

# FINAL TRANSCRIPT

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## **AMKR - Q2 2011 Amkor Technology Inc Earnings Conference Call**

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## CORPORATE PARTICIPANTS

**Ken Joyce**

*Amkor Technology Inc - President, CEO*

**Joanne Solomon**

*Amkor Technology Inc - CFO*

## CONFERENCE CALL PARTICIPANTS

**Farhan Rizvi**

*Credit Suisse - Analyst*

**Wenge Yang**

*Citigroup - Analyst*

**Jake Kemeny**

*Morgan Stanley - Analyst*

**Raj Dave**

*Citigroup - Analyst*

## PRESENTATION

**Operator**

Good afternoon, ladies and gentlemen, and welcome to the second quarter 2011 Amkor Technology Inc. earnings conference call. My name is Alicia 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, Wednesday, July 27, 2011, and will run for up to one hour. Before we begin this conference call, Amkor would like to remind you that there will be forward-looking statements made during this conference. These statements represent current view of Amkor management. Actual results could vary materially from such statements.

Prior to the conference call, Amkor's first quarter 2011 earnings release was filed with the SEC on Form 8-K. The earnings release, together with Amkor's other SEC filings, contain information on risk 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. Ken Joyce, Amkor's President and Chief Executive Officer. Please go ahead, sir.

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**Ken Joyce** - *Amkor Technology Inc - President, CEO*

Thank you, Alicia, and good afternoon, everyone. With me today is Joanne Solomon, our Chief Financial Officer. To begin, second quarter sales of \$688 million and gross margin of 19% were at the higher end of our expectations. We achieved strong results in the face of extraordinary supply chain challenges due to the tragic earthquake in Japan. Our global workforce did an outstanding job working closely with our customers and supply chain partners to resolve these supply issues. We did, however, experience some material shortages. In addition, the wafer shortages initially experienced by our Iwate, Japan factory have been resolved, and this factory is fully operational.

Overall, the negative impact to our second quarter sales due to uncertainties in the electronics industry supply chain, was less than half of the \$50 million estimate provided when we gave our second quarter financial guidance back in April. In addition, second quarter sales growth was constrained by greater than expected weakness in demand for wireless baseband chips by a single OEM. Looking beyond these two items, demand for communications and consumer electronics applications was solid. We also saw some improvement in networking, where we have been experiencing some softness in demand the past few quarters.



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Although gross margin of 19% for the second quarter was at the higher end of our guidance, we experienced significant margin pressure from unfavorable foreign exchange rate movements, higher gold prices, and lower utilization of certain assets supporting consumer applications, networking, and the isolated weakness in communications I just mentioned. We continue to exercise discipline in our pricing policy in this challenging environment, where rising raw material costs and manufacturing costs and temporary pockets of excess capacity are pressuring gross margins and profitability. We also remain focused on increasing efficiency and cost-effectiveness as an organization. However, it's important to maintain a rational pricing environment in order to promote a healthy supply chain.

Looking ahead to the third quarter, we expect sales growth to be consistent with our typical seasonal patterns. Strong demand for communications and a seasonal increase in gaming is expected to drive sequential revenue growth of 5% to 12%. In support of this growth and to meet the capacity requirements of our leading customers, we are currently planning capital additions of approximately \$225 million for the second half of 2011 and \$425 million for the full year. Much of our capacity spending this year is in support of our newest and most advanced interconnect technologies for wireless communications, including flip chip CSP packages, flip chip stacked CSP and fine pitch copper pillar flip chip. Our sales of these packages have more than doubled in the first half of 2011 compared to the same period in 2010.

To continue driving technology leadership and innovation, our capital spending in the second half of the year includes approximately \$25 million for research and development initiatives to support next-generation interconnect technologies such as wafer-level fan outs and Through Silicon Via. We are also investing in wire bond assets that support the migration of gold wire bonding into copper. Third quarter gross margin is expected to be in the range of 17% to 20%. We anticipate that unfavorable foreign currency rates and rising gold prices will continue to put pressure on our gross margins in the third quarter. We also see some areas of excess capacity, as global consumer spending remains muted in the face of uncertain macroeconomic environment.

In closing, we are seeing solid demand for our package interconnect technologies and strength across many of our end markets as we move into the second half. The migration to flip chip and copper wire bonded packages is accelerating. As the price of gold continues to rise, we are actively engaged with our customers to drive the transition to these technology platforms. Over the past few quarters, we have been investing in capacity to support this business. As a result, Amkor is well-positioned to meet the needs of our customers in 2011 and beyond. And with that, I'll now turn the call over to Joanne.

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

Thank you, Ken. And good afternoon, everyone. Our first quarter sales of \$688 million were up 3% sequentially and were at the higher end of our expectations. Our chip scale packages were down 9% due to the weakness in wireless baseband chips Ken discussed. Ball grid array and leadframe packages and test services all grew more than 10% each. Our sales to integrated device manufacturers, our IDM customers, were 45% in the second quarter, essentially flat with the first quarter. We anticipate that the revenue split between our IDM and our fabless customers will remain around 50/50 for the third quarter 2011. The pricing environment remains stable with very little price erosion this quarter.

Gross margin for the second quarter was 19%, at the high end of our anticipated range, and consistent with Q1. Compared to our gross margin of 24% in the second quarter of 2010, foreign currency and gold drove about half of the decline. And as Ken mentioned, the pockets of excess capacity added further pressure. Our operating expenses of \$74 million were slightly lower than the first quarter and our expectations. For the third quarter of 2011, we expect operating expenses to remain generally consistent with the second quarter.

During the quarter, we successfully completed a series of debt transactions. We issued \$400 million of new senior notes, which are due in 2021, and bear interest at 6.625%. We used the net proceeds from the issuance of these notes to redeem in full the \$264 million of our 9.25% senior notes due 2016 and to refinance the \$43 million of our 2.5% convertible senior notes due May 2011. We also used proceeds to pay the related fees, expenses and accrued interest and the balance of the proceeds will be



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used for general corporate purposes. We recognized charges of approximately \$16 million, with no net tax effect, or \$0.05 per diluted share, due primarily to premiums paid to retire the existing debt. With these charges, earnings per diluted share would have been at the higher end of our anticipated range.

These transactions are the latest examples of our continued success in capitalizing on market opportunities to enhance our liquidity, strengthen our balance sheet, reduce our interest expense, and mitigate future refinancing risks on very favorable terms. Income taxes were slightly higher than our expectations. We now anticipate that our effective tax rate for the third quarter and full year 2011 will be around 13%. The higher effective tax rate is caused by higher losses in tax jurisdictions like the US, where we maintain a full valuation allowance. The losses in the US were largely driven by the refinancing costs. We ended the quarter with a cash balance of \$475 million, total debt of \$1.3 billion and net debt of \$848 million. Additionally, we were free cash flow positive again, in the second quarter. With that, we will now open up the call for your questions. Operator?

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## QUESTIONS AND ANSWERS

### Operator

Thank you. (Operator Instructions) And our first question is from the line of Satya Kumar with Credit Suisse. Please go ahead.

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### Farhan Rizvi - Credit Suisse - Analyst

Hi. This is [Farhan] calling in for Satya. Thanks for taking my question. I had a question regarding Q3 gross margins. Your revenues are up and gross margin is only 17% to 20%. How do you see the spread between labor, material and others in Q3?

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### Joanne Solomon - Amkor Technology Inc - CFO

The split between labor, materials, would be generally consistent with what we saw for the second quarter. And let me just give that to you so you have that handy. So second quarter, it was about 42% materials, 12% labor, and the rest depreciation and other costs, which was 21%.

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### Farhan Rizvi - Credit Suisse - Analyst

Thank you. That's very helpful. So in the third quarter, you would expect it to be similar?

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### Joanne Solomon - Amkor Technology Inc - CFO

Similar. Product mix has a tendency to shift things around a little bit, which is why we give a range with respect to gross margin. So depending on where the actual mix shakes out, you may have some movement within that gross margin range.

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### Farhan Rizvi - Credit Suisse - Analyst

Okay, so your -- but in terms of your guidance, you are assuming pretty much similar to what you had in Q2?

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### Joanne Solomon - Amkor Technology Inc - CFO

Similar. I would expect an uptick in materials because of the added pressure from gold as gold prices continue to increase and the average gold price increases for the quarter, you'll start to see some pressure on that material percent number.

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**Farhan Rizvi** - *Credit Suisse - Analyst*

Got it. Thank you. And where do you see the utilization rates for Q3, for packaging and [tests]?

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

The utilization rates for Q3 would be in the low 80%.

**Farhan Rizvi** - *Credit Suisse - Analyst*

For both? For both the packaging and [tests]?

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

Yes. They would be close.

**Farhan Rizvi** - *Credit Suisse - Analyst*

Okay. Thanks.

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

And let me just correct the break out of the materials percentages. It's about 43% for materials in Q2, 15% for labor, and then 23% for depreciation and other. I apologize. I was looking at the wrong year.

**Farhan Rizvi** - *Credit Suisse - Analyst*

Okay, thank you. No problem. And last question I had was in terms of your Q2 inventory, can you talk about was it planned or unplanned, the increase that you saw in inventory?

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

The increase in inventory, with respect to Japan, there were some swings in movement in inventory as people were trying to make sure we were mitigating the impact of Japan. You also see higher inventory levels for us as we're heading into Q3 to prepare so I would say it's more or less as we would expect heading into Q3. When I look at our inventory days, it's fairly consistent. I don't see an unusual build up of our inventory. Our inventory levels are appropriate.

**Farhan Rizvi** - *Credit Suisse - Analyst*

Okay. That's all I had. Thank you.

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

Thank you.

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**Operator**

Thank you. Our next question is from the line of Wenge Yang of Citigroup. Please go ahead.

**Wenge Yang - Citigroup - Analyst**

Hi. Thank you for taking my questions. A couple of things. In terms of the guidance for Q3, can you comment on what's driving the upside and downside for the range of 5% to 12%?

**Ken Joyce - Amkor Technology Inc - President, CEO**

Well, we're seeing some seasonal uptick in the gaming. The communications market remains very solid for us. As we said, we were impacted in the second quarter by one OEM. We expect that we were going to see some recovery here as we are in Q3. And the consumer, the -- we still see it as solid, although there is some uncertainty out there with respect to overall demand in terms of the macroeconomic economy. But overall, we feel good. We did see networking remains a little bit soft, but as we saw some improvement in Q2, we expect that to go forward in Q3. So we see some seasonal trends, actually, as we go in, and based on our discussions with our customers, we feel confident that we have good solid demand moving in to the third quarter.

**Wenge Yang - Citigroup - Analyst**

Okay. There are a lot of discussions on the chip inventory moving higher for the semiconductor makers. How does that affect their ordering pattern in the last couple of weeks?

**Ken Joyce - Amkor Technology Inc - President, CEO**

Well, what we can say is what we see. I can't speak for the entire industry, but what we see is that there has been a build up in the die banks in our factories. And what does that tell us? Who are the customers that are building in there? Well, they're actually taking one step -- once the front end makes the decision to put those into production, they take them and give them to us, and that's good news. What I think what we're seeing there is that our customers and their customers downstream are managing their inventories really very closely, and it probably is somewhat of a reflection of what I talked about a few minutes ago. This cloud of uncertainty that's starting to rise with respect to the demand picture. I don't it's so much of an inventory issue; I think inventories may be in the right area. It's about where this demand ultimately comes out.

**Wenge Yang - Citigroup - Analyst**

That's helpful. Turning to the CapEx side, your taking a slightly different route versus some of your competitors, and the Taiwan competitors are spending more money on the copper wire bonding while you are investing more heavily in advanced packaging technologies. Can you give us some outlook on how this is going to play out in the next couple of quarters in terms of end market demand?

**Ken Joyce - Amkor Technology Inc - President, CEO**

I feel very good where we're at. There has been a migration from obviously from gold to copper wire bond. But there's also a migration going on to flip chip at the high end. And we've invested a lot of money there in the flip chip. So I really feel very good with the money we put there. That being said, we're investing more in copper and we're converting our customers over also on copper wire bond. But you're absolutely right. We've been focusing more on the leading edge packages on flip chip.

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And flip chip this quarter is 36% of our total revenue, the highest it's ever been. So I think we're making the right investments and we're going to benefit from that.

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

Yes, I think the only thing that I would add is with respect to our focus on flip chip and more specifically, the flip chip and chip scale packaging, that's what positions us really well to support the smartphones and the tablets. And so our technology investments into flip chip is what gives us our share positioning in smartphones and tablets.

**Wenge Yang** - Citigroup - Analyst

Okay. So with heavy spend -- relatively high CapEx [intensity] the last two -- in 2010, 2011, how do you see the CapEx trend moving forward, 2012 and beyond?

**Ken Joyce** - Amkor Technology Inc - President, CEO

Well, as you know, it depends on where the demand goes. Because CapEx decisions are not short-term decisions. These assets are good. We estimate investments in support of our customers' demand forecasts, we're going to do that. With that being said, we remain committed to disciplined CapEx that, that drives profitable growth.

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

You're right on the historical trends. Our capital intensity has been trending to this 14%, and last year, we were higher than 14% as we had the heavy investments in R&D as well as facilities. So I could see us staying at relatively high capital intensity but as the industry continues to go through technology transitions, a lot of the wireless carriers migrated from the wire bond packages this year into the flip chip packages this year, which was -- it's great. It's great for us, we are well positioned to support that. That drove higher capital intensity and as we talked about it as well, in support of leadframes and also some of the wire bond laminate packages, we have to invest to support the migration to copper. And Ken mentioned that in his prepared remarks that, that trend is accelerating now that gold is around \$1600 an ounce. With respect to the compression on gross margins, we are incentivized to migrate more and more of our customers out of gold wire bond. With that said, there are some packages that will always stay in gold wire bonding and we'll continue to support that.

**Wenge Yang** - Citigroup - Analyst

Okay. Last question regarding interest expenses. With all the refinancing activities, what are you seeing -- the interest expenses could come down in 2012 versus if you don't do anything?

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

We did increase our debt. We are relatively neutral on debt this year versus last year. So I would expect our quarterly interest rate to be around \$80 million. We do have some amortizing debt that in a foreign jurisdiction, so that moves the needle a little bit. But that's a relatively low interest rate. So, I -- it's a \$20 million a quarter, \$80 million a year on interest expense.

**Wenge Yang** - Citigroup - Analyst

Okay. Thanks.

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**Operator**

Thank you. (Operator Instructions) The next question is from the line of Jake Kemeny, Morgan Stanley. Please go ahead.

**Jake Kemeny** - Morgan Stanley - Analyst

Hi, Joanne. I just had a question for you. Do you guys expect to continue to generate free cash flow in the back half of the year?

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

Yes. Our expectation is that we'll be free cash flow positive for the year and that does include being free cash flow positive in Q3 and Q4 depending on the timing of CapEx payments. It will shift around between how it will -- we'll definitely break out in Q3 and Q4.

**Jake Kemeny** - Morgan Stanley - Analyst

And with that, what are the proceeds? Is there any other debt that you can look to reduce in the cap structure?

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

As far as reducing debt in the cap structure, we have some really attractive long-term debt that we've put up this year and last year that put the \$345 million at 2018 and \$400 million at 2021. As a reminder, in 2014, we have a convertible note. That's \$250 million; that has an exercise price of \$3.02. And between that -- between 2011 and 2014, we have some of that amortizing foreign debt. So there is a -- there are some payments that we make throughout those years.

**Jake Kemeny** - Morgan Stanley - Analyst

Okay. And I think on previous calls you commented that you'd like to have -- run the Company with a net debt position of \$500 million. Is that still accurate?

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

That has been our long-term goal is to manage down to a net debt of \$500 million. That said, we are a much bigger Company now. Our debt-to-EBITDA ratio is just above 2. Our interest coverage ratio is strong. And so we're growing as a Company, our EBITDA is -- it remains strong, so our ability to carry our debt, it remains solid.

**Jake Kemeny** - Morgan Stanley - Analyst

Okay. Great. That's all I had. Thank you.

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

Great. Thank you.



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**Operator**

Thank you. The next question is from the line of Raj Dave with Citigroup. Please go ahead.

**Raj Dave** - Citigroup - Analyst

Hi, guys. Thanks for taking my call. I have two questions. The first one is on the smartphone side, probably a broader level question. How are you guys, on the one hand it sounds like there is a benign picture of what you're painting from a demand standpoint, consumer demand. On the other hand, Apple, Android phone sales are just record penetration levels everyday. And so I'm trying to reconcile the two and understand that communications is only one part of your business. How are you guys positioned to capture this pretty powerful wave? And then the second was question is on the Japan supply-chain disruptions. How do you see that? Has that stabilized? What are you seeing there?

**Ken Joyce** - Amkor Technology Inc - President, CEO

On the smartphone side, I believe we're really well positioned. That's where we've been making our investments in support of the advanced technologies that are driving this growth. And as you say that market continues to be robust and we participate not always directly into the OEMs, but through many of our customers into the OEMs that you mentioned. So I think from a smartphone position, we are extremely well positioned. In terms of what we've invested in capacity available and taking advantage of that market. And with respect to the -- situation in Japan, once again, as the CEO, I'm absolutely pleased with our workforce worldwide -- I mean they worked around-the-clock, early in the period with customers and suppliers to make sure that we got the supply, that the supply chain moved smoothly. We've largely worked through that. I think there could be a small spillover of some of those materials issues into Q3, but I think it's largely cleaned up and shouldn't have a significant impact on us in Q3. But what impact there is, is already built into our guidance.

**Raj Dave** - Citigroup - Analyst

Thank you.

**Operator**

Thank you. (Operator Instructions) There are no further questions at this time. I will turn it back over to management for any closing remarks.

**Ken Joyce** - Amkor Technology Inc - President, CEO

Well, since there are no further questions, we'll end the call. And I thank everyone for their participation here today. Thank you.

**Operator**

Ladies and gentlemen, this concludes the Amkor Technology Inc. second quarter earnings conference call. If you'd like to listen to a replay of today's conference, please dial 1-800-406-7325 or 303-590-3030 and enter in the access code of 445-5478. Thank you for your participation. You may now disconnect.

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