share of 28 cents in Q1 last year.

Our diluted shares outstanding for the quarter were 43.4 million shares, which reflects shares repurchased as part of our expanded share repurchase program. Our stock buyback in Q1 2023 amounted to $11.9 million. Cumulatively, since the start of the program in September last year to the end of Q1 this year, we've repurchased 2.5 million shares or $24.4 million and we continue to exercise the buyback that was authorized by the Board.

Moving to the balance sheet:

We ended the quarter with $212.1 million of cash and no debt, down from $225.5 million of cash at the end of Q4 2022. The primary cash outflow in Q1 was the $11.9 million spent on stock buybacks. We expect to continue to draw down on our cash balance in the coming quarters driven primarily by our buyback program, payment of termination related charges subject to the voluntary resignation program, and normal CAPEX. Based on our forecast, we anticipate our cash could range between $165 and $190 million between Q2 and Q3, depending on whether we choose to enter into a long-term supply agreement with a 12-inch wafer foundry. We believe our balance sheet position is strong and positions us well during this period of macro uncertainty.

Net accounts receivable at the end of the quarter totaled $32.1 million, which represents a decrease of 9.1% from Q4 2022. Our days sales outstanding for Q1 was 51 days and compares to 53 days in Q4.

Inventories, net at the end of the quarter totaled $36.4 million. This compares to $39.9 million in Q4 2022. Our average days in inventory for Q1 was 73 days and compares to 82 days in Q4.

Lastly, Q1 CAPEX was $0.1 million. As I mentioned earlier, for 2023, we continue to anticipate CAPEX to be approximately $10 million, which is nearly 60% lower from the 2022 level.

That concludes the CFO section of today's prepared remarks, let me now turn the call over to YJ for guidance.

YJ Kim
Thanks Yujia

We expect our results to remain soft in the near term, but we believe both Power and Display are poised for a recovery in the second half of this year based on our current customer feedback. Based on our current projections, and assuming a steady state global economy, we are cautiously optimistic that our key financial metrics have the potential to show sequential improvement in both the third and fourth quarters of 2023.

Now moving to our second quarter guidance:
While actual results may vary, for Q2, Magnachip currently expects:

- Revenue to be in the range of $58 million to $63 million, including about $8 million of Transitional Foundry Services in our Gumi Fab.

- Gross profit margin to be in the range of 21% to 23%.

Thank you. That concludes the prepared remarks section of our call today, operator you may now open up the call for questions.