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## AMKR - Q2 2019 Amkor Technology Inc Earnings Call

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**OVERVIEW:**

Co. reported 2Q19 revenue of $895m and loss per share of $0.04. Expects 3Q19 sequential revenue growth to be 15% and net EPS to be in range of loss of $0.03 to income of $0.17.

## CORPORATE PARTICIPANTS

**Megan Faust** *Amkor Technology, Inc. - Corporate VP & CFO*

**Stephen D. Kelley** *Amkor Technology, Inc. - President, CEO & Director*

**Vincent Keenan** *Amkor Technology, Inc. - VP of IR*

## CONFERENCE CALL PARTICIPANTS

**Jeffrey A. Rand** *Deutsche Bank AG, Research Division - Research Associate*

**Randy Abrams** *Crédit Suisse AG, Research Division - MD and Head of Taiwan Research in the Equity Research Department*

## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the Amkor Technology Second Quarter 2019 Earnings Conference Call. My name is Laura, and I will be your conference facilitator today. (Operator Instructions) As a reminder, this conference is being recorded. I would now like to turn the call over to Vincent Keenan, Vice President Investor Relations. Mr. Keenan, please go ahead.

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**Vincent Keenan** - *Amkor Technology, Inc. - VP of IR*

Thank you, Laura. Good afternoon, everyone, and thank you for joining us for Amkor's Second Quarter 2019 Earnings Conference Call. Joining me today are Steve Kelley, our Chief Executive Officer; and Megan Faust, our Chief Financial Officer. Our earnings press release was filed with the SEC this afternoon and is available on our website.

During this conference call, we will use non-GAAP financial measures, and you can find the reconciliation to the U.S. GAAP equivalent on our website. We will also make forward-looking statements about our expectations for Amkor's future performance based on the environment as we currently see it. Of course, actual results could be different. Please refer to our press release and other SEC filings for information on risk factors, uncertainties and exceptions that could cause our actual results to differ materially from these expectations. Please note that the financial results discussed today are preliminary and final data will be included in our Form 10-Q.

And now, I'd like to turn the call over to Steve.

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**Stephen D. Kelley** - *Amkor Technology, Inc. - President, CEO & Director*

Good afternoon. Thanks for joining the call. Today I'll review our second quarter performance and our third quarter outlook. I'll discuss market conditions and provide additional color on our automotive business.

Our second quarter revenue was just above midpoint guidance and flat to the first quarter. Our profitability was at the high end of guidance, due primarily to the impact of our cost control efforts. In the general market, which we define as everything but mobile communications, second quarter revenue was flat to first quarter as expected. We believe that the general market has stabilized and is poised for growth. In the third quarter, we expect revenue in the general market to increase approximately 10% sequentially, driven mainly by the ramp of advanced SIP in the consumer space. The remainder of the general market should grow sequentially at a low single-digit rate.

In the mobile communications market, second quarter revenue was also flat to first quarter as forecasted. We expect third quarter mobile revenue to be up almost 25% sequentially due to production ramps of flagship smartphones. Our overall revenue is expected to grow above 15% sequentially in the third quarter. We also have a positive view of the fourth quarter, which leads us to believe that the worst of the recent slowdown is behind us.

We have taken advantage of open capacity in our factories to speed new product and technology qualifications, accelerate quality improvement initiatives and improve manufacturing efficiency. These efforts have helped us secure new design wins, which are expected to drive growth in the second half of this year and into 2020.

As a technology leader, Amkor has all of the key enabling technologies our customers need. Most of these technologies were originally developed to meet the demanding requirements of mobile communications and high-performance computing customers. Now, many of these same technologies are being deployed in other markets, including automotive. In general, automotive customers are highly sensitive to performance and reliability. So our proven flip chip technology is a perfect fit for high pin count ICs found in ADAS and other data-intensive automotive applications. Our advanced wafer-level fan-out technology is a popular choice for automotive radar applications allowing our customers to eliminate substrates and improve performance. Finally, our advanced SIP technology is a great fit for high-end automotive infotainment systems, where performance is paramount. We believe that we are the leading outsourced assembly partner for many of the top companies that design and build ADAS image processor, automotive radar, high-end infotainment and other automotive subsystems. And with our strong technology platforms, we are well positioned to capture future growth opportunities.

Technology is very important for automotive customers, but is only one of many factors critical to success. Equally important are an automotive quality culture and a track record of continuous improvement. Due to the extended life cycles of automotive products, long-term supply stability is an important issue. Suppliers must demonstrate a long-term commitment to operate and invest in key factories.

We believe that Amkor checks all the boxes for automotive customers: performance, quality and reliability, best-in-class technology, stability and a long-term commitment to the business. And we're a familiar face. We've been building automotive-grade ICs for more than 40 years. We are encouraged by recent trends in our automotive business. In the first half of 2019, advanced packaging revenue in the automotive and industrial market was up more than 15% year-on-year. Increased electronic content and our strong competitive position were the key factors that drove that growth.

In the third quarter, we expect automotive and industrial revenues to grow mid single-digit sequentially. Both advanced and mainstream revenues are forecasted to grow. The growth in mainstream revenue is encouraging and may indicate that downstream inventory issues are abating.

In closing, I'd like to note that the CapEx controls we put in place last year have not impacted our momentum in areas important to our future growth, such as the development of new capabilities, the expansion of capacity in key growth areas such as advanced SIP and flip chip and our continuous quality improvement initiative.

Megan will now provide more detailed financial information.

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**Megan Faust** - *Amkor Technology, Inc. - Corporate VP & CFO*

Thank you, Steve, and good afternoon, everyone. Today, I will review our second quarter results and provide some comments about our third quarter outlook.

Our second quarter 2019 revenue of $895 million came in as expected, flat with the first quarter. Similar to the first quarter, our factories were focused on cost control, resulting in gross margin at the high-end of our guidance range. Operating expenses were lower than expected, primarily due to reduced discretionary spending. In addition, we had a modest gain in Q2 of $3 million on the sale of real estate in Japan.

The combination of better gross margins and lower operating expenses drove operating income margin up 100 basis point sequentially to 2.5%. Our second quarter loss per share of $0.04 includes a charge of $0.03 per share related to the early redemption of our $525 million senior notes due 2022. As a reminder, we refinanced these notes last quarter, pushing out the maturity 5 years to 2027.

We ended the quarter with over $550 million of cash on hand and total liquidity of over $700 million. Our strong balance sheet and liquidity allow us to continue to invest in new growth initiatives across our end markets.

Before I turn to guidance, I would like to note that we have a begun a 3-year project to rationalize our wirebond manufacturing footprint in Japan. The project will require some modest incremental expense over time which we see as a prudent investment in the business. Future growth with our Japanese customers will largely come from advanced products which are built in factories outside of Japan where we have scale.

Moving on to the third quarter outlook. We expect a 15% sequential increase in revenue as Steve mentioned earlier, to have a positive impact on operating margin, net income and EPS. Third quarter gross margin is expected to be in the range of 12% to 16%. Gross margin expansion will be constrained by changes in product mix and midyear cost increases.

Operating expenses are expected to be consistent with Q2, adjusted for the $3 million gain on the sale of real estate. Generally, our effective tax rate is around 25%, subject to a minimum level of taxes not dependent on our income. We expect the bottom line to be in the range of a net loss of $7 million or $0.03 per share, to net income of $41 million or $0.17 per share. We remain focused on CapEx discipline, which includes continued allocation of capital to key growth opportunities. We are holding our target for 2019 CapEx payments unchanged at $475 million.

We have a goal of generating positive free cash flow in 2019, which would represent our 5th consecutive year for this key metric. We reacted quickly to the industry slowdown and demonstrated the resiliency of our business model. Our focus on cost control and CapEx discipline together with our positive view of the second half should enable us to meet our free cash flow goal.

With that, we will now open the call up for your questions. Operator, you may begin the polling now.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) We have your first question from Sidney Ho with Deutsche Bank.

**Jeffrey A. Rand** - *Deutsche Bank AG, Research Division - Research Associate*

This is Jeff on for Sid. Congratulations on the good quarter managing expenses. Going forward, how much more room is there to manage OpEx or gross margin without impacting the business?

**Megan Faust** - *Amkor Technology, Inc. - Corporate VP & CFO*

Jeff, so with respect to operating expenses, we have done a fairly good job this year reducing those. I would say for the rest of the year, if you were to look at that, we still anticipate about a mid-single digit reduction OpEx. As it relates to cost of goods sold, given that we're expecting an increase in demand for the second half. We would expect some of those costs to come back with volume.

**Jeffrey A. Rand** - *Deutsche Bank AG, Research Division - Research Associate*

Great. And then 5G has been kind of a popular topic through earnings. Can you guys just talk about that opportunity and kind of where the biggest opportunity, is that on the infrastructure side now? Or kind of when you get to the 5G handsets in a few years?

**Stephen D. Kelley** - *Amkor Technology, Inc. - President, CEO & Director*

Yes, Jeff, I think of 5G in three basic areas: One is handsets, of course, one is the infrastructure and then one is in automotive. And so we're working on all 3 of those areas to gain share. So essentially some of the individual products we're working on today includes things like processors, modems. There's quite a bit of activity in RF front end, which includes antenna-in-package modules, transceivers, even power management. So as you look at the handset, which is the single biggest opportunity, there is some incremental gain for OSATs particularly in the front end module space and the power management space.

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**Operator**

We have your next question comes from Randy Abrams with Crédit Suisse.

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**Randy Abrams** - *Crédit Suisse AG, Research Division - MD and Head of Taiwan Research in the Equity Research Department*

I wanted to -- maybe the first one just a follow-up on the gross margins and the OpEx. For the gross margins, I guess the guidance was also flat but you are into the seasonal strong period in guiding a good sequential increase. Maybe go through because you mentioned in the prepared remarks there's some mix changes. But just some of the factors impacting the margins this year, were you not getting the leverage you sometimes do. And on the OpEx, I guess, Megan, if you can clarify, I think you mentioned, mid single-digit OpEx savings. So you've brought it down to $100 million, but then had the real estate gain. So I guess, in terms of absolute -- just to clarify the number, like if you expect mid single-digit off the $100 million ex -- or maybe if you can just clarify what your outlook in OpEx dollars would be towards second half?

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**Megan Faust** - *Amkor Technology, Inc. - Corporate VP & CFO*

Sure. Why don't I take that one first, that one is easier. The mid single-digit was referencing what we would expect for full year OpEx reduction. And we think we are on track to meet that goal for the year. As it relates to gross margin and expansion and what we're experiencing for Q3, as we've shared before with the high fixed cost structure and the leverage, generally we would see 40% to 50% drop through. And if you look year-over-year, from Q3 '18 to Q3 '19, that's we're right in that range, that we would expect 40% to 50%. So sequentially that is a different story and as that drop through is much lower on an increase of over $100 million in revenue and that's really driven by two reasons. The first reason we mentioned, about 2/3 of that is related to a change in product mix. So historically, you'll see that it's very common in the second half of our year given the seasonal builds to have an increase in material content and that's what we're experiencing and seeing here in Q3. That's also part of the advanced SIP product that we're ramping, that Steve mentioned in the consumer market. The second item is that relates to about 1/3 of the reason and that's due to some normal midyear labor and other costs increases that we expect. Labor, we tend to have the merit and promotions happen midyear, so that's a structural expense increase. And then there are some other low COGs that are more seasonal like electricity increase rates, et cetera, that increase in the middle of the year. And the last, there is some onetime expenses in there as well, some modest expenses for the Japan rationalization project we mentioned. So that's what's contributing to the drop through.

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**Randy Abrams** - *Crédit Suisse AG, Research Division - MD and Head of Taiwan Research in the Equity Research Department*

Okay. If I could follow-up on the Japan rationalization, because you mentioned there's some expense -- there will be a little bit of expense increase. But could you go through that project? Is this intended to be a upgrade like the costs will be to upgrade the capacity or is it more to restructure, so downscale the capacity and then eventually the cost structure would have a change? So maybe if you can talk a bit more of what you're doing in the Japan facilities?

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**Megan Faust** - *Amkor Technology, Inc. - Corporate VP & CFO*

Sure.

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**Stephen D. Kelley** - *Amkor Technology, Inc. - President, CEO & Director*

Maybe, why don't I just say a few words and then I'll turn it over to Megan. Basically, in Japan, we're trying to reduce our factory footprint. The Japan factories are all wirebond or mainstream factories and the demand for mainstream products is steadily declining over time. So our job in Japan basically is to consolidate, to reduce the footprint so we can maintain reasonable margins. The focus in Japan for us is really growing with our Japanese customers in advanced packaging. And so what we're seeing is most of the new products are ramping in factories outside Japan.

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**Randy Abrams** - *Crédit Suisse AG, Research Division - MD and Head of Taiwan Research in the Equity Research Department*

Okay. Great. And I have a question I just wanted to ask on the outlook. The third quarter in mobile, the 25% actually seems even a bit stronger than normal. And I think separately you mentioned new design wins coming through second half this year into 2020. If you could talk maybe the factors on above seasonal and if it's just a function that we came off a low base start of the year. If that's part of it or its you're seeing actually a change where it's somewhat market share related or customers expecting a better second half. Because I think in that you're also expecting strength already into fourth quarter? So maybe if you can talk a bit more on the design wins and also the second half like the driver of that strength or the sequential pickup?

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**Stephen D. Kelley** - *Amkor Technology, Inc. - President, CEO & Director*

Yes, Randy, that's good question. So I think you're right. Most of the increase is coming up off a low base. So the first half was pretty difficult I think. As you recall, we went through a pretty significant inventory correction in many different smartphone markets and then we're also in a downcycle in the general market. So when you compare first half to second half then you get quite a increase. In Q3 specifically, we're seeing the smartphone side up almost 25%, and then we're getting help from the consumer side where we've got some new SIP-based products ramping in consumer. As you move into Q4, the reason we're optimistic is we see both of the big opportunities continuing into Q4, whether it's smartphone built or the consumer IC ramp. But we also see the general market is starting to recover. We have a small -- low single-digit increase outside consumer in Q3. And if we look at the historical patterns, we should see continued recovery in the general market in the coming quarters. So that's why we're optimistic on Q4 and also optimistic about 2020.

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**Randy Abrams** - *Crédit Suisse AG, Research Division - MD and Head of Taiwan Research in the Equity Research Department*

Okay. And then if I could fit just one last question just with all the -- there's a lot of moving parts with trade war. But to the extent it's kind of 2 factors. You've been expanding the China business over time. I guess, how the shifts in the supply chain if it's changing your projections working and expanding into China customers or serving international customers out of the Shanghai facility? And if you could also comment if you saw anything on the Huawei impact. Whether it's slowdown and then picking back up or there's maybe a more of a disruption continuing on that segment until they're back to normal?

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**Stephen D. Kelley** - *Amkor Technology, Inc. - President, CEO & Director*

Okay. So just to make sure I have your questions. One is the competitive position in China vis-à-vis China OSATs, second is impact of Huawei and third is international customers in Shanghai.

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**Randy Abrams** - *Crédit Suisse AG, Research Division - MD and Head of Taiwan Research in the Equity Research Department*

Yes. And I think competitive position in China. How that ramp up of the Greater China business is progressing?

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**Stephen D. Kelley** - *Amkor Technology, Inc. - President, CEO & Director*

Yes, sure. Okay, why don't we start with the China OSAT question. Our strategy in China has always been very well defined. We only compete in the advanced packaging area, because our philosophy is, if we can't do it better than the Chinese OSATs, then we're probably not going to win in Mainland China. And so that really hasn't changed too much over the past year. Clearly, if there are local competitors who could do everything we could do, provide the same bundle of goods and services then we're probably going to lose. So our growth in China has really been built on the fact of that we have technology leadership, we execute well on our factory in China and factories outside China. And we keep our mainland China customers happy. So that strategy is not going to change. If we look back to when we started this program back in 2013, our revenues are up around 7-fold in Greater China. Well, our revenues as a company are only about 55%. So we've been gaining share in China faster than we have in the rest of the world. As I look at Huawei, again, we don't have much direct exposure there because we don't do business with high silicon. We never really had high silicon as an account. So there's not much to lose there for us. We do feel the impact of some of the things happening with Huawei through our other customers. So any of our customers who supply into Huawei, into the infrastructure or the phone groups. Obviously, if they have an impact, we feel it. But we don't think it's that material for our results overall. As far as the international, yes, the last question, the international customers in Shanghai. At this point, none of our international customers in Shanghai have expressed an interest in moving that business to other locations. But if they do, that's one of the benefits of our factory strategy is that we have advanced factories in a number of different locations outside China, which duplicate our capabilities in China.

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**Operator**

(Operator Instructions)

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**Vincent Keenan** - *Amkor Technology, Inc. - VP of IR*

Thank you, Laura. This ends the question-and-answer portion of our call. I will now turn the call back to Steve for his closing remarks.

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**Stephen D. Kelley** - *Amkor Technology, Inc. - President, CEO & Director*

Okay. I would like to recap our key messages. First, second quarter revenue met our expectations. Profitability was better than expected. Second, third quarter revenue should be up about 15% sequentially, driven by production ramps for flagship phones and strengthen advanced SIP for the consumer market. And finally, we're positive about the fourth quarter and believe that the worst of the slowdown is behind us. Thank you for joining the call today.

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**Operator**

Thank you, everyone, for participating. This concludes today's conference. You may now disconnect.

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