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AMKR - Q4 2014 Amkor Technology Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 09, 2015 / 10:00PM GMT

OVERVIEW:

AMKR reported 4Q14 net sales of $853m. Co. expects 1Q15 revenue to grow 6% YonY.

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CORPORATE PARTICIPANTS

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

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

Joanne Solomon *Amkor Technology, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Randy Abrams *Credit Suisse - Analyst*

Suji Desilva *Topeka Capital Markets - Analyst*

David Duley *Steelhead Partners - Analyst*

Jairam Nathan *Sidoti & Company - Analyst*

Sidney Ho *Deutsche Bank - Analyst*

Atif Malik *Citigroup - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Amkor Technology Fourth-Quarter and Full-Year 2014 Earnings conference call. My name is Sayeed, and I will be your conference facilitator today.

(Operator Instructions)

As a reminder, this conference call 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 & Corporate Communications*

Thank you, Sayeed.

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 the 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.

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

Good afternoon, and thanks for joining the call. Today I'll discuss Amkor's fourth-quarter results, our 2014 performance, our 2015 priorities, and our first-quarter forecast.

Fourth-quarter revenues of $853 million came in much stronger than we expected. These stronger revenues drove gross margin to 23% after adjusting for litigation settlement. This was our best quarterly gross margin performance since 2010.

Our sales into the mobile communications market grew 13% in the fourth quarter driven by strength in the iOS ecosystem. Sales into most other end markets were also better than expected. Our 2014 financial objectives were to drive meaningful year-on-year revenue and earnings growth. I think that we made good progress against those objectives with revenue growth of 6%, adjusted gross margin improvement of 130 basis points, and adjusted EPS growth of 60%.

Revenue grew steadily over the course of 2014 from roughly $700 million in Q1 to over $850 million in Q4. We have now delivered meaningful growth in revenues and profitability for two years in a row. Over a two-year horizon, our revenue was up 13%; adjusted gross margin is up 300 basis points; and adjusted earnings per share have doubled.

We continue to expand our participation in the smartphone and tablet market. In addition to increased apps processor and base band revenue, we grew our business in NAND Flash, power management, RF and managed products. Some of our notable advanced product ramps in 2014 included a major 20-nanometer apps processor, a leading edge power amplifier module, and a 15-nanometer memory product. All three of our advanced product manufacturing hubs -- Korea, China, and Taiwan -- have been quite busy this year. Our three-country footprint for advanced products allows customers to choose Amkor factories which best fit their supply chain needs.

We also ramped new technologies in our mainstream business, including a MEMS fusion product which combines multiple sensors into a single package and a memory module combining NAND Flash and low-power DRAM.

Automotive sales grew around 25% in 2014. This market is attractive to Amkor because of its steady growth, as well as its need for high-quality and reliability. Amkor and J-Devices, our joint venture in Japan, together generated more than $750 million in 2014 automotive revenues, meeting our goal for the year. We also saw steady year-over-year growth in our computing, networking and industrial end markets.

J-Devices delivered record sales of more than $900 million in 2014. We continue to broaden and deepen our cooperation with J-Devices on many fronts including sales, operations and R&D.

I will now discuss our expectations and priorities for 2015. Our financial objectives this year are unchanged from 2014. We aim to deliver meaningful revenue and earnings growth. We anticipate year-on-year revenue growth and improved profitability. We expect to make capital investments of roughly $600 million, including $150 million for K5 construction. K5 is our state-of-the-art factory center in Korea expected to come online in 2016.

Our first priority in 2015 is to broadly deploy the technology and capacity we originally put in place for flagship smartphone applications. We intend to drive utilization at our advanced assembly and test facilities by capturing second-wave opportunities. One of our key advanced technologies is Wafer Level Chip Scale Packaging, where growing demand continues to spur further investment. We have over 50 customers who have migrated to Wafer Level packaging because it is a cost-effective and reliable way to meet the demanding requirements of today's mobile devices. Our heavy investments in this area are paying off.

Our second priority is to capture the next wave of flagship smartphone and tablet opportunities. We are working closely with leading customers and wafer foundries at the most advanced process nodes. The good news is that we can largely reuse our existing assembly and test equipment for the sub 20-nanometer products. We are also developing small form factor packages for next generation analog, and mixed signal ICs and modules.

Our R&D team is developing cost-effective package technologies for mobile devices and other applications, which will ramp to volume in 2016 and later. Their objective is to deliver reliable, high-quality packages while keeping bill of material and process costs under control. Moving forward, we expect much more integration to occur at the package level for economic reasons.

Our third priority is to grow our business with fabless IC companies in Greater China. We made good progress here in 2014, doubling our sales volume and expanding the size and capability of our customer support team. We've recently hired a seasoned sales leader for Greater China, whom we believe can take us to the next level.

Our fourth priority is to grow our automotive business, a key element of our long-term strategy. Finally, we will continue to work closely with J-Devices and plan to consolidate their results starting first quarter of 2016.

Moving on to our first-quarter forecast, we expect Q1 2015 revenues to grow 6% year on year, our 10th consecutive quarter of year-over-year growth. That represents a sequential decline of 13%, largely due to a softer mobile device market following a particularly strong fourth quarter.

Joanne will now provide more detailed financial information.

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

Thank you, Steve.

Good afternoon, everyone. We delivered a very strong fourth quarter, with record net sales of $853 million. Non-GAAP gross margin increased 410 basis points, and non-GAAP earnings per share grew 90% sequentially. These results demonstrate our ability to deliver meaningful margin and earnings expansion from improved utilization.

In January, we reached a comprehensive settlement of our litigation with Tessera. We agreed to pay a total of $155 million in 16 equal quarterly installments over the next four years.

In Q4, we recorded an incremental pretax charge of $87 million, which is net of the prior accruals and net of $18 million that will be accretive to interest expense over the next four years. Operating expenses in the quarter were $80 million, which was up slightly from $78 million in the third quarter. For the first quarter 2015, we expect operating expenses to remain around $80 million. Our earnings benefited from a $6 million favorable impact from foreign currency translation. Our effective tax rate for the year was 25%, and we expect it to also be around 25% for the first quarter and full year 2015.

In January, we increased our ownership in J-Devices to 66%. We acquired an additional 6% ownership from Toshiba for $13 million. We expect to increase our ownership to 80% by 2016 and anticipate spending around $45 million for the additional 14% ownership. We generated EBITDA of $815 million this year, adjusted to exclude the settlement charge. This was up $160 million or nearly 25% from 2013.

J-Devices generated $145 million of EBITDA from their 2014 record revenues. So together, Amkor and J-Devices produced over $950 million of EBITDA this year. And finally, at December 31, we had total debt of $1.5 billion and our debt to EBITDA was 1.9 times, excluding the settlement charge. Our liquidity is solid with $450 million in cash and $485 million in available credit line and undrawn secured-term loans.

With that, we'll now open the call for your questions.

Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Randy Abrams, Credit Suisse.

Randy Abrams - *Credit Suisse - Analyst*

Yes. Hi, thank you, and good result on the gross margin. I wanted to ask actually on the outlook, first on the mainstream products where that part pulled back a bit, just outlook if you see start of a recovery for that business and just some actions to fill some of the capacity on the mainstream products? And for the advanced packaging, or more in the mobile business, you mentioned one of your priorities as far as filling that capacity and having good demand at both high-end and in low-cost packages.

Could you talk about your view on the foundry structure, if some of the APs move to 2016 versus 2014, if that affects your allocation and if it eventually adopts info on some of the advanced packaging if you could participate on some of those opportunities at the high-end?

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

Okay. Randy, I'll try to address your questions in order. First on the mainstream side of the business, this is the wire bond part of our business, and I think of that as three different areas. We have a traditional wire bond business which is centered up in the Philippines. And that business is driven by automotive, by industrial, by MEMS, by consumer and in a lot of different markets and networking. And I think what we'll see there is continued steady growth. I think Q4, we saw a bit of a step-back, but I think we'll see year-on-year growth in that area for Amkor.

On the advanced side, you wanted to talk about the foundry structure in 2016 versus 2014. The way I address that question is first to take a look at what happened in 2014. And I think the most important fact there was that Amkor performed very well at 20-nanometer. So we assembled and tested a number of products there for leading customers and clearly met or exceeded their yield throughput and capacity targets. So I think we're very well-positioned going into the next generation, whether it's 16-, 15-, 14-nanometer, I think we have the equipment in place, we're down the learning curve and we have the engineering expertise to pull it off.

Randy Abrams - *Credit Suisse - Analyst*

Okay. If I could ask a follow-up the second question on gross margins. For fourth quarter, for the upside in gross margin excluding the Tessera, if you could go through what drove it? If that was the product mix from the mobile products and advanced products? And for your outlook for margin into 2015, where you'd see kind of high season margins progressing; if kind of similar levels to what we achieved last year, or what kind of the range for what you could expect as we go back toward peak season?

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

Yes, Randy, I think for the fourth quarter the primary driver to the improved gross margin was just better sales, better utilization of our existing capacity. We're a high fixed-cost company, so when we drive higher sales, we have good follow-through. Mix also impacted it, but to a much lesser extent. As I look to 2015, we definitely perceive an improvement in gross margin year-on-year. If you look back the last two years, 2013 and 2014, we showed steady improvement in gross margin and I foresee the same outcome in 2015.

Randy Abrams - *Credit Suisse - Analyst*

Thanks a lot.

Operator

Suji Desilva, Topeka.

Suji Desilva - *Topeka Capital Markets - Analyst*

Thanks. Hi, guys. In terms of meeting the upside you guys had, did you have any challenges on the capacity side for the advanced products this quarter?

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

No. We didn't. Because we were ready to handle an upside, so despite our poor forecasting ability from the financial side, our factories were ready and we didn't really overstress the factories in Q4.

Suji Desilva - *Topeka Capital Markets - Analyst*

Okay, great. And on the mainstream side, you talked about the weakness there a little bit. Can you talk about the competitive landscape versus some of the guys in Asia and whether pricing is a factor there to get business there or how well-positioned you are for that competitive push going forward?

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

Yes, on the mainstream business, I'll complete the thought I articulated earlier in the call, but there are three parts. The Philippines, we have our memory business in China and then we have a discrete business in Malaysia. So I think price is competitive in all three areas.

Most of our leverage today is in volume, so the key in our mainstream business is to really fill our existing capacity. If we could do that, we could generate better gross margin. There's not a whole lot of price leverage.

Suji Desilva - *Topeka Capital Markets - Analyst*

Okay, great. And last question, on mainstream versus advanced, do you expect that mix, Steve, to stay around 50/50?

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

I think, looking at the outlook for 2015 and where our upsides are, I would hope that we could move the advanced products a little faster than mainstream. But I think 50/50 is not a bad place to start.

Suji Desilva - *Topeka Capital Markets - Analyst*

Great. Thanks, Steve; thanks, Joanne. Congratulations on the good quarter.

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

Thank you.

Operator

David Duley, Steelhead.

David Duley - *Steelhead Partners - Analyst*

Let me add my congratulations on a nice quarter and a really nice improvement on the gross margin front. And I think it was asked earlier, but I just wanted to ask it in a slightly different way. Once you have a seasonal improvement in your business sometime in the middle of the year, would you expect to be able to exceed this gross margin that you just threw up in the fourth quarter?

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

Yes, I would think so, because I think for the year we're going to be better 2015 than 2014. And I think when we hit our peak in the second half of this year, I think it's fair to assume that we could meet or exceed our Q4 gross margin.

David Duley - *Steelhead Partners - Analyst*

Okay. And just a little bit more color about the CapEx investments next year. Typically you might provide us with kind of a summary perspective of how the CapEx might be broken out, but I'm more interested in maybe you giving us your view on as far as the advanced packaging area, will you guys be making significant investments in the fan-out type processes? Help us understand inside the advanced packaging area, besides wafer bump and Chip Scale packaging, or whatever you like to classify it as. What are the key areas of investments?

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

Sure, I would like to make a comment there. Just to review, our current plan is to spend $600 million in capital spending in 2015. $150 million of that for K5 and $450 million to expand capacity and for other purposes. Last year we spent just over $680 million for capital projects. So it was a peak year. This year we can afford to spend a little less and depend more on some of the capacity we installed last year.

That said, we still see demand outstripping supply on the wafer-level CSP area, so we continue to invest there. We invest in the wafer-level fan-out technologies. We have our own technologies that we're developing, which we think offer very good cost to the customers. And I think we'll also invest some more in advanced Flip Chip.

The last area that we're investing quite a bit in is our System-in-Package area, where we're focused on RF modules in particular, so we're showing significant growth in that business in 2015.

David Duley - *Steelhead Partners - Analyst*

So just as a clarification, that's similar to what we hear from ASC, they call their SiP business System in a Package, so you're kind of moving into that area where you are producing Wi-Fi modules and whatnot?

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

We've actually been in the SiP business for 15 years, we just didn't talk about it a whole lot. The way to think about SiP is that we're just moving more and more off the circuit board into a package. So whether it's multiple die, passive components, you name it, we're trying to put it into a smaller area for the customer. And one word for that is SiP; another is module. But we've been using them more or less interchangeably.

David Duley - *Steelhead Partners - Analyst*

Okay, thank you.

Operator

Jairam Nathan, Sidoti.

Jairam Nathan - *Sidoti & Company - Analyst*

Hi, thanks for taking my question. Just first on gross margins, I was looking at your first-quarter guidance. Revenue is up 6% year-over-year but gross margin seemed to be down. Is there any mix issues you expect or what's behind that?

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

I wouldn't characterize it as mix as much as the drop from Q4 to Q1 compared to Q4 of 2013 to Q1 of 2014. So the fixed costs that we added the second half of the year are what's being underabsorbed in Q1, leading to the lower gross-margin guides.

Jairam Nathan - *Sidoti & Company - Analyst*

Okay. And more a longer-term, you're kind of starting this year with, I would guess, two headwinds in a sense. One is QUALCOMM losing some business on the Samsung side and the potential for Apple going to Samsung away from TSMC. Now if these things pan out, like when -- how -- can you talk about something that can offset these changes at big customers?

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

Let me just address both of your issues. We generally don't talk about particular customers, but I will address them in general.

I think in this case, with the QUALCOMM issue, is fairly public now. They talked about in their earnings call. And yes, the loss of that particular socket certainly affected our first-half business plan. But what we're seeing is QUALCOMM is doing very well with that particular Snapdragon 810 product with a number of different customers. And a number of those customers have come out publicly in the past two weeks and endorsed the product and we expect that business to come roaring back in the second half of this year.

But QUALCOMM is our biggest customer. We are their biggest OSAT supplier. We work closely with them on a number of technology developments across the spectrum from the ultra low tier to the premium tier.

The other question was regarding Apple foundry strategy. I'd like to just speak generally about what's going on in the industry. And the clear trend is that most of our customers buy wafers from foundries and they send those wafers to OSATs for assembly and test. That's because that model offers the most flexibility, a more competitive cost base, and less risk. So it's a tried-and-true approach and it works.

We've executed very well at 20-nanometers for multiple customers. So I really think, no matter which way Apple goes, we are well-positioned for the Apple ecosystem. I think we have good share and we'll maintain share moving into 2015.

Jairam Nathan - *Sidoti & Company - Analyst*

Okay, thank you. And lastly, with regard to your Chinese fabless companies, do you have a target for sales in 2015? I think you said you doubled it in 2014.

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

Our aim in 2015 is to grow the China Taiwan business by about 65% to 70%. My hope is that we can double it again. So that's the challenge I've given to the sales team, but what we built into a plan is about 65% to 70% growth year on year.

Jairam Nathan - *Sidoti & Company - Analyst*

Okay, thank you. That's all I have.

Operator

Sidney Ho, Deutsche Bank.

Sidney Ho - *Deutsche Bank - Analyst*

Thanks for taking my question and congrats on a very strong result. For revenue, for first quarter, your historical five-year average is down somewhere around 6% and you are guiding down 13%. How much of that -- I think you talked a little bit about being a strong quarter, but how much of that do you think is a pull-in to Q4 and how much is incremental weakness from, say, the Chinese OEMs given what MediaTek guidance earlier today?

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

Okay, I'll make a comment. If you look historically, Q1 is a seasonally slow quarter for us and the rest of the industry. And the reason why you see such a dramatic decrease from Q4 to Q1 is really the strength of Q4.

The iOS ecosystem had an unprecedented quarter from number of phones shipped. I think Tim Cook said it was an all-time record for Apple, and we benefited from that, as well as other suppliers. The other thing we benefited from in Q4 was that our share in that ecosystem was higher than we forecasted, which is good news. So I think if you look quarter-on-quarter, it's somewhat misleading because of the strength of Q4.

Sidney Ho - *Deutsche Bank - Analyst*

All right; that makes sense. Should we think about Q2, you should be seeing a snap-back off a tougher comp?

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

Yes, I think you'll see Q2 up over Q1. You'll see Q3 over Q2; and Q4, it's too early to call.

Sidney Ho - *Deutsche Bank - Analyst*

Got you. In terms of -- switching to gross margin, obviously very impressive gross margin in Q4. And if you look at the mainstream products revenue was down 3%, units down about 15%, can you help us understand how much of a margin tailwind when you can get the mainstream capacity to fully utilize at whatever that level is, is defined?

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

So I can add some color. The mainstream does generally operate below the corporate average, so it does provide some headwind when it's strong to compressed, but it's still great from a return perspective and great from a cash-flow perspective. But the trends of how do we get margins to hit the targets in Q3 and Q4 of next year is going to be strong utilization, both advanced, strong utilization in mainstream.

Sidney Ho - *Deutsche Bank - Analyst*

Got it. And if I can squeeze in one more on the gross margin. I guess just based on the midpoint of your guidance for Q1, it would suggest incremental gross margin somewhere around 50%? Is that the right way to think about your margins when revenue is starting to grow for the rest of the year or is there some mix -- I understand there's probably some mix, really, the issue there as well.

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

I think, generally speaking, we do average about a 40% incremental gross margin. Clearly for Q4 you saw increment margin well ahead of the 40%, but, as a general rule of thumb, the 40% to 50% is a decent increment margin. From a what's fixed and what's variable, materials is by far the only real true variable cost we have. A lot of our labor, depreciation and other costs of manufacturing are all fixed. Materials is running around 36%.

Sidney Ho - *Deutsche Bank - Analyst*

Great. Thank you and congrats.

Operator

(Operator Instructions)

Atif Malik, Citigroup.

Atif Malik - *Citigroup - Analyst*

Hi, thanks for taking my question, and good job on the results and guide. Can you talk about your packaging and testing mix exiting this year? Should we be thinking something different from the 85/15 split? And if you can also talk about the profitability, the gross margins of each of the segments?

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

Atif, we've been running just about at the 85/15, and I think that's a good expectation for 2015 as well. As we do more wafer-level processing, we're getting strong attach to probes, so that, over time, potentially could give a little bit of a lift to test. Test being more capital intensive, operates at gross margins ahead of corporate average.

Atif Malik - *Citigroup - Analyst*

Okay. And then with respect to your guidance, I recall last year in the September quarter you saw weak Android sales on the fingerprint center opportunity. So understand Q4 a high mark because of iOS success, but as I look into the guide for the March quarter, how do we feel comfortable that the guide is derisked for any platform ramp perhaps with Android system in the March quarter?

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

I think we made pretty good progress. If I take a look at where we are positioned in the Android ecosystem, we've got a reasonable starting position, but we won quite a few new designs in the second half of last year. So I expect our market share to grow this year in Android. And we'll benefit from that starting in March of this year.

Atif Malik - *Citigroup - Analyst*

Great. Thanks.

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

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

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

I would just like to recap our key messages. First, Q4 was a very good quarter for Amkor with record revenues and improved profitability. For the full year, we grew overall revenue 6%. We doubled sales to customers in China and Taiwan, and we grew automotive revenues 25%. We delivered 20% gross margin and a 60% increase in EPS after adjusting for a litigation settlement.

We expect to grow revenues and profitability in 2015. And our technology leadership position is paying dividends, enabling us to offer cost-effective package-level integration choices to our customers. Thank you for joining us today.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes our program. You may all disconnect.