Magnachip Semiconductor
Prepared Remarks for Q4 2023 Investor Conference Call

February 28, 2024

Steven Pelayo

Hello everyone. Thank you for joining us to discuss Magnachip's financial results for the fourth quarter and full year ended December 31, 2023. The fourth 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 are YJ Kim, Magnachip's Chief Executive Officer and Shinyoung Park, our Chief Financial Officer. YJ will discuss the Company's recent operating performance, business overview and directional guidance for 2024, and Shinyoung will review financial results for the quarter and provide guidance for the first quarter and full year of 2024. YJ will then briefly re-cap the Company's business strategy. 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. Such statements are based upon information available to the Company as of the date hereof and are subject to change for future developments. Except as required by law, the Company does not undertake any obligation to update these statements.

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 as supplemental measures of Magnachip's operating performance that may be useful to investors. A reconciliation of the non-GAAP financial measures to the most directly comparable GAAP measures can be found in our fourth 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 Q4 earnings call.

First, I believe it's important for investors to understand how our financial results fit into the big picture as we undergo a substantial transformation in our business over the next couple of years.

- First, we're dramatically shifting priorities in our Display business to be laser-focused primarily on China. This strategy builds upon 20 years of OLED driver success, primarily in Korea, and follows the industry's dramatic shift to China production.

- Second, we will be working this year and next to fill idle fab capacity in our Gumi fab as we transition away from supplying non-core Transitional Foundry Services, to higher margin Power products.

- Third, starting earlier this year, we began operating under a new structure that streamlines our go-to-market strategy, strengthens the potential for increased shareholder value, and also improves transparency for investors.

Let me provide more detail on each of these transitions:

- The first major transition involves China, which is becoming the new center of the OLED display universe. We're executing on a strategy to penetrate this vibrant market with feature-rich OLED standard products, and I'm pleased to say we've made tremendous progress so far. We've laid the groundwork for success by establishing a China-dedicated entity, and by building strong working relationships with Chinese panel makers and leading smartphone OEMs. Over the past few quarters, we've doubled our resources and staff in China amassing a team of more than 20 professionals dedicated specifically to our OLED display business. In addition, we hired senior advisors from a top 5G semiconductor company, the financial services sector and the China supply chain to help accelerate our progress… and I now personally travel to China on nearly a weekly basis to meet our strategic customers, partners, and strategic OEMs.

Our work in China is beginning to pay off. We've already secured two smartphone design-wins with leading OEMs, and expect more are on the way. It's part of our strategy to serve the full spectrum of models from mainstream to foldables. I'm confident that the results of our strategy will become apparent beginning later this year, with more significant revenue growth expected in 2025.

- The second major transition involves the idle capacity we expect in our Gumi fab created by the wind-down of our Transitional Foundry Services business. We plan to fill the idle capacity with our existing power product portfolio, as well as with a new slate of next-generation power products that we will introduce over the next several quarters. We believe these products will be on par with some of the best global suppliers of power products.

As we've said previously, this fab transition will depress gross margins until we can adequately replace the legacy Transitional Foundry Services business with higher-margin power products, and we intend to share updates on our perspective on this transition on a quarterly basis.

- To help achieve our goals during these transitions, we've now streamlined the structure of the company by creating two main business entities to better align our product strategies, and also to provide more transparency to investors through our new MSS (Mixed-Signal Solutions), which includes Display and Power IC products, and PAS (Power Analog Solutions), our traditional Power Discrete, businesses. To help investors better track our business progress, we will break out MSS and PAS revenue as well as gross margin beginning on the Q1 earnings call. The reasons for deciding to separate the standard products businesses structurally and operate independently are mainly because Display/Power IC are fabless and Power Discrete is an IDM business. In addition, the separation allows for the following benefits:

    1. Increase shareholder value by maximizing the valuation of each business. The separation allows a foundation for more efficient and transparent business structure that can fuel future sustainable growth through strategic financing and investment.

2. Strengthen business performance management by establishing independent and responsible management systems.

3. Enhance flexibility in business portfolio and increase strategic responsiveness to environmental changes.

We are confident that the strategies I've outlined will put us on a path to achieve a sustained recovery over the next two years.

While we typically provide guidance for one quarter only, I feel it's important in the current environment to provide directional guidance for 2024:

We currently expect double-digit revenue growth in both the newly organized MSS and PAS businesses. Overall, we expect total company revenue to be flat-to-up-slightly in 2024 over 2023, primarily due to the phase-out of Transitional Foundry Services. Gross margin for the consolidated company is expected to be in the range of 17% to 20% for the year, severely impacted by the idle capacity when the Transitional Foundry Services revenue winds down. While the near-term outcome is disappointing, rest assured that my team and I are committed to working every day on behalf of our shareholders to improve the results.

Now that I've provided the big picture context, let's review our Q4 results. Revenue was $50.8 million and gross margin was 22.7%, both near the low-end of our guidance range. During the quarter, our OLED business was impacted by slower design-win progress than expected due to longer OEM evaluation cycles. During Q4, we also embarked on another key OLED project aimed at diversifying our customer base to enter the smartwatch display market. Our Power business results were down 20.5% sequentially, primarily due to the ongoing inventory correction in industrial end markets, particularly in China's e-bike market and the solar sector.

Now, let me now provide updates to each of our businesses under the 2023 financial reporting convention:

Beginning with our Display business. Q4 revenue was in-line with our expectation at $5.2 million, down 30.8% year-over-year and 18.3% sequentially. We received our first pilot production purchase order in China for our first chip from an after-service market player during the December quarter and we are making progress on many additional fronts.

Specifically:

- **Q4** marked the beginning of initial shipments in China of our first OLED DDIC chip that we taped out in 2022. In Q4 2023, we were awarded our 1st design-win and related PO for the after-service market. While its immediate financial contribution is expected to be modest, it marks our first pilot production PO in China and is a significant step towards the acceptance of our product capabilities as well as our team's efforts.

- Moving on to our current generation OLED DDIC products, our third OLED DDIC chips successfully completed design-in evaluation at a leading Chinese smartphone OEM and been assigned a high-volume model for launch in Q2 2024. This resulted in a Design Win, with obtaining a pilot production PO, *as* a second source supplier. For this leading Chinese Smartphone OEM, we've been qualified and added to their Approved Vendor List. Moreover, we have been chosen to also work with them on their fall 2024 model with our new next-generation chip, which we've prioritized and we will sample next quarter.

- Additionally, our second chip is still going through a design-in evaluation phase at a global smartphone OEM. We will provide an update on this once we receive the status from the OEM evaluation.

Specifically,

- Mid last year, we announced that we began developing another OLED DDIC chip targeted for the fast-growing foldable smartphone market. Third party research firm China Securities estimates global foldable handsets are projected to grow over 50% a year over the next few years and reach over 100 million units by 2027 from just approximately 15 million units today.

- Finally, we are excited to announce that we partnered with a watch solution provider in China during Q4 to develop a new product targeting the OLED smartwatch display market. This is an adjacent market where we are applying our smartphone DDIC technology know-how and development expertise. The delivery of the first sample is expected in mid '24. This initiative demonstrates our strategy to expand into new, high-growth markets with new product offerings that showcase our ability to innovate across segments.

- **With regard to our OLED automotive business:** We began production shipments to our large Korean panel maker for three different car models from two top-tier European car manufacturers between May and July 2023. Modest revenue from those devices began in May 2023 and is expected to continue for a few years given longer automotive lifecycles.

All these efforts underscore our commitment to innovation and market expansion.

Moving on to our Power business: Q4 revenue was $36 million, down 22.3% year-over-year and 20.5% sequentially. Sequentially, our Power business was impacted by an ongoing inventory correction in industrial end markets, particularly e-bike and solar. We also saw weakness in consumer TV and PC power. On a positive note, we secured two new smartphone designs-wins for our Low Voltage MOSFET family, which grew more than 20% sequentially in the fourth quarter for that product family. While the overall power business results in the fourth quarter were disappointing, we currently expect a gradual recovery in our Power business in the first half of the year, with increased momentum in the second half. Our major markets, such as consumer, computing and communications already underwent a major inventory correction over the last year.

We continued to focus on execution in Q4. We developed and launched new Power products and saw strong momentum in our design-win activities. In Q4, we secured a new design-win and began mass production for a major U.S. automotive brand that will contribute to revenue growth in 2024. I am extremely proud of the progress we have made in our Automotive business, as revenue for the full year 2023 is up over three times compared to 2022. I look forward to building on this momentum in coming years.

We also continued to innovate. In October, we announced two new 650V SJ MOSFETs that reduce the overall footprint by nearly 60% as compared to other products from competitors. These new MOSFETs offer excellent design flexibility, efficient heat dissipation, and low resistance characteristics. As a result, they are well-suited for various applications that require compact size and high efficiency, such as OLED TVs, servers, lighting products, laptop chargers and adapters.

In summary, in our Power business, our product portfolio is getting stronger as we continue to focus on rolling out next-generation power products to maintain our momentum of design-ins and wins. These new products will provide the foundation to fill our Gumi fab, achieve better margins and help us get back to profitability. Entire families of our next generation products will be forthcoming in 2024. We will be releasing the next generation 650V IGBT in the first half of 2024, followed by 6th generation Super Junction MOSFETs and 6th generation IGBTs in Q3 of this year, and 8th generation MV MOSFETs and 8th generation LV MOSFETs in Q4 of this year. We expect these next generation product families to match or surpass the performance of our Tier 1 competitors. This will position us well to compete for higher-end industrial and automotive markets, as well as serve our existing markets such as consumer, computing, and communications better. Additionally, we will be introducing a new line of commodity products by the end of the fourth quarter to improve fab utilization.

I'll come back to wrap up the call after Shinyoung gives you more details of our financial performance in the fourth quarter and provide Q1 and full year 2024 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 $50.8 million, down 17% sequentially and down 16.7% year-over-year. Revenue from the standard products business was $41.2 million and revenue from Transitional Foundry Services was $9.6 million. Within standard products, Display business revenue was $5.2 million and Power business revenue was $36 million.

Gross margin in Q4 was 22.7%, down from 23.6% in Q3 mainly driven by lower fab utilization. Compared to the same period last year, gross margin decreased 370 basis points from 26.4% primarily as a result of unfavorable product mix, lower fab utilization and higher fab costs. Going forward, please keep in mind that there likely will be more volatility in our gross margin due to the relative sizes of the newly organized businesses on a standalone basis. In addition, among other things, product mix, fab utilization, and input manufacturing costs will impact our quarterly gross margin by business.

As a reminder, our Transitional Foundry Services contract with SK Key Foundry expired at the end of August 2023 and we are planning to wind down these foundry services starting in Q1 2024 and the revenue is expected to be approximately $2 to $3 million per quarter in the first half of 2024. Transitional Foundry Services accounts for approximately 30% of our Gumi capacity when fully utilized with foundry products. This anticipated decline is significantly impacting our factory utilization rate in Gumi which is negatively impacting our product gross margins for the Power business.

Turning now to Operating Expenses. Q4 combined R&D and SG&A was $27.5 million. This compares to R&D and SG&A of $23.7 million in Q3 2023 and $26.2 million in Q4 last year. R&D in Q4 was $15.4 million as compared to $11.6 million in Q3 and $13.7 million in Q4 last year, due to higher mask set costs. Stock compensation charges included in operating expenses were $1.7 million in Q4 compared to $2.1 million in Q3 and $1.5 million in Q4 last year.

Q4 operating loss was $15.9 million. This compares to an operating loss of $9.2 million in Q3 and operating loss of $10.1 million in Q4 2022. On a non-GAAP basis, Q4 adjusted operating loss was $14.1 million, compared to adjusted operating loss of $7.1 million in Q3 and $8.6 million in Q4 last year.

Net loss in Q4 was $6.0 million as compared with a net loss of $5.2 million in Q3 and a net income of $3 million in Q4 last year.

Q4 adjusted EBITDA was negative $10.0 million. This compares to a negative $2.7 million in Q3 and negative $4.8 million in Q4 last year.

Our GAAP diluted loss per share in Q4 was 16 cents, as compared with diluted loss per share of 13 cents in Q3 and diluted earnings per share of 7 cents in Q4 last year.

Our non-GAAP diluted loss per share in Q4 was 21 cents. This compares with diluted loss per share of 4 cents in Q3 and 36 cents in Q4 last year.

Our weighted average diluted shares outstanding for the quarter were 38.8 million shares. In Q4, under our new stock buyback program authorization of $50 million, we repurchased approximately 1.1 million shares or $8.2 million. We had about $36.4 million remaining out of the new $50 million program at the end of December 31, 2023.

Moving to the balance sheet:

We ended the quarter with no debt and cash of $158.1 million, down from $166.6 million at the end of Q3 2023. The primary cash outflow during the quarter was approximately $8.2 million of stock buybacks.

Net accounts receivable at the end of the quarter totaled $32.6 million, which represents a decrease of 20.6% from Q3 2023. Our days sales outstanding for Q4 was 59 days and compares to 62 days in Q3.

Our average days in inventory for Q4 was 77 days and compares to 61 days in Q3. The absolute dollar value of our inventory was up slightly quarter over quarter, while lower cost of sales primarily drove the calculation for days of inventory higher. Specifically, inventories, net at the end of the quarter totaled $32.7 million. This compares to $30.8 million in Q3 2023.

Lastly, Q4 CAPEX was $4.7 million and for the full year 2023, we spent $7 million, in line with our previous estimate that we reaffirmed last quarter.

Now moving to our first quarter and full-year 2024 guidance:
Beginning in Q1, we will begin reporting results under the newly organized businesses: MSS and PAS.

While actual results may vary, for Q1 2024, Magnachip currently expects:

- Consolidated revenue to be in the range of $46 to $51 million, including approximately $3 million of Transitional Foundry Services.
    - MSS revenue to be in the range of $8 to $10 million. This compares with MSS equivalent revenue of $8.6 million in Q4 2023.
    - PAS revenue to be in the range of $35 to $38 million. This compares with PAS equivalent revenue of $32.6 million in Q4 2023.

- Consolidated gross profit margin to be in the range of 17% to 20%.
    - MSS gross profit margin to be in the range of 40% to 43%, which includes the positive impact of expected one-time non-recurring engineering revenue. This compares with MSS equivalent gross profit margin of 41.3% in Q4 2023, which also included one-time non-recurring engineering revenue.
    - PAS gross profit margin to be in the range of 15% to 18% due primarily to the expected decline in Transitional Foundry Services revenue. This compares with PAS equivalent gross profit margin of 18.0% in Q4 2023.

For the full-year 2024, we currently expect:

- MSS revenue to grow double digits year-over-year as compared with MSS equivalent revenue of $44.4 million in 2023.

- PAS revenue to grow double digits year-over-year as compared with PAS equivalent revenue of $151.3 million in 2023.
- Consolidated revenue flat-to-up-slightly year-over-year as recovery in MSS and PAS is offset by the phase-out of Transitional Foundry Services.
- Consolidated gross profit margin between 17% to 20% due to idle capacity expected from the phase-out of Transitional Foundry Services. This compares with the consolidated gross profit margin of 22.4% in 2023.

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

YJ Kim

I want to emphasize points I made earlier because they are important for investors to understand where we are, and where we are headed.

1. Our Display business is building upon our past success in Korea to focus more squarely on China. As a sign of the importance of the China market, we have formed a dedicated China operating entity, enabling us to forge strategic partnerships with key players in the smartphone, TV, automotive and ecosystems. This move strengthens our market presence and fosters valuable relationships within the industry. As we benefit from these strategic initiatives in our China operations, we are optimistic about the trajectory ahead for our display business.

2. We are dealing head-on with an expected drop in fab capacity in our Gumi fab as a result of the expected drop-off in Transitional Foundry Services, and will provide regular updates on our plans.

3. We’ve separated the structure of the company into two entities to increase shareholder value by: maximizing the valuation of each segment, strengthening business performance management, and enhancing flexibility to respond to changes in the business environment. The move also will dramatically increase our transparency to the investor community.

   Thank you to our shareholders for your patience. We appreciate your support as we work to achieve our goals.

   Now I will turn the call back to Steven. Steven?

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

Steven Pelayo – 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.