THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

AMKR - Q4 2019 Amkor Technology Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 10, 2020 / 10:00PM GMT

OVERVIEW:

Co. reported 4Q19 sales of $1.18b and EPS of $0.41. Also reported 2019 net income of $121m and EPS of $0.50. Expects 1Q20 revenue to be $1.08-1.16b, net income to be $22-59m and EPS to be $0.09-0.24.

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

Krish Sankar *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

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

Shek Ming Ho *Deutsche Bank AG, Research Division - Director & Senior Analyst*

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Q4 2019 Amkor Technology, Inc. Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I will now turn the call over to Mr. Vincent Keenan, Vice President of Investor Relations. Sir, please go ahead.

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

Thank you, Lee. Good afternoon, everyone, and thank you for joining us for Amkor's Fourth Quarter and Full Year 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 a 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 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-K.

And now I would like to turn the call over to Steve.

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

Good afternoon, and thanks for joining the call. Today, I'll discuss our fourth quarter and full year performance, our 2020 priorities and our first quarter outlook.

Our fourth quarter revenue was up 9% sequentially and up 9% year-on-year. Robust demand for advanced packaging in the communications and consumer markets drove revenue above our guidance range. Fourth quarter operating margin was 10%, and EPS was $0.41.

Looking back on 2019. I am pleased with how we handled a challenging market environment in the first half of the year. We cut discretionary spending but continue to invest strategically in advanced packaging capacity and quality improvement initiatives. These investments contributed to our strong second half performance.

In 2019, many of our advanced technologies migrated into new high-volume markets. One example is Amkor's advanced SiP technology, which now has a firm foothold in the consumer and automotive markets, complementing our leadership position in the smartphone market. Another example is our best-in-class wafer-level fan-out technology, which is now deployed in automotive radar as well as smartphone applications.

Customers in a wider variety of markets are now leveraging Amkor's technology to miniaturize, improve performance, increase reliability and lower system cost. Increased demand for advanced packages, in particular, advanced SiP packages drove most of our revenue growth in the second half of 2019. And on a full year basis, our advanced system package business grew 9% to $1.1 billion.

Now I'd like to review our 2019 performance in some key target markets. In communications, we experienced strong double-digit growth in the second half of the year, fueled by our participation in successful flagship phone launches. In automotive and industrial, advanced package revenue grew 14% year-on-year. Driver assistance and infotainment applications accounted for much of that growth. Finally, in Consumer, a new advanced SiP engagement drove impressive growth in the second half of the year.

2019 was a successful year for Amkor. In the first half, we demonstrated the resiliency of our business model under challenging market conditions. In the second half, the leverage in our business model drove significant improvement in profitability as revenue surged. We generated more than $100 million in free cash flow in 2019, marking the fifth consecutive year of positive free cash flow. We exited the year with significant revenue momentum and a strong balance sheet. Looking forward, we are optimistic about 2020. Demand in most of our target markets is expected to be strong.

In communications, we expect the ramp of 5G technology to spur a robust upgrade cycle as well as an increase in electronic content per phone. Much of the additional content growth will come in the RF module and power management areas where Amkor is strong. Over the course of the year, we also expect antenna and package revenue to grow.

In consumer, miniaturization and performance requirements continue to expand the opportunity for Amkor. Our advanced SiP technology is a natural fit for customers trying to squeeze a lot of functionality into a very small space.

In high-performance computing, the need for advanced chips and modules continues to increase, particularly for data center applications. This is a long time area of strength for Amkor, and we expect to benefit from the continuing growth in data generation, processing, storage and transmission.

In automotive, we foresee continued growth in advanced packaging, as data-intensive driver assistance and infotainment systems continue to migrate from the high end into the mid-range of the market.

Our priorities in 2020 remain the same. Continuous quality improvement, high yields, great customer service and best-in-class technology. These are the building blocks of customer satisfaction. We expect approximately $550 million in capital expenditures this year, an increase of $75 million over 2019. Most of this CapEx will be used to increase advanced package capacity and capability.

Now let's move to our first quarter forecast. At the midpoint of guidance, we expect revenue to be up 25% year-on-year and down 5% sequentially. We foresee continued strong demand in the communications and consumer markets.

I'd like to close with a few words on coronavirus containment efforts and their effect on our first quarter forecast. Throughout our factory network, we have taken strong protective measures to ensure the health and well-being of our employees. That is our first priority. The next priority is to safeguard production output for our customers. Today, all the Amkor factories are fully operational and sufficiently staffed to meet customer demand. We are dealing with some minor, relatively isolated supply issues. Our first quarter forecast takes those supply issues into account as well as the incremental costs associated with our employee protection efforts. At this point, we have seen no meaningful changes in our demand profile as a result of the coronavirus outbreak.

In summary, 2020 is setting up as a strong growth year for Amkor. Key growth drivers include the rollout of 5G, advanced SiP in multiple markets and advanced packaging for automotive.

Megan will now provide more detailed financial information.

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

Thank you, Steve, and good afternoon, everyone. Today, I will review our fourth quarter and full year results and then provide some comments about our first quarter outlook.

Fourth quarter sales increased 9%, both sequentially and year-over-year to a record $1.18 billion. Gross margin 18.9% is up 200 basis points from the year ago quarter, and operating income margin increased 300 basis points year-over-year to 10%. Our improved profitability this quarter was a direct result of the leverage in our model. We earned $0.41 per share in the fourth quarter, which includes approximately $0.05 of tax benefits we had not anticipated.

We also generated $244 million of EBITDA and EBITDA margin was nearly 21%. As Steve mentioned earlier, 2019 was a year of 2 contrasting halves. While first half revenue was impacted by the inventory correction, the second half of 2019 was much stronger, growing 26% over the first half. As a reminder, we have relatively high fixed costs, so we typically expect 40% to 50% of any revenue dollar change to drop-through to gross profit. Cost control measures in 2019 mitigated the impact of lower sales on profitability in the first half and positioned us for strong leverage when growth returned in the second half. Less than 25% of the 2019 revenue decline flowed through to gross profit. As a result, we generated $233 million of operating income for the year. And our operating income margin of 5.8% declined only 23 basis points from 2018.

Interest expense declined $7 million in 2019 or 9%. This was primarily due to the full year impact of the 2018 redemption of $200 million of 6 5/8% senior notes with proceeds from a term loan from a fixed interest -- with a fixed interest rate of only 1.3%.

Net income for the year was $121 million or $0.50 per share. Net income was reduced by $11 million of noncash discrete income tax charges and an $8 million charge related to the early redemption of $525 million of our senior notes due 2022. The combination of these items represented an $0.08 reduction of EPS.

We generated $756 million of EBITDA, and our EBITDA margin was 18.6% in 2019. In response to the inventory correction, we took a cautious and pragmatic approach to CapEx in 2019. We reduced CapEx payments by $75 million from 2018 levels, down to $475 million for 2019.

We targeted investment in strategic programs that increase capacity and capability in advanced packaging technologies. These investments are expected to support growth in 2020 as well as maintain our high-quality standards.

Strong second half revenue combined with our cost control and CapEx discipline resulted in $104 million of free cash flow for 2019, marking our fifth consecutive year of positive free cash flow. The benefits of our consistent free cash flow are reflected on our balance sheet and our credit ratios have improved meaningfully.

During the fourth quarter, we entered into a new foreign syndicated term loan of approximately $260 million with a fixed interest rate of 1.35%. The proceeds were primarily used to repay higher rate foreign bank debt and the refinancing is expected to generate annual interest savings of approximately $5 million. Due to the timing of these transactions, our balance sheet at December 31 includes proceeds of $120 million and the corresponding liability that was paid down in January 2020. After giving pro forma effect to the paydown of the bank debt as of December 31, we are well-positioned to fund future growth, with total liquidity of $1.2 billion including $775 million of cash on hand.

As Steve mentioned, we have included in our guidance an estimate based on what we know today, for the impact of supply chain constraints and increased labor costs due to the coronavirus outbreak. We expect Q1 revenue to be between $1.08 billion and $1.16 billion. Gross margin is expected to be in the range of 14.5% to 17.5%. In Q1, we expect operating expenses of around $110 million. The increase from Q4 is primarily due to restructuring costs in Japan. We are lowering our full year effective tax rate to around 20%. We expect net income in Q1 of between $22 million and $59 million, or $0.09 to $0.24 per share. Our 2020 forecast for capital expenditures is around $550 million.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question is from Sidney Ho from Deutsche Bank.

Shek Ming Ho - *Deutsche Bank AG, Research Division - Director & Senior Analyst*

Great. And congratulations on good quarter and guide. My first question is on the China coronavirus impact. You talked about some minor supply issues related to that. Can you help us quantify that impact in terms of how that impacted your revenue, cost of goods sold and operating expenses?

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

Yes, Sidney, we're not going to get too granular on the exact number. But let me just walk you through our analysis. The manufacturing team got on top of the issues pretty early, and we identified alternative sources of supply for most of the components and piece parts that we have sourced out of Chinese factories. And there were basically a few items where we didn't see a way to mitigate the shortfalls within the quarter, so we incorporated those shortfalls into our manufacturing plant, and thereby into our Q1 financial forecast.

Shek Ming Ho - *Deutsche Bank AG, Research Division - Director & Senior Analyst*

Okay. Maybe move on to the next one. I think your 1Q revenue is generally down high single digit, low teens on a sequential basis and, clearly, you're guiding down about 5%. Steve, you talked about continued strength in communications and consumer, but outside of consumer, how should we think about the growth rate of the other segments when compared to seasonality? And if I can extend that question a little bit more, how should we think about your revenue growth -- maybe your overall revenue growth relative to normal seasonality beyond first quarter?

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

Sure, Sidney. So in Q1, again, we're forecasting 25% up from Q1 of '19 and 5% down sequentially. In addition to the consumer SiP product, which should be running at high-volume, similar to the same volume that we saw in the fourth quarter, we also see continued strength in communications. We saw the iOS ecosystem demand continue into January, and we expect that to be relatively strong through most of the quarter. There are also a couple of flagship phones that will be launched towards the end of Q1, which are helping us in the communication space.

I think when you look beyond communications and beyond the consumer SiP project and you look to the general market, that looks pretty seasonal. It's down mid- to high-single digits, so it's about what we would expect in a normal year.

Shek Ming Ho - *Deutsche Bank AG, Research Division - Director & Senior Analyst*

Great. That's helpful. My last question, if I may. For your gross margin guidance for Q1, it's down sequentially, which is understandable given lower revenue, but the decline is a little more than I expect. If you can help us bridge the gross margin from Q4 to Q1, specifically, how much is related to fringe benefit increase, maybe product mix and market mix, depreciation, et cetera, that will be great? And as you go through the remainder of the year, what are some of the factors we should think about other than the incremental revenue you're going to get?

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

Okay, Sidney. So I'll start with your question on Q1. So as you know, our guideline for modeling flow-through is generally 40% to 50%. And as you mentioned the flow-through from Q4 to Q1 is shy of that. Things can impact our flow-through various headwinds or tailwinds. Those can include product mix utilization, foreign currency, et cetera. So in Q1 as compared to Q4, we are forecasting a product mix shift to higher material content advanced packages, such as SiP and flip chip, so this is what's constraining the flow-through. Our mix -- our fixed manufacturing costs are actually declining as you would expect in the normal model, so there's nothing unusual happening there.

With respect to your question on the full year. As a reminder, we don't give full year guidance. But as it relates to the material percentage, we do expect to have continued growth in advanced SiP. So as you're looking for the full year, you could probably use the Q4 exit amount as a guideline. Just to remind you though, we are still experiencing underutilization in the general market. And so once that general market does recover, that will benefit the gross margin expected later in the year.

Operator

Your next question is from Randy Abrams from Crédit Suisse.

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

And good job on the results. I wanted to ask maybe the first follow-up on the -- first on the virus situation. If you can maybe talk a little bit more about the bottlenecks, I guess, directly, what you're seeing in terms of where are some of the material constraints? And then maybe just a step further just with some of the factories having a bit of a delay coming back. I'm curious, like, maybe the unknown factor is kind of a tricky point, having the call now, just whether you're getting the full feedback on both the production impact further downstream? And then also, it's kind of a moving part, but the demand impact from what's happening in China? So I'm just curious how much you're getting that feedback now or factoring it into guidance?

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

Okay. Yes, on the bottlenecks, basically, they're very small parts. Things like lids and capacitors and so forth that we're run into issues on. So for most of those parts, there are alternatives available. But for a few of them, we couldn't find an alternative this quarter. That's what's causing us to back-off a little bit in our guidance for Q1.

As far as the demand signals, like I said earlier, we have not seen anything change in the demand picture except we have seen some increases in demand in our wire bond factories outside China. And so we booked some additional revenue there or some additional orders that we attribute to customer concerns about China shortages. And that's really one advantage we have as Amkor is that we have 20 factories, 19 of which are outside China. So that helps us quite a bit in helping our customers come up with alternative supply chains.

Now the second part of your question was regarding any other demand signals we see out there. I think your concerns are valid. Obviously, our customers are gathering data as well on other parts that may be in short supply. We're monitoring that situation on a daily basis. It's fluid. And then, of course, if there are changes in end-customer demand, particularly, out of China that's going to take some time to filter through into our order book. But we're going to monitor that on a daily basis.

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

Okay. Great. And maybe if I can follow-up on the -- if you could just give us the kind of the reference, how much of your production is out of the China factory? And I mean, if there is -- if you've had to deal with any slowdown from just labor coming back, where there's measures to take? And then from a demand side, if you kind of have a view how much of your demand -- I think, I was wondering if your direct customer, like, how much of your direct customer and then maybe if it's -- it's probably difficult to know where all the parts go, but like the end demand from kind of China market, just to kind of see how much demand is impacted or could be impacted in the China market?

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

Yes. So let me -- I think you're asking 2 different questions: One is about our China factory, the other is about the China market. So let me just take those in order. So our China factory is operating well. Again, we moved quickly. And our basic approach was to put in place a relatively close system for the employees. So it's actually safer to work at Amkor than it is to go to the outside world. And so we enhanced number of aspects within the factory. We improved our meals and so forth. We enhanced our screening, so it includes the usual things like body temperature checks, hand washing, masks and so forth. And we eliminated visits to the factories by our customers and nonessential personnel. And finally, we shut down travel. So I think we've created a pretty safe environment within the factory in China. We also adjusted the shift schedule, so that it allows us to keep the factory running more or less at full speed. So I'm very happy with the measures that we've taken in China, and the output continues unabated at this point.

With regards to the China market demand, again, that's something we just have to wait and see, and see what impact that has on our order book. But today, we haven't seen any meaningful shifts, except for the additional orders we've received in our wire bond factories outside China.

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

Okay. Great. And if you could talk on the advanced SiP on the consumer. I think you -- maybe it's a clarification from back in the fourth quarter, I think, when you're saying the run rate in Q4, is that kind of they are telling if we take that x4, that's kind of your rough run rate you're expecting for 2020? And I'm curious because those are lumpy depending on projects and maybe your visibility for the new wave of projects later 2020, how you're feeling is in terms of growing with the new wave? And maybe how you see it broadening out or any risk on that side for the SiPs in the consumer side?

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

Yes, Randy. So as far as comments made with respect to -- and I think you're getting at the elevated material content. My suggestion to at least look at Q4 because that's an actual -- it's all of our products mixed together in Q4. And that's a good marker because there was strong SiP in Q4. So as we look out to 2020, as you had said, material content can be pretty lumpy with new projects coming on, seasonality, et cetera. So I think that's a decent guide to look forward. And then the unknown is the return of the general market, which would help to moderate that.

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

Okay. I guess, my question also on the revenue side, how you're thinking about the revenue side for 2020? And then, how you're thinking about the product or design interaction for kind of the next wave of projects like maybe for next peak season, like any upside or risk, at least, at this stage, it could change?

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

Yes, Randy. I would have to say that we're very optimistic about 2020 based on our position in the markets that we target. I think on the communications side, we're there in most of the new 5G phones. And I think in the general market, we'll expect that to recover at some point this year. It's hard to break exactly when, but it will recover. I think in automotive, we're the clear leader, and we're very well positioned as the demand for advanced packaging will continue to increase for these data-intensive systems. Consumer, obviously, we've got a great position, and we'll be fighting for more consumer business as we head into 2021. So I'm pretty optimistic. I think 2020 is going to be a good year for Amkor.

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

Okay. That's great. And last question on the general market. Last year, it looks like advanced packaging, in fact, you drove a lot of the growth. General market kind of, I mean, it was, you could say, sluggish through the year. And I think you've been looking for kind of the signals of pickup. I guess, at this stage, now into 2020, how is your view for general market, like maybe relative to industry like you start to track growth again? Or it looks like it's still going to be sluggish for a bit longer?

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

Yes. I think in Q4, we saw some positive signals, particularly in automotive, so that was good. After many quarters of declining revenue and wire bond, I think -- if you think about the general market in total, I think, the common theme from our customers is they believe the inventory correction is over. So that's good. And then the real question is, how fast do you recover? And that's the tough one to answer. But if I look back in our history, we see changes in market psychology. When you're contracting, the psychology is to not build inventory and to restrict orders. But then when lead times start to firm up and perhaps stretch the psychology changes and more customers decide to place orders, and we're back into a more normal run rate. So at some point, that's going to happen. I don't know exactly when, but I think it's sometime this year.

Operator

Your next question is from Krish Sankar from Cowen & Co.

Krish Sankar - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Congrats, Steve and Megan, on the great results. I had a couple of questions. Number one, is on CapEx. It looks like your CapEx is back to your 2017-'18 level. Can you help us understand, you did say that a lot of it is going to advanced packaging. Is there a way to like kind of like quantify it? What it is to date or this year relative to '17-'18? And then I have a follow-up.

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

Yes, I think you're right. It's very close to '17-'18 levels, more normal level of CapEx. We have restricted it last year in response to the downturn. But if I break it down, of the $550 million that we intend to spend on CapEx in 2020, more than 60% of that will be spent on expanding advanced package capacity. So this is for advanced system and package, for wafer-level, for flip-chip products. And that's per demand we see in the near term. A bit more than 30% will be spent on facilities, quality improvement and R&D. That includes our continued work on panel-level fan-out as a potential successor technology for wafer-level fan-out. And then the remainder of our $550 million will be spent on wire bond package capacity expansion.

Krish Sankar - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Got it. Very helpful, Steve. And then another follow-up. Thanks for giving the color. I understand you don't want to quantify the impact of Q1 revenues because of the virus. I'm just kind of curious, like, hopefully, sooner than later when the virus issue subside, as demand snaps back, do you actually think there's going to be a lag effect because the supply chain cannot keep up with the demand impact? And if so, is there a way to like figure out what the lag effect would be?

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

Yes, I really -- that's a tough one to answer. But I think, certainly, when we run into issues like this, I think, people start to err on the side of building more and not building less because you want to ship as much as possible into your end market. So we think things will come back later this year

Krish Sankar - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Got it. Got it. If I can just squeeze one more, Steve. Last year, Chinese New Year was in February, this time it is earlier and, typically, in the back end business, demand snaps back after Chinese New Year. Arguably, this time it is like delayed because of the virus. Do you think the dynamics this time would be different than a year ago quarter?

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

Well, the thing is we haven't seen any change in the demand picture yet except for some of the additional demand we've received in our wire bond factories outside China. So we are going full speed ahead until we see signals that tell us that there's going to be impact on our demand.

Operator

(Operator Instructions)

I am showing no further questions at this time. I would like to turn the conference back to Mr. Vincent Keenan for any closing remarks.

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

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

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

Yes. I'd like to recap our key messages: First, we closed out 2019 with a very strong fourth quarter as both revenue and profitability exceeded the high end of expectations. Second, the momentum, which drove our fourth quarter performance is continuing into the first quarter of 2020. And finally, we are optimistic about the coming year, given our excellent position in many of the industry's highest growth markets. Thank you for joining the call today.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation, and have a wonderful day. You may all disconnect.