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AMKR - Q3 2014 Amkor Technology Inc Earnings Call

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OVERVIEW:

Co. reported 3Q14 sales growth of 6% sequentially and YonY. Expects 4Q14 revenues to be \$755-805m.



CORPORATE PARTICIPANTS

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

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

Joanne Solomon *Amkor Technology, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Chad Dillard *Deutsche Bank - Analyst*

Randy Abrams *Credit Suisse - Analyst*

Suji De Silva *Topeka Capital Markets - Analyst*

Jairam Nathan *Sidoti & Company - Analyst*

Atif Malik *Citigroup - Analyst*

Geoff Hulme *Amici Capital - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Amkor Technology Third Quarter 2014 Earnings Conference Call. My name is Candace and I'll 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, IR and Corporate Communications*

Thank you, Candace, 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 reconciliations 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 and CEO*

Good afternoon and thanks for joining the call today. We delivered all-time record revenue in the third quarter, driven by strength in mobile communications. Sales grew 6% sequentially and year-on-year, following 10% sequential growth in the second quarter. Excluding revenue from our divested Japanese subsidiary, Amkor revenues grew 8.5% sequentially and year-on-year.



Our advanced product sales grew strongly in the third quarter, with flip chip and wafer-level packages leading the way. Normalizing for the sale of our Japanese factory, mainstream product sales also grew in the quarter, driven primarily by increased demand for managed products. We had expected even stronger growth in Q3, but fell short of our goal, principally due to the ripple effect of lower demand in the high-end Android market.

This demand pattern also impacted our 4Q revenue expectations. We experienced impressive strength in the iOS ecosystem and this strength is carrying over to Q4. We increased our sales to fabless companies in China and Taiwan by 40% sequentially and are on track to double our sales to these customers year-on-year.

The automotive market is also a key element our growth plan. We expect our automotive sales to grow roughly 25% this year. This market segment is attractive to Amkor because of its steady growth, relative stability, and need for high-quality and reliability, which leverage one of Amkor's strengths. We expect that Amkor and J-Devices together will generate more than \$750 million in automotive revenue this year and reach a \$1 billion run rate by 2017.

In our other major markets: computing, consumer, networking, and industrial, we expect to see steady year-over-year growth. Our efforts to broaden Amkor's customer base and expand our business with current customers are beginning to pay off. The foundation of our future growth is our leading-edge technology. In Q3, we ramped a major 20-nanometer product to high volume, exceeding our yield and throughput targets.

We are working closely with multiple foundries and customers at the 14 nanometer, 15 nanometer, and 16 nanometer nodes and we expect to ramp the 15 nanometer memory product to volume in the fourth quarter. Also in the third quarter, we ramped both RF, System in Package, and Power System in Package products to high volume. These SIP products are expanding Amkor's participation in the smartphone and tablet markets.

We also achieved significant milestones in the mainstream business last quarter. We began high-volume manufacturing of a sensor fusion product which combines pressure, temperature, and humidity sensors in a single MEMS package. We ramped a memory module combining NAND Flash and DRAM aimed at the entry-level and midrange smartphone markets. We began to ramp our Power FET business with multiple customers, leveraging our copper flip technology.

J-Devices has delivered record sales this quarter. J-Devices' Management team is focused on a consolidate and fill strategy to improve structural profitability. The alignment and collaboration between Amkor and J-Devices is quite good. Both parties are seeing clear benefits from the alliance.

For reporting purposes, we currently treat J-Devices as an investment. We expect to consolidate their results no later than 2016, adding roughly \$1 billion to Amkor's annual revenue. Looking ahead to the fourth quarter, we expect mobile communications revenue to grow, offset by seasonal declines in the consumer, computing, and industrial markets. We expect between \$755 million and \$805 million in revenues in the fourth quarter.

We are maintaining our 2014 capital investment plan at roughly \$675 million. Most of this investment is for wafer-level packaging, advanced flip chip, and advanced test equipment. The demand for this capacity is spread across many customers, which reduces our investment risk. We believe that these investments are critical in maintaining our technology leadership and our position as a leader in the advanced products business.

In late Q3, we begin construction on K5, our new factory and R&D center in Korea. We plan to make K5 the world's most efficient advanced packaging and test facility, the world's premier center for packaging R&D, and a magnet for talented engineers and scientists. Construction work will continue through 2015 and into early 2016. Joanne will now provide more detailed financial information.

Joanne Solomon - Amkor Technology, Inc. - CFO

Thank you, Steve. Good afternoon, everyone. We saw solid sequential and year-over-year sales growth in the quarter, driven by share gains in the mobile device end markets. Gross profit remained flat sequentially as we invested in our infrastructure, people, and equipment in support of this year's major premium smartphone launches.

Gross margin for the fourth quarter is expected to be 18.5% on the lower revenues. We expect to see improvement in our gross margin in the coming quarters from revenue growth and utilization improvements.

Operating expenses in the quarter were \$78 million, which was down from \$90 million in the second quarter. R&D expenses decreased as our 20 nanometer and other technology initiatives moved from the development stage into production.

Our SG&A expenses were down, principally from lower incentive compensation and lower legal fees. For the fourth quarter, we expect our operating expenses to be around \$80 million. Our earnings benefited from an \$8 million favorable impact from foreign currency. This is primarily attributable to the depreciation of the Korean won and the resulting impact on our balance sheet items denominated in that currency.

Our effective tax rate in the third quarter was 25% and we expect an effective tax rate of around 25% for the fourth quarter. Finally, at September 30, we had total debt of \$1.5 billion and our debt-to-EBITDA was 2 times. Our liquidity is solid with \$485 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.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Chad Dillard, Deutsche Bank.

Chad Dillard - Deutsche Bank - Analyst

Can you talk about what you're seeing for the first half 2015 demand and whether it's as robust as you were expecting three months ago? What I'm trying to get at is, how does this change your calculus for CapEx for the next 12 months?

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

Yes, I'd be happy to make a comment there. We're still positive about first half 2015, Chad, but we're not quite as positive as we were a few months ago. When I look at the first half of 2015, I look at it, I divide it into two parts, the mobile communications part and then everything else.

Mobile communications demand revolves around three ecosystems: the Apple ecosystem, which we think will continue doing well in the first half; the Samsung ecosystem, we're not sure, but we have high hopes for the Galaxy phone; and then China. China has some positive stimulus from the 4G ramp. Again, difficult to predict, but those are the major variables on the mobile communications side. Everything else, the non-mobile communications market, I don't foresee much either up or down. We're forecasting low single-digit growth or decline. We'll just have to see how it plays out.

What that means for our capital is we intend to constrain our capital next year. Right now, we would target to spend something less than \$500 million in new capital equipment; that's excluding our expenditures on K5.

Chad Dillard - Deutsche Bank - Analyst

That's helpful. Secondly, I just want to get a sense of how your market share is tracking if you compare where you were on 28 nanometer versus some of the future nodes, 20 and 16?



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

That's a great question. We actually thought, we think they picked up some market share this quarter and we're on track to pick up some more next quarter, and we just compare our revenue growth in Q3 versus our peers. We certainly like the trend this quarter.

I think at 20 nanometers, we're very well-positioned. We're engaged with all the major players at 20 nano and it's driving our growth here in the second half of the year.

Chad Dillard - Deutsche Bank - Analyst

Great.

Operator

Randy Abrams, Credit Suisse.

Randy Abrams - Credit Suisse - Analyst

The first question I wanted to ask, on the margins that you reported, it looks like a modest decline, but I wanted to see: the mix looked like advanced products still did pretty well. I just wanted to go through, I think, factors for margin, what may have impacted a bit relative to your earlier expectations, whether pricing or product mix were other factors?

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

Randy, that's a good question. I don't think it's really pricing or product mix per se. I think what happened was, we saw our fixed costs go up in Q3. We were planning for, obviously, a stronger quarter, and so we just didn't have the absorption that we planned to have in Q3, which impacted our margins. I think our outlook is still to grow significantly in 2015, to grow faster than the market, so I think we'll grow into our new fixed cost structure, but it hit us in Q3.

Randy Abrams - Credit Suisse - Analyst

Great. For one of the growth drivers, you mentioned automotive with J-Devices at \$750 million and direction to move to \$1 billion, I think you said, by 2016. Could you talk about how much is -- maybe the split between what's at core Amkor versus at J-Devices and how much you think is organic, like the end market growth versus, is there a component that you see a market share opportunities to get to that \$1 billion level?

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

Yes. So, my statement was a \$1 billion run rate by 2017, and the split is roughly \$400 million J-Devices, \$350 million Amkor in 2014. The growth will be a combination of organic, as well as some movement into the Company. So, we have some things happening on the J-Devices side, and it's not organic growth. It's going to boost their sales level in 2016. I think we have a good degree of confidence in this target of \$1 billion in 2017. Again, that puts us in a leadership position in the automotive OSAT market.

Randy Abrams - Credit Suisse - Analyst

A follow-up on that, could you talk about the profitability as we look to consolidate? If you're at 80% ownership by 2016, how we should think about the impact on gross and operating margins, just if we flow it through our model by 2016?

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

Yes, I think if you take a look at J-Devices, what we see today, we have gross margins in the, let's say, 12% to 14% range, and we're working on plans to move those into the 15%-plus range. Ideally, we'd like to see that business settled in the mid-teens. Again, that's part of the consolidate and fill strategy, bringing business into the factories in Japan and consolidating factories within Japan.

Operator

Suji De Silva, Topeka.

Suji De Silva - Topeka Capital Markets - Analyst

First of all, on some of the differentiated projects: the RF, the memory, the sensors, what kind of ultimate margins do those have relative to the rest of the business? Are they growing to a material percent of the revenues, or are they still early stage?

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

Yes, let me just clarify your question. You're saying on the differentiated product, our customer sole source products, if we get a better margin with those as opposed to other products?

Suji De Silva - Topeka Capital Markets - Analyst

Correct. And if they're growing to a material part of the revenue, Steve?

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

Okay. Yes, I think that if you take a look at the products that are growing this year, much of that growth is occurring in mobile com and many of those products are sole source. I think that helps. Obviously, it creates more margin for our customers. However, the competition is still pretty fierce, even for those sole source products.

I think that, for us, it gets back to how fast can we get the money back for these capital investments that we make to support these leading-edge products? It's more of a capital return on investment dynamic than it is flowing directly from the sole source nature of our customers products.

Suji De Silva - Topeka Capital Markets - Analyst

Understood. The other question, Steve, is a little longer-term, maybe perhaps on a 2.5D and 3D packaging, is that something that you can think can have a material impact on the financials near term or whether it's kind of a further out trend or whether you're starting to see some of the impact today?

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

I think we're starting to see some of that impact. 2.5D is a pretty broad definition. I think what you're seeing is a lot of activity at Amkor, at TSMC, at other OSATs, where we're trying to find the right model. Because whatever approach we take, it has to make economic sense for our customers.

So I see a lot of innovation right now, particularly within Amkor, trying to achieve that goal. The goal is to functionality into the same amount of space. So we're seeing a strong trend that way and I think we're engaged with a number of our customers trying to get to a low-cost way to put in more functionality to a given amount of space. I'm encouraged. I think it is going to have a material impact on our revenue, probably starting in 2016.

Suji De Silva - *Topeka Capital Markets - Analyst*

Okay, great. Thank you.

Operator

Jairam Nathan, Sidoti.

Jairam Nathan - *Sidoti & Company - Analyst*

Thanks for taking my question. To an earlier question, you put the revenue picture in the first half into the three buckets: Apple, Samsung and China. Can you give us some idea about the relative content that Amkor has between these three?

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

Yes. I think within the Apple ecosystem, we have strong content. Samsung, also, probably not quite as strong, but we do pretty well, particularly with the higher-end models. China, we have the least exposure. There is one customer that we have who's a leading customer in that ecosystem, but we still have a long way to go to become more exposed in China and Taiwan sales. We're growing rapidly. We'll double the sales year-on-year, but we need to continue that type of growth rate over the next few years.

Jairam Nathan - *Sidoti & Company - Analyst*

Just a follow-up on continuing that growth rate; longer-term, how should we look at Amkor's revenue growth, either has more as an outperformance compared to wafer starts for the industry?

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

Our goal is to grow a bit faster than the industry. We did that last year and I think we'll do that this year. It's going to be close. I think that's the way you should model it. Take the industry growth rate and put something a little bit higher than that for Amkor.

Jairam Nathan - *Sidoti & Company - Analyst*

Okay. All right. Thanks.

Operator

(Operator Instructions)

Atif Malik, Citigroup.



Atif Malik - Citigroup - Analyst

Thanks for taking my questions. You had a market share of about 15% last year; 12% Amkor, 3% J-Devices. Can you provide us a guess of where your market share could stand this year and maybe next year?

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

We don't forecast market share, but I can tell you I think the trends are positive. I think Amkor will gain market share in the second half of this year and we certainly are trying to gain market share again next year. What I see with J-Devices is also positive. They continue to gain market share within the Japanese supply base. So, I would say the bias is possible, but we don't really forecast it.

Atif Malik - Citigroup - Analyst

Got it. A follow-up, can you talk about your utilization rate in the September quarter and what are you expecting for the December quarter?

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

Yes, we stopped publishing the utilization rates some quarters ago, because we didn't find it had a lot of meaning for us. We may commence that again sometime next year, but I think the best proxy for us is looking at our gross margin. Clearly, the problem we had is that we didn't utilize enough of our equipment in Q3 and won't do it in Q4 either. And so, we're basically trying to move more revenue, more customers into Amkor to get that utilization up.

Atif Malik - Citigroup - Analyst

Got it. One last one on the industry: your OpEx was 11% of your sales. Did you see any kind of weakness from your customers in the industrial market? We have heard microchip, a couple of other companies talk about China being weaker for industrial demand, or are you just seeing seasonal trends there?

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

I'd have to say we're seeing seasonal trends. We still have a relatively strong forecast from our customers, so we're actually applying a bit of judgment to the forecast we have today. I can't say that we've seen any wholesale correction per se. I think there are pockets in the industry where there may be inventory issues, such as 3G phones in China, but we're not that exposed to that market.

Operator

Geoff Hulme, Amici Capital.

Geoff Hulme - Amici Capital - Analyst

Thanks. I was wondering if you could give us an update, given the most recent developments at the USPTO and in the California courts, what is your plan regarding the IP situation with Tessera? Is there some way to come to an agreement with them so the Company can use its capital to grow revenues and not accrue a liability at a rate of supposedly \$30,000 a day?

Joanne Solomon - Amkor Technology, Inc. - CFO

From our perspective, we believe the recent decisions are in error. We are planning to pursue all avenues of appeal. As far as updates go, we're going to file our SEC document over the next couple of weeks and any further updates, you can see it there.

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

That's all the Q&A that we have, so that ends the call today. I'd like to turn it over to Steve for his closing remarks.

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

Thank you, Greg.

Let me just recap our key messages. First, excluding revenue from our divested Japanese subsidiary, our Q3 revenues grew 8.5% sequentially and year-on-year. We successfully ramped a flagship 20-nanometer product to high volume and are engaged in development programs at the 14-nanometer, 15-nanometer, and 16-nanometer nodes.

Sales to Taiwan and China fabless companies grew 40% sequentially. Finally, we are encouraged by the macro trends in our business, particularly the move to functional integration at the package and module level, which offers Amkor an opportunity to add more value.

Thank you for joining us today.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Have a great day, everyone.

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