OVERVIEW:
Co. reported 3Q18 results. Expects 4Q18 revenues to be $1.02-1.10b and net income to be $5-34m, or $0.02-0.14 per share.
CORPORATE PARTICIPANTS

Chris Chaney  Amkor Technology, Inc. - VP of IR
Megan Faust  Amkor Technology, Inc. - Corporate VP & CFO
Stephen D. Kelley  Amkor Technology, Inc. - President, CEO & Director

CONFERENCE CALL PARTICIPANTS

Anastazia Goshko  BofA Merrill Lynch, Research Division - MD
Jeffrey A. Rand  Deutsche Bank AG, Research Division - Research Associate
Randy Abrams  Crédit Suisse AG, Research Division - MD and Head of Taiwan Research in the Equity Research Department

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Amkor Technology Third Quarter 2018 Earnings Conference Call. My name is Carmen, and I will be your conference facilitator today. (Operator Instructions) And as a reminder, this conference is being recorded.

I would now like to turn the call over to Chris Chaney, Vice President, Investor Relations. Mr. Chaney, please go ahead.

Chris Chaney  Amkor Technology, Inc. - VP of IR

Thank you, Carmen. Good afternoon, everyone, and thank you for joining us for Amkor’s Third Quarter 2018 Earnings Conference Call. Joining me today are Steve Kelley, 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 our website.

During this conference call, we will use non-GAAP financial measures, and you can find the reconciliation to the U.S. GAAP equivalent on 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 financial results discussed today are preliminary and final data will be included in our Form 10-Q.

And now I’d like to call -- turn the call over to Steve.

Stephen D. Kelley  Amkor Technology, Inc. - President, CEO & Director

Good afternoon. Thanks for joining the call. Today, I’ll review our third quarter results and fourth quarter forecast. I’ll discuss our revenue gains in mobile communications as well as our progress in 2 key growth areas: automotive and advanced SIP.

We had a strong third quarter. Revenue met guidance, and earnings came in above the high end of our range. As expected, strength in mobile communications, particularly in the iOS ecosystem accounted for nearly all of our 7% sequential revenue increase. Through the first 9 months of the year, revenue has grown 6% compared to the same period in 2017. Most of this growth came from advanced packages for mobile applications.
Although we recognize the smartphone unit growth is moderating, we still see a lot of incremental opportunity for Amkor in this very large market. 3 content-related trends are driving increased opportunities: First, new features, which require additional ICs; second, increasing package-level integration throughout the phone; and third, the accelerating migration of features from the high end into mid-range phones. Over the medium term, we see 5G as a major upgrade catalyst in the smartphone market. Driven by space constraints and performance requirements, the smartphone market has largely transitioned to advanced packages, such as wafer-level, flip chip and advanced SIP.

We see a similar transition occurring in the automotive market, albeit more selectively and at a slower pace. This transaction is being driven by data-intensive systems, such as ADAS, which utilize complex, high pin count ICs only available in advanced packages. As recently as early 2017, only 15% of our automotive revenue came from advanced packages. Today, it’s over 20% and will continue to grow in 2019. This migration to advanced products is a good trend for Amkor, given our advanced package expertise and experience.

Most automotive-grade advanced packages are built in our state-of-the-art factories in Korea. The automotive business is capital efficient, since it largely reuses equipment we originally installed for the communications and computing markets.

Moving to advanced SIP, which drove nearly $300 million in third quarter revenue. Our current expectation is that 2017 SIP revenue will be up nearly 20% over 2017 to roughly $1 billion. Advanced SIPs are popular because they allow customers to save space, save money and improve performance. Where silicon-level integration doesn’t make economic sense, advanced SIPs are the right choice. Leading markets include smartphones, IoT and automotive.

Moving to our outlook. We expect revenue of $1.02 billion to $1.1 billion in the fourth quarter, with most market segments down sequentially. We are prepared to limit capital spending should the soft demand environment continue into 2019. This potential reduction in capacity-related CapEx would not impact spending on new capabilities or on our continuous improvement initiatives. In addition, the long-term revenue outlook for our Japanese factories has weakened over the past year. We are reassessing the size of our factory footprint in Japan to ensure that it is aligned with long-term demand.

Moving forward, our core objective, balanced revenue growth, remains the same. This balance across multiple markets, applications and geographies reduces our sensitivity to demand swings in any particular market or at any particular customer. To achieve that balanced growth, we will continuously improve our value proposition for customers, building on our strengths, stability, technology execution, quality and service.

Megan will now provide more detailed financial information.

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

Thank you, Steve, and good afternoon, everyone. Today, I will review our third quarter results, improvements in our balance sheets and our fourth quarter outlook.

Overall, I am pleased with our results for the third quarter. Better-than-expected gross profit and EPS were driven primarily by improved operating leverage. Gross margin grew 160 basis points sequentially due to increased sales and a favorable foreign currency impact on fixed costs. Although gross margin percentage was down year-over-year, EPS and EBITDA margin were comparable. In addition, our ending cash balance of $550 million was higher compared to last year’s third quarter balance.

Operating income grew 300 basis points sequentially to 8% of sales, up from 5% of sales last quarter. EBITDA in Q3 grew 13% sequentially to $235 million, resulting in a 21% EBITDA margin. CapEx was $88 million, down from $159 million in the prior quarter. We generated $133 million in free cash flow during the quarter.

Moving on to our balance sheet. We lowered our average interest rate substantially by entering into a new term loan at a fixed rate of 1.3%. We used the proceeds to redeem the remaining $200 million of our 6 5/8% senior notes. The refinancing lowered our interest expense by $11 million annually. We will begin to see the benefit of the lower interest expense in the fourth quarter.
Our balance sheet is sound, with $1.4 billion of total debt and a debt-to-EBITDA ratio of 1.6x as of September 2018. Our liquidity is also solid. At the end of the third quarter, our total liquidity was approximately $825 million with cash of about $550 million and available undrawn loan of $275 million.

Based on our revenue expectations for the fourth quarter, we expect gross margin to be in the range of 13% to 15%. Operating expenses in the fourth quarter are expected to be similar to Q3 levels. We expect net income in Q4 to be between $5 million and $34 million or $0.02 to $0.14 per share.

Our estimated tax rate remains around 25% for the full year. Note, however, that we continue to evaluate our provisional estimates of the complex provisions of the new U.S. tax reform act, and these estimates could change as we refine our analysis and apply any new guidance on this law. Finally, our guidance for CapEx remains unchanged at around $600 million.

With that, we will now open the call up for your questions. Operator, you may begin the polling now.

**QUESTIONS AND ANSWERS**

**Operator**

(Operator Instructions) And our first question comes from Sidney Ho with Deutsche Bank.

**Jeffrey A. Rand - Deutsche Bank AG, Research Division - Research Associate**

This is Jeff Rand on for Sidney. Can you talk a little bit about your noncomm business and what macro trends you’re seeing? Are you seeing any inventory buildup with customers?

**Stephen D. Kelley - Amkor Technology, Inc. - President, CEO & Director**

So on the noncommunications business, we characterize it as a general market. I would say that if you look across our market segments today, computing and memory are roughly flat Q3 to Q4. The remainder of our general market segments are down mid-single-digit range.

**Jeffrey A. Rand - Deutsche Bank AG, Research Division - Research Associate**

Great. And then just on the gross margin, seems to be a little down in the fourth quarter. Do you see that rebounding next year? And kind of what are the puts and takes for you to see some margin expansion?

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

Sure, Jeff. So the Q4 guidance is down 7% from Q3 and 8% from prior year Q4. So just wanted to remind everyone, we are focused on cash flow and earnings. And given this Q4 forecast, our model would suggest that will generate over $800 million EBITDA for the year. So to address your gross margin specific question, that's a function of revenue and cost, and the lower gross margin percent is actually attributable to two things: First, the decline in Q4 revenue is what's causing -- Q4 is causing lower capacity utilization or the lower gross margin percentage you're speaking of. The second factor is, we have a few high material content, advanced SIP programs. So with respect to the future outlook, it's really a function of capacity utilization that will improve gross margin.
Operator
(Operator Instructions) And we have a question from the line of Randy Abrams with Crédit Suisse.

Randy Abrams - Crédit Suisse AG, Research Division - MD and Head of Taiwan Research in the Equity Research Department
Yes. I wanted to ask a follow-up question just on the demand outlook. If you could talk about your customers, how they’re discussing the slowdown in demand. How much is tied to excess inventory versus what they’re seeing slowdown in demand? And if they could talk about what factors whether it’s trade war related or there’s other factors on the slowdown. And if they’re giving any profile in terms of duration and magnitude of slowdown, if they see this as a short-term inventory correction or something that may extend somewhat into 2019.

Stephen D. Kelley - Amkor Technology, Inc. - President, CEO & Director
Yes. Randy, I would say that every customer has a slightly different story. For most, it’s excess inventory. But I think excess inventory and like the demand, there are two sides of the same coin. So we’ll have to see how that plays out. None of our customers have given us specific feedback about 2019 and their long-term demand expectations. We’re taking a wait-and-see approach. We’re taking a cautious approach on CapEx because it has been quite some time since the general market’s gone through a slowdown. So we’ll see how Q1 looks in a few months and take our next steps.

Randy Abrams - Crédit Suisse AG, Research Division - MD and Head of Taiwan Research in the Equity Research Department
Okay. And on the first question asked about the nonmobile business. But if you could elaborate a bit on mobile, maybe the 2 ecosystems, like iOS and Android, how you’re seeing that trend. And normally in first quarter, you get a bit of incremental high-end Android, if you expect that tailwind to continue.

Stephen D. Kelley - Amkor Technology, Inc. - President, CEO & Director
Yes. So I think for the year, looking back in 2018, I think the iOS market was strong for us is typical in the second half. So Q3, we’re seeing it continue into Q4. I think the Android market, whether you’re talking Samsung or the Chinese smartphone makers, I think, overall that’s been a bit less volume than we expected this year. I think the market has been somewhat attenuated. I think as we move into next year, we do expect to see a seasonal uptick in Q1 for the Android ecosystem, and we’re looking forward to a solid year, mobile communications 2019.

Randy Abrams - Crédit Suisse AG, Research Division - MD and Head of Taiwan Research in the Equity Research Department
Okay. And if I could ask on the Japan business, where you’re evaluating, I think, the footprint. Could you talk about the range of alternatives? Is this something you expect like a restructuring or potential asset sale? And is it more something you’d restructure for cost side? Or is it something that would change the revenue like selling factory, but also selling some of the revenue you’re generating from some of those customers?

Stephen D. Kelley - Amkor Technology, Inc. - President, CEO & Director
Yes. Let me just explain a little bit about our -- my comment and the issue we see. So right now, we have a factory network in Japan, which largely supports the needs of domestic customers. That’s older factories from a number of different Japanese customers. These factories focus almost exclusively on older wire bond packages, in particular, TQFP. And the demand for those particular packages is going down over time. So many of the new opportunities we have with Japanese customers actually involve advanced packages. And we’re building those packages in our advanced factories in Greater China, in Korea and in some cases, in Portugal. So we see the overall demand environment is decent in Japan. But we’re just using our factory network to build these advanced packages for Japanese customers. The second part of your question, we don’t have any intent to sell businesses per se, but we think there is some improvements we can make to our factory network in Japan, which will increase our utilization.
Randy Abrams - Crédit Suisse AG, Research Division - MD and Head of Taiwan Research in the Equity Research Department

Okay. Great. The last question, just the CapEx, I fear you -- probably most of this here, like your maintaining was largely set earlier in the year. If there's a way to think -- I think prior next year, the view was similar type of CapEx level. Is there an early way to think about now how you're viewing CapEx for next year? And also, let's say, the slowdown continues, how much you'd view semi-fixed versus how much you could pair back if you needed to cut further.

Stephen D. Kelley - Amkor Technology, Inc. - President, CEO & Director

Yes. Randy, I think the way to think about 2019 is that of the $600 million we spent in 2018, we're certainly not going to go higher than that. I would expect the CapEx to go down in 2019 because I think we built a reasonable amount of capacity in 2018, which we haven't made full use of yet. So it's going to go down. How far it can go down remains to be seen, depends on the demand environment, but I think I would probably refer you back to 2015 to look at a situation where we're able to pull CapEx back in response to a persistent slowdown.

Operator

(Operator Instructions) And our next question comes from Ana Goshko with Bank of America Merrill Lynch.

Anastazia Goshko - BofA Merrill Lynch, Research Division - MD

Actually, I think most of my questions were just covered in the prior segment. But one final question. You obviously talked about the negative leverage you've got going on in the gross margin with the revenue kind of weakness now. And then the potential levers to pull on capital expenditures. What about on the OpEx side? Are you at a place now where you feel like you're at sort of a base level of OpEx? Or are there any levers to pull there should the downturn continue?

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

Ana, thanks for your question. On the OpEx side, we have continued to control OpEx and actually continued to decrease those as expected over the course of 2018. So I believe we're approaching what we would expect to be our base for OpEx. At this point, no significant levers identified at this time.

Operator

And I'm not showing any further questions in the queue, sir.

Chris Chaney - Amkor Technology, Inc. - VP of IR

Okay. Thank you, Carmen. This ends the question-and-answer portion of our call. I'd now like to turn the call back over to Steve briefly for some closing comments.

Stephen D. Kelley - Amkor Technology, Inc. - President, CEO & Director

Thanks, Chris. I'd like to recap our key messages. First, we had a strong third quarter, delivering 7% revenue growth and solid profitability. Second, we expect our fourth quarter revenue to be in the range of $1.02 billion to $1.1 billion. And finally, we are encouraged by our gains in important
markets, such as communications and automotive. Good execution in these areas will drive sustainable increases in revenue and earnings. Thank you for joining the call today.

Operator

And ladies and gentlemen, this concludes today’s conference call. You may now disconnect.