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AMKR.OQ - Q3 2021 Amkor Technology Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Amkor Technology Third Quarter 2021 Earnings Conference Call. My name is Hillary, and I will 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 Jennifer Jue, Head of Investor Relations. Ms. Jue, please go ahead.

Jennifer Jue - *Amkor Technology, Inc. - Senior Director of IR and Finance*

Thank you, operator. Good afternoon, everyone, and thank you for joining us for Amkor's Third Quarter 2021 Earnings Conference Call. Joining me today are Giel Rutten, our Chief Executive Officer; and Megan Faust, our Chief Financial Officer.

Our earnings press release was filed with the SEC this afternoon and is available on the Investor Relations page of our website, along with the presentation slides that accompany today's call.

During this presentation, we will use non-GAAP financial measures, and you can find the reconciliation to the U.S. GAAP equivalent on our website. We will 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 differ. 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 would like to turn the call over to Giel.

Giel Rutten - *Amkor Technology, Inc. - President, CEO & Director*

Thanks, Jennifer. Good afternoon, everyone, and thank you for joining the call today.

We delivered outstanding financial results in the third quarter with record revenue of \$1.68 billion and record profitability. Strong execution, high factory utilization and controlled spending resulted in record quarterly EPS of \$0.74. When combined with the strong first half results, we generated \$1.74 of EPS in the first 3 quarters, doubling last year performance in the same period. Revenue was up 24% year-on-year, and 20% sequential growth comes on top of an excellent second quarter. Continued momentum drove record performance in all end markets, most notably in communications and consumer, where we saw sequential revenue increases of 28% and 22%, respectively.

Our communications business grew 24% year-on-year, representing 43% of total quarterly revenue. The main driver for growth here is the strength in the smartphone market, particularly in 5G, with current industry forecast of nearly 500 million 5G-enabled smartphones to be built this year.

We expect 5G to remain an important growth driver, and we continue to invest in technology and manufacturing scale to support our customers in these growing markets.

In the automotive and industrial markets, we achieved another quarterly revenue record with sequential growth of 9% and year-on-year growth of 42%. The growth underlines a strong recovery in this market, although supply chain constraints, especially in wafer and substrate supply, dampened further growth.

The strong recovery of our automotive business is mainly due to significant trends of new products in this domain, particularly supporting the rapid proliferation of ADAS functionality and the accelerated electrification of car models. Amkor is well positioned to support these innovations with a solid technology portfolio and an established automotive qualified manufacturing base. In ADAS, we are ramping the assembly of the latest generation processors using our advanced flip chip technology and the portfolio of radar and optical sensors using wafer-level fan-out technology.

For electrical vehicles, we are enabling the assembly of high-power silicon carbide devices in our Japan factories, utilizing unique wire bond and lead frame technology. Although we foresee some short-term and midterm constraints in automotive supply chain, we believe the long-term growth drivers in this market remain in place, resulting in the continued expansion of semiconductor content per car. Market forecasts show growth rates in the automotive market that exceeds the average semiconductor industry growth.

Strength in the consumer market resulted in a better-than-expected sequential increase of 22%. We continue to diversify our product and customer portfolio in IoT wearables, and we ramped several new products in the third quarter. We expect this market to be an important driver of growth, and our overall product and customer pipeline for advanced SiP solutions in this sector remains strong.

Revenue in the computing market set another quarterly record, with sequential growth of 9% and year-on-year growth of 28%. Further upside was tempered by constraints in material supply, especially high-end substrate materials. During the quarter, we experienced solid performance in all computing applications and a further strengthening of our project pipeline. We continue to invest in technology and manufacturing scale to capitalize on opportunities in emerging segments like AI and high-performance computing.

Finally, our test business grew 19% year-on-year in the third quarter to a record \$225 million as we broaden the scope of our test services for 5G communications and system-level testing.

Our manufacturing organization did an excellent job managing the steep production ramp in the third quarter, most notably for advanced packaging in our factories in Korea. During the quarter, we added capacity and ran several new products while working through obstacles in the supply chain caused by COVID restrictions and supply constraints for material and equipment. We work closely with our suppliers and customers and managed to keep the impact limited, although we experienced some revenue impact for our SiP business due to short supply of critical ICs.

We expect the constraints on material and equipment supply to continue into next year. To mitigate risk, we have expanded agreements with several of our suppliers as well as most of our top customers to warrant the better supply assurance in future periods.

In the U.S., we continue to monitor investment policies to incentivize domestic semiconductor manufacturing, and we are exploring a possible factory location to align with the U.S. investments of other major semiconductor companies.

Our CapEx target for the year remains at \$775 million, with major investments for wafer-level and flip chip technology, SiP and test capacity as well as facility expansions.

Now let me turn to our fourth quarter outlook. We are expecting the fourth quarter to be another solid quarter with revenue of \$1.64 billion at the midpoint of our guidance. This represents a year-on-year increase of 20% for both the quarter and the full year. For 2021, we expect double-digit percentage growth in all end markets, and we remain confident in our strong market position and the overall demand environment.

Megan will now provide more detailed financial information.

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

Thank you, Giel, and good afternoon, everyone. Amkor delivered strong financial results in Q3, setting new records for revenue, gross profit, operating income, EPS and EBITDA.

Third quarter revenue of \$1.68 billion was up \$274 million or 20% from the second quarter. And as Giel noted, all of our end markets set new revenue records.

During the quarter, we successfully navigated through several disruptions in the supply chain, specifically material constraints for wafers, substrates and components. These disruptions primarily impacted the communications end market, where our growth was hindered but still in line with historical seasonality. This was partially offset by upsides in our consumer advanced SiP portfolio for IoT wearable products.

Revenue for advanced products grew 26% sequentially and represents around 70% of our business. This significant growth is driven by new product introductions, primarily in advanced SiP, supporting the communications and consumer end markets.

Our revenue for mainstream products grew 4% sequentially and 27% year-on-year, principally due to recovery in the automotive market.

With high levels of utilization, gross margin expanded 150 basis points year-on-year to 19.3%, and our gross profit of \$325 million is an all-time record.

Operating expenses for the quarter came in as expected at \$113 million. Our focus on controlling OpEx during a period of significant growth contributed to record operating income of \$211 million.

Operating income margin expanded 160 basis points sequentially to 12.6%.

Net income for the quarter was \$181 million, resulting in an all-time record EPS of \$0.74.

We generated record EBITDA of \$358 million in Q3, and EBITDA margin was 21.3%.

Shifting to the balance sheet. We ended the quarter with \$790 million of cash and short-term investments and total liquidity of \$1.2 billion.

At September 30, total debt was approximately \$1 billion, and our debt-to-EBITDA ratio is 0.8x, well below our target of 1.5x. With respect to our capital allocation policy, we will reinvest in the business, supporting technology and capability advancements in R&D as well as capacity expansion for organic growth. This may be equipment as well as facilities expansion when needed. Target capital intensity in the low teens and efficient utilization enables profitable growth.

We will continue to optimize our debt structure with respect to amount, cost and duration. We have reduced our interest expense by over 20% or \$11 million for the 9 months ended September 30 compared to the same period in the prior year. We also have access to reserve liquidity for unforeseen events or opportunities.

As it relates to strategic investments, we target technology enhancements adjacent to our core competencies and geographic diversification supporting our customers' supply chain needs, for example, in the U.S. or other locations that are developing a semiconductor supply chain.

Returning capital to shareholders remains a priority, and we expect to grow the dividend over time. Our solid financial position provides flexibility to achieve these priorities.

Moving on to our fourth quarter outlook. We expect continued strength in the market with revenue to be between \$1.59 billion and \$1.69 billion. Considering the midpoint of our Q4 guidance, 2021 revenue growth is estimated to be around 20% over prior year. Gross margin is expected to be similar to Q3, between 18% and 20.5%. We expect to maintain operating expenses at around \$115 million. We expect our full year effective tax rate to be around 15% due to discrete tax benefits and favorable foreign currency movements.

Q4 net income is expected to be between \$140 million and \$190 million, resulting in EPS of \$0.55 to \$0.75. Our forecast for capital expenditures for the full year remains at \$775 million for a capital intensity in the low teens.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Randy Abrams of Credit Suisse.

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

Okay. Yes. Good job on the results, especially factoring the supply constraints. I wanted to ask on the fourth quarter guidance where at the midpoint is a small revenue decline. Could you elaborate -- some years, I think it's flat, plus or minus. For fourth quarter, how much of that is a supply constraint impacting sales versus -- I'm curious if you're also seeing any areas of pushout due to customers also facing some mismatched shipping product. So if you could elaborate a bit on the sequential decline [granted] off a high base in the third quarter.

Giel Rutten - *Amkor Technology, Inc. - President, CEO & Director*

Randy, this is Giel. Let me try to give you a first flavor of Q4 guidance.

Now the fourth quarter for Amkor generally is a little bit up or down. It can be up a few percent or down a few percent. The guidance is currently 2% down. Mostly, we see a correction in the communication market where we see still some constraints in components, specifically also critical ICs.

I don't see a correction, as you mentioned, in the end markets where, let's say, end customers are correcting their build plans based on imbalance in the supply chain. So to me, it's still a continuation of the third quarter with limited supply of specific ICs.

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

Okay. And if you could elaborate on constraints. You talked about a couple in the remarks, but auto, the constraints you're seeing in the -- and if you could give us a look at how you see the constraints evolving. So I think auto was one area. High-end substrate was an area, and if you could elaborate more on the constraints in ICs. Are these mostly small IC like power management? Or is it across different ICs? So yes, if you could elaborate a bit on the constraint and how you see it continuing, looking forward as we go into next year.

Giel Rutten - *Amkor Technology, Inc. - President, CEO & Director*

Okay. No. The way that we see and experience constraints is slightly different in each market segment.

If we take, for example, the automotive market, we observed the constraints in the beginning of the year was mostly wafer constraints. Later on in this year's Q3, Q4 and also into next year, we see constraints continuing but then shifting more on the substrate side, specifically the higher-end substrates in automotive applications like ADAS, which is generally designed in advanced silicon nodes, we observed constraints there. And the basis is the same for the computing market.

Now on the communication markets, however, we see multiple different dynamics. There, we see for our SiP business, a continued shortage of specific components or ICs. And as you already mentioned, these are ICs which are, let's say, smaller ICs generally designed in the more mature nodes and that we see share continue in the fourth quarter.

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

Okay. And if you could give an initial view -- I mean you mentioned it's mostly supply side, not demand side. Is there an initial view -- well, I'm sure we'll get more detail in a few months, but for first quarter, how it's looking, if it looks like factoring the supply/demand you could see above seasonal first quarter and then how you're viewing next year in terms of the overall environment, if you're expecting good year, still supply-constrained year or -- and I'm curious on the risk side if you see any areas where inventory is building up, like components that are more available but needing to slow that down.

Giel Rutten - *Amkor Technology, Inc. - President, CEO & Director*

Well, we don't guide for, let's say, the first quarter next year or even beyond that, Randy. But on the inventory and supply situation, there is some short-term inventory buildup because of some of the components constraints, and that would result in some buildup of inventory of other components. Although our view is that, that's still a small effect in the overall supply chain.

We also see end customers being less conservative on holding more inventories. So we expect that based on their risk management, overall inventory during the year will continue to increase.

Now on the supply side -- on the wafer supply side, I believe that there, the constraints will ease in the first half of the year. On the substrate supply side, it may take a little bit longer. I mean significant investments are made for substrate supply, let's say, capacity increases. But that will, in my view, only come on stream towards the fourth quarter of next year.

So in short, I mean, I don't see significant inventory buildup. And some of these constraints will ease a little bit in the second quarter, and some of them will continue till the fourth quarter next year.

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

Okay. And one last question I'll ask for the -- I'm curious the SiP business driver if it's -- I think, traditionally, that consumer SiP was audio, if that's still a big driver. Or if you could give a profile of SiP like how much now it looks like it's growing this year and the profile, if you could talk a bit more about this pipeline and how it looks for continuing to grow the SiP opportunities.

Giel Rutten - *Amkor Technology, Inc. - President, CEO & Director*

Yes, our SiP opportunities, in the third quarter, we saw significant strength in SiP. On the communications side, it was slightly moderated because of the supply constraints that I mentioned before. On the consumer side, it was strong, although also there, we see some constraint, but it's -- we had significant strength on the consumer side. We believe that to continue.

We see also a diversification on the product side, both on the communication as well as on the consumer side. And SiP, more broadly, is also entering applications like automotive where we have strength, specifically on the digital, let's say, dashboard site. So multiple applications, strong product pipeline and in our view, it's a growth engine going forward.

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

Okay. And maybe one more just on the margin implication. It looks like from a capacity perspective, you're running near full. With the gross margin now kind of where you're operating at this level fairly high, 19%, 20%, is that view just kind of the high point or you could say like up-cycle margin if business remains healthy? Or is there a room like if we have a good year for some further margin leverage?

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

Randy, I...

Giel Rutten - *Amkor Technology, Inc. - President, CEO & Director*

To make a point...

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

Yes, I can take that, Randy. So with respect to gross margins being at 19%, 20%, while we're operating at high utilization, we do have still some capacity, specifically in our Japan location. So there is some upside there.

And then the only other comment I would make is one of the other variables besides utilization that does impact gross margin percentage is product mix. So with respect to that mix of products, that can have an impact on gross margin percentage where we would have -- could have some upside as well.

Operator

(Operator Instructions) Our next question is from Art Winston of Pilot Advisors.

Arthur Michael Winston - *Pilot Advisors, L.P. - CEO, President, and Chief Operations Officer*

Thank you for the really great results and the great outlook. I have 2 questions. The first one is, given the very sharp increase in your material costs, what about the possibility of raising selling prices to offset these sharp increases in the materials?

Giel Rutten - *Amkor Technology, Inc. - President, CEO & Director*

Well, Art, let me answer that. We mentioned it also earlier on in previous calls. The general arrangements that we have with our customers is that cost increases on the material side are factored in the prices to our customers. So if our material cost is increasing, specifically for substrates, what we're seeing now and also other materials, then we factor that into adjustments to pricing to our customers.

Arthur Michael Winston - *Pilot Advisors, L.P. - CEO, President, and Chief Operations Officer*

It's factored in. Okay.

Giel Rutten - Amkor Technology, Inc. - President, CEO & Director

No. no. It will be factored in. If it continues to go up, prices to customers will also go up.

Arthur Michael Winston - Pilot Advisors, L.P. - CEO, President, and Chief Operations Officer

Okay. Good. Megan touched on the last one. Other than in Japan, is the utilization rate pretty much high across every place else except perhaps in Japan?

Giel Rutten - Amkor Technology, Inc. - President, CEO & Director

Yes, we...

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

Go ahead, Giel.

Giel Rutten - Amkor Technology, Inc. - President, CEO & Director

Yes. I mean, third quarter, fourth quarter are, for Amkor, our peak quarters. There were some areas, there are still some underutilization. Megan already mentioned that in Japan. But overall, we have a very strong utilization across our factories.

Arthur Michael Winston - Pilot Advisors, L.P. - CEO, President, and Chief Operations Officer

Good. And my last question is in terms of the automotive, if the supply congestion were to ease, should we assume that your automotive shipments would be sharply higher correlating with the increased amount of car builds across the world? Would that happen?

Giel Rutten - Amkor Technology, Inc. - President, CEO & Director

Well, in the quarter, in Q3, we saw...

Arthur Michael Winston - Pilot Advisors, L.P. - CEO, President, and Chief Operations Officer

No, I'm talking about going forward, not in...

Giel Rutten - Amkor Technology, Inc. - President, CEO & Director

Oh, going forward?

Arthur Michael Winston - Pilot Advisors, L.P. - CEO, President, and Chief Operations Officer

Yes, yes.

Giel Rutten - Amkor Technology, Inc. - President, CEO & Director

Yes. I think in my view, we're still not at the peak of our automotive business. If we take, for example, applications like ADAS or digital dashboards or in-car networking, it's still in the early beginning. So it's not only the car volumes, but it's also the attach rate of these advanced functions into the car. And what we believe is that there is an acceleration in the car markets for 2 elements.

First is ADAS, but also electrification of the cars is increasing much steeper curves than what was expected 2 years ago. So it will continue to increase. And as mentioned, we believe that the semiconductor content per car and the overall semiconductor market and automotive is growing faster than the average semiconductor growth rate.

Arthur Michael Winston - Pilot Advisors, L.P. - CEO, President, and Chief Operations Officer

We can assume that the product mix would be more profitable for the more advanced and complex electrification products that you're making going forward will be more profitable.

Giel Rutten - Amkor Technology, Inc. - President, CEO & Director

Well, we have pockets that are more profitable than others, but that will be a correct assumption.

Operator

Our next question is from Vijay Rakesh of Mizuho.

Vijay Raghavan Rakesh - Mizuho Securities Co., Ltd., Research Division - Research Analyst

Giel and Megan, I was wondering on the auto, industrial side, what's your split within that of auto, industrial? And when you look at autos, you mentioned ADAS and electrification, just wondering how -- what percent of your automotive was geared to ADAS and EV?

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

So Vijay, we don't break out auto and industrial separate. However, the majority of that market is automotive. And then with respect to your second question, it was specifically asking about the concentration of ADAS in our automotive?

Vijay Raghavan Rakesh - Mizuho Securities Co., Ltd., Research Division - Research Analyst

Yes, ADAS and EV.

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

Yes. So we don't break out ADAS, EV. We also have a significant amount of infotainment in automotive. And then as a reminder, all of that traditional mainstream business is in automotive.

We are seeing significant increase in the advanced portion of automotive, but we don't break out those segments separately. This quarter, we did see an increase in ADAS from the prior quarter as well as in electrification.

Vijay Raghavan Rakesh - Mizuho Securities Co., Ltd., Research Division - Research Analyst

Got it. And as you look at Q4, your December quarter, in terms of the mildly softer 2% down, I guess, how would you look at auto, industrial and the comm side into Q4? I know you mentioned comm had some, I guess, constraints. But how would you look at auto, industrial and the comm side trending into Q4?

Giel Rutten - Amkor Technology, Inc. - President, CEO & Director

Megan, do you want to comment on this?

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

Sure. Yes. So automotive, we're seeing more flattish in Q4, so continued strength despite the supply chain constraints. And communications is where we are seeing a decline in Q4. And as Giel has mentioned previously, we are seeing continued shortages in specific IC components. And it is fairly historically seasonal to see a downtick in communications in Q4, given the timing of the different phone launch cycles.

Operator

At this time, I'm showing no further questions. I would like to turn the call back over to Giel for closing remarks.

Giel Rutten - Amkor Technology, Inc. - President, CEO & Director

Okay. Thank you. Well, before closing the call, I would like to recap our key messages.

For the third quarter of 2021, we delivered all-time record revenue of \$1.68 billion and record EPS of \$0.74. For the fourth quarter, we expect robust year-on-year growth of 20% with revenue of \$1.64 billion. Supply chain constraints of substrates and components are expected to continue into Q4 and into the next year.

We expect a gradual recovery in the second half of next year when new capacity comes online. We are working closely with our customers and suppliers to help mitigate risks from these ongoing constraints.

The main catalyst for future growth are 5G, IoT, automotive and high-performance computing, and Amkor is well positioned in these key markets.

Last but not least, I would like to thank the global Amkor team for delivering this record quarter.

Thank you for joining the call today.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect, and have a wonderful day.

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