

FINAL TRANSCRIPT

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AMKR - Q3 2011 Amkor Technology Inc Earnings Conference Call

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Ken Joyce

Amkor Technology Inc - President & CEO

Joanne Solomon

Amkor Technology Inc - CFO

CONFERENCE CALL PARTICIPANTS

Farhan Rizvi

Credit Suisse - Analyst

Wenge Yang

Citigroup - Analyst

Eric Ruebel

MTR Securities - Analyst

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the third quarter 2011 Amkor Technology earnings conference call. My name is Camille, and I'll be your conference operator for today's call. At this time, all participants will be in a listen-only mode. Following the presentation, the conference will be open for questions. This conference call is being recorded today, Thursday, October 27th, 2011, and will run for up to one hour.

Before we begin this call, Amkor would like to remind you that there will be forward-looking statements made during the course of this conference call. These statements represent the current view of Amkor management. Actual results could vary materially from such statements.

Prior to this conference call, Amkor's third quarter 2011 earnings release was filed with the SEC on Form 8-K. The earnings release together with Amkor's other SEC filings contain information on risk factors, uncertainties, and expectations that could cause actual results to differ materially from Amkor's current expectations.

I would now like to turn the conference over to Mr. Ken Joyce, Amkor's President and Chief Executive Officer. Please go ahead, sir.

Ken Joyce - Amkor Technology Inc - President & CEO

Thank you, Camille, and good afternoon, everyone. With me today is Joanne Solomon, our Chief Financial Officer. Today, I'll talk about our third quarter results, some steps we are taking to mitigate the challenges to profitability that we've been experiencing in 2011, and guidance for the fourth quarter. Joanne will then discuss our financial performance in more detail. And finally, we'll open up the call for your questions.

To begin, third quarter sales of \$740 million were close to the midpoint of our guidance, while gross margin of 17% and earnings per share of \$0.11 were at the low end.

Sequentially, sales were up 8%, driven by solid demand in communications, particularly for smart phones and tablets, and a seasonal increase in the consumer area led by our strong position in gaming.

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Turning to our other end markets, networking and computing held steady, and we saw a slight decline in automotive and industrial, as some customers adjusted inventory levels in the face of an uncertain demand environment.

Our gross margins have been under pressure throughout 2011 with the principle contributors being unfavorable foreign exchange rates, higher gold prices, and pockets of underutilized capacity. The accelerated migration of gold wire bond products to flip chip has opened up wire bond capacity faster than we've been able to redeploy these assets. And this has been one of the primary contributors to our 2011 utilization gap.

We're committed to addressing these challenges to profitability and currently focused on rationalizing our cost structure and improving utilization. These efforts are already underway, and during the third quarter, we implemented an 8% reduction in force in our Philippines manufacturing operation.

We expect to improve our labor cost by about \$2 million on a quarterly basis through this action. We're also looking at other areas for improving our cost structure, including further alignment of our workforce with customer demand, investing in operating efficient initiatives in our factories, and achieving greater cost savings on material and equipment through our continued focus on supply chain management.

Although the shift of packages out of wire bond and into flip chip has led to some gaps in utilization of our wire bond assets, this migration is a positive story overall from a revenue and return perspective. This quarter, about 40% of our revenues came from flip chip applications, up from about 30% in Q3 of last year. And Amkor has the largest share of flip chip market in the OSAT industry. Our flip chip packages generally yield both a better -- a higher margin and a higher return than our wire bond packages.

In addition, we are working on a number of initiatives to improve the utilization of our wire bond assets. Our efforts include ramping NAND memory production in our China facility, promoting the adoption of our copper wire bond solutions, and increasing penetration of IDMs as they pursue asset-light business strategies.

Looking ahead to the fourth quarter, we expect sales to decline between 5% and 12% from the third quarter. Based on the current level of demand for smart phones and tablets, our wireless communications business is expected to remain strong. However, we see a general softening in demand in other areas driven by the uncertain macroeconomic environment, coupled with the seasonal decline in gaming.

As I mentioned earlier, we continue to see solid demand and high returns from our newest and most advanced interconnect technologies for wireless communication packages and for flip chip packaging overall.

To support this demand and to meet the capacity requirements of our leading customers, we spent \$123 million on capital additions in the third quarter. And we're currently planning additions of \$100 million to \$125 million for the fourth quarter for a total of \$425 million to \$450 million for the full year.

These investments primarily support smart phones and tablets, leadframe efficiency improvements through high-density matrix packaging, and research and development initiatives, including next-generation interconnect technologies, such as Wafer Level Fan Out and Through Silicon Via.

Fourth quarter gross margin is expected to be in the range of 15% to 18%, as we expect to see some margin pressure from lower utilization commensurate with the decline in revenues. Our gross margin guidance does not include any additional restructuring charges. That said, we are evaluating adjustments in our cost structure in light of our current demand expectations.

Turning to cash flow, I'm pleased to say that we expect 2011 to be our sixth consecutive year of positive free cash flow. So, even with the downturn in revenues, gross margin pressures, and significant investments in capacity for our customers and research and development, we should again be free cash flow positive for the year.



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With that, I'll now turn the call over to Joanne.

Joanne Solomon - *Amkor Technology Inc - CFO*

Thank you, Ken, and good afternoon, everyone. To begin, we grew our revenues to \$740 million in the third quarter, which was up 8% from Q2. Strong demand for our communications products, supporting smart phones and tablets, drove our chip-scale package sales up 17%.

Our ball grid array packages were up 16% due to the seasonal boost in gaming. A slight decline in auto and industrial end markets caused a 4% decline in our leadframe packages, and our test business was also down slightly in conjunction with the decline in leadframe products.

Our sales to integrated device manufacturers were 48% in Q3, essentially flat with the second quarter. The pricing environment has become increasingly competitive, as industry utilization softens. That said, price erosion was in the normal range at around 1% for Q3.

Gross margin for the third quarter was 17%, down from 19% in the second quarter. The restructuring charge together with higher gold prices drove around half of the margin decline from the second quarter. The other drivers of the sequentially lower gross margin were price erosion and higher manufacturing costs, which more than offset the benefit of the higher utilization we saw. The restructuring charge in total was \$4.8 million, of which \$4.4 million was charged to cost of sales, and the rest went to SG&A.

Our operating expenses of \$78 million were slightly higher than the second quarter and our expectation. The increase was primarily driven by legal fees for our ongoing patent arbitration. We expect operating expenses for the fourth quarter to be back down at the levels we incurred in the second quarter.

Our other expenses decreased \$24 million from the second quarter primarily due to three items. As a reminder, our second quarter operating expenses -- our second quarter other expenses included \$16 million of premiums we paid to retire debt.

Second, we had a favorable swing in foreign currency from a \$3 million loss in Q2 to a \$3 million gain in Q3, which was primarily attributed to the depreciation of the Korean won and Taiwan dollar and the resulting remeasurement of the balance sheet items denoted in those currencies.

And finally, we saw lower interest expense driven by our successful refinancing efforts earlier this year.

Income taxes were lower than our expectations. We had an effective tax rate of 8% versus expectations of 13%. The lower rate was due to additional Korean tax incentives with retroactive effects back to the beginning of 2011. We expect an effective tax rate of 21% for the fourth quarter and 14% for the full year.

On August 30, 2011, our Board of Directors authorized the repurchase of up to \$150 million of our common stock. As of yesterday, we repurchased 17 million shares for a total of \$77 million. We believe this investment in our company enhances stockholder value and reflects our confidence in Amkor's future.

We ended the quarter with a cash balance of \$483 million, total debt of \$1.3 billion, and net debt of \$843 million. Additionally, we were free cash flow positive again in the third quarter and, as Ken mentioned, expect to be free cash flow positive for the full year.

With that, we'll now open the call up to your questions. Operator?

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QUESTIONS AND ANSWERS

Operator

Thank you, ma'am. Ladies and gentlemen, we'll now begin the question-and-answer session. (Operator Instructions). Our first question is from the line of Satya Kumar with Credit Suisse. Please go ahead.

Farhan Rizvi - Credit Suisse - Analyst

Hi, this is Farhan for Satya Kumar. I had a question regarding your flip chip business. You reported as part of CSP, right? Is that correct?

Joanne Solomon - Amkor Technology Inc - CFO

So, it's in actually a couple places. Part of it is in CSP with a lot of our communications packages are principally in CSP. So, part of flip chip is in CSP, but it's also in BGA. When we look at BGA, flip chip BGA goes into things like gaming, high-end servers, and that's a component of BGA. And then some of the bumping is actually in other packaging. So, it's combined in those three areas is where you would get the total. And overall, it's 40% of our packaging.

Farhan Rizvi - Credit Suisse - Analyst

Okay. And how are the utilizations in the flip chip portion of your business? Is that better than your overall utilization? And what kind of level are you seeing there?

Ken Joyce - Amkor Technology Inc - President & CEO

The flip chip utilization is very strong. It's in the wire bond area in particular that we've been seeing some pockets of open capacity as things transition from wire bond into the flip chip area.

Farhan Rizvi - Credit Suisse - Analyst

Okay. And when you say strong, is it like more than 90%? Is that reasonable, or -- ?

Ken Joyce - Amkor Technology Inc - President & CEO

-- I don't have that number right in front of me, but I doubt that it's that high.

Joanne Solomon - Amkor Technology Inc - CFO

Yes, it's high 80s.

Farhan Rizvi - Credit Suisse - Analyst

Okay. Okay. So, when we look at the utilization levels for Amkor and compare it to your peers, it seems like your utilizations are a little bit lower than your competitors. What's the main reason? And even though like you seem to have like lesser exposure

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to leadframes than some of the other competitors, is it like you're less aggressive about pursuing the leadframe business, or what's going on?

Joanne Solomon - Amkor Technology Inc - CFO

Yes, so, there's no industry standard way of calculating utilization, and especially when you have a very diverse mix of packages. Sometimes, the units get to be very deceiving.

As an example, units for leadframe are -- we have 1.5 billion units for leadframes and 0.5 billion of units for chip scale packaging. And chip scale packaging is a more significant piece of our puzzle.

So, sometimes the utilizations aren't very comparable between industry partners because of mix and depending on how they calculate. Generally, what I always recommend is that you can sequentially compare our utilization to discern a good trend, but when you start trying to compare our utilization to our competitors, it gets to be a little bit more challenged.

Farhan Rizvi - Credit Suisse - Analyst

Then I have another question related to your gross margins and basically like the effect the gold prices are having on it. Can you mention like how much of your total revenues are -- is coming from gold? I mean, basically, how much is gold as a percentage of your revenue? Is it like 13.5%?

Joanne Solomon - Amkor Technology Inc - CFO

Yes, sure. Our gold spend is about 13% of our revenues. And as a reminder, we do recover a large percentage of that gold spend, either directly within price or as a separate adder. It's about 85% is what we estimate that we recover of those gold costs. But, that still has a very significant impact on our gross margins because a lot of that has very little markup associated with it. And just as a general rule of thumb, about \$100 change of gold will impact us about 25 to 30 basis points of gross margin.

Farhan Rizvi - Credit Suisse - Analyst

Got it. So, in terms of your guidance, what kind of assumptions are you building in for the gold prices? Like, the gold prices went up quite sharply in third quarter. Now, is that something that you would see in the fourth quarter, or is it all being reflected in third quarter?

Joanne Solomon - Amkor Technology Inc - CFO

Our posture with respect to forecasting both gold and FX is we try not to speculate too heavily where prices are going to be. So, we tend to heavily weight where they are as of today. So, based on gold prices trading around \$1,700, I would say that that's what we would have included in our forecast.

Farhan Rizvi - Credit Suisse - Analyst

Okay.

Joanne Solomon - Amkor Technology Inc - CFO

I know today it's gone up above the \$1,700, but so I would say right around \$1,700 is where our forecast -- .

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Farhan Rizvi - *Credit Suisse - Analyst*

-- But, in terms of like the gold cost you incur, is there like a lag time in it, like the gold that you -- that would go into cost as like, say, there's a delay, like it was bought like a quarter ago, or -- ?

Joanne Solomon - *Amkor Technology Inc - CFO*

-- Yes, there's some lag. I would suggest it's probably no more than two or three weeks. We tend to operate very heavily with some vendor-managed inventory with respect to gold. So, there's not that much of a lag, but it is about two to three weeks of a lag.

Farhan Rizvi - *Credit Suisse - Analyst*

Got it. Then one more question I have is the -- related to like this year compared to other. It seems like the fourth quarter guidance for this year, like overall (inaudible) is lower compared to the previous years. Can you -- like, typically fourth quarter is the stronger. So, just wanted to hear your thoughts on what is -- ?

Ken Joyce - *Amkor Technology Inc - President & CEO*

-- I think that's a reflection of the overall macro economy and the softening of demand that you're seeing.

Farhan Rizvi - *Credit Suisse - Analyst*

And is that across all sectors, barring communication? Is that a fair way to think about it or even communications you would -- ?

Ken Joyce - *Amkor Technology Inc - President & CEO*

-- No, communications remains, as we said, remains very strong and very solid, so that part. But, I think, other than communications, the overall macro economy seems to be -- have some uncertainty and is causing some weakness in -- softness in demand.

Joanne Solomon - *Amkor Technology Inc - CFO*

Yes, the only other thing I would highlight is with respect to the seasonality of our gaming. We have a very strong and dominant position in gaming. Gaming tends to be -- it tends to peak Q3. And we tend to see October being okay gaming and then November, depending on how big of a gaming season it is, you may see some gaming sales in November.

This year, our gaming season ended a little bit earlier than we expected. So, that's also driving part of the, I would say, more-than-seasonal adjustment to our fourth quarter. So, it's -- Q3 had a good benefit of gaming, but then it's going away largely for Q4. So, that has some impact in addition to what Ken has mentioned about the -- just the general macro environment impacting some of our more wire bond packages and the bright spot being smart phones and tablets, which we expect to continue for Q4.

Farhan Rizvi - *Credit Suisse - Analyst*

Thank you. That's all I have.

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Joanne Solomon - Amkor Technology Inc - CFO

Thank you for your questions.

Operator

Thank you. And our next question is from the line of Wenge Yang with Citigroup. Please go ahead.

Wenge Yang - Citigroup - Analyst

Hi, thank you for taking my questions. First question is regarding your customers' behavior. What's the inventory level right now? And is there any destocking activities still going on at this point?

Ken Joyce - Amkor Technology Inc - President & CEO

Wenge, I think that the customers are adjusting inventories. We saw some of that clearly in the automotive sector. And once again, I think it's a reflection of the softening in the more macro economic -- macro economy.

Wenge Yang - Citigroup - Analyst

Okay. So, TSMC actually mentioned last night that they saw customers' inventory actually below the seasonal levels, could be seven to eight days below seasonal average in the past years. So, is that a similar thing you saw in your customer base?

Ken Joyce - Amkor Technology Inc - President & CEO

Once again, I can only speak to our customer base. And as we said, communications for us and smart phones and the tablets, I think the inventories are being well managed. It's been solid for us. If you look in the areas of the end markets of networking, I think inventories are being very closely managed there. Automotive, industrial, it looks like there is some correction going on. So, it depends on the end markets I think that you're looking at.

Wenge Yang - Citigroup - Analyst

Okay. Question on CapEx. In the last earnings call, you guided CapEx to be I think around 425 level, and this time the Q4 CapEx actually moving up, so make the whole year closer to 450. Considering the utilization rate is relatively low, could you justify why you actually continue spend in terms of CapEx?

Ken Joyce - Amkor Technology Inc - President & CEO

Absolutely. I believe we're spending in the right areas. And a lot of our spend has gone into the flip chip in support of communications and tablets. That's been a heavy part of our investment this year for communications. But, we've also been spending incrementally on cost reduction activities that hopefully we'll see the benefits of in improved utilization in the future.

And one of the other areas very important to us is that we continue to invest in some of the R&D initiatives for next-generation packaging. And that's in Wafer Level Fan Out and TSV initiatives that we have that we think are very, very important. The easy thing to do would be pull back in this slower environment, but it's our future. So, we have to invest in those R&D areas.

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Joanne Solomon - Amkor Technology Inc - CFO

The only other piece I would add is, as Ken mentioned in his script about the ramping for NAND memory in China, that is taking some facilities, clean room space that we need to expand. And that is driving some of the spend as well in the fourth quarter.

Wenge Yang - Citigroup - Analyst

Okay. Is that -- because technology's going to continue to evolve. So, is that safe to say that you're going to continue to spend at this level just to sustain your technology leadership?

Joanne Solomon - Amkor Technology Inc - CFO

I would say the -- with respect to investments in R&D, I think they've been particularly heavy with respect to Through Silicon Via as well as Wafer Level Fan Out. I believe that will start to moderate. And with respect to capacity, it was a big transition year to flip chip, so ramping both for flip chip CSP as well as our fine pitch copper pillar.

So, I think some of the capacity investments that we're making, maybe we can start to moderate, and some of the R&D investments will start to moderate. But, we're very much focused on matching up the CapEx dollars with the revenue opportunities. We invested very heavily in support of our communications customers, two in particular that grew with us this year 20% to 25%. So, as Ken mentioned, we're investing for the guys that are bringing the demand in. And then we're also setting up for the future.

Wenge Yang - Citigroup - Analyst

That's helpful. Just couple of questions regarding some specific events -- first one is the Thailand flooding. I understand you don't have factories in Thailand. Do you have -- do you see any impact on your business or any actually opportunities if customers shifting from Thailand to other regions?

Ken Joyce - Amkor Technology Inc - President & CEO

Well, first and foremost, our condolences and sympathy go out to the people of Thailand. And this is certainly an ongoing tragedy. As you mentioned, we don't have facilities in Thailand. And it's really hard to tell what the impact of this is going to be on the broader electronics industry.

That being said, we have a number of customers with operations in Thailand. We've been working very closely with them. There could be some upside opportunities to help them out, particularly some of the IDM customers, to help them get through and prevent any kind of disruptions in their business. So, yes, we do see some opportunities as a result of this. But, once again, it really is a tragic circumstance. And we'll do whatever we can do to help those people of Thailand as well as our customers.

Wenge Yang - Citigroup - Analyst

Would it be safe to say that it's still too early to say? So, those potential opportunities are not factored into your guidance for Q4?

Ken Joyce - Amkor Technology Inc - President & CEO

They are not factored into our guidance right now.

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Wenge Yang - Citigroup - Analyst

Okay. One last question regarding your acquisition of Toshiba factory in Malaysia, could you give us some justification on why did you acquire that factory and also what P&L impact will that be after you took over the operation?

Ken Joyce - Amkor Technology Inc - President & CEO

Sure. Look, Toshiba's an industry-leading player in the area of discretes or power discretes in particular. It's a great way for Amkor to gain scale in this business. Toshiba has some excellent IP in this area. And it plays along the lines of our -- an extension, if you will, product line extension of some of our leadframe business. So, we're really, really very excited about it.

In terms of what the impact, we can't comment at this point in time because we're currently in due diligence on the project.

Joanne Solomon - Amkor Technology Inc - CFO

And just as a reminder, it's a nonbinding MOU at this stage. And to the extent we have any changes, we'll update accordingly.

Wenge Yang - Citigroup - Analyst

Is it okay to comment on what revenues they generated last year from that factory's operation?

Joanne Solomon - Amkor Technology Inc - CFO

We're bound by confidentiality provisions at this point with Toshiba. So, when we get to the point where we can make further announcements, we're very excited about this opportunity. And we'll give that detail for you.

Wenge Yang - Citigroup - Analyst

Any timelines on when the deal will be closed?

Joanne Solomon - Amkor Technology Inc - CFO

Our expectation is that it would be sometime during the first quarter is -- that we would close the deal.

Wenge Yang - Citigroup - Analyst

Okay. Thanks.

Joanne Solomon - Amkor Technology Inc - CFO

Great. Thank you, Wenge.

Operator

Thank you. (Operator Instructions). Our next question is from the line of Eric Ruebel with MTR Securities. Please go ahead.

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Eric Ruebel - *MTR Securities - Analyst*

Hey, good afternoon. Ken, in your prepared remarks, you talked about the sort of excess capacity in fine pitch wire bond. And you also mentioned -- I thought that you were starting the NAND flash business to sort of fill in on capacity.

Joanne, you mentioned that you're spending also to support the NAND flash. So, help me understand how you're approaching that business, how large it could be. Historically, I think you've stayed away from kind of the real commodity memory programs.

Ken Joyce - *Amkor Technology Inc - President & CEO*

Well, Eric, you're right. We haven't participated in a big way in DRAM. With respect to NAND, we've been doing NAND for different customers, Samsung and Micron and others. So, we've been doing NAND.

We currently have some really large opportunities with some customers in Japan, some IDMs. We've been ramping for them very vigorously in China operations. And that's what Joanne was talking to earlier when we talked about some of the investments in facilities.

It's also given us the opportunity to redeploy some of our existing wire bond assets from some of our other locations into China to use some of those. So, it's a great opportunity in a lot of ways for us, one, redeploying some underutilized assets in other locations. And two is to build I think a significant opportunity with I think a good return potential for us in our China operations.

Joanne Solomon - *Amkor Technology Inc - CFO*

Specifically, my comment with respect to the facilities, as a reminder, we have a very large building in China in Shanghai in the Waigaoqiao Free Trade Zone. The building itself is a shell. And as we need clean room space, we keep expanding the clean room. So, because of the redeployment of some of these assets that Ken talked about into China, we did have to expand some of the clean room space within the building. So, we're not building a building as much as we're expanding out the internal clean room space.

Eric Ruebel - *MTR Securities - Analyst*

So, could you give me a sense of if you're consolidating, how much capacity could this be? And if the program is successful, is this something that we could expect to see as a margin positive? How many quarters would that take?

Joanne Solomon - *Amkor Technology Inc - CFO*

So, with respect to the NAND opportunity, as a general reminder, we have a large wire bond presence in both Korea as well as the Philippines. The Philippines tends to have more of the leadframe assets. A lot more of the advance wire bonding is in Korea. So, a lot of the assets that we're redeploying are actually coming from Korea.

The opportunity could be very significant. We've redeployed some of the existing wire bond assets, as Ken mentioned already, from communications. Samsung has been a big consumer of our NAND memory so far in Korea. And we're starting to ramp with Toshiba as well, largely in China, but we also do some in Japan for them.

So, the full impact on gross margins, it will absolutely help create some contribution margins for us. But, I don't have any specific numbers to share with you at this time.

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Eric Ruebel - *MTR Securities - Analyst*

Okay. Ken, in the past you've talked about sort of customer shipments to customer forecast, sort of delivery, delivery of die to forecast. And I was wondering if you could comment in the current environment if you're seeing any slippage with respect to sort of shipments to forecast.

Ken Joyce - *Amkor Technology Inc - President & CEO*

Eric, the die support in support of customer forecast in communications has been solid. It's been strong right up to today. We are seeing some softness in the wire bond areas. And that, once again, we think is partially a reflection of this transition from wire bond into flip chip. And part of it is the overall macroeconomic environment.

Eric Ruebel - *MTR Securities - Analyst*

Thanks, guys.

Ken Joyce - *Amkor Technology Inc - President & CEO*

Thank you, Eric.

Joanne Solomon - *Amkor Technology Inc - CFO*

Thanks, Eric.

Operator

Thank you. And there are no further questions at this time. I would now like to turn the call back over to management for closing remarks.

Ken Joyce - *Amkor Technology Inc - President & CEO*

We thank everyone for participating in the call with us here today. So, good afternoon.

Operator

Ladies and gentlemen, this concludes the third quarter 2011 Amkor Technology earning conference call. If you'd like to listen to a replay of today's conference, please dial 1-800-406-7325 or 303-590-3030 with the access code of 4478852. ACT would like to thank you for your participation. You may now disconnect.

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