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AMKR - Q2 2018 Amkor Technology Inc Earnings Call

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

CONFERENCE CALL PARTICIPANTS

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 Second Quarter 2018 Earnings Conference Call. My name is Haley, 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 Chris Chaney, Vice President of Investor Relations. Mr. Chaney, please go ahead.

Chris Chaney

Thank you, Haley. Good afternoon, everyone, and thank you for joining us for Amkor's Second 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 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 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 Steve.

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

Good afternoon, and thanks for joining the call. Today, I'll review our second quarter results and third quarter expectations. I'll also discuss current market conditions and provide some additional color for 2 of our faster-growing areas: advanced SiP as well as MEMS and sensors.

First, I'd like to note that we had a very strong first half of 2018, with 10% year-on-year revenue growth. In the second quarter, our revenues were up 4% sequentially and 6% year-on-year. This was a record second quarter for Amkor and our 10th consecutive quarter of year-on-year revenue growth.

We experienced sequential growth across all end markets. Our strongest market was communications, where we benefited from incremental demand from iOS ecosystem customers. From a technology perspective, much of the revenue growth came from advanced system-in-package, or SiP, which was up 14% sequentially and 38% year-on-year. We partnered with our customers in this area, utilizing our technology to squeeze as



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much functionality as possible into a very small space. It's not uncommon for Amkor advanced SiPs to combine more than 100 electrical elements, including multiple ICs into a single package.

Smartphones, the ultimate space-constrained, high-performance products drive advanced SiP volume today. Within today's high-end smartphones, these advanced SiPs perform an array of functions, including signal processing, data storage, communications and sensing. Advanced SiP products are also found in smart watches and vehicles. Production yield is extremely important in this business due to the high value of each module. Amkor achieves very high yield performance through a combination of precision assembly technologies, advanced material handling systems, a focus on quality and, most of all, strong engineering capability.

Advanced SiP is less capital intensive than wafer-level packaging. The other big technology used in space-constrained applications. In last year, advanced SiP products generated over \$800 million in revenue for Amkor.

Another fast-growing area is our MEMS and sensors business, which focuses primarily on mobile and automotive applications. In the first half of 2018, this business grew 30% year-on-year. We recently added a third MEMS and sensor production line in Korea, complementing our lines in the Philippines and China. Within the next 12 months, we plan to add a fourth line in Portugal and a fifth in Japan.

We've been able to grow our share of the smartphone fingerprint sensor market to roughly 33% by volume. Although capacitive sensors make up the bulk of our fingerprint sensor revenue, we're also well positioned in the optical sensor market.

Like advanced SiP, the MEMS and sensor business is capital efficient with a high degree of equipment we use. The more significant engineering challenges are in product testing, given the need to generate nonelectrical stimuli over a variety of conditions.

Moving to our outlook. We are expecting around 7% sequential growth in the third quarter, driven largely by increased demand from iOS ecosystem customers. We've experienced more than 20% content growth in each new generation of iOS phones over the last 3 years, and we believe that our content will continue to increase in 2018.

In the general semiconductor market, which we defined broadly as everything but smartphone ICs, we see continued strength in the third quarter. Recent channel checks indicate healthy general market conditions.

This general market is important to Amkor. In fact, over the past 5 years, we've made a concerted effort to increase our exposure to markets, such as automotive, consumer and computing. In 2017 and through the first half of 2018, these markets accounted for more than 55% of revenue, up from 44% in 2014.

We believe that engaging with a broad set of customers across multiple markets and geographies is the best way to achieve consistent financial performance. The muted seasonality of the general market tends to improve overall utilization, which enhances profitability.

In the second half of this year, we will continue to focus on the basics, execution, quality, technology and service. Good performance in these areas will please our customers and set us up for a successful 2019.

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 second quarter results, share some comments regarding our recent debt refinancing and provide our third quarter outlook.

Second quarter 2018 revenue came in at the high end of guidance, driven by strong demand from smartphone customers. Net income and EPS exceeded expectations. As Steve mentioned earlier, our Q2 mobile communications business included significant sales of advanced SiP. Our preferred SiP business model is based on consignment of the high-value silicon, particularly ICs, by the customers. For strategic reasons, we chose

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in this smartphone cycle to engage in a couple of high-volume SiP program, where we agreed to purchase high-value silicon. The value-added margin dollars and cash flow associated with these strategic SiP programs are attractive. And the business is capital efficient, using equipment that is typically fungible with other packaging applications. However, the higher material content constrained our gross margin percentage in Q2 and is expected to have a similar effect in the third quarter.

EBITDA in Q2 was over \$200 million, a healthy increase of nearly 20% sequentially. First half EBITDA was also up 6% year-over-year after adjusting for the sale of K1 in Q2 2017.

Net income and earnings per share grew significantly from the first quarter due to increased sales. We also benefited from a \$7 million foreign currency gain related to the remeasurement of our balance sheet liabilities denominated in foreign currencies.

Moving on to our capital structure. We are pleased with our recent financing activities. Earlier this month, we entered into a new 5-year term loan for approximately \$230 million. We plan to use the proceeds to redeem all of the outstanding \$200 million of fixed and 6 5/8% senior notes due in 2021. The new term loan bears interest at a fixed rate of 1.3%, reducing our annualized net interest expense by \$11 million. This is in addition to the \$13 million of annualized interest savings already realized from last year's senior notes redemption. Accumulated payoff of our 2021 senior notes improved our earnings by \$0.08 per share on an annualized basis.

Our balance sheet is sound, with \$1.3 billion of total debt and a debt-to-EBITDA ratio of 1.5x as of June 2018. Our liquidity is also solid, with over \$600 million in cash and available undrawn loans at the end of the second quarter. This month, we replaced our existing revolving credit facility. The new credit facility has been increased from \$200 million to \$250 million, and the maturity days have extended to July 2023.

Our outlook for the third quarter is positive. We expect net sales, gross margin, net income and EPS to all be up sequentially. More specifically, we expect revenue in the range of \$1.1 billion to \$1.18 billion, with gross margin in the range of 15% to 17%. Operating expenses are expected to be around \$110 million, depending on the R&D activity in the quarter.

We expect net income in Q3 to be between \$28 million and \$55 million or \$0.12 to \$0.23 per share. Our estimated tax rate remains at 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, we continue to expect 2018 CapEx to be around \$600 million.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Randy Abrams of Crédit Suisse.

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

The first question I wanted to ask on the guidance. You're guiding about 7% growth, which is about in line with your peer in Taiwan. I'm curious so it's -- how much of that is factoring in the SiP? And the factor for that in prior year's third quarter saw a bit higher seasonality. So if you could give a flavor for what's happening the rest of the business, like picking up that SiP, but if you're seeing any softness in other parts of the business?

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

Yes, Randy, just speaking in general, we divide the market into 2 parts: smartphone and general market. In the general market, we're seeing continued strength, but really no growth quarter-on-quarter. That particular part of the business has been strong for many quarters in a row now. What's driving the growth in Q3 is basically the iOS ecosystem, which includes advanced SiP. We're not seeing any growth out of the Android ecosystem, either in China or in the Samsung ecosystem.

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

Okay. If you could give a flavor, I guess, for the advanced SiP maybe as a percent of revenue or absolute in second half, the run rate maybe the type of projects that you're taking on that are having you pass on some of the material cost.

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

Okay, Randy. So looking at SiP, we disclosed that our full year 2017 SiP was over \$800 million. So we expect to grow that in 2018. I think you were specifically asking for that amount for the second half. So we wouldn't disclose the second half now.

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

Okay. If I could ask, I guess, the margin model, traditionally in peak season, it would reach close to 19%, 20%. It might be this year a different mix without the Android and auto contribution in SiP. But I guess, could you go through the factors for difference versus prior peak season margins? And maybe you kind of in the future if you're kind of looking what you expect now as SiP grows, will you expect kind of peak leverage to reach for the gross margin line?

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

Yes, Randy, just as a reminder, in the second half of last year, we did operate roughly 20% gross margin, if you take out the restructuring charges we had in Japan. Now obviously, this year, we're not reaching that level. And in the second half it's largely because of the strategic advanced SiP projects that we took on. What we expect, though, is in 2019 that our material percentage will revert to the mean and that our sales will continue to grow as they have in the past few years. Therefore, we're expecting substantial margin expansion next year and certainly in the second half of next year when we see the seasonal strength.

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

Okay. And last question I wanted to ask just on the -- kind of where you're sitting for overall capacity, if any areas of constraints or if, I guess, on the flip side, if you're comfortable with capacity, how you see the overall kind of CapEx levels, if this is kind of current run rate the expected kind of continue and also looking toward next year?

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

Okay. I think this is the time when we do run it through some constraints because of the intensity of builds we're taking in advanced products. So we are seeing constraints in some of the advanced lines, such as flip chip BGA, and we're definitely using the capacity we have in our bumping lines and in our advanced SiP factory. So the utilization should be fairly healthy this quarter. In the mainstream side, we also see continued good business. So utilization rates are good. Our factory in the Philippines, which is our mainstream factory. Our CapEx level this year, we projected \$600 million, which is a \$50 million increase over 2017. We're still confident the \$600 million is the number for 2018. We haven't looked at next year yet from a CapEx standpoint, but I don't anticipate any major changes up or down for 2019.



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Operator

(Operator Instructions) I'm showing no further questions.

Chris Chaney

All right, Haley. Thank you, ladies and gentlemen. This will conclude our Q&A session. And now, I'd like to turn the call back over to Steve for some final closing remarks.

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

Thanks, Chris. I'd like to read recap our key messages. First, our second quarter revenues were up \$40 million or 4% sequentially. In the first half of 2018, our revenue grew 10% year-on-year. Second, we expect our third quarter revenues to be up around 7% sequentially, due primarily to seasonal strength in communications. And finally, we see continued strength in the general semiconductor market through the third quarter. Thank you for joining the call today.

Operator

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

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