Magnachip Semiconductor
Prepared Remarks for Q4 2022 Investor Conference Call
February 16, 2023

Yujia Zhai

Thank you for joining us to discuss Magnachip's financial results for the fourth quarter ended December 31, 2022. The fourth quarter earnings release that was issued today after the stock market closed 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 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 first 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 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 us today and welcome to Magnachip's Q4 2022 earnings call.

I will begin today's call with a summary of our Q4 results as well as our performance for the full year 2022. After that, I will provide a detailed update on each of our business segments before turning the call over to Shinyoung to go over our financials in more detail and provide guidance for Q1 2023.

Starting with Q4 results. Revenue was $61 million, near the high-end of our guidance range. Nevertheless, Q4 revenue was lower by 44.7% year-over-year and 14.3% sequentially. Gross profit margin was 26.4%, within our guidance range. By business line, Display revenue was $7.6 million and Power revenue was $46.3 million. As we indicated last quarter, these results were primarily driven by:

- Severe wafer shortages in our OLED business, which prevented our new designs at our leading Korean panel customer to hit new key product launch windows in the second half of 2022.

- Our OLED business was also impacted by weak consumer demand in China and globally, which led to an inventory correction by Android smartphone OEMs.

- In our Power business, the record momentum we set in the first half of the year slowed significantly in Q4 as macro conditions and consumer demand deteriorated, leading to inventory builds across a number of our end markets.

Looking back at the full year, total revenue was $337.7 million and gross profit margin was 30.0%, down 28.8% and 240 basis points year-over-year, respectively. By business line, our Display business solely contributed to the significant year-over-year decline as revenue was only $71.4 million compared to $205.3 million in 2021. Our Power business revenue in 2022 was $230.5 million, up 1.2% year-over-year from $227.8 million. It goes without saying that 2022 was a very difficult year on many fronts, particularly for our Display business. However, we stayed focused and executed on what we could control and achieved key milestones in 2022 that we believe sets the foundation for a solid recovery in 2023.

In our Display business:

- We successfully won a new Tier 1 panel customer outside of Korea, which marked the expansion of our OLED business into international markets. We are currently working with this customer on two OLED DDIC design projects and I am happy to report today that our first chip was successfully qualified by this customer in December and we will begin shipping towards the end of Q1 2023.

- Further, our 2nd OLED DDIC project with this customer successfully taped out in November are in-house and we are ahead of schedule to deliver the first sample in this month and production is expected to begin in the second half of 2023. This second chip offers significant performance and feature improvements over our first chip and alternative products. We are extremely excited about this new chip and multiple prospective smartphone makers are already showing interest for their new smartphones.

- We also strengthened our global supply chain by qualifying two additional 28 nm foundries, one of which was in strategic partnership with our new OLED customer. In total, we now have three 28 nm 12-inch OLED foundries qualified and we anticipated these foundries to increase our wafer allocation by 2 to 4x over the next few years compared to our 2022 levels. Going forward, wafer supply should not be a constraint on OLED segment revenue.

- At our leading South Korean panel customer, in Q4, we completed qualification of our first OLED chip for an automotive center display and we will begin shipping this quarter. We expect this to be used by a leading European luxury auto manufacturer. In addition, we taped out a new high-end smartphone DDIC project during Q4 and that is expected to begin production in the 2nd half 2023.

In our Power Solutions business:

- 2022 was a record year and was stronger fundamentally than what our Q4 revenue trend indicates. In 2022, we were awarded a record 209 design-In/wins across our entire Power Solutions product portfolio, more than double the number of designs awarded in 2021 and 2020.

- It was also a record year for revenue from our Premium products, which grew 10% year-over-year and represented a record 55.9% of Power Solutions' revenue, up from 51.5% in 2021. This strength helped overall Power ASPs over 2021 and 2020 levels.

- Revenue from our SJ MOSFETTs and IGBT products also set record highs in 2022. IGBT strength was most notable, with revenue growing 52% year-over-year thanks to extremely strong demand from solar inverter manufacturers. We expect this area of our business to continue to remain strong going forward thanks to the transformative clean energy policies globally to combat climate changes.

- In 2022, we remained focused on R&D and introduced many innovative performance power products across a wide range of applications from smartphones, automotive, solar, consumer products and industrial.

- In Q4, we unveiled our first power management chip optimized for OLED IT applications. The newly-designed sub-PMIC provides a variable voltage control that enables automated custom refresh rates based on the frame rate. This greatly improves power consumption and enables a smooth and comfortable viewing experience for games and videos.

- Further, in our Power Solution's Automotive business, in Q4, we introduced our 8th-generation 150V MXT MOSFET for optimized for Light Electric Vehicles' motor controllers and battery management systems. This MOSFET improves the drain to source resistance by over 28%, improves heat dissipation, and can operate in extreme temperatures between -55 Celsius to up to 175 Celsius, making it suitable to be used in a wide range of xEV applications. Our Automotive business saw significant momentum in 2022 and is exiting the year with multiple design-ins projects for leading Asian automakers and is expected to start contributing revenue in 2023.

In summary, while 2022 presented many challenges, particularly during the latter half of the year, we remain optimistic about the future. Our OLED business is poised for a recovery in 2023, with revenue projected to increase significantly in the second half as we ramp shipments of our four design-in projects with our two leading panel customers. We continue to expect the first half of 2023 to be impacted by elevated inventory levels and a very weak macro environment but the reopening of China is a very welcomed development and should lead to an improvement in their economy and consumer demand, which will help both our businesses.

For our Power Solutions business, we expect to maintain the momentum of design wins and Premium tier product mix. However, it's important to note that our Power business is not immune to the broader economic downturn which impacts consumer related applications and we expect the first half of 2023 to also be challenging. We believe that this will largely be due to macro factors rather than anything specific to fundamentals as the data points I just highlighted are a testament to the competitiveness of our Power products. Q1 is also typically our seasonally slowest quarter following holiday shipments and is impacted by slower activity around Chinese New Years. Looking forward, as channel inventories are consumed and the broader economy recovers, we expect to see a rebound in Power revenue.

In closing, despite a very challenging 2022, and an anticipated challenging 2023, our team remains committed to:

- One, introducing new competitive power products and accelerating next generation products, especially in new applications such as Automotive.

- Two, continuing our successful sales momentum of design wins in Power to drive business with current and new customers, which will improve our FAB3 utilization as well as margins.

- Three, accelerate next generation OLED DDICs for our customers domestically and internationally to hit the volume production by 2nd half 2023.

- Four, expand new OLED products for international markets to solidify foundation for future growth in 2024.

- Five, we have initiated a voluntary resignation program where we expect 4-5% of employees may apply for this program with our choice to accept or reject the applicants.

- And finally, I have voluntarily taken a 10% reduction in my salary for 2023 and rest of the senior management team are also deferring a portion of their base salary until we execute on our commitments.

Now, I will turn the call over to Shinyoung to go over Q4 results and give our Q1 guidance. Shinyoung?

Shinyoung Park:

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

Total revenue in Q4 was $61 million, down 14.3% sequentially and down 44.7% year-over-year. Revenue from the standard products business was $53.8 million, down 14.2% from Q3 and down 45.9% YoY. As YJ already mentioned, both the sequential and YoY decrease were mainly attributable to the supply constraints for wafers in our OLED business 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 $46.3 million, down 18% sequentially and down 20.5% YoY. The sequential decline accelerated from last quarter driven by deteriorating consumer demand for TV, smartphones, e-bike and computing applications.

Gross profit margin in Q4 was 26.4%, down from 35.0% in Q4 2021 but up from 24.2% in Q3 2022. The lower gross profit margin year-over-year was mainly due to unfavorable mix from lower Display revenue as well as lower utilization rate of Fab 3. The 220 basis point sequential improvement was primarily due to the absence of material inventory reserves or write-offs during the quarter. As a reminder, we recorded a $3.3 million scrap charge in Q3 related to demand weakness as a result of elevated smartphone inventories. Looking forward, we have reduced production at our Fab 3 in response to the industry-wide slowdown and inventory correction. As a result, our Q1'23 gross profit margin will be further impacted by lower utilization as well as higher manufacturing input costs such as electricity and wages. We expect gross profit margin to recover as volume and utilization improves in the second half.

Turning now to Operating Expenses. Q4 SG&A was $12.6 million, as compared to $11.4 million in Q3 2022 and $13.3 million in Q4 last year. Q4 R&D was $13.7 million, as compared to $13.3 million in Q3 2022 and $12.2 million in Q4 last year. Stock compensation charges included in operating expenses were $1.5 million in Q4 compared to $0.8 million in Q3 and $1.6 million in Q4 2021. Note that our Q3 SG&A was lower due to adjustments in Q3 to reduce then year-to-date accruals related to performance-based stock compensation.

Q4 operating loss was $10.1 million. This compares to an operating loss of $10.0 million in Q3 and an operating income of $63.9 million in Q4 2021. As a reminder, our Q4 2021 operating income benefited from $49.4 million of net termination fees related to our merger deal with Wise Road that was terminated in December 2021. On a non-GAAP basis, Q4 adjusted operating loss was $8.6 million, compared to adjusted operating loss of $6.6 million in Q3 and adjusted operating income of $14.4 million in Q4 last year.

Q4 adjusted EBITDA was negative $4.8 million. This compares to negative $3.0 million in Q3 and a positive $18.1 million in Q4 a year ago.

For the full year 2022, we recognized a tax expense of $5.2 million, due mainly to realized foreign currency gains recognized at our operating entity in Korea as a result of FX volatility during the year and a decrease in the Korean subsidiary’s deferred tax assets as a result of a change in corporate income tax rates, which was announced in December 2022.

Net income in Q4 was $3.0 million as compared with net loss of $17.2 million in Q3 and a net income of $53.6 million in Q4 a year ago.

Our GAAP diluted earnings per share in Q4 was 7 cents, as compared with a loss per share of 38 cents in Q3 and an earnings per share of $1.12 in Q4 last year.

Our non-GAAP diluted loss per share in Q4 was 36 cents. This compares with non-GAAP diluted earnings per share of 2 cents in Q3 and 29 cents in Q4 last year.

Our diluted shares outstanding for the quarter were about 44.1 million shares, which reflects shares repurchased as part of our expanded share repurchase program that we announced in mid-September, and we continue to exercise the buyback that was authorized by the Board.

Moving to the balance sheet:

Our cash balance at the end of Q4 was $225.5 million, down from $250.8 million at the end of Q3. The primary cash outflows in Q4 was planned CAPEX of $11.6 million, $8.9 million spent on stock buybacks and $7.9 million of annual contribution of statutory severance to certain external deposit accounts to comply with the local labor rules. We expect to continue to draw down on our cash driven primarily by continuation of our buyback program, an LTA prepayment to secure wafers at our leading foundry partner and normal CAPEX. Based on our forecast, we anticipate our cash may reach as low as $160 million during 2023 if we execute the LTA.

Net accounts receivable at the end of the quarter totaled $35.4 million, a decrease of 3.8% from Q3. Our days sales outstanding for Q4 was 53 days and 47 days in Q3.

Inventories, net totaled $39.9 million compared to $37.3 million in Q3. Our average days in inventory for Q4 was 82 days and 64 days for Q3. Higher average days in inventory for Q4 compared to Q3 was due mainly to a lower cost of sales, which decreased about 17% quarter over quarter.

Regarding our CAPEX plan, as I mentioned earlier, Q4 CAPEX was $11.6 million and for the full year 2022, we spent $23.4 million, in line with our previous estimate of $23.5 million that we provided last quarter. For 2023, we now anticipate CAPEX to be approximately $10 million, which is nearly 60% lower from the 2022 level.

In regard to our capital structure, in Q4, we repurchased approximately $9 million worth of stock or approximately 900K shares and continue to be active in the market with the approximately $37 million remaining in our buyback program at the end of Q4. We ended the year with $225.5 million cash and zero debt. This solid balance sheet allows us to confidently navigate any further economic downturns that may arise during this period of uncertainty.

Before moving to the first quarter guidance, I would like to note that we just commenced a voluntary resignation program and expect to complete it by the end of the first quarter. Due to the voluntary nature of this program, we are unable to provide an exact amount of the related financial impact at this time. However, under the assumption that about 4-5% of our employees apply for this program, we expect to have annual cost savings up to $3 million with the total cash cost of approx. $8.5 million to $12 million, about 35 – 40% of which relates to statutory severance.

Now moving to our First quarter guidance:

While actual results may vary, for Q1, Magnachip currently expects:

- Revenue to be in the range of $55 million to $59 million, including about $5 million of Transitional Fab 3 Foundry Services.

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

Thank you and now I will turn the call back over to YJ for closing remarks.

YJ Kim:

Thank you Shinyoung. Before we begin Q&A, I’d like close today by thanking all of our shareholders for their continued support during these challenging times. I’d also like to reiterate my earlier comments about our recovery plan for 2023 and beyond. We remain firmly committed to setting the business back on a solid foundation of growth this year and will execute it by:

- One, introducing new competitive power products and accelerating next generation products, especially in new applications such as Automotive.

- Two, continuing our successful sales momentum of design wins in Power to drive business with current and new customers, which will improve our FAB3 utilization as well as margins.

- Three, accelerate next generation OLED DDICs for our customers domestically and internationally to hit the volume production by 2nd half 2023.

- And finally, we will further expand new OLED products for international markets to solidify foundation for future growth in 2024.

With that I’ll turn the call back to over to Yujia

Yujia Zhai

Thanks YJ. So that concludes the prepared remarks section of this earnings call. Operator, please begin the Q&A session.

Yujia Zhai – Closing Remarks

Thank you! This concludes our Q4 earnings conference call. Please look for details of our future events on Magnachip’s Investor Relations website.

Thank you and take care.