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AMKR - Q4 2012 Amkor Technology, Inc. Earnings Conference Call

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OVERVIEW:

AMKR reported 4Q12 sales of $723m and EPS of $0.13. Expects 1Q13 revenues to be down 5-11% from 4Q12.

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CORPORATE PARTICIPANTS

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

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

CONFERENCE CALL PARTICIPANTS

Chad Dillard *Deutsche Bank - Analyst*

Jeff Harlib *Barclays Capital - Analyst*

David Foropoulos *UNUM Corporation - Analyst*

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the fourth-quarter and full year 2012 Amkor Technology, Inc. earnings conference call. My name is George, 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 call will be open for questions. This conference call is being recorded today, Wednesday, February 13 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 fourth-quarter and full year 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 the conference over to Mr. Ken Joyce, Amkor's President and Chief Executive Officer. Please go ahead, sir.

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

Thank you, George, and good afternoon, everyone. With me today is Joanne Solomon, our Chief Financial Officer. Today I will talk about our fourth-quarter and full year 2012 results and guidance for the first quarter of 2013. Joanne will then discuss our financial performance in more detail and finally we will open up the call for your questions.

To begin, we are pleased with our fourth-quarter results and improvements over the prior quarters of 2012 and the fourth quarter of 2011. Bolstered by solid sales growth in mobile communications, fourth-quarter sales of $723 million, gross margin of 18% and earnings per share of $0.13 were all at the higher end of our expectations. Additionally, fourth-quarter sales were up 4% from $695 million in the third quarter, and up 6% from $684 million in the fourth quarter of 2011.

Our investments in support of the communications end market are really paying off and continue to gain momentum. Driven by a notable strength in smartphones and tablets, our fourth-quarter communications revenue set a new record and represented 58% of our total sales. In our other end markets, we saw a seasonal decline in gaming and a general softening in demand due to the uncertain macroeconomic environment. For the full year 2012, our communications revenue grew 12%.

That said, total sales declined slightly as the strength in communications was offset by softness in the other end markets. Our home electronics and gaming businesses were lower than the levels we have seen in the past few years due to insourcing by some of our IDM customers, and softness in our wire bond business. Technology, leadership and innovation is one of the cornerstones of our success and a key element of our business strategy.

We have been investing significant resources in support of the newest and most advanced interconnect technologies for mobile communications packages and the sophisticated probe and final test equipment required for these devices. As a result of this strategy, Amkor has the largest share of the Flip Chip and wafer level packaging market in the OSAT industry.

For the full year 2012, our Flip Chip and wafer level packaging sales grew $127 million or 12% compared to 2011 and represented nearly 50% of our packaging sales. We spent $533 million on capital additions for the full year. Our spending was focused primarily on packaging equipment and advanced test platforms in support of 28 nanometer chip sets, NAND memory, power management and connectivity applications and research and development projects.

Looking ahead to the first quarter of 2013, we are seeing seasonal demand patterns with revenues expected to be down 5% to 11% from the fourth quarter of 2012. Although mobile communications revenues are expected to be down from their record levels in the fourth quarter, they should still be well ahead of the first quarter 2012. First-quarter gross margin is expected to be in the range of 14% to 17%. We operate in a capital intensive business and the amount and timing of our capital spending is driven primarily by the specific demands presented by our customers.

Naturally, this demand is influenced by many factors and can be fluid over time, increasing or decreasing from today's expectations. With that in mind, we are currently planning capital additions of around $125 million for the first quarter and around $450 million for the full year 2013, primarily to support growth opportunities we see in mobile communications. We are also planning an additional $150 million in capital spending for the acquisition of land and commencement of construction relating to our previously announced new factory and R&D center in South Korea. This investment will strengthen our competitive position over the long term as the industry leader providing advanced technology and help ensure our future growth.

Last month we exercised our option to increase our ownership interest in J-Devices Corporation, a joint venture amongst Amkor, Toshiba Corporation and the original investors in J-Devices. J-Devices provides semiconductor packaging and test services and is the largest independent OSAT company in Japan. The Japanese semiconductor industry is moving to a more fab-like model. J-Devices acquired certain packaging and test operations from Fujitsu in 2012, and recently announced that it has signed an MOU with Renesas for the acquisition of the semiconductor backend production business of three Renesas facilities in Japan.

We believe that the strong relationship between our two companies will create substantial value for Japan-based semiconductor companies and our stockholders. In closing, we are well-positioned to take advantage of the significant long-term growth opportunities in mobile communications. We are investing in the right packaging and test technologies for the right customers and in the right markets. We believe that all these planned investments can help to drive profitable growth, enhance our technology leadership and provide solid returns. And with that I'll now turn the call over to Joanne.

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

Thank you, Ken, and good afternoon, everyone. To begin, our fourth-quarter revenues increased 4% sequentially to $723 million. Solid sales growth in mobile communications drove favorable results in several areas. Chip scale package sales grew 30%. Test sales were up 16% and other packaging services, which includes wafer bumping, increased 6%, all due to our strong position in communications.

Ball grid array package sales declined 23% due to seasonal patterns in gaming and consumer electronics. And leadframe package sales were down 15% from a general softening in demand due to the uncertain macroeconomic environment. Gross margin of 18% was an improvement of 160 basis points over last quarter. Leverage from higher sales drove the improvement. Although this is partially offset by the impact of unfavorable foreign exchange rate movement.

Our operating expenses of $70 million were up from $63 million in the third quarter. The sequential increase includes a restructuring charge at one of our manufacturing operations as well as higher professional fees. We expect operating expenses to be around $75 million in the first quarter of 2013. Our other expense of $25 million was up from $22 million in the third quarter. The sequential increase includes higher interest expense due to our increased debt level and cost for the early retirement of debt.

Our effective tax rate in the fourth quarter was 26% and 23% for the full year 2012. For the first quarter, we expect an effective tax rate of around 28% and for the full year 2013 we expect an effective tax rate of around 22%. As Ken mentioned, we have exercised our option to increase our ownership interest in J-Devices. We will purchase newly issued shares for approximately $75 million, and our percentage ownership of J-Devices will increase from 30% to 60%.

The transaction is expected to close in March 2013 and we expect to use cash on hand or borrowings under existing facilities to fund the purchase price. To give you a sense of their scale, fourth quarter 2012 revenues for the combined J-Devices and backend operations acquired from Fujitsu were around $200 million. As with many joint ventures, the governance provisions applicable to J-Devices restricts our ability, even after obtaining majority ownership, to cause J-Devices to take certain actions without the consent of the other investors. Accordingly, we will continue to account for our investment in J-Devices using the equity method of accounting, and continue to record our pro rata share of their earnings in our income statement.

Moving on to our liquidity and capital structure. At December 31 we had $413 million in cash, total debt of $1.5 billion and net debt of $1.1 billion. During the quarter we entered into a $100 million term loan facility. We expect to draw on this facility in 2013 to support our planned investment this year and the exercise of the J-Devices option. Turning to our new factory and R&D center in South Korea, in February we acquired the land for $100 million. From a cash perspective, we paid $10 million in February and we expect to pay around $40 million in the third quarter of 2013 and around $50 million in the fourth quarter of 2013.

We anticipate that construction should commence towards the end of this year and we may spend $50 million in 2013 for construction. And we expect to spend a total of around $300 million for the construction of the facility over the next several years. We believe our liquidity is sound. Our next debt maturity is April 2014 and is our $250 million convertible note. This instrument is well in the money and we expect that it will be converted into equity rather than paid at maturity.

In light of our potential investments in 2013 and 2014, for this and other projects, we are exploring some additional credit lines, possibly in the amount of $300 million or so, which will provide additional funding for us if needed. In summary, as Ken discussed, we believe our investments can help drive profitable growth, enhance our technology leadership and provide solid returns. With that we will now open the call up for your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Vishal Shah, Deutsche Bank.

Chad Dillard - *Deutsche Bank - Analyst*

This is Chad Dillard online for the Vishal Shah. Thanks for taking my question. First off could you talk a little bit about key opportunities that you see with J-Devices?

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

Yes. We are really very happy with this opportunity, as we said. J-Devices is the largest independent OSAT in Japan. They were formed several years ago as a joint venture between Toshiba and Amkor and the original investor, J-Devices, to handle the outsourcing of Toshiba's backend system LSI. In 2012, they worked with Fujitsu, who is outsourcing their backend operation. And more recently, as I say, they have announced that they are working on acquiring some factories from Renesas, as they outsourced some of those.

So, it's a very exciting opportunity for Amkor to participate in the expansion of our business in Japan. We've had a long-standing relationship in Japan. J-Devices is doing roughly, as Joanne indicated, roughly $200 million per quarter, and will be increasing in size, we believe, as they go forward. Their products that they serve are mainly in consumer electronics, industrial and automotive, and a lot of wire bond products.

So where we have been focused over the past number of years on advanced technologies, this allows us also to participate significantly in the more mainstream or legacy products, also. So, it gives us a real growth opportunity for us, real strong cash flow with a rather minimal capital investment. So we are real pleased with this opportunity.

Chad Dillard - *Deutsche Bank - Analyst*

Great, thanks. Can you talk a little bit about your competitive environment and where you see the greatest opportunity for share gains or penetration for this year?

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

Of course. We are the market leaders in Flip Chip and advanced technologies. We believe we are well positioned there. We -- in the legacy and the wire bond products, we are a little bit more challenged, but clearly the other area that we are really well positioned is in mobile communications. So, clearly, the right markets with the right customers, as we say. It continues to grow and we have the advanced technologies to support that, so it's been a critical part of our growth strategy moving forward and gives us a very strong position to differentiate on technology and a very strong competitive advantage against our competitors. So, we're very comfortable in that place where we are.

Chad Dillard - *Deutsche Bank - Analyst*

Got it. And, lastly, how should I think about your utilization rates. If you think about between the first half and the second half of the year?

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

So, when you look at our typical patterns, the second half tends to be better utilized than the first half. Q1 tends to be the trough with growing to the second quarter but the first half tends to be not as strong as the second half.

Chad Dillard - *Deutsche Bank - Analyst*

Got it, thank you.

Operator

(Operator Instructions). Jeff Harlib, Barclays.

Jeff Harlib - *Barclays Capital - Analyst*

Good afternoon. Just with J-Devices, can you talk about how the margins look and other -- that's my main question. How do their margins compare to Amkor's margins and do you expect any required investment from Amkor?

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

I can start off. With respect to J-Devices, as Ken mentioned in his prepared remarks, they continue to be transforming as a corporation. As we own them for the first three years here with principally the predecessor operations that supported mainly Toshiba. Just in December they did the acquisition of several factories from Fujitsu, so they are basically doubling in size here in December. And to the extent that the transaction contemplated with Renesas closes, then they will take the next incremental step.

As Ken mentioned, it is wire bond product. Wire bond product it tends to operate as a lower gross margin percent. I would say that -- while we haven't fully comprehended what the fully merged operation is over the long term, but I would describe it as the mid teens, mid-to high-teens. At this point, as I mentioned in my prepared remarks, we are not going to consolidate J-Devices. So you only see us continuing to pick up the equity pick up, so it will be accretive to earnings. But you won't see the revenue growth or any of the potential compression in gross margin.

Jeff Harlib - *Barclays Capital - Analyst*

Okay. And with your growth in smartphones and tablets, can you talk -- in terms of the capacity that is being added for that, is it different than some of your other products and markets in terms of capital intensity? And do you have design wins to be comfortable that revenues are going to continue to accelerate in that segment?

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

I can start off with the capital intensity comment. With respect to mobile phones, we have strong attach to test, so there is a higher level of capital intensity of serving the mobile communications market. And we have several chips that are heading into a smartphone. So, base band apps processor, a memory stack, some of the MEMS devices for the microphone. So we are seeing things that would be on the Flip Chip CSP side, which would be a conventional package, as well as the wafer level CSP which is lower pin count then maybe for connectivity and the like.

So, we are very deep into the phone, but because of the higher test attach, because of some of the wafer level processing investment, you see a higher capital intensity. That said, some of these areas actually have lower labor intensity, so we are swapping some of the costs with the differing mix.

Jeff Harlib - *Barclays Capital - Analyst*

Okay, that's helpful. And, lastly, any comments on what you're seeing in the pricing environment in -- either in specific areas or generally?

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

Jeff, this is Ken, as you well know, in the OSAT space, pricing is always very competitive and we are always in discussions with our customers on price reduction. That being said, the pricing environment is certainly more robust in the advanced technologies that a lot of those advanced technologies are being used in mobile communications, so we compete really very well in that space. The pricing is more competitive in the commodity and the mature markets, but we believe we compete there very well also.

Jeff Harlib - *Barclays Capital - Analyst*

Okay, thank you.

Operator

David Foropoulos, UNUM Corporation.

David Foropoulos - *UNUM Corporation - Analyst*

I just had a couple of questions. This is obviously a significant year of capital intensity and capital investments. As you move through the year into 2014, should we get back to normal type levels? Can you talk through any of that please?

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

Yes, I can. So, with respect to 2013 we are investing about $400 million of CapEx. The way that CapEx breaks out is it's about 50% packaging, or -- yes, about 50% packaging, 30% test and 20% R&D and some of the other manufacturing areas. So, that's the $450 million. We also acquired $100 million of land on top of that, and then we'll start construction, make a construction deposit, about $50 million. So all in, that's about $600 million this year.

With respect to the construction, to build the facility in Korea, that's going to run us about $300 million, of which I said we would spend about $50 million this year. In 2014 we're going to have $250 million for the building. With respect to the normal CapEx to support our business, this year's capital intensity at the $450 million range is probably an appropriate level for the business as we continue to grow. But, obviously, that's all going to be dependent on where demand is and if there's any kind of correction or further growth.

David Foropoulos - *UNUM Corporation - Analyst*

And you also have the $75 million investment in Japan, too, so it's kind of $675 million all in, right?

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

That's right.

David Foropoulos - *UNUM Corporation - Analyst*

Okay. So the next year with the $250 million going into the building and construction, it seems like you'll probably be north of $600 million again, I would think, all else equal.

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

Yes, without giving specific guidance with respect to 2014, if you assume relatively flat CapEx, then your number would be in the neighborhood.

David Foropoulos - *UNUM Corporation - Analyst*

Great. And one other question. Do you have -- I don't know what type of line of sight, but there's a lot of chatter about inventory or lack of inventory in the supply chain. Can you guys give us any color where you see that? Is it lean or is it spotty? Can you help us out there?

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

Well, the view that we have right now is when we talk with our customers, it's our view that the inventories are rather lean at this point in time.

David Foropoulos - *UNUM Corporation - Analyst*

Is that at the end-user level? Is that at your semiconductor customers?

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

I believe it's both, from what I am hearing.

David Foropoulos - *UNUM Corporation - Analyst*

Okay. All right, thank you very much.

Operator

(Operator Instructions). I'm showing there are no further questions. I'll turn the call back to Ken Joyce for closing remarks.

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

I'd like to thank everyone for participating in our call here today.

Operator

Ladies and gentlemen, this does conclude our conference for today. If you'd like to listen to a replay it will be available for the next 24 hours by dialing 303-590-3030, or 1-800-406-7325 with the access code of 4584487. We thank you for your participation. You may now disconnect.
