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AMKR - Q3 2012 Amkor Technology, Inc. Earnings Conference Call

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OVERVIEW:

AMKR reported 3Q12 revenues of \$695m. Expects 4Q12 revenues to be \$675-725m or down 3% to up 4% from 3Q12.



CORPORATE PARTICIPANTS

Kenneth Joyce *Amkor Technology, Inc. - Pres, CEO*

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

CONFERENCE CALL PARTICIPANTS

Farhan Rizvi *Credit Suisse - Analyst*

Chad Dillard *Deutsche Bank - Analyst*

Tom Rebinoff *Fore Research and Management - Analyst*

PRESENTATION

Operator

Good afternoon, ladies and gentlemen and welcome to the third quarter 2012 Amkor Technology, Incorporated earnings conference call. My name is Douglas, and I will 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 25, 2012, 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's management. Actual results could vary materially from such statements.

Prior to this conference call, Amkor's third quarter 2012 earnings release was filed with the SEC on Form 8-K. Their earnings release, together with Amkor's other SEC filings, contain information on risks factors, uncertainties and exceptions that could cause actual results to differ materially from Amkor's current expectations.

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

Kenneth Joyce - *Amkor Technology, Inc. - Pres, CEO*

Thank you, Douglas, and good afternoon, everyone. With me today is Joanne Solomon, our Chief Financial Officer. Today, I will talk about our third quarter 2012 results and guidance for the fourth quarter. Joanne will then discuss our financial performance in more detail. Finally, we will open up the call for your questions.

To begin, third-quarter sales of \$695 million were up 1% from the second quarter. Solid demand for wireless communications in both packaging and test was the key driver of our business in the third quarter. Lower-than-anticipated supply of 28-nanometer wafers in the early heart of quarter and the overall weakness in the semiconductor market and general economy constrained our growth.

Wireless communications is a key strategic focus for us, accounting for 44% of our revenue this quarter. Demand for smartphones and tablets continues to grow at a healthy pace, and a number of our major customers have deep penetration in these devices. We package and test many of the different chips used in these devices, including the applications processor, digital basebands, memory, audio processor, integrated connectivity, power management, MEMS sensors and other functions.

Sales and support of consumer electronics grew sequentially in the third quarter, driven by a seasonal increase in gaming, although insourcing by an IDM customer and some softness in the gaming box market contributed to lower growth levels than in previous years. Accounting for 24% of our business, the consumer electronics end market spans devices as varied as gaming consoles, televisions, set-top boxes, portable media and

digital cameras. Some of the chips we handle for these devices include the CPU, GPU, memory, video controller, integrated connectivity and MEMS sensors.

Capital additions were \$173 million during the third quarter, primarily in support of customers in smartphones and tablets. We accelerated the purchase of some 28-nanometer test equipment to meet the ramp in demand for communications at the end of the quarter. Capital additions for the year are expected to remain around \$500 million as we continue to support the growing demand for communications in the fourth quarter and beyond.

We operate in a capital-intensive business, and the timing of our capital spending is driven primarily by specific demands presented by our customers. As I have often stated, one of the key elements of our business strategy is the focus on technology leadership and innovation. We have been investing significant resources in our advanced packaging, and much of our capacity spending this year is in support of our newest and most advanced interconnect technologies for wireless communication packages and the sophisticated probe and test equipment for these devices.

These investments are paying off as the migration from wire bond packaging to Flip Chip and Wafer Level packaging continues. This migration is being driven by strong demand for smartphones, tablets, e-readers, gaming devices and the networks required to handle the explosive growth in wireless content.

For the nine months of 2012, our Flip Chip and wafer-level packaging sales grew \$68 million or 9% compared to the prior year and accounted for 48% of our packaging revenues in the third quarter of 2012. As a result of this strategy, Amkor has the largest share of Flip Chip and wafer-level packaging market in the OSAT industry.

Looking ahead to the fourth quarter of 2012, our revenues are expected to be in the range of \$675 million to \$725 million, or down 3% to up 4% from the third quarter. Fourth-quarter gross margin is anticipated to be in the range of 16% to 19%. We expect solid growth in wireless communications in the fourth quarter of 2012 as our investment in this market continues to gain momentum. The anticipated growth in communications during the quarter is expected to offset the general softening in demand we see in other end markets due to the weak and uncertain macroeconomic environment and the normal seasonal decline in gaming.

In closing, while the macroeconomic environment remains challenging, our lead customers are well positioned to take advantage of the strong growth in smartphones and tablets. Our strategies of closely collaborating with our customers, meeting their capacity requirements and delivering technology solutions that enable the advanced functions in these sophisticated devices are clearly aligned with this trend. And we believe our planned investments can help drive profitable growth, enhance our technology leadership and provide solid returns.

And with that I will now turn the call over to Joanne.

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

Thank you, Ken, and good afternoon, everyone. To begin, our second-quarter revenues increased 1% sequentially to \$695 million. We saw the expected sequential increase in gaming and some growth in networking, which drove our ball grid array package sales up 9%. Our chip scale package sales declined 4% due to a slowdown in demand for wire bond array packages. Our lead frame packages declined 3% as the business we gained following the flooding in Thailand returned to normal levels. Finally, our test services grew 5%, driven by wireless communications.

Gross margin of 17% was consistent with our adjusted gross margin last quarter. The decline in utilization and higher depreciation costs caused some modest compression.

Our operating expenses of \$63 million were down from \$67 million in the second quarter. The sequential decline was primarily due to a reduction in compensation expense during the period. We expect operating expenses to be around \$65 million in the fourth quarter. Other expense of \$22 million was down from \$25 million in the second quarter. In the second quarter, we accrued \$4 million of interest expense for an arbitration loss contingency.

Our effective tax rate of 30% in the third quarter was higher than anticipated due to a discrete tax charge of \$3 million for an accrual of an uncertain tax position in a foreign jurisdiction. Comparing sequentially, in the second quarter we recognized a discrete tax benefit of \$4 million for the release of a tax reserve established in a prior year. And for the full year, we expect an effective tax rate of around 20%.

Moving onto our liquidity and capital structure, at September 30 we had cash in the amount of \$549 million, total debt of \$1.6 billion and net debt of \$1.1 billion. During the quarter, we took advantage of favorable conditions in the capital markets to successfully complete the debt refinancing transaction. We issued \$300 million of new senior notes which are due in 2022 and bear interest at 6.375%, and we used approximately \$225 million of the net proceeds to repay debt, of which \$68 million was paid prior to September 30 and \$157 million was paid in October. This new 10-year note extends our maturities and mitigates future refinancing and liquidity risk.

In summary, as Ken discussed, we're well positioned to take advantage of the significant growth opportunities in wireless communications and we believe our investments can help drive profitable growth, enhance our technology leadership and provide solid returns. With that, we will now open up the call for your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator instructions) Satya Kumar, Credit Suisse.

Farhan Rizvi - Credit Suisse - Analyst

Hi, this is Farhan asking the question on behalf of Satya. I wanted to probe a little bit on your guidance for next quarter. Can you just provide some color on what the different trends you expect in the different packaging types?

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

A lot of the strength we expect to see in the fourth quarter is on the communication side. As has been discussed in our script and in the press release, the supply of 28-nanometer has been slow, but things have improved throughout Q3 and things were strong as of September. So we expect that trend to continue into the fourth quarter. So we are seeing growth in support of wireless communications into the fourth quarter, and we do expect that that will potentially, at the midpoint, be offset by weakness in the other areas. There is the normal sequential decline for gaming that happens in the fourth quarter, but broadly, the macro is impacting the general demand on the other side, on pieces other than the communications.

Farhan Rizvi - Credit Suisse - Analyst

Thanks, and another question I had was on 20-nanometer. It seems like TSMC indicated this morning that it is seeing a lot of demand from its customer on 20-nanometer, and also on 16-nanometer, and that 16-nanometer might start ramping by end of next year. So I just wanted to hear your thoughts on what strength you are seeing on leading 20-nanometer and 16-nanometer. Is Amkor engaged in any of those developments as well on packaging?

Kenneth Joyce - Amkor Technology, Inc. - Pres, CEO

Yes. We closely collaborate with all of our customers and we are working with them on the lower nodes. But right now, the focus for us has been on the 28. But, clearly, the lower nodes we are also working and have programs in place. But the real focus for us right now is on 28-nanometer.



Farhan Rizvi - *Credit Suisse - Analyst*

Thank you, that's all I have.

Operator

Terence Whalen, Citigroup.

Unidentified Participant

It's (inaudible) for Terence. Can you guys talk about, on the wireless communication side how many customers is the current ramp spread over, and how should we handicap the risk of overcapacity as you and other OSATs are simultaneously adding 28-nanometer capacity?

Kenneth Joyce - *Amkor Technology, Inc. - Pres, CEO*

Well, it depends on the customers that you serve. In the wireless space, on the handsets and the tablets, you have different players. And the two dominant players who are out there are doing extremely well. So if you are supplying into that base, you're going to do well. QUALCOMM and Texas Instruments are two of our largest customers, and we believe they are doing well and supporting into that. And we have many other customers that support into that supply chain.

There are the less dominant OEMs that haven't done as well on both the handsets and the tablet side, and to those that are supplying into there, there are some head winds. But I don't believe right now that there's really any buildup on the OSATs that I can see on excess capacity. We are all running pretty strong in support of our customers. I know we are, and I believe our competition is. So I don't believe there is much excess capacity in support of the communications applications all.

Unidentified Participant

Now on the PC side, there is growing concern that the weakness we are seeing in the PC market could be structural, then cyclical. Can you talk about in terms of your PC exposure what the percentage of your sales are PC driven, and again, the risk of access or offsetting the capacity on that side if the PC demand remains weak into next year?

Kenneth Joyce - *Amkor Technology, Inc. - Pres, CEO*

Yes. PC is a rather small part of our portfolio overall. And Joanne, you have that percentage handy on the end market.

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

11%.

Kenneth Joyce - *Amkor Technology, Inc. - Pres, CEO*

Its 11% on the end market, thank you. And we're mostly into the peripherals. We do not do DRAM packaging. Some of our competitors do that, so we wouldn't feel that impact of the computing. We do supply into customers that supply into hard disk drives and other peripherals. We are seeing some softness there, as they are also.



So I think we are a rather small player in the computing and -- but what we do see and where we do play, we are seeing some softness there. Was there another part of the question? I'm sorry.

Unidentified Participant

Yes, a question on partnering with foundries like TSMC. On their call this morning, TSMC talked about in case if Apple moves its (inaudible) their business from Samsung to (inaudible) they will be working with OSATs on package and package kind of applications. Can you talk about any discussion, any dialogue that you are having with TSMC in helping them out on that front?

Kenneth Joyce - Amkor Technology, Inc. - Pres, CEO

We have excellent relationships with TSMC, GLOBALFOUNDRIES, UMC, all of the major foundries -- Intel/Samsung, even, in the sense that they play. We can't speak to any specific customer, but I can tell you that we work with them on all their leading-edge products there and we are really well-positioned as far as the communications space goes, and the foundries know that.

Unidentified Participant

And last one for Joanne -- on the capital intensity, or the CapEx ramping to next year, how should we think about capital spending for next year beyond the \$500 million allocated for this year?

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

With respect to next year, we are certainly monitoring the macro environment and where the demand is, and we are understanding the growth coming from communications. So this time we don't have a specific guide with respect to CapEx for next year. But looking back over the last three years, our capital intensity has been higher than typical, and our capital intensity has been ranging to the 16% to 18%. And each of those years had fairly significant and isolated areas that we were investing. As an example, this year our test investment has typically represented 20% of our spend, and this year it represents 40% of our CapEx spend.

We do expect some of that will moderate. So when you look at, historically, we have been at 16% to 18%; if you start to assume levels of growth, a more normal level of capital intensity would be more like 14% or 15% capital intensity.

Unidentified Participant

Great, thanks.

Operator

Vishal Shah, Deutsche Bank.

Chad Dillard - Deutsche Bank - Analyst

This is Chad Dillard calling in for Vishal. Thank you for taking my question. Could you talk about any type of margin pressure that you are seeing as you are pursuing more business on the tester or wafer level packaging side?

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

With respect to margin pressure, a lot of it has to do in our business model on the scale you reach. And as Ken mentioned in his prepared remarks, we are really well-positioned on both the Flip Chip side as well as on the wafer-level processing side. And we are broadly positioned. There are several chips in support of smartphones and tablets that are migrating to wafer-level CSP. We have a broad set of customer base, so given the higher level of utilization, we are actually seeing good gross margins. So we don't see it as a negative to margin. We actually see it as a positive to margin. And what's great about the wafer-level CSP side, is that it fits really well with our turnkey test offering. So you get a lot more -- the probe to the assembly side of it. So it's strong attach, and the more services we provide, the more value add we capture.

Chad Dillard - Deutsche Bank - Analyst

Great, thank you. And then, as you look towards 2013, can you talk about the areas of your business where you see the greatest risk of under or outperformance?

Kenneth Joyce - Amkor Technology, Inc. - Pres, CEO

Well, clearly, we think as we move into 2013 -- it's a little early with the uncertain economic conditions. But one thing we can say is we are really well-positioned in the communications space. And we believe that that's going to continue into 2013 and beyond, that smartphones and tablets -- we are really, really strong positioned there. So we see that. As far as some of the other markets, I think with the uncertainty we are seeing here in Q4, it's a little premature to talk as to how they're going to perform.

Chad Dillard - Deutsche Bank - Analyst

Got it. And just going back to the test business, can you just elaborate on where your growth targets are, what type of share you hope to gain in that area?

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

With respect to test, test has been about 10% of our revenues. Because the mix of our customers are starting to migrate more towards turnkey -- and it's, again, mostly in support of the communications side -- we don't have a specific target, but I could see it getting into the mid-to low teens.

Chad Dillard - Deutsche Bank - Analyst

Okay, great, thank you.

Operator

(Operator instructions). Tom Rebinoff, Fore Research and Management.

Tom Rebinoff - Fore Research and Management - Analyst

Actually, I have two questions. The first question is, could you talk about the linearity in the quarter and whether, I guess, the end of the quarter was any different from the beginning? The second question is, in the wireless space, specifically, are you seeing any demand softness at all, or is the main issue still the 28-nanometer supply?



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

With respect to the linearity of the third quarter -- apologies, we've got a bit of an echo. With respect to the linearity of the third quarter, we saw the end of the quarter being much stronger than the early part of the quarter, especially with respect to the wireless side of it. And remind me of the second part of the question?

Tom Rebinoff - Fore Research and Management - Analyst

In the wireless space specifically, are you seeing any demand softness? I'm guessing that's probably not the case, but just trying to understand if anything has changed, because obviously you have been pretty bullish on that particular segment. It looks like that hasn't changed, but I just wanted to confirm that that is the case.

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

Yes, heading into the fourth quarter, that is based off a view of strength in the wireless space.

Tom Rebinoff - Fore Research and Management - Analyst

Got it. And I guess maybe one more question, just more broadly speaking. What are you seeing from your competitors? Are you seeing any price competition? Are you seeing them getting more aggressive in any specific segments? Any insights would be very useful.

Kenneth Joyce - Amkor Technology, Inc. - Pres, CEO

Well, pricing our business is always very competitive. On the high-end packages where the utilization is very high for us and our competitors in the communications space, the pricing is pretty stable. It's when you get into the mainstream and the legacy product, commodity product, as markets start to soften as we are seeing, you can see very difficult price competition. I think that's an overview, Joanne. I don't know if you had any comments you want to add to that color.

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

No, that's right. I think we, as the market share leader in the Flip Chip and wafer-level processing side, we compete very favorably on that side. They also compete in that space. Some of our competitors have been doing better on the wire bond side. And it's a competitive industry, but we compete very favorably. We certainly have a level of technology leadership in the industry.

There are some tier 2 players that are trying to penetrate into more of a tier 1 space, but we think the tier 1 will continue to dominate.

Tom Rebinoff - Fore Research and Management - Analyst

And just one last question -- so it looks like, as far as communications are concerned, you're pretty happy with that piece of the business. It looks like it's ramping up, I guess notwithstanding some of the 28-nanometer issues. But could you maybe spend just a minute and talk about your other three or four major segments -- consumer, computing, networking? Just give us a sense of what the major trends are that you're seeing right now.

Kenneth Joyce - Amkor Technology, Inc. - Pres, CEO

Well, during the quarter, our other segments performed pretty well other than computing. Computing was down somewhat for us during the quarter, but our auto and industrial sector was up slightly and our networking was up slightly. The two that we just talked about upfront, the reason we are so excited with communications, that's about 48% of our business right now. Consumer electronics, which we talked about, which includes



gaming, is around 24%. So there's about not quite 70% of your business. The others that we talked about is computing being down, auto, industrial and networking showing some improvement. So we are pleased with that performance during the quarter.

Tom Rebinoff - *Fore Research and Management - Analyst*

Alright, thank you very much.

Operator

And at this time there are no further questions in the queue. I would like to turn the call back over for closing remarks.

Kenneth Joyce - *Amkor Technology, Inc. - Pres, CEO*

Well, we would like to thank everyone for joining us on the call today and participating in our call. Thank you.

Operator

Ladies and gentlemen, that does conclude our conference for today. We would like to thank you for your participation and you may now disconnect.

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