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AMKR - Q1 2018 Amkor Technology Inc Earnings Call

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OVERVIEW:

Co. reported 1Q18 revenue of $1.03b. Expects 2Q18 revenue to be around $1.03b.

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Amkor Technology first quarter earnings conference call. My name is Grace, and I will be your conference facilitator today. (Operator Instructions) As a reminder, this conference call is being recorded. Joining us today are Steve Kelley, Chief Executive Officer; and Megan Faust, Chief Financial Officer.

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

I would now like to turn the call over to Chief Executive Officer, Steve Kelley.

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

Good afternoon, thanks for joining the call. Today I'll review our first quarter performance and our second quarter forecast. In addition, I'll discuss how our strategic initiatives and acquisitions are driving balanced growth for Amkor. Year-on-year, first quarter revenue was up 14%. This is a significant jump and a good start to the year. On a sequential basis, revenues were down 11% after a very strong fourth quarter. Nearly all of the sequential decline was due to a slowdown in the high-end smartphone market. This is a normal seasonal pattern in the high-end smartphone space and was fully anticipated in our first quarter guidance. In other markets, including automotive, industrial, computing and consumer, we experienced healthy demand in the first quarter. We expect the second quarter to look much like the first quarter. Our midpoint revenue guidance of $1.03 billion is roughly flat sequentially and up 2% year-on-year.

In the communications market, second quarter revenues will be flat to slightly down sequentially due to continued weakness in high-end smartphones. Some of that weakness will be offset by increased demand in the low- and mid-tier Android market. In our other end markets, we see solid demand in the second quarter.

Component lead times are relatively long and distributor inventories are relatively low. This robust demand environment is good for Amkor and for many of our customers. Looking to the second half, we expect the general semiconductor market to remain strong. The worldwide economy is growing at its fastest rate since 2011. For the IMF's recent update, the world economy grew by 3.8% in 2017 and is expected to grow 3.9% in both 2018 and 2019. Electronic content is also growing, across a wide variety of applications. We expect the high-end smartphone production will increase in the second half to support the launch of multiple new flagship phones.

Now I'll step back and discuss our balance growth objective as well as the key initiatives and acquisitions, which support that objective. Balanced revenue growth remains our overriding objective for a simple reason. As a high-fixed cost technology company, the only way to improve our financial performance over the long term is to grow revenue. The balanced part of the objective has manifested itself in 2 ways. First, we've moved to generating the higher percentage of our revenue in more stable markets such as automotive. This reduces our reliance on the more dynamic communication segment. Second, we've gone deeper and broader in each of our served markets, reducing our reliance on any 1 customer, product or application. We believe that our balanced growth approach is leading to sustainable gains in factory utilization and financial performance. It also produces better results in trough quarters, as demonstrated in the first quarter. Our automotive growth initiative has been an important part of our balanced growth strategy. 4 years ago, automotive accounted for roughly 11% of Amkor's total revenue. Today, it accounts for more than 25%. Over the same time period, revenue from the communications market moved from 56% of total revenue to 44%. Our Greater China growth initiative has been key to broadening our participation in the communications market. We are now positioned better in the mid and lower tiers of the market, while remaining very strong in the high-end. This will benefit us in Q2 since we expect an increase in mid- and low-tier demand to partially offset weakness in the high-end. And finally, our advanced SiP initiative has been critical to our success in the communications, automotive and computing markets. Amkor's advanced SiP technology toolkit and capacity will be a catalyst for future growth. Moving forward, we will continue to focus on these key growth initiatives.

Now I'd like to touch on recent acquisitions and how they support our growth. Our acquisition of J-Devices doubled Amkor sales into the automotive market. It strengthened our competence in automotive assembly and test and allows us to better support both Japanese and non-Japanese automotive customers. Our acquisition of NANIUM, a world-class wafer-level fan-out technology adds capacity to Amkor. The NANIUM technology complements Amkor's wafer-level CSP technology and capacity.

In addition, having a factory in Portugal has increased partnership opportunities with European customers. And finally our acquisition of a power discrete factory in Malaysia increased our participation in the automotive, industrial and computing markets. The power discrete market is growing steadily. It will be a source of stable revenue growth for Amkor.

In short, we see plenty of opportunities for Amkor to grow in the coming years. We are bullish in our semiconductor market overall. The trends in artificial intelligence, IoT, high-performance computing, automotive, storage and other markets bode well for the sector. The trend towards miniaturization is very positive for Amkor, since our advanced SiP toolkit enables customers to integrate at a packaged level at a reasonable cost with high yields and excellent reliability.

And finally, the trend towards consolidation in our customer base is also a positive, since bigger customers prefer to deal with bigger, more capable OSATs such as Amkor. Ultimately, we grew because customers choose to do business with us. Over the course of 50 years, we developed a loyal customer base because we are a stable and reliable manufacturing partner with excellent technology.

Moving forward, we are dedicated to delivering the best bundle of technology, service, execution and quality. That bundle differentiates us and facilitates our growth. Megan will provide more detailed financial information.

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

Thank you, Steve, and good afternoon, everyone. As a reminder, in Q1 2018, we changed our revenue recognition accounting in accordance with the new required U.S. GAAP standard. The change in revenue recognition does not have a meaningful impact on our financial results. All prior periods have been adjusted to the new standard so they are comparable. A table showing the adjustments to the previously reported period is included on our website.

Today, I will review our first quarter results, share some historical financial data demonstrating the positive effects of our balanced growth strategy and provide some comments about our second quarter expectation. Our financial results for Q1 2018 are in line with guidance. We delivered record first quarter revenues of $1.03 billion, up 14% year-on-year.

Operating margin, net income and EBITDA, all showed solid gains year-on-year. Profitability improved due to our healthy growth in sales, despite an unfavorable foreign currency impact of 120 basis points compared to Q1 2017. Because we operate with high-fixed cost, revenue growth is the key to our success. Our balanced growth strategy, both organically and through select acquisition has substantially improved our financial performance over the past 3 years. The following are some key metrics that help us understand these trends.

Annual sales have increased from $2.9 billion in 2015 to $4.2 billion in 2017, a CAGR of over 20%.

Earnings per share have increased from $0.22 per share in 2015 to $1.10 per share in 2017. We have increased our annual EBIDTA to nearly $1 billion in 2017 from $660 million in 2015. With the increase in EBITDA, our debt EBITDA ratio has significantly improved from 2.4x in 2015 to just 1.3x as of March 2018. We have exercised CapEx discipline, reducing our capital intensity from 19% in 2015 to 13% in 2017, while still significantly growing the business over the same period. As a result, we have successfully generated annual positive free cash flow since 2015 and expect to be free cash flow positive again in 2018 for the fourth consecutive year.

All of these favorable trends have had a positive impact on our financial health.

In 2017, we redeemed $200 million of high interest senior note. This produced a pretax annual interest savings of $13 million.

At the end of Q1 2018, we had nearly $500 million in cash and around $300 million in available undrawn loan. As of March 31, we had total debt of $1.3 billion, down from $1.6 billion at the end of 2015. We have improved our net debt position from over $1 billion in 2015 to around $750 million at the end of 2017. Over the past few years, we have also taken steps to manage our cost structure. During 2017, we completed a multiyear factory consolidation plan in Japan to reduce our factory footprint from 11 plants to 6. In Korea, we closed and sold our K1 factory, which resulted in a pretax gain of over $100 million in 2017. We transitioned most of the K1 business to other Amkor factories. These factory consolidation efforts improve our utilization and enhance profitability.

Moving to our second quarter expectation, revenues are expected to be around $1.03 billion. We expect second quarter gross margin to be between 14% and 16%. Our full year 2018 forecast for capital expenditures is unchanged at around $600 million. Operating expenses are expected to be around $120 million for the second quarter. R&D expense includes labor, depreciation and other costs associated with K5. As we bring lines up to production, some of these costs transitioned to cost of goods sold. For now we expect our 2018 full year effective tax rate to be around 25%. Note, however, that we continue to evaluate our provisional estimates of the complex provision of the new U.S. Tax Reform Act and these estimates could change as we refine our analysis and apply any new guidance on this law.

With that, we will now open the call up for your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Randy Abrams with Crédit Suisse.

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

I wanted to ask a question on -- it was a good first quarter, but for second quarter outlook, where it looks now a little bit below the traditional seasonal where you set to get some pickup. Could you, I guess, just clarify with some exclusively related to high-end smartphone and the follow-up to that is just with that view, do you expect that maybe a little bit of softness on that smartphone market to affect the second half or potentially drive below seasonal or flipside coming off lower base and component drawdown and it could see a pickup? But I'm curious how you're looking at second half and then also have a second revision, what drove the revision?

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

Yes, Randy. For -- so second quarter, we split it into 2 parts. One is high-end smartphones and the other is everything else. If you look at everything else, we're very happy with the level of demand. In the general marketplace, we've seen now 8 straight quarters including Q2 of very healthy demand. So we think that business is in good shape. And as I mentioned, the general market, I think in general, demand is somewhat ahead of supply. So that's very good for Amkor and many of our customers. In the high-end smartphone market, there was, obviously, a large build in the latter part of 2017. And I think the industry, including Amkor, is working off some of that inventory, but we expect the second half to be pretty strong for 2 reasons. One is, we think the general market is going to stay strong based on everything we see in the marketplace. And secondly, we know there are a number of flagship phones that will be launched in the second half, which will drive, I think, a strong demand for ICs and for Amkor services.

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

Okay, great. And you talked on the -- there's like some bottlenecks in the supply chain such as some of the passive components, and I'm curious too, there's been a bit of talk also on the equipment lead times maybe a little bit longer for certain tools. For your business, I'm curious if you're seeing impacts on deliveries, just from some of these constraints and also if there's any areas of tightness where you're having to increase CapEx or if you feel like in those broad-based markets you have with the J-Device network and your other CapEx you have a good capacity to meet that demand?

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

Yes, you may have noticed we spent a lot on CapEx in Q1 and that was largely due to equipment we installed in the last 4 months of 2017. So we did run into quite a few bottlenecks in Q3 of last year, particularly in our advanced product lines as we decided to go ahead and make some incremental investments there, so that we're better equipped to handle the surge this year. Beyond that, I think we see isolated bottlenecks, some MLCC issues here and there. We see bottlenecks, but we've been tackling them, I think, fairly successfully. So we don't believe any of the bottlenecks to date have hindered our revenue.

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

Okay. And last question, there's a lot of discussion in the market about the cryptocurrency and blockchain. If you could give a flavor maybe how much contribution do you think that's bringing to the business? And then also how you're seeing the order patterns and sustainability or continued strength in that business?

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

Yes, so in cryptocurrency in blockchain, we're engaged with some of the top mining-ASIC customers. We did see an upsurge in demand in the past 3 to 4 months. And I could tell you, we are rather limited exposure. Our exposure, as the percent of total revenue, is in low single digits. So we see this as opportunistic business. But also strategic in the sense that many of these mining-ASIC customers are also working on ASICs and other chips for artificial intelligence. So we think it's important to be there at the beginning in those applications. So we think a lot of the business we're doing with the minors will transition to AI-type applications moving forward.

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

Okay. If I can squeeze in one more just on the China business where you talked about some pickup. If you could give maybe a frame work, how you're -- because you also have penetration or share gain or you've been kind of improving from a lower base. Could you maybe give a perspective how much you see the China business growing and maybe how you're seeing the China Android market after the slower year last year?

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

Yes, what we saw in China, Randy, is that the smartphone market was somewhat muted through most of Q1, and then we saw a pickup start in March that's continuing, obviously, through Q2. So seeing quite a bit of activity in that ecosystem. Some of it within the Greater China Southwest customer base, but also some of that demand is benefiting other customers that we have in North America and Europe. So I think it's offsetting to a certain extent, some of the softness we saw in high-end over the past month and looking forward.

Operator

(Operator Instructions) And our next question comes from Ana Goshko with Bank of America Merrill Lynch.

Anastazia Goshko - *BofA Merrill Lynch, Research Division - MD*

You touched on it, but I was looking at the higher CapEx spend in the quarter and look sort of a little lot of trend, I'd say. So could you just explain more what that was for? And if it was rollover spending from last year, should we really think about the guidance for this year as CapEx is being down year-over-year?

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

Yes, let me just review the CapEx. I think first, you're right, it's primarily a spillover from last year. Our budget for this year is $600 million for CapEx in 2018, and we're reaffirming that budget. We knew going into this year that a lot of it will be front-end loaded based on the equipment we installed late in 2017. Also, as a matter of perspective, we spent $550 million in 2017, so $600 million in 2018. We're in the same neighborhood, so not a big increase in CapEx.

Anastazia Goshko - *BofA Merrill Lynch, Research Division - MD*

Okay. And then I apologize if I missed this, did you provide guidance for what we should expect for the OpEx in the second quarter?

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

Yes, Ana, we provided OpEx guidance of $120 million for Q2.

Operator

And our next question comes from Sidney Ho with Deutsche Bank.

Shek Ming Ho - *Deutsche Bank AG, Research Division - VP*

Just a follow-up on the couple of questions earlier. I want to understand the snapback that you are expecting for the communications market in the second half. Do you expect the second half communications business dollar-wise to be similar to the second half of last year? Or do think it's still going to be lower because last year was kind of overbuilt situation? Do you have that visibility at this time?

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

I'm assuming, it's hard to say precisely what the dollar surge will be, but what we can do is look at the past years. And typically, when you have multiple flagship phones coming out, that's a good thing for Amkor. So every year since 2013, our content in those advanced platforms has increased. So we think if our customers and our customers' customers build the same amount of phones that they did last year, we should see some surge, if not better than what we saw last year.

Shek Ming Ho - *Deutsche Bank AG, Research Division - VP*

Okay. Maybe a question for Megan. You talked about that the OpEx being $120 million for Q2, but you also talk about some of the costs moving from R&D as production increases at the K5. Is that happening now? And are you still expecting OpEx to somehow go back to this $105 million level? And how quickly will that happen?

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

Yes, Sidney. Yes, we have started to move some of our OpEx that is related to K5 into cost; that happened starting in Q1, and we have that built into our guidance for Q2. That's happening over the course of moving production lines into COGS. It will not complete we don't believe, by the end of 2018, based on our forecast of the K5 production schedule. But I will affirm that when we have finished completing that, we do expect normal quarterly OpEx to be at $105 million.

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

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

Well, just to recap our key messages. First, first quarter revenues were up $125 million year-on-year. We are very pleased with the 14% increase. Secondly, our second quarter revenues will be roughly flat sequentially and up 2% year-on-year. Finally, looking to the second half, we expect a general semiconductor market to remain strong. We also expect that high-end smartphone production will increase to support the launch of multiple new flagship phones. Thank you for joining the call today.

Operator

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