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AMKR - Q1 2012 Amkor Technology, Inc. Earnings Conference Call

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**OVERVIEW:**

AMKR reported 1Q12 sales of \$655m and EPS of \$0.06. Expects 2Q12 revenue of \$670-700m.



## CORPORATE PARTICIPANTS

**Ken Joyce** *Amkor Technology, Inc. - Pres, CEO*

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

## CONFERENCE CALL PARTICIPANTS

**Alfar Hon** *Credit Suisse - Analyst*

**Chad Dillard** *Deutsche Bank - Analyst*

**Wenge Yang** *Citigroup - Analyst*

## PRESENTATION

### Operator

Good afternoon ladies and gentlemen, and welcome to the first quarter 2012 Amkor Technology earnings conference call. My name is Camille. 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, Thursday April 26, 2012, and will run for up to one hour.

Before we begin this call, Amkor would like to remind you that there will be forward-looking statements made during the course of this conference call. These statements represent the current view of Amkor management. Actual results could vary materially from such statements.

Prior to this conference call, Amkor's first quarter 2012 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. - Pres, CEO*

Thank you Camille, and good afternoon everyone. With me today is Joanne Solomon, our Chief Financial Officer. Today I will talk about our first quarter 2012 results and guidance for the second quarter. Joanne will then discuss our financial performance in more detail, and finally we will open up the call for your questions.

To begin, first-quarter sales of \$655 million, gross margin of 16% and earnings per share of \$0.06 were all at the high end of our expectation. Our strong position in wireless communications continues to drive our business and we saw notable improvement in our test services segment. We also benefited from additional lead frame packaging business from some of our customers whose supply chains were disrupted by the flooding in Thailand during the fourth quarter of 2011.

From an end market perspective, wireless communications, gaming and other consumer electronics and networking were seasonably down from the fourth quarter of 2011. Computing grew mainly due to the additional lead frame business I just mentioned.

Looking ahead to the second quarter of 2012, our revenues are expected to be in the range of \$670 million to \$700 million, or up 2% to 7% from the first quarter.

Second-quarter gross margin is expected to be in the range of 16% to 18%.



Wireless communications is a key strength for us. Although our growth in the second quarter appears to be muted, due to some softness in demand in fine pitch copper pillar flip chip applications, and the current shortage in available 28 nanometer capacity to meet the strong demand for these chips, our growth in the second quarter should also benefit from a modest seasonal increase in gaming. However, our gaming business for the second quarter and full year 2012 is expected to be lower than the levels we have seen in the past few years due to in-sourcing by some IBM customers and the overall softness in the gaming box and peripherals market.

We expect solid growth for wireless communications in the second half of 2012 as consumer demand continues to build and the supply of 28 nanometer wafers improves.

Several of our major customers that sell into smartphones and tablets have substantially increased their demand forecast with us. To support these exciting new opportunities to grow our business, we are increasing our estimate of 2012 capital expenditures to around \$550 million. Test services will be a particular focus this year as we expect to invest about 45% of our total capital additions in new test capacity. This additional spending is expected to help improve profitability.

The main drivers of our incremental spending and increased focus on test services are 28 nanometer chipsets, power management and connectivity applications, and NAND memory. As part of our efforts to support power management and connectivity applications, we're also expanding our wafer level CSP capacity.

Our leading customers are well-positioned to take advantage of the explosive growth in smartphones and tablets. Our strategies of closely collaborating with our customers, meeting their capacity requirements and delivering technology solutions that enable the advanced functions in these sophisticated devices are clearly aligned with this trend.

We operate in a capital-intensive business, and the timing of our capital spending is driven by the specific demand presented by our customers. This year, we are seeing significant opportunities that may only begin to generate additional revenue in the third and fourth quarter and beyond.

It is important that we invest for our customers during this critical window of opportunity so that we can achieve our long-term strategic objectives for growth and profitability. If customer demand and the incremental capital additions come in as currently forecasted, we may be modestly free cash flow negative for the year. But to be clear, our liquidity and balance sheet remain strong.

In closing, we are well-positioned to take advantage of the significant growth opportunities in wireless communications. And we believe our planned investments can help drive profitable growth, enhance our technology leadership and provide excellent returns. With that I'll now turn the call over to Joanne.

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

Thank you, Ken, and good afternoon everyone. To begin, our first-quarter revenues declined 4% sequentially to \$655 million. We saw the expected seasonal decline in demand for our packaging services, which drove our Chip Scale Package sales down 10% and our ball grid array packages down 8%.

The business we gained helping some customers whose supply chains were disrupted by the flooding in Thailand drove our lead frame package sales up 7%. And finally, our test services were up 6% due to growth in our NAND memory business.

Our gross margin for the first quarter of 16% was flat with the fourth quarter and at the high end of our guidance. As part of our continuing efforts to rationalize our cost structure, we completed a voluntary retirement program in Japan during the first quarter, and recorded a restructuring charge of \$7 million or about \$0.03 per diluted share. \$5 million of this charge was recorded in cost of sales and \$2 million in selling, general and administrative expenses. Helping to offset this impact were labor savings from our 2011 and first-quarter 2012 cost reduction activities and a decline in our severance obligations in Korea.



Our operating expenses of \$71 million were up from \$68 million in the fourth quarter. The sequential increase was mainly driven by the Japan restructuring costs recorded in SG&A. We expect operating expenses to be around \$70 million in the second quarter.

Our effective tax rate of 22% for the first quarter was higher than expected due to larger losses in Japan, where we maintain a full valuation allowance. The larger losses were driven by the restructuring charges. Due to favorable discrete items, we expect an effective tax rate of around zero for the second quarter. For the full year, we expect an effective tax rate of around 12%.

Our Board of Directors previously authorized \$300 million for the repurchase of our common stock, of which \$167 million remains under the program. During the first quarter we purchased 1 million shares for \$4.5 million.

The timing, manner, price and any amount of any future repurchases will be determined at our discretion. Purchases under the plan will of course depend upon a variety of factors, including economic and market conditions, the cash needs and investment opportunities for the business, and price.

An increase in our receivables, coupled with our first quarter capital expenditures, resulted in negative free cash flow in the first quarter. We ended the quarter with a cash balance of \$381 million, total debt of \$1.4 billion and net debt of \$974 million. And our liquidity and balance sheet remain strong.

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

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## QUESTIONS AND ANSWERS

### **Operator**

(Operator Instructions). Satya Kumar, Credit Suisse.

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### **Alfar Hon - Credit Suisse - Analyst**

This [Alfar Hon] calling for Satya. Thanks for taking the question.

I wanted to find out why the Taiwan foundries are guiding up like 15% to 22%, and it still is up close to 10% for second quarter, and Amkor is only guiding 5% up. So can you just talk about like why -- the growth that you are seeing, why is it different from what's being seen by some of your peers?

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### **Ken Joyce - Amkor Technology, Inc. - Pres, CEO**

Yes. We are seeing some softness in some demand for some of our fine pitch Flip Chip copper pillar applications from some of our customers. And also there has been -- the demand for 28 nanometer has certainly exceeded the available supply. And that has reduced -- caused some slowness in our demand.

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### **Alfar Hon - Credit Suisse - Analyst**

Okay. You mentioned the Flip Chip softness. Is that something that you feel, because of competitive reasons, where your customers have shipped it to another supplier? Or do you think it's just seasonal effect?



**Ken Joyce** - *Amkor Technology, Inc. - Pres, CEO*

No, we've seen some softness and the second quarter. But we expect a very strong rebound in the second half of the year for those packages. So it's a temporary slowdown in demand from some of our customers for that particular package.

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**Alfar Hon** - *Credit Suisse - Analyst*

Got it. Can you talk about your utilization rate on the testing and packaging side?

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

Yes. For the first quarter, utilization on the packaging side was in the low 70%, test was in high 70%. And our expectations for the second quarter is that will see packaging start again to grow to the high 70%. And we do expect packs to go to the low 80%. So we are seeing some of the seasonal recovery that you would expect in the second quarter.

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**Alfar Hon** - *Credit Suisse - Analyst*

There seems to be like a switch, like normally for the past few quarters, your utilization on the packaging sides were a little higher than the testing site. And now you're also guiding to a (inaudible) CapEx on the test side. So I just want to understand what's going on, why -- what's leading to like higher utilization on the test side, and also what specifically is driving such high increases on your test side as well?

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

Yes. Going back to Q4, our packaging utilization was in the low 70%, as was test. We are starting to see stronger growth in the test services that we offer in support of NAND memory in our fabless customers, and in smartphones and tablets. And as we increase our investment in wafer levels to CSP in support of the communication space, we are doing more probe testing.

So we are seeing more investments and we're seeing investments that are paying off, so that's what's driving the higher utilization in test.

With respect to packaging, we had a diverse customer base in end markets that feed into that, so there are some areas that are very highly utilized, like on -- in support of the communications area, although as Ken mentioned, fine pitch Flip Chip copper pillar is adjusting in the second quarter.

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**Alfar Hon** - *Credit Suisse - Analyst*

Got it. And then in terms of your test capacity additions, if you can give -- provide some color on how much is going towards the logic side and how much is memory and in terms of your CapEx.

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**Ken Joyce** - *Amkor Technology, Inc. - Pres, CEO*

The CapEx is going to be combined for both logic and memory, and in support of 28 nanometer chipsets, and we are also -- as Joanne indicated, we are increasing our wafer level CSP so we are buying some probe equipment for there, too.

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**Alfar Hon** - *Credit Suisse - Analyst*

Got it. One last question, in terms of your co-op and -- you had some -- recently you announced some licensing of your technology for a Japanese provider. Can you talk about what was that about, and how will that benefit you?



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**Ken Joyce** - *Amkor Technology, Inc. - Pres, CEO*

SHINKO took a license to our TMV through Mold Via Technology, and with that, there was an upfront payment. There will be an ongoing royalty that we will receive for them, and they can use our technology there through Mold Via and the trade market we have there.

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**Alfar Hon** - *Credit Suisse - Analyst*

How much was this one-time benefit in first quarter? Was it a significant amount and regarded in your revenues?

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

Our licensing revenues generally run around \$2 million to \$3 million a quarter.

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**Alfar Hon** - *Credit Suisse - Analyst*

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

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**Operator**

Vishal Shah, Deutsche Bank.

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**Chad Dillard** - *Deutsche Bank - Analyst*

This is Chad Dillard on the line for Vishal, and thank you for taking my question.

So, given the rollout in NAND packaging has been a focus for you to improve capacity utilization and gross margin, I was curious to get your view on how the increasingly negative outlook for memory has affected your utilization targets, especially since you're planning to target a gross margin 20% ending 2012.

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

Overall when I look at our stacked CSP packaging in support of NAND, we do expect it to be well-utilized. And it's a ramping line, so we are keeping ramp in line with the demand we are seeing. So we don't expect an adverse impact on our gross margins.

We're sort of digesting as much as we can. We are well-positioned with the major memory players, which are very well-positioned on the devices that are selling right now. So we feel good right now. We don't expect it to be a drag on gross margins for the second half.

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**Chad Dillard** - *Deutsche Bank - Analyst*

Great, thank you. And also you mentioned you have a \$25 million target in terms of uplift or cost reduction. I was trying -- just kind of curious about where you are on the roadmap and how much further you have to go to fully realize that.



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

Things are looking really good. The majority of that was coming out of the restructuring activities in Japan. There was multiple prongs to that program. Part was the voluntary retirement program, part was the elimination of subcontractors, and then rightsizing some of the compensation practices.

So we are on track. A lot of the action we needed to take, we have taken. So we feel good about \$25 million savings initiative we had.

With respect to -- because we are seeing strong second-half growth, when you look at labor overall from all our factories, we'll have some offsetting increases in labor to support the higher level in demand.

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**Chad Dillard** - Deutsche Bank - Analyst

Great, thank you.

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**Operator**

(Operator Instructions). Wenge Yang, Citigroup.

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**Wenge Yang** - Citigroup - Analyst

Thank you for taking my questions. First, regarding the outlook for the second half, clearly the foundry guys are much more positive and [rating] cutbacks to meet the capacity demand. What is your view for the back end in the second half?

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**Ken Joyce** - Amkor Technology, Inc. - Pres, CEO

Once again, we see very strong demand patterns. We are very optimistic for the second half. We are looking for good solid growth, and we are putting the equipment and the capacity in place to support that demand.

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**Wenge Yang** - Citigroup - Analyst

Another way to ask is if you compared to last quarter's earnings, incrementally your view on the second half, is that improving or pretty much the same?

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**Ken Joyce** - Amkor Technology, Inc. - Pres, CEO

No, the earnings would definitely be improving.

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**Wenge Yang** - Citigroup - Analyst

Okay. So, Joanne, based on that, last time you commented that if the revenue did pick up in the second half, you should see gross margins to return above 20% level. And so, with another quarter and some of the puts and takes, what is your current view on the gross margin in the second half, and what are some of the elements that drive it up or down?



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

As you said, ultimately it will depend on demand. But we do expect Q3 and Q4 gross margins to be in the 20%. The utilization is a big driver and that comes from demand. And the demand patterns with respect to smartphones and tablets, which are wireless broadly, supports both our packaging and test assets.

We are making good progress with respect to filling our wire bond lead frame assets, so on some of the areas that were challenged for us last year, we do expect that to begin to close. And that shouldn't be a drag on our gross margins.

As Ken mentioned, gaming is one of the areas that we are watching to see how much the decline in demand could potentially be ultimately -- offset it by wireless infrastructure. But things are in good shape and we do expect that gross margins for Q3 and Q4 to be back in the 20%.

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**Wenge Yang** - Citigroup - Analyst

That's helpful. And regarding the CapEx, and you made a decision last quarter to lower your CapEx to improve your free cash flows, and then a quarter later you changed the direction to actually increase your CapEx.

Can you walk us through what makes you to do this change? And obviously you have the benefit to gain more business and market share, but on the other side you definitely suffer from the free cash flow and cash position. So, with the pros and cons, what prompted you to actually make the decision to increase CapEx instead of maybe walk away from some of the business?

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**Ken Joyce** - Amkor Technology, Inc. - Pres, CEO

Well, since our February earnings call we've had some -- we've seen very strong demand increases from several of our most important customers in the wireless communications area in support of smartphones and tablets. It's just an opportunity that we would not want to pass on, in terms of our long-term objectives of profitability and growth. And these are really strong opportunities with our tier 1 customers, and we have to be there to support them, and we are.

So we had to make a change in direction in terms of -- are we going to make the investment to support that demand, and for us the answer is clearly yes.

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**Wenge Yang** - Citigroup - Analyst

Okay, understand. And so based on the plan, current plan, most of those CapEx will be spent in the first half, to gearing towards the capacity of the second half. Is that your current plan? And what -- so you mentioned testing as a specific area of investment. On the packaging side, what's the area you're going to invest with increased CapEx?

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

So the split between the first half and the second half, as a reminder Q1 CapEx was \$125 million and our guide for Q2 was \$200 million. So \$325 million of the \$550 million is the first cap. Q3 will be another high level of capital expenditures. The split between assembly -- between packaging and test is about 40% packaging, 45% test, and the remaining 15% is general manufacturing support facilities and R&D.

The investments in packaging, Ken in his prepared remarks mentioned investments in power management and connectivity. That's on the low pin count, wafer level CSP. So we are making investments in wafer level CSP. A lot of those chips are the ride-along chips for the ASP processor that we are seeing on the high end. So that is taking out some of the packaging investment.



We invest for -- on the memory side, we continue to make some investments in NAND to bolster some of the existing capacity. And then we are investing for advanced wire bonding and also copper wire bonding. So those are the printable packaging investments.

And on the tester side, as Ken mentioned we are investing both for final test and probe. And on the final test side it would both be for logic as well as memory.

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**Wenge Yang** - Citigroup - Analyst

One of the previous callers asked a question about utilization, and testing utilization still a mid-80 percentage points in Q2. So, with still some capacity left, why we need to invest to add more testers?

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

It's always the type of testers and the type of test platform. The investments in test that we are making today are in support of the 28 nanometer chipsets. So those are on the [PF 1600], and as well as some advanced memory testers. So that's testers -- test platforms that we don't currently have. As well as on the [pro-verse] side we are seeing a lot more in the way of pro business as we expand our wafer level CSP.

With respect to the existing assets, they are well-utilized. There are some pockets where we can always do better.

With respect to us compared to Sil, it's really hard for me to comment too much on their utilization. I know they have some greater exposure to fabless companies historically, so maybe that's why their utilization is a little higher. But I'm just guessing.

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**Wenge Yang** - Citigroup - Analyst

Okay. Last question is regarding ASP, could you comment what the ASP trend in the quarter?

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

With respect to ASP on a like for like basis, we were down only about 1%. If you look at the pricing environment overall, in areas where we are seeing capacity constraints and tight capacity, heading into the second half, like in support of wireless communications, pricing is very stable. On the commodity side, that business operates in a very competitive pricing environment. So as we are starting to see capacity firm up somewhat on the commodity side, things are starting to temper.

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**Wenge Yang** - Citigroup - Analyst

Okay. So it's relatively stable. Just want to add one more if I can. Obviously in the front end, foundries had a serious shortage in terms of leading-edge capacities. Just want to check in the back end, is there any capacity issues, particularly in some other advanced packaging capabilities that match into the mobile demand?

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**Ken Joyce** - Amkor Technology, Inc. - Pres, CEO

No, we have adequate capacity. It's really the supply, really, of -- on the wafer side.



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

Yes, CapEx side secured the slots on the assembly and test equipment we need and have scheduled deliveries, and we have no concerns with our ability to ramp up to meet the demand when we start getting a higher input of the 28 nanometer chips.

**Wenge Yang** - Citigroup - Analyst

Great, thank you.

**Operator**

There are no further questions at this time. I would now like to turn the call back over to Mr. Joyce for closing remarks.

**Ken Joyce** - Amkor Technology, Inc. - Pres, CEO

Well, we thank everyone for their participation in the call today.

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

Good day.

**Operator**

Ladies and gentlemen, this concludes the first quarter 2012 Amkor Technology earnings conference call. If you'd like to listen to a replay of today's conference, please dial 1-303-590-3030 or 1-800-406-7325 with the access code of 453-2650. ACT would like to thank you for your participation. You may now disconnect.

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