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AMKR - Q1 2015 Amkor Technology Inc Earnings Call

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OVERVIEW:

AMKR reported 1Q15 sales of \$743m. Expects 2Q15 revenues will be relatively flat to 1Q15.



CORPORATE PARTICIPANTS

Greg Johnson *Amkor Technology Inc. - Senior Director of Finance & IR*

Steve Kelley *Amkor Technology Inc. - President & CEO*

Joanne Solomon *Amkor Technology Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Suji DeSilva *Topeka - Analyst*

Jairam Nathan *Sidoti & Company - Analyst*

Randy Abrams *Credit Suisse - Analyst*

Atif Malik *Citigroup - Analyst*

Sidney Ho *Deutsche Bank - Analyst*

Sam Goodyear *MidOcean Partners - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Amkor Technology first-quarter 2015 earnings conference call. My name is Danielle, and I will be your conference facilitator today.

(Operator Instructions)

As reminder, this conference is being recorded.

I would now like to turn the call over to Greg Johnson, Senior Director of Finance and Investor Relations. Mr. Johnson, please go ahead, sir.

Greg Johnson - *Amkor Technology Inc. - Senior Director of Finance & IR*

Thank you Danielle, 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 reconciliation 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.

And now, I'd like to turn the call over to Steve.



Steve Kelley - Amkor Technology Inc. - President & CEO

Good afternoon, and thanks for joining the call.

Today I'll discuss our first-quarter results, our second-quarter outlook, and the progress of our key growth initiatives.

First-quarter results met our expectations. Sales grew 7% year on year to \$743 million, driven by increased demand for advanced packaging and test solutions.

We experienced strong year on year growth in our wafer level, SIP, and MEMS product lines. We also saw very strong year on year growth in Greater China. Earnings per Share increased \$0.03 year on year, and we generated \$60 million in free cash flow.

We anticipate that second quarter 2015 revenues will be relatively flat to Q1. Demand will be constrained in the second quarter, primarily due to inventory adjustments and other issues at one of our major customers in the mobile device segment. We expect growth to resume in the second half, driven by the launch of new flagship mobile devices.

Many of the capacity and technology investments we made in 2013 and 2014 are paying off this year. Recently installed wafer level, MEMS, and SIP capacity is well utilized.

First quarter revenues more than doubled year on year at our Greater China Falvis customers. Growing in China and Taiwan is very important for the Company since it broadens our exposure to the midrange and entry-level segments of the mobile device market. We can typically address the needs of these important second-wave customers using existing assets, which improves our capital efficiency.

A key part of our value proposition in greater China is our regional manufacturing footprint, particularly our world-class factory in Shanghai. In terms of revenue generation, our Shanghai operation is the second largest factory at Amkor. It is arguably the most advanced OSAT facility in China.

We manufacture products with both international and local customers, with a heavy emphasis on wafer level technology and sophisticated multi-dye packaging. We intend to significantly expand this factory in the coming year to accommodate steadily increasing demand.

We have a larger strategy to broaden Amkor's base of customers not just in Greater China, but also in Europe and the US. The number of customers generating at least \$30 million in annual revenue increased by 30% over the past two years. Over time, this broadening of the customer base will enhance the overall health of our Business.

The long-term trend looks very positive for Amkor. More integration is occurring at the package and module level as the economics of advanced silicon nodes become more and more challenging. Also working in our favor is the relatively high cost of adding new advanced packaging capacity. It narrows the playing field, since only the largest OSATs, along with a select few foundries and IDMs, are willing to make the necessary capital investments.

Our R&D team's top priority is to develop cost-effective packaging solutions, which maximize yield and minimize building, material, and process costs. Our efforts in investment in leading-edge technology paid off for us last year at 20 nanometer, and will pay off again later this year, when 16 nanometer and 14 nanometer products hit the market. These latest process nodes largely reuse already purchased equipment, which is helping to drive reduced capital intensity in 2015.

Our SIP, or system-in-package, business is another advanced technology area that is gaining significant traction, particularly for RF applications. Our center of excellence for this business is our K4 manufacturing plant in Gwangju, South Korea.

To assure our leadership position in advanced packaging and test technologies, we are building K5, a new R&D and advanced manufacturing center located about 30 minutes from Incheon airport in South Korea. Construction is progressing on schedule.



We expect to begin product calls in the second quarter of 2016, followed by first production in the second half of 2016. We believe that K5's engineering talent, advanced capabilities, and competitive cost base will be a powerful draw for advanced, packaging, and module customers.

Growing our automotive businesses is also a key part of our long-term strategy. Amkor and J-Devices, our joint venture in Japan, together generated more than \$0.75 billion in 2014 of automotive revenues, making us the number one OSAT provider in the automotive space.

Automotive is a natural fit for Amkor, given our emphasis on quality, execution, and manufacturing stability. We are working closely with the joint venture partner, J-Devices, on a number of fronts. J-Devices is the largest OSAT in Japan and the seventh-largest globally, with revenues of over \$900 million per year. We currently own 66% of J-Devices, and expect to consolidate their results starting in the first quarter of 2016 after we increase our ownership stake to 80%. Consolidating J-Devices will cement our position as the second largest OSAT in the world, well ahead of the next two players.

Our 2015 capital expenditure plan remains unchanged, around \$600 million, including \$150 million for K5 construction. In closing, I would like to note that Amkor recently received Intel's preferred quality supplier award for the second consecutive year. We are proud to be one of a select group of suppliers Intel recognized for outstanding performance in 2014.

Joanne will now provide more detailed financial information.

Joanne Solomon - Amkor Technology Inc. - CFO

Thank you, Steve, and good afternoon, everyone.

First quarter revenues grew 7% year on year. Units were flat with the prior-year quarter. Advanced product units were up 540 million, driven by growth in wafer level packaging and SIP. Mainstream product units defined by 550 million, as our discrete operations in Malaysia saw the planned transition of small signal products back to a Toshiba-owned factory.

Operating expenses in the quarter were \$80 million, essentially flat from the fourth quarter. For the remainder of the year, we expect our operating expenses to remain around this level. Our effective tax rate for the quarter was 20%, as we benefited from a discrete tax item in a foreign jurisdiction. We expect the quarterly effective tax rate to be around 26% for the rest of the year.

In January we increased our ownership in J-Devices from 60% to 66%. Our equity pickup from J-Devices contributed \$0.03 to our first-quarter EPS.

We generated EBITDA of \$840 million over the past 12 months, adjusted to exclude a litigation charge. J-Devices produced \$145 million of EBITDA over the same period. So together, Amkor and J-Devices generated nearly \$1 billion of EBITDA over the past 12 months.

On March 31, we had total debt of \$1.5 billion, and J-Devices' debt was only \$50 million. On a standalone basis, Amkor debt to non-GAAP EBITDA was 1.8 times, and on a combined basis, debt to non-GAAP EBITDA was 1.6 times. And finally, we generated \$60 million of free cash flow in the first quarter. Our liquidity is solid, with about \$500 million in cash and \$450 million in available undrawn loans.

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

QUESTIONS AND ANSWERS

Operator

Suji DeSilva, Topeka.



Suji DeSilva - Topeka - Analyst

Hi, Steve. Congratulations on the cashflow generation, there. The way that the phone customers playing out here, Steve -- how's the second half versus first half going to look this year versus typical years, in terms of splits?

Steve Kelley - Amkor Technology Inc. - President & CEO

I think the second half is definitely going to be stronger.

Obviously, the second-quarter forecast was a bit of a surprise for us, so we have some work to do as we move into the second half. But one of the positive things about the second half is that there are number of new platforms from Apple that are launching into the market, and we have very good content in many of those platforms. So, that gives me a lot of hope.

The second major driver is our seasonal uptick in the mainstream business. Typically, we'll see a nice pop in the second half from our wire bond businesses, typically on the order of 48% to 52% from the first-half, second-half standpoint. Sometimes a little bit better, like last year. So, I'm very positive about the second half. I think the second quarter is a bit of a hiccup for us

Suji DeSilva - Topeka - Analyst

Okay, great. And then you talked about growth of the number of large customers, \$30 million plus. Can you talk about whether those are all smart phone, tablet, mobile customers, or whether you're seeing some of those large customers come in in another categories?

Steve Kelley - Amkor Technology Inc. - President & CEO

So, we're talking about customer that generate \$30 million or more annually for Amkor, so that would put you in the top 25, basically. So what we're seeing is a number of customers that are entering that zone are actually non mobile comm customers. They're large IDMs, as well as [flagship] companies who have broad exposure to the chip markets. So that is encouraging for us.

Suji DeSilva - Topeka - Analyst

Absolutely. Last question, you talked about the reuse of equipment in 16 nm coming up this year versus 20 nm. How much are reuses of that? And how often does that cadence happen? It sounds like 20 nm was a big investment that would repeat every X generations. So just curious on the dynamic, there?

Steve Kelley - Amkor Technology Inc. - President & CEO

Yes, so, it's fortunate that we're able to re-use the equipment. So basically, from a packaging standpoint, the 14 nm and 16 nm products look the same, so by the time you get to that top layer, it's basically the same geometries. So that helps us.

You know, at 10 nm, I'm not sure at this point. We'll have to wait and see, and see how things develop at the foundries as to whether we're going to have to invest a lot more in new equipment.

Suji DeSilva - Topeka - Analyst

Okay, great. Thanks, guys.

Operator

Jairam Nathan, Sidoti.

Jairam Nathan - Sidoti & Company - Analyst

Hi, thanks for taking my question. With regard to your -- the customer you talked about for the guidance decline, for the flat guidance for Q2, what kind of visibility do have with regard to -- with respect to that customer? And I had a follow-up.

Steve Kelley - Amkor Technology Inc. - President & CEO

Well, I think we have reasonable visibility with respect to that customer. Obviously, all of us depend on the end customer to make the call. Many times that call is made at the last minute. So, that's why the magnitude of the decline in Q2 was a surprise for us. There's some inventory issues that occurred, as well as some resetting because of some of the share loss.

But you know, this is the business we're in. The smartphone business as an all-or-nothing business. You win some, you lose some. But, you move on.

So, we will continue to work closely with that major customer. We're going to partner with them on the package and test side, and try to make them even more successful with their end customers over the coming 12 months.

Jairam Nathan - Sidoti & Company - Analyst

Okay, and then my other question was regarding CapEx. You maintained your CapEx. What kind of flexibility do you think you can have if things don't work out in the second half?

Steve Kelley - Amkor Technology Inc. - President & CEO

With regards to CapEx, if you take a look at our year-on-year CapEx, we're -- if you exclude K5, which is the new facility in South Korea, we are down about \$200 million from 2014, 2015, so we're already economizing on CapEx. We still have flexibility. If the second half turns out worse than we expect, we have the flexibility to turn the faucet off, if we want to.

So I think right now, we do intend to invest the full amount, because we see a lot of good growth opportunities in the market today, and they're in areas where we're already full. The wafer level area, the SIP area, the MEMS area, we're doing quite well and we don't want to constrain our growth in those areas.

Jairam Nathan - Sidoti & Company - Analyst

Okay. Thank you; that's all I had.

Operator

Randy Abrams, Credit Suisse.

Randy Abrams - *Credit Suisse - Analyst*

My first question, wanted to ask a little more on the guidance. If you could talk -- was pretty much the full impact from the key customer and their project and inventory, or just if you saw any impact across the broader customer base? Whether mainstream or advance packaging, or from the different end markets? If you could talk about the behavior on the rest of the customer base?

Steve Kelley - *Amkor Technology Inc. - President & CEO*

Yes, I'd be happy to, Randy. We took a very close look at this, obviously, and I have to say that 75% of the miss was the single customer issue. We had one other customer that had a market share issue, but looking across the broad market, we just saw the normal puts and takes of a normal quarter. Some customers are up a little bit, some are down a little bit. So at this point in time, we don't see signs of a broad market correction.

Randy Abrams - *Credit Suisse - Analyst*

Great. If I could ask the other question on the -- you mentioned a few times about the SIP opportunity. Could you talk about how you're addressing, and how broad -- I think you mentioned RF, but the applications you're targeting?

And related to that, how you're seeing the fanout market developing, and how Amkor would be positioned, if you are seeing it? Like, what applications you're seeing fanout, and if it's something that looks like it's coming just at high-end or starting to broaden out?

Steve Kelley - *Amkor Technology Inc. - President & CEO*

Yes, so let me talk a little bit about SIP. Right now, as you said, the RF and front-end modules are driving our business. But we also have opportunities in fingerprint sensors. We have opportunities in other part of the phone. As you see the phone start to -- their are various vendors who are trying to create modules that encompass more than one piece of active silicon.

So, we are very engaged in those efforts. We also see opportunities in automotive, and we see opportunities in the Internet of Things. And if I try to categorize the direction we're going in, we're going into the areas that are more IC and packaging intensive, and less of the board level type SIP's. So we're trying to add as much value as we can at Amkor.

Randy Abrams - *Credit Suisse - Analyst*

Okay, and I guess on the info, if you're seeing much adoption for fanout, and any impact, positive or negative, on fanout? I guess with TSMC working on info for high-end project?

Steve Kelley - *Amkor Technology Inc. - President & CEO*

Yes, certainly, info is out there.

We have our own technologies, and what we're seeing today is that the end customers are evaluating info. They are evaluating the technologies from Amkor and other suppliers. And as in the past, success or failure of any particular approach is usually driven by the economics. Inject the materials cost, the equipment costs to set up a line, and the yield of the process. The yield is particularly important.

So, the other dynamic is that all these customers require multiple suppliers. You just can't be a single supplier to the major mobile device manufacturers today. So, what ends up happening is one technology becomes mainstream, and then the rest of the suppliers obtain licenses to that technology. So, I think a similar scenario is going to play out here over the next 12 months. Our customers will determine the winning approaches, and then we'll license our technology to others, including TSMC, or we'll license technologies from TSMC, or a combination of both.



But I think that's what will play out, and usually this is very valuable process for us, because the customers will help all of us improve our approaches.

Randy Abrams - *Credit Suisse - Analyst*

Great. Thanks a lot.

Operator

Atif Malik, Citigroup.

Atif Malik - *Citigroup - Analyst*

Hi, thanks for taking my question. Steve, with respect to your expectations for second half growth, I just wanted to understand if you're assuming that customer coming back in those expectations, or you expect that customer to take its packaging and testing to its customer?

Steve Kelley - *Amkor Technology Inc. - President & CEO*

I think in the second half, this will be a combination of factors. I think the customer that's going through a reset this quarter will come back to a certain extent, and we'll share in that upturn with that customer.

But I'm speaking more broadly, where we have exposure through a number of different customers to these new mobile device launches in the second half. So I think we're going to benefit from that surge, and that will be compounded by the recovery of mainstream and also some share gains we're making in China and Taiwan.

Atif Malik - *Citigroup - Analyst*

Okay. And then did you see any handset weakness in China? I know you're still growing from small base in China. And also, if you can quantify for us, flagship exposure of your mobile sales? Basically the two big smartphone makers, what percentage of your mobile sales are those two big smartphone makers?

Steve Kelley - *Amkor Technology Inc. - President & CEO*

Yes, I'll talk to the Greater China issue. Traditionally, we have not had a lot of exposure to the ups and downs of the China market. However, in the past 18 months, we have become more involved in that market, and engaged one particular customer who is doing quite well in that market, today. So, so far what we've seen has been positive. Again, our exposure is a lot different than some of our competitors, who are more broadly exposed to many different customers in the China, Taiwan region.

Atif Malik - *Citigroup - Analyst*

And what percentage of sales are the two big smartphone makers?

Steve Kelley - *Amkor Technology Inc. - President & CEO*

Are you talking -- could you just tell me which companies you're referring to?



Atif Malik - Citigroup - Analyst

I'm referring to Apple and Samsung.

Steve Kelley - Amkor Technology Inc. - President & CEO

Okay.

Do we have that number?

Joanne Solomon - Amkor Technology Inc. - CFO

We've never guided a specific number. I would just characterize it as a majority of our revenues would be tied to those two platforms.

Atif Malik - Citigroup - Analyst

And then last question on the re-use of equipment. The comments that you made, are those limited to packaging, or also testing where you're seeing more re-use of equipment?

And is re-use being driven by demand shortfall at 20 nm and you capacity that you can use it for 16 nm? Or the technical requirements of 20 nm and 16 nm are very similar, that you can use the equipment on the test side?

Steve Kelley - Amkor Technology Inc. - President & CEO

Yes, so my comment on re-use applies to both assembly and test equipment, which is good. Because the test equipment these days is very expensive.

With regards to the capacity, we put in place a fair amount of capacity last year, and as you know, this market tends to be pretty dynamic. Goes up, goes down, and so the next-generation of 16 nm and 14 nm comes into play as the 20 nm demand is fading; so the two product cycles complement each other.

Atif Malik - Citigroup - Analyst

Okay. And then one last one on the CapEx, (inaudible), it seems like all those stats are showing pretty good CapEx [discipline]. Just curious, in terms of what do you think of the reasons, the drivers were this time around? The CapEx seems a lot more different from everyone.

Steve Kelley - Amkor Technology Inc. - President & CEO

So, I think your question is why is the CapEx down this year as opposed to last year? I think it's probably a similar story to what we're telling. I think there were some major programs last year that required a lot of spending on the part of OSATs, and so we put in place a lot of capacity which we're reusing this year.

Atif Malik - Citigroup - Analyst

Thanks.



Operator

Sidney Ho, Deutsche Bank.

Sidney Ho - Deutsche Bank - Analyst

Hi, thanks for taking my questions. Just a quick clarification. I'm hoping to quantify the revenue miss from this one handset customer. So typically, your second quarter, you see high single-digit growth on a sequential basis, and you said 75% of that miss is coming from this one customer.

So if [backs down] a little bit, that's somewhere around \$50 million, and follow-up to an earlier question, how comfortable are you not losing share in that particular customer?

Steve Kelley - Amkor Technology Inc. - President & CEO

I think your estimate is roughly right. I think we see somewhere in the \$40 million to \$50 million range is the direct impact in Q2. From that particular customer.

You know, I think on a share question, moving forward, we compete every quarter for share at every customer. So we have to stay competitive from a price standpoint, and from a technology standpoint. So it's very difficult to predict share. All I can say is, in the past, we have been the number one OSAT supplier, and we would like to keep that position, moving forward, with that particular customer.

Sidney Ho - Deutsche Bank - Analyst

Okay. My follow-up question is, can you talk about what kind of impacts have you seen from currency depreciation on end-market demand or competitive landscape? It looks like currency should give your competitors some cost advantage, but has that impacted your business, yet?

Joanne Solomon - Amkor Technology Inc. - CFO

Well, from Amkor's perspective, currency has been a tailwind. The vast majority of our revenues are US dollar based. We do have some cost that are denominated in local currencies, labor and utilities. So, as the dollar strengthened, we got a benefit.

With respect to end market, the impact of currencies, I think that the trends that are driving the demand are strong from a mobile communication standpoint, and that there's just broad demand for mobile communications. So it seemed unaffected by currency.

Sidney Ho - Deutsche Bank - Analyst

Yes, if I can squeeze in one more question. Your mainstream wire bond ASP is up for the last two quarters, but your volume on a year-over-year basis is down and revenue is also down. Can you help us -- I think, Joanne, you have mentioned on your prepared remarks, but can you help us out in terms of the dynamics behind that?

How should we think about ASP and volume, going forward for the year, wire bond side?

Joanne Solomon - Amkor Technology Inc. - CFO

With the addition of the discrete business into the portfolios of mainstream, it had increased units exponentially. And there's this one piece of business that, at the time of acquisition, it had always been planned to go to a Toshiba-based factory.

So, we migrated that over this past quarter. So that's a lot of the variability that you're seeing in mainstream, and it's not -- while it's technically the calculation of an ASP, it's very much driven off of mix in the discretely.

Sidney Ho - *Deutsche Bank - Analyst*

Okay. Thank you.

Operator

Sam Goodyear, MidOcean Partners.

Sam Goodyear - *MidOcean Partners - Analyst*

Hi, thanks for taking the call. I was just hoping you could remind us what the impact of the consolidation of J-Devices would be on your leverage? And also just wondered if you had any comments on your 7 3/8% notes of 2018? They've just stepped down with the call premium. I was just wondering if there was any comments you could make on that?

Joanne Solomon - *Amkor Technology Inc. - CFO*

Okay, certainly. So, Amkor's debt is \$1.5 billion, and J-Devices debt is only \$50 million. They have cash of about \$85 million on their balance sheet. From a debt to EBITDA standpoint, standalone we're at 1.8 times. On a combined basis, we're on a 1.6 times. So, with the addition of J-Devices, it's substantially improves the capital structure, improves it further.

On the step down of the 2018 notes, the 7 3/8%, we continually look at our alternatives to further improve our capital structure and lower our costs of debt, and so it's starting to get very interesting when you look at that step down on that call price, coming here on May 1.

Sam Goodyear - *MidOcean Partners - Analyst*

Thank you very much.

Joanne Solomon - *Amkor Technology Inc. - CFO*

Thank you

Greg Johnson - *Amkor Technology Inc. - Senior Director of Finance & IR*

Thanks very much, Sam. Our Q&A now is over. And I'd like to hand the call back to Steve for his closing remarks.

Steve Kelley - *Amkor Technology Inc. - President & CEO*

I would like to recap our key messages.

First, Q2 demand will be constrained primarily due to inventory and other issues at a single large mobile device customer. We believe that growth will resume in Q3, driven by the launch of new flagship mobile devices. Our outlook for the medium and long-term remains very positive. We plan to continue making strategic investments in both capacity and technology.



We are exercising financial discipline. Operating expenses are flat, year on year. Free cash flow was up. We continue to focus on revenue growth as the overriding priority for the Company. We will continue to broaden our customer base, and go deeper at the customers we already have.

Thank you for joining us, today.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program.

You may all disconnect. Everyone, have a great day.

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