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# EDITED TRANSCRIPT

AMKR - Q4 2018 Amkor Technology Inc Earnings Call

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**OVERVIEW:**

Co. reported 4Q18 sales of $1.08b and EPS of $0.12. Expects 1Q18 revenues to be $880m.





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## CORPORATE PARTICIPANTS

**Vincent Keenan** *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

**Edgar Burling Roesch** *Sidoti & Company, LLC - Research Analyst*

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

**Shek Ming Ho** *Deutsche Bank AG, Research Division - Director & Senior Analyst*

## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the Amkor Technology Fourth Quarter and Full Year 2018 Earnings Conference Call. My name is Valerie, 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 conference over to your host, Mr. Vincent Keenan, Vice President, Investor Relations. Mr. Keenan, please go ahead.

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**Vincent Keenan** - *Amkor Technology, Inc. - VP of IR*

Good afternoon, everyone, and thank you for joining us Amkor's Fourth Quarter and Full Year 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 a 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-K.

And now, I would like to turn the call over to Steve.

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

Good afternoon. Thanks for joining the call. Today, I'll discuss our fourth quarter and full year 2018 performance, our first quarter outlook and our priorities for 2019.

In the fourth quarter, all of our end markets performed better-than-expected, pushing revenue to more than $20 million above midpoint guidance. This additional revenue together with a favorable product mix drove improved profitability. For the year, we grew total revenue 3% to $4.3 billion, a record high for Amkor. In addition, we delivered free cash flow of $120 million, our fourth consecutive year of positive free cash flow.

Revenue is up 5% in communications, up 2% in automotive and industrial, up 3% in computing and down 3% in consumer. The 2% automotive and industrial growth consisted of double-digit growth outside Japan largely offset by a customer-specific inventory correction in Japan.

Our capital spending in 2018 was $547 million. Most of those CapEx dollars were used to expand capability and capacity for advanced packages, including wafer-level, System-in-Package and flip chip technologies. Wafer-level and SiP are backbone technologies for space constrained, performance-sensitive applications. Flip chip packages are used by a broad base of customers for communications, computing and automotive applications. They are a popular choice for high pin count products. Our investments in advanced technologies are driving growth with advanced product revenue up 8% in 2018 after growing 15% in 2017.

Our sales of advanced packages into the automotive market grew nearly 50% in 2018, largely due to new data-intensive applications. The high pin count and performance requirements of these products dictate the use of advanced rather than wire-bond packages. The most popular advanced packages for automotive are flip-chip BGA, SiP and wafer-level fan-out. Typical applications include ADAS, infotainment and connectivity.

Automotive IC customers expect their manufacturing partners to maintain qualified factories for at least 10 years after product launch to support long product life cycles. So they tend to gravitate towards stable manufacturers such as Amkor. After all, we've been in the assembly and test business for over 50 years. And for most of that time, we've been serving the automotive market.

We understand that serving this market needs continuously upgrading our factories and quality systems to keep pace with stringent automotive requirements.

Now I'd like to say a few words about 5G technology. A key driver of future growth for the industry and for Amkor. We are involved in many 5G development projects and expect to see significant ramps in 2020. As 5G capable handsets hit the market in volume. 5G phones will require more silicon and more capable batteries. A key challenge for designers will be fitting these new ICs, modules and batteries into a relatively small space. And that's where Amkor can add value deploying innovative, reliable and efficient packages to help our customers miniaturize optimize performance and manage power consumption.

Our technology strength together with our long-term participation in the smartphone market position us well for the transition to 5G.

Now let's move to our first quarter forecast. At the midpoint of guidance, we expect revenue of $880 million. This is more than our typical first quarter seasonal decline, and reflects the inventory correction currently underway in the smartphone market. We estimate that 75% of our sequential revenue decline is tied to reductions in smartphone-related demand. The remainder is due to a lackluster general market and is a continuation of the weakness which started in the third quarter of 2018. We believe that the general market is going through a normal cyclical correction after over 2 years of strong demand.

Based on the aggregate forecast from our customers, we believe that the first quarter will be our trough revenue quarter and expect that the second half of the year will be stronger than the first.

In this dynamic market environment, we think it prudent to restrain spending, to help us reach our goal of a fifth consecutive year of positive free cash flow.

Our target capital spending for 2019 is $475 million, down roughly $75 million from 2018.

We will minimize spending on incremental capacity. But continue to spend on strategic programs, which improve our competitive position. We've also taken other general measures to reduce spending throughout the company. Looking forward, our long-term objective remains the same, balanced revenue growth. To achieve that goal, we will continue to focus on the basics: reducing cycle time; improving quality; ramping new products; maximizing yield; and developing innovative, reliable technology for our customers.

Megan will now provide more detail on financial information.

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

Thank you, Steve, and good afternoon, everyone. Today, I will review our fourth quarter and full year results, then provide some comments about our first quarter outlook.

Fourth quarter sales of $1.08 billion were 2% above the midpoint of guidance. Gross margin of 16.9% was nearly 200 basis points above the high end of guidance, primarily as a result of higher sales and favorable product mix. The better-than-expected gross profit drove operating income margin of 7%.

Net income of $0.12 per share in the quarter was also well above the midpoint of guidance. Net income for the quarter was reduced by a Net $17 million discrete income tax charge or $0.07 per diluted share, primarily due to a one-time true up for U.S. tax reform.

Overall, 2018 was a solid year. Sales increased 3% over 2017 to a record $4.3 billion. We generated $258 million of operating income and operating income margin of 6%.

CapEx of $547 million represented a 13% capital intensity consistent with 2017. We redeemed $200 million of our 6.625% senior notes with the proceeds from a new term loan with a fixed rate of 1.3%. The refinancing lowered our interest expense by $11 million annually.

We delivered strong cash flow with EBITDA of $837 million, cash flow from operations of $663 million and free cash flow of $120 million. Excluding the one-time proceeds from the sale of our K1 factory in 2017, free cash flow increased nearly 50% in 2018, our fourth consecutive year of positive free cash flow.

Over the past 4 years, we generated more than $500 million in free cash flow. We significantly strengthened our balance sheet in 2018, ending the year with $682 million of cash on hand and over $1 billion of total liquidity. Debt stands at $1.3 billion, and we reduced our net debt by over $100 million from 2017.

We expect Q1 to be the trough quarter in 2019, with gross margin of between 9% and 13%. As a reminder, a large portion of our manufacturing costs are fixed, resulting in high operating leverage for our business. This leverage benefits us when sales increase, where we generally see $0.40 to $0.50 of every incremental revenue dollar fall through to gross profit. Conversely, we get a negative effect on gross margin when revenue goes down as gross profit decreases at a faster rate than revenue.

Operating expenses are expected to be around $115 million for the first quarter, well below Q1 2018 level. We expect a net loss in Q1 between $64 million and $16 million or $0.27 to $0.07 per share. Generally, our effective tax rate is around 25%, subject to a minimum level of taxes, not dependent on our income. Our 2019 forecast for capital expenditures is $475 million.

We've experienced many cycles like this in the past. And we expect sales to improve in the second half of the year. In the meantime, our strong balance sheet and liquidity allows us to continue to invest for the future while executing our balance growth strategy.

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

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from Sidney Ho of Deutsche Bank.

**Shek Ming Ho** - *Deutsche Bank AG, Research Division - Director & Senior Analyst*

I have a few. If I take your guidance for Q1, that 3 quarters of the decline is tied to the smartphone market, that would imply a quarter-over-quarter -- probably down more than 30%, and that's even lower than what you guys did in the March of 2017. How should we think about the recovery from the Q1 level? And are you still expecting coms revenue to grow this year?

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

Okay, Sidney. Yes, I think your calculation is correct that we saw the revenue down by more than 30%, right, in smartphones. That's an accurate observation. And I think what's going on this year, which is a little bit different is we're seeing a slowdown in both the Android and the iOS markets. So I think you're seeing a pullback in both the markets and that's hitting us in Q1. It will probably bleed in Q2 a bit. But it's hard to predict how fast the inventory will burn off.

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**Shek Ming Ho** - *Deutsche Bank AG, Research Division - Director & Senior Analyst*

Okay. Maybe switching over to the automotive market. You talked about one customer is going through inventory digestion. But outside of that, maybe related to that, is that particular customer stock ordering more normally now? And maybe broadly speaking, how does the automotive market -- how do you see the rest of the year play out?

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

Sure. Yes, that particular customer that went through the inventory problems in 2018 is still digesting inventory. So we don't see that situation improving anytime soon. It could improve in the second half but probably not in the first half for that particular customer. More broadly, when we look at the automotive market, we look at it in 2 parts. One part is the more advanced packaging, which is tied to the new systems like ADAS and connectivity, safety, infotainment. And we continue to see that market growing pretty rapidly. We're in a very good position there because we're the #1 OSAT for automotive and particularly, for advanced packages. The other part of the automotive market, you may want to characterize it as classical automotive, where you're looking at body electronics, engine controls, those types of things. I think that market is a little bit under pressure and will be until automotive sales pick up.

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**Shek Ming Ho** - *Deutsche Bank AG, Research Division - Director & Senior Analyst*

Okay. My follow-up is that if you look at your gross margin guidance for Q1, if you assume a typical incremental margin, I understand, when revenues goes down, your margins goes down. But it would suggest gross margins to be -- it's going to be less than 10%. But if you look at where gross margins was historically when the last time revenue was at a similar level, I have to go back to Q1 of 2016, I think at that time the gross margin was closer to 14%. Can you just help to understand what are the moving parts between 10% and 14%? As well as you guys talk about higher material content in the -- related to advanced SiP programs. Has that headwind go away yet?

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

Sidney, I'll take that question. So it sounds like you understand the model with respect to the incremental margin aspect. So as it relates to looking back, I believe you're pointing to Q1 '17 where we had a similar amount of revenue and a bit higher margin. So the puts and takes there, it's really that now we're operating with lower capacity utilization. So over the past 2 years, we have increased our revenue generating capacity, which at the same level of revenue would not allow us to achieve a similar level of gross margin. As it relates to the high-material-content products you mentioned, that's having less of an impact in our Q1 '19 guidance.

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**Operator**

(Operator Instructions) Our next question comes from Randy Abrams from Crédit Suisse.

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

Okay. Yes, I have a couple of questions, some in follow-up to Sidney. The first one -- just in some of the comments about driving the trough in first quarter. Could you talk maybe a little bit more about the order patterns and behaviors you're seeing now from customers? If they're giving you indication inventory exiting Q1 is back to normal levels and that's driving pickup? Or you're starting to see some signs on demand? But maybe give kind of a feel on what you're seeing the last few weeks, if you're starting to get any better signals from customers?

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

Yes, Randy, I'll make a few comments. Obviously, we're just guiding for Q1 today. But I think your question is more towards what gives us confidence that Q1 is the trough quarter. And what we do is we do aggregate customer forecasts. We have forecast that go through Q2. And right now, those forecasts show improvement and some moderate market growth in Q2. But this is a dynamic forecast environment as we have experienced over the last couple of months. So right now we're in a wait-and-see mode to see how revenue develops in March, and what our momentum is going into April. But nearly all of our customers have expressed the belief that Q2 will be better than Q1. And the second half will be better than first half.

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

Okay, great. And it sounds like a couple applications you're expecting -- or maybe not banking on too much yet -- so the Japan automotive and -- so is it the right assumption there's areas; Japan, auto, smartphones, may be more second-half weighted? And you're seeing it in some of the other areas. So like the non-Japan auto or some of the consumer networking? So it's kind of a uneven recovery is how should we think about it, and then picks up hopefully more into second half across applications?

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

Yes, again, I divide the market in 2 parts. We have the smartphone-related demand. And then we have everything else, which we call the general market. And in the general market, we expect to see recovery starting in Q3 because that will mark the fifth quarter after we saw the beginning of the downturn in Q3 of last year. So our experience is it takes about 4 quarters for these cycles to work themselves out in the general market. In the smartphone part of the business, we do expect the seasonal surge in the second half, primarily driven by the iOS ecosystem. So what we notice every year, no matter what the market conditions are, we do see that upturn in second half based on the launch of flagship phones. So that's what's driving our optimism for the second half. And in addition to that, all of our customers are optimistic about the second half.

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

Okay. And you mentioned in some of the prepared remarks on 5G as a driver. Is it early to see, I guess, when you look at both the RF and SiP and the main chip, is there a way to think about content or the mobile business kind of on a per-phone or a content opportunity? I don't know if you've enough signals yet on how your opportunity changes like moving 4g to 5G as that rolls out?

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

Yes, Randy, it's hard to quantify but certainly there's more silicon in a 5G phone. So I think the best way to think about it is the 5G phone is additive. And so everything your 4G phone is, plus more. And obviously, the biggest opportunity for us is helping our customers squeeze all that additional circuitry into the same amount of space essentially. Because in the all likelihood, the batteries will need to be bigger because 5G phones will consume more power. So that reduces the board space and then you have incremental silicon. So it puts a lot of pressure on our customers to really shrink the size of their designs to make use of the real estate.

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

Okay. And then I just have two other questions. One on the CapEx, if you could talk maybe a bit more on -- it looks like spending more toward technology or strategic priorities. If -- maybe if you could elaborate a bit more, kind of, where some of the investments are being prioritized for this year?

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

Yes, Randy, for this year, our budget right now is $475 million for CapEx, which is down about $75 million from last year. And where we're directing most of that spend is into advanced products. And we see opportunities in fan-out, in SiP, and those 2 areas in particular, where we're spending money to broaden our capacities, and in some cases, build new capacity. So I'd say that's -- those are the 2 main focus areas for us.

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

Okay, and then last question. Maybe a bit more on sales margins. If there's a way to think for full year, just given the low base to start the year, if you expect we could get some above seasonal or Amkor-specific projects to get back to a flat year for overall or fetch the target? And then a way to think about gross margins, I guess, relative to few years ago -- kind of a follow-up to Sidney's question. But if there is a way to think about getting back to 20% gross margin with the capacity you have in place now, like what type of revenue level you need to get to?

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

Okay, Randy, I'll answer the first half of your question, then turn it over to Megan for the second half. So the way we're looking at 2019 right now is a tale of 2 halves. I think first half is going to be a challenge with the smartphone correction. And the fact that we're in the tail end of the general market slowdown. But the second half, we see as a different business environment because of the recovery we think in the general market and also because the smartphone market will pick up.

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

And then Randy, with respect to your question about profitability, as far as -- previously, we've given some target sales to achieve a 20% margin. We've come off that because there several factors that impact that. Recently, was the product mix. And then, of course, now what's impacting us is utilization. So to give you another figure, we've looked at our model. And to breakeven bottom line, that would take about $950 million of quarterly revenue run rate. And so with that and then the function of increasing utilization, that's where we would see margin expansion.

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**Operator**

Our next question comes from Sidney Ho, Deutsche Bank.

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**Shek Ming Ho** - *Deutsche Bank AG, Research Division - Director & Senior Analyst*

I have two follow-up questions. The first one is, I think last quarter you talked about looking at the factory footprint in Japan and tried to figure out what's the right thing to do. Can you give us an update on that? And if there is anything -- is there anything we should think about margin benefit that you expect, both on the gross margin line and the operating expenses side?

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

Sure. As a reminder for our listeners, I mentioned last quarter that we've seen a decrease in demand within Japan for wire bond packages. So our factory network in Japan is totally focused on wire bond, and these are older packages so the demand is steadily declining and we need to reduce our fixed cost. We made substantial progress over the past few months putting together a plan to do just that, which involves reducing our footprint and reducing our overhead in Japan. I'm not prepared to discuss the details today. But I hope to be able to provide more details in our next earnings call.

**Shek Ming Ho** - *Deutsche Bank AG, Research Division - Director & Senior Analyst*

Okay, that's helpful. Maybe -- my follow-up to that is -- to Randy's question about the CapEx. You haven't really talked too much about SWIFT and NANIUM, those fan-out products. Can you maybe talk about what kind of capacity increase are you expecting within that $475 million of CapEx? And maybe what kind of revenue expectations do you have for those products this year?

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

Yes. So the fan-out investment we'll be making will be focused primarily on low-density fan-out. So these are the NANIUM technologies. So we're investing in both Porto, our Portugal factory, as well as in K5 in Korea. So we are quite happy with the way that's going. The -- that NANIUM acquisition worked out very well for us. The technology, we think is best-in-class for fan-out from both a yield standpoint and a quality standpoint. We're also very happy with the people that joined Amkor after the acquisition. And we see a lot of opportunities to grow that business. In addition, we're seeing opportunities within Europe to engage more broadly with the European customers who want a European supply chain. So we're building other capabilities in Porto, including test, including MEMS, and some other packages that we're moving into Europe at the request of European customers.

**Operator**

Our next question comes from Edgar Roesch of Sidoti & Company.

**Edgar Burling Roesch** - *Sidoti & Company, LLC - Research Analyst*

Yes, a lot of my questions have been answered already. But I wanted to check in on operating expenses, which declined by about 2% when you combine SG&A with R&D in 2018 versus 2017. And that's with revenue up. So I was just wondering, Megan, you mentioned some efforts, maybe, to curb spending, could it be driving towards another 2% decline over the course of 2019?

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

Yes, we're not giving guidance on OpEx, Ed. But I would expect that with our efforts we will be able to reduce the OpEx lower in 2019 compared to 2018.

**Edgar Burling Roesch** - *Sidoti & Company, LLC - Research Analyst*

Okay. All right, very good. And then I think the question was already answered pretty well. So on the gross margin, there is no effect of the higher material content affecting that Q1 outlook. Is that the right message?

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

Right, that's correct.

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**Operator**

I'm showing no questions at this time. I would like to turn the call back over to Vincent Keenan for any closing remarks.

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**Vincent Keenan** - *Amkor Technology, Inc. - VP of IR*

Thank you, Valerie. This ends the question-and-answer portion of our call. I would now turn the call back to Steve for his closing remarks.

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

I'd like to recap our key messages. First, 2018 was a good year for Amkor Technology. We grew revenue 3% and generated $120 million of positive free cash flow. Second, we expect Q1 '19 revenues of approximately $880 million, more than our typical first quarter decline due largely to an inventory correction underway in the smartphone market. Finally, we're optimistic about the second half of the year when we expect more favorable market conditions. Thank you for joining the call today.

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**Operator**

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

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