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AMKR - Q2 2014 Amkor Technology Inc Earnings Call

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OVERVIEW:

AMKR reported that 2Q14 revenue grew 10% sequentially and 3% YonY. Co. expects 3Q14 revenue to be \$840m at the midpoint of guidance.



CORPORATE PARTICIPANTS

Greg Johnson *Amkor Technology, Inc. - Senior Director of IR and Corporate Communications*

Steve Kelley *Amkor Technology, Inc. - President & CEO*

Joanne Solomon *Amkor Technology, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Randy Abrams *Credit Suisse - Analyst*

Suji De Silva *Topeka - Analyst*

Chad Dillard *Deutsche Bank - Analyst*

Jairam Nathan *Sidoti & Company - Analyst*

David Duley *Steelhead - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Amkor Technology second-quarter 2014 earnings conference call. My name is Jamie, 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 Greg Johnson, Senior Director of Investor Relations and Corporate Communications. Mr. Johnson, please go ahead.

Greg Johnson - *Amkor Technology, Inc. - Senior Director of IR and Corporate Communications*

Thank you, Jamie, and good afternoon, everyone. Joining me today are Steve Kelley, our President and Chief Executive Officer; and Joanne Solomon, 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 US GAAP equivalent at 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 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. With that, let me hand it over to Steve.

Steve Kelley - *Amkor Technology, Inc. - President & CEO*

Good afternoon, and thanks for joining the call today. We had a strong first half and are looking forward to a very strong second half of 2014. We expect record third-quarter revenues to drive improved gross margin and improved earnings per share. Our leading edge technologies will fuel second half growth as mobile devices with high end core content are launched to market. We now expect to grow Amkor revenues faster than the overall semiconductor market in 2014, as we did in 2013.



Our Q2 revenues were up 10% sequentially and 3% year on year. Strength in the second quarter was broad based with communication products leading the way. Our execution in the advanced product area has been very good and contributed to some important wins in the second quarter. These wins served to firm up our expectations for the second half of 2014 and offered encouraging outlook for the first half of 2015.

In the third quarter, we expect revenues to grow by approximately 10%. Our midpoint Q3 revenue guidance is \$840 million, well above our previous peak. Had we not transferred our Japan operations to J-Devices, our midpoint Q3 guidance would have been roughly \$860 million, a 12% sequential increase.

We continue to focus on expanding our participation in the smartphone and tablet market. In addition to our applications processor and baseband work, we are a major player in NAND flash and power management ICs and are rapidly growing the RF module business. Our fingerprint sensor and MEMS businesses are experiencing strong growth. In addition, we are investing in fusion sensor products, which combine multiple sensors and a microcontroller into a single package.

All three of our advanced product manufacturing hubs, Korea, China, and Taiwan are quite busy right now. Our three-country footprint allows customers to choose manufacturing locations which best fit their supply chain needs.

Mainstream product sales are also expected to grow in the second half of 2014. Our efforts to broaden Amkor's customer base and engage more deeply with current customers are beginning to show results. Sales into all of the major market areas: automotive, industrial, consumer, networking, and computing are expected to rise in 2014.

Amkor's 2014 sales into the automotive market should be up 25% year over year. Combined Amkor and J-Devices automotive revenues are expected to exceed \$750 million this year and reach a \$1 billion yearly run rate within three years. The automotive business is relatively stable but leverages Amkor's strengths and is a key part of Amkor's revenue foundation. We continue to broaden and deepen our cooperation with J-Devices on many fronts, including sales, operations, and R&D.

Amkor owns a 60% stake in J-Devices, the world's 7th largest OSAT and the largest OSAT in Japan. From a financial standpoint, Amkor currently accounts were J-Devices as an investment. We expect to consolidate J-Devices results by 2016 adding roughly \$1 billion to Amkor's revenues.

Now I would like to spend a few moments talking about our R&D priorities. Our R&D team's number one priority is developing low cost packaging solutions for the next generation of mobile devices. Solutions which minimize bill of material and process cost while maximizing yields and reliability performance. This development effort is particularly important for customers seeking cost-effective alternatives to further silicon level integration. Our R&D team is currently engaged in projects at the sub 20-nanometer level in addition to their efforts at the 20- and 28-nanometer nodes.

Another important R&D focus area is the development of wafer-level packages for larger ICs. These wafer-level chip scale packages are increasingly the package of choice for many ICs using mobile devices. They provide a very low-profile product at a competitive cost. Wafer-level CSPs are also a preferred solution for wearable and Internet of Things applications.

To take advantage of attractive sales growth opportunities in the first half of 2015, we are increasing our 2014 capital investment plan to approximately \$675 million, an increase of \$100 million from the guidance provided in April. Most of this incremental capital investment will be in wafer-level packaging, advanced flip chip, and advanced test capacity. Our early investments in these areas have already paid off.

Amkor is today the clear technology and volume leader in the advanced packaging and test area. Advanced packages are now the preferred choice in both the high-end and the mid-range segments of the smartphone market, which together account for roughly 90% of mobile phone IC value. The demand for advanced packages is also being driven by a second wave of mobile device customers who are transitioning out of wire bond into wafer level and flip chip packages.

This technology transition is opening the door for Amkor at many accounts where we have grown presence today. As I have said many times since during the import, our principal objective is growing revenue to drive sustainable earnings growth. 2012 marked the end of a several-year period

with relatively flat sales and profits. In 2013, we saw sales grow 7%, gross margin improve by 160 basis points, and earnings per share improve from \$0.24 to \$0.50.

2014 is looking even better with strong year-over-year growth, improved gross margin, and improved earnings per share. Our investments in advanced packaging capacity and leading edge testers are paying dividends for us and providing the needed foundation for growth into 2015. Joanne will now provide more detailed financial information.

Joanne Solomon - *Amkor Technology, Inc. - CFO*

Thank you, Steve, and good afternoon, everyone. Overall, 2Q was a strong quarter and consistent with our expectation. Our gross margin improved 110 basis points over the second quarter of 2013. The increase was primarily due to sales growth, favorable product mix, and lower material costs.

Operating expenses in the quarter were \$90 million. This was up from \$83 million in the first quarter principally from project specific professional and consulting fees and our R&D activities in connection with the ramp of 20-nanometer production and other technology initiatives. For the rest of 2014, we expect our operating expenses to be around \$85 million a quarter.

Our effective tax rate in the second quarter was 29%. This was driven by discrete tax items and changes in our earnings mix among foreign jurisdictions. For the full-year 2014, we now expect an effective tax rate of around 25%.

The other income caption shown on our income statement includes two items related to foreign currency. We recognized a \$9 million gain on the sale of our Japanese subsidiary to J-Devices. The gain was mainly driven by the release of accumulated foreign currency translation adjustments. We also recognized an offsetting loss of \$4 million from the impact of unfavorable foreign exchange rate movement in the quarter.

Our equity pick-up from our 60% ownership in J-Devices in the second quarter was \$20 million. J-Devices recognized a gain on their purchase of our Japanese subsidiary as they were able to book a deferred tax asset for net operating loss carry forward for which we had a valuation allowance. Our 60% share of that gain was \$9 million. J-Devices also received the first annual settlement of a two-year take-or-pay contract this quarter. Our share of this settlement was \$8 million. We had originally forecast the settlement for the next quarter. The remaining \$3 million was generated from J-Devices operation and that's what result considering that this is their seasonally slowest quarter.

And finally at June 30, we had total debt of \$1.5 billion. Our debt to EBITDA was 2.1 times. Our liquidity is solid with \$525 million in cash and \$435 million in available revolving credit lines and undrawn secured term loans. With that, we will now open the call up for your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Randy Abrams, Credit Suisse.

Randy Abrams - *Credit Suisse - Analyst*

Yes, hello, good morning. The first question, I want to see if you could talk about the increase in CapEx. Just what, I guess, is prompting the upward revision and I guess coupled with some of your competitors or peers in the group also raising CapEx? Just how you are viewing overall supply side, just in terms of new investment coming in and any potential risk where we could get into oversupply situation?

Steve Kelley - Amkor Technology, Inc. - President & CEO

Randy, let me address that question two ways. First, a little more color on why we increased the spending forecast.

We had a few things happen in Q2 that were positive for Amkor. We had a major customer who awarded us more share through the end of this year and into next year.

We also had another major customer who won a significant program. That drove from acceleration of spending we were planning to make in 2015 we pulled into 2014.

The third major item was really the fact that this move to wafer level chip scale packaging has accelerated. So we are basically using all of our available capacity this quarter in that particular part of our business so it's incumbent on us to build some more capacity there.

I think the second part of your question was more general, are we building too much assembly test capacity in the OSAT industry, is that correct?

Randy Abrams - Credit Suisse - Analyst

Yes, that's correct.

Steve Kelley - Amkor Technology, Inc. - President & CEO

My feeling is probably not. Let me just -- I'll spend a few minutes discussing why I think that.

The first factor is, is IDM spending is way down on some of the test equipment. With a few exceptions, most IDMs today depend on Amkor and other OSATs for their incremental assembly and test equipment needs.

The second area is that our OSAT tam is shifting rapidly so many of our competitors right now are playing catch-up when it comes to advanced product investment. A third factor is really the fabless customers continue to grow at a faster rate than the overall chip industry, and we are keeping pace with them.

Lastly, and maybe most importantly, the cost per incremental unit of capacity in advanced packaging is simply higher. If you take a look at these advanced packaging facilities that we've put together, it looks like a wafer fab, a lot of big machines, very few people so a lot of capital expense but your margin is better on those types of products. I hope that answers your question.

Randy Abrams - Credit Suisse - Analyst

Yes, that's helpful. The second question, it's probably two separate ones I'll try to fit into one. On the wafer level packaging that you're mentioning, could you talk how much of it is the fan-in which is used in mostly like connectivity, Wi-Fi, versus if you're starting to need to invest to see the fan-out wafer level packaging for baseband or time-based spent AP memory?

And it's probably a little bit separate but you highlighted the sensors and MEMS as a growth area, and if you could talk about maybe how big that -- how fast that area is growing and how big that's getting? I know it's two slightly separate questions, but thank you.

Steve Kelley - Amkor Technology, Inc. - President & CEO

Yes, so, your first question was on wafer level packaging, some idea about fan-in in versus fan-out. I think the fan-out part of it still fairly new. We see some of that but not a whole lot at this point. We have development efforts going on with a number of customers in that area but we will have to see how that plays out.

Fan-out is one approach to the high-level of integration that our customers demand from next-generation. And we've got other approaches and I think what will happen there is that the best cost solution will win. Whatever solution wins we'll go with that one. But right now I think we have more effort focused on some of the non-fan-out approaches to the mobile device equation.

The second part of your question is sensors and MEMS. We are seeing tremendous growth right now in excess of \$100 million in sales this year. We are seeing it not only in the mobile phone area but also in automotive areas and the Internet of Things applications as well.

We get good economies of scale here. We have a cavity MEMS line in our Philippines facility where we manufacture a wide variety of MEMS on a single line which allows us to pass on better costs for our customers.

Randy Abrams - *Credit Suisse - Analyst*

Thank you.

Steve Kelley - *Amkor Technology, Inc. - President & CEO*

Thank you.

Operator

Suji De Silva, Topeka.

Suji De Silva - *Topeka - Analyst*

Hello, guys. Nice job in the quarter.

Steve, you talked about the -- some of the Tier 2 handset baseband guys moving over to advanced packaging. How far are we in that transition? Is it still early innings and how much share do you expect to get as that transition happens?

Steve Kelley - *Amkor Technology, Inc. - President & CEO*

I think the transition is happening fairly quickly. I expect 60% to 70% of the transition happen in the next 12 months in the second tier. And I think it will be largely complete by the end of 2015.

The goal I've articulated this year is to at least double our sales into the China and Taiwan fabless region this year. I expect a similar goal for next year, so we are expecting to move our share up. I won't be happy until we have about 30% of the share of that China-Taiwan fabless market but that's going to take some time.

Suji De Silva - *Topeka - Analyst*

Great, and then also a question on the gross margin. You've achieved I think your low 20% target at \$800 million. What can we expect next there? And is it really driven more by mix in advanced packaging, or I think utilization is pretty full but I just wanted to get a sense of that breakout.



Steve Kelley - Amkor Technology, Inc. - President & CEO

I think it's partly mix but really I think we have more to gain on the utilization side. So we're working closely with the factories in the coming quarters to try to improve their efficiencies. So I think there's some gains to be made there that are still out there.

Suji De Silva - Topeka - Analyst

Would you articulate a next target or should we think about low 20% being the level for now?

Steve Kelley - Amkor Technology, Inc. - President & CEO

Right now low 20% is the level. That's what I would model. But we are obviously aiming for better than that over time.

Suji De Silva - Topeka - Analyst

Great. Thanks, Steve.

Operator

Chad Dillard, Deutsche Bank.

Chad Dillard - Deutsche Bank - Analyst

Hello, thanks for taking my question. Just had one on wafer-level packaging market and can you just talk about how you expect that market to grow this year?

Steve Kelley - Amkor Technology, Inc. - President & CEO

Yes. The wafer-level packaging market is growing faster than the industry can put capacity in place. That's probably the best way I can put it.

What we are seeing right now is that any integrated circuit which goes into a smartphone or a tablet or to any high sensitive application is trending quickly towards that solution. What's happening there is the wafer-level CSPs are really now the package of choice for even the midrange products and smartphone area. So you will see adoption of this package throughout the industry in the coming 6 months to 12 months.

Chad Dillard - Deutsche Bank - Analyst

Then on the consumer segment, can you just provide a some detail on your share expectations? Do you see any benefit from some of the PC market starting to come back to life and just overall any other opportunities for share gains?

Steve Kelley - Amkor Technology, Inc. - President & CEO

I think the way we view the non-mobile market right now, which includes consumer and computing and networking, industrial, and so forth. We see it is pretty steady. From a supply standpoint, I think you've seen the semiconductor industry adapt to a low growth environment. So there's not a lot of capacity being added there, particularly at the IDM level. So I think it looks okay, just from a supply standpoint.



From a demand standpoint, we really see that the PC market and other markets have stabilized. And we don't expect great things but we expect, let's say, steady growth and worst case flat in those most markets.

Chad Dillard - *Deutsche Bank - Analyst*

That's all for me. Thank you.

Operator

Jairam Nathan, Sidoti.

Jairam Nathan - *Sidoti & Company - Analyst*

Hello, thanks for taking my question. We are seeing a lot of competition between foundries to get the next business and getting into the 1X nodes and stuff. So one of them has an integrated model. The other has -- uses a lot more As this share keeps shifting or the risk of shifting from one to the other, how does Amkor gauge that risk when they are doing your CapEx runs?

Steve Kelley - *Amkor Technology, Inc. - President & CEO*

That's a very good question. Let me make a few comments about the OSAT supply chain.

First if you take a look at the market today, our customers, the vast majority of both the fabless and the IDM chip companies prefer to maintain separate foundry and OSAT supply bases. They buy wafers from the foundries and they buy package and test services from the OSAT.

Why? Because this model offers much more supply-chain flexibility and also keeps the cost base very competitive. I would say it's a tried-and-true approach and it works.

The other key point is that we work closely with all the wafer foundries today. TSMC, SMIC Global, all view Amkor as a preferred partner. Intel awarded us the Preferred Quality Supplier Award last year.

We are working with most of those foundries at the sub 20-nanometer level. We've got good relationships with these foundries. What I think is going to happen is that if we execute the 20-nanometer node, and we will, if we perform well, deliver the right products in sufficient volume then we'll be very well-positioned for the next node. It really comes down to execution and I think the end customers will ultimately determine the supply chain at the 40-nanometer and 60-nanometer nodes.

Jairam Nathan - *Sidoti & Company - Analyst*

Okay, thanks, and my second question was on the higher CapEx now. Would some of that -- does that go to K5s on the equipment or is that a separate discussion here?

Steve Kelley - *Amkor Technology, Inc. - President & CEO*

That's a separate -- so K5 is a separate discussion. That is not included in the latest raise so -- that's a topic we'll come back to in the next earnings call, but I did comment on K5 the last earnings call. We're spending some money this year as we begin construction. We spend the bulk of the money on K5 next year and then complete our construction in early 2016.



Jairam Nathan - *Sidoti & Company - Analyst*

Okay. Thank you.

Operator

(Operator Instructions)

David Duley, Steelhead.

David Duley - *Steelhead - Analyst*

Thanks for taking my question. You mentioned that you had a second-tier handset customer, I guess migrating from wire bonded solutions to advanced packaging solutions. Could you help me understand how that's going to impact utilization rate of your older equipment? And do you other customers to backfill that migration?

Steve Kelley - *Amkor Technology, Inc. - President & CEO*

Yes, it is been a key sore point for Amkor for a number years and we put a major press in Asia and in other customers in the US in particular to try to ensure that we keep our leading edge assets full. So leading edge being both the assembly and the test assets. And what we are seeing is that most of the second wave customers are adopting the same test platforms in the same package types as the first wave technology leaders. It works very well for us.

So whatever it requires from us to capture second wave customers is not necessarily capital investment but investment in people. So that's what we've been doing this year is we've been building up our service infrastructure, and technical support infrastructure in Asia so that we can secure the business from these second wave customers.

David Duley - *Steelhead - Analyst*

Okay. And could you help me understand two things. What will be the impact on the gross margins, I guess, on a quarterly basis maybe this year and next year with the higher CapEx?

And could you just give us what the overall utilization rates of the separate areas of your equipment was? Thank you.

Joanne Solomon - *Amkor Technology, Inc. - CFO*

On the capital intensity point and how -- the increase in capital and how it impacts our depreciation rates, for Q2 depreciation expense was running about 13%. So we do see that notching up with some of the higher increased capital intensity of the wafer level processes, so it could go to 14%-ish, 15% over time.

David Duley - *Steelhead - Analyst*

And so maybe you think 15% next year and 14% this year since you won't be able to get the stuff in place immediately?



Joanne Solomon - Amkor Technology, Inc. - CFO

I think that's fair.

David Duley - Steelhead - Analyst

Okay and just one as a follow-on. How should we think about how you spend this money? Will it all be in the third quarter incrementally or will you spend a lot in the fourth quarter as well?

Joanne Solomon - Amkor Technology, Inc. - CFO

It will be over the Q3 and Q4. We have fairly long payment terms with our capital equipment guys so the payments will be actually over Q3 and Q4

David Duley - Steelhead - Analyst

Okay.

Greg Johnson - Amkor Technology, Inc. - Senior Director of IR and Corporate Communications

Thanks, Dave. This ends our Q&A. I will now turn the call back to Steve for his closing remarks.

Steve Kelley - Amkor Technology, Inc. - President & CEO

I would like to recap our key messages. We delivered a solid second quarter with 10% sales growth, an improvement in gross margin and profitability.

We expect a very strong third quarter and second half 2014. We are poised to outgrow the semiconductor industry and improve our profitability for the second year in a row. And finally, we are making good progress in achieving our primary corporate objectives, growing revenue and driving sustainable earnings growth.

Thank you for joining us today on the call.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.

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