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AMKR - Q3 2016 Amkor Technology Inc Earnings Call

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OVERVIEW:

AMKR reported 3Q16 revenues of nearly \$1.1b. Expects 2016 revenues to be approx. \$3.9b and EPS to be \$0.54.



OCTOBER 31, 2016 / 9:00PM, AMKR - Q3 2016 Amkor Technology Inc Earnings Call

CORPORATE PARTICIPANTS

Greg Johnson *Amkor Technology, Inc. - VP of Finance and IR*

Steve Kelley *Amkor Technology, Inc. - President & CEO*

Megan Faust *Amkor Technology, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Randy Abrams *Credit Suisse - Analyst*

Sidney Ho *Nomura Securities International, Inc. - Analyst*

Atif Malik *Citigroup - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the Amkor Technology third-quarter earnings conference call. My name is Andrea and I'll 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 Greg Johnson, Vice President of Finance and Investor Relations. Mr. Johnson, please go ahead.

Greg Johnson - Amkor Technology, Inc. - VP of Finance and IR

Thank you, Andrea, and good afternoon, everyone. Joining me today are Steve Kelley, our President and Chief Executive Officer, and Megan Faust, our new 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 US GAAP equivalent at our website. These non-GAAP measures include combining J-Devices' financial results for certain periods, prior to their consolidation.

We will also make forward-looking statements about our expectations for Amkor's future performance, based on the environment as we currently see it, and statements about the impact of the earthquakes in Japan. 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.

Steve Kelley - Amkor Technology, Inc. - President & CEO

Good afternoon, and thanks for joining the call. Today, I'll discuss our third-quarter results and our fourth-quarter outlook. In addition, I'll provide an update on some of our key growth initiatives.

First, however, I'd like to welcome Megan Faust, our new CFO. Megan knows Amkor well, having served as our Corporate Controller for the past six years. She is a CPA, and spent 10 years at KPMG before joining Amkor. Megan will discuss our financial performance and answer your questions during our call today.



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In the third quarter, we generated revenue at the high end of our guidance. We saw notable strength in smartphones across multiple tiers. Sales in automotive, Greater China, and advanced SIP were all up sequentially, reflecting the continued success of our growth initiatives.

Our 18% sequential revenue growth drove gross margin and profitability to the high end of our guidance. Earnings per share increased \$0.23 sequentially, and doubled year on year. In addition, we generated \$106 million in free cash flow in the quarter.

Mobile communications revenue grew \$100 million sequentially. The majority of this growth came from the iOS ecosystem, where we were able to leverage our expertise in advanced SIP, MEMS and other technologies. We also saw gains in the Android ecosystem, particularly in China.

Our advanced SIP business grew 45% sequentially, and contributed over 20% of total revenue. We saw particular strength in RF and PA modules, as well as in fingerprint and other sensors.

Laminate-based advanced SIPs are the preferred modular form factor for mobile and automotive applications. They require high precision assembly technology, a core competence of Amkor. Most of these laminate-based advanced SIPs are built at our K4 manufacturing plant in Gwanju, Korea.

In Greater China, Amkor revenue grew 25% sequentially. This growth came primarily from new customers, who value our combination of advanced technology, quality, execution and service. Increased business in this important region is driving better factory utilization, and broadening our participation in multiple tiers of the mobile device market.

Our Shanghai factory is well-positioned to service both local and international customers. It is Amkor's second-largest factory by revenue, and offers a wide variety of advanced packaging and test services, including wafer probe, 8 and 12-inch wafer bumping, wafer level packaging, and advanced SIP. Last quarter, we completed an expansion of this factory, boosting clean room space by nearly 45% to roughly 625,000 square feet.

A portion of our expanded Shanghai factory houses Qualcomm's new test center, which began operations this month. This new test center will combine Amkor's extensive test experience and clean room facilities, with Qualcomm's industry-leading product development and test capabilities. We are excited to work together with Qualcomm in this new operation.

Our expanded relationship is a natural extension of the long history of close cooperation between our two companies. The co-location of the test center and our Shanghai factory may also help us to capture a greater share of Qualcomm's packaging business.

Automotive accounted for 24% of our third-quarter revenue. On a combined basis, third-quarter automotive revenue of \$260 million was up 35% year on year, and up 17% sequentially. J-Devices performed well in the third quarter, showing healthy growth in both revenue and profitability.

Our plan to reduce our overall factory footprint in Japan, part of our consolidate and fill strategy, is on schedule. Consolidation activities should be largely completed by the end of 2017.

I'd like to close my third-quarter commentary with a few words about our power discrete business which we established in July 2013 with the purchase of Toshiba Semiconductors' Malaysia factory. The acquisition was a cost-effective way to expand our participation in the automotive and industrial markets. We achieved a significant financial milestone in the third quarter, when our cumulative EBITDA from the power discrete business surpassed our invested capital, including acquisition costs.

We accomplished this 36-month payback by aggressively reducing costs while maintaining good service levels. This has been a successful tuck-in acquisition for Amkor. We look forward to growing the business in 2017 by ramping new customers to high volume.

Moving now to our fourth-quarter outlook. We expect that Fourth Quarter revenues will be up 54% year on year, but down 5% sequentially. Demand is solid in nearly all end markets. iOS ecosystem demand is particularly good.



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We are maintaining our 2016 capital spending plan at roughly \$650 million, including \$170 million for construction of K5, our new R&D and manufacturing facility in South Korea. Based on our Q4 guidance, we expect 2016 revenues to be approximately \$3.9 billion. This represents a \$1 billion increase over 2015, driven primarily by the successful consolidation of J-Devices.

We expect full-year gross margin to be approximately 17.5%, an increase of 100 basis points year on year. Earnings per share are expected to be \$0.54, (sic-see press release "\$0.55") more than double our 2015 performance. Megan will now provide some more detailed financial information.

Megan Faust - Amkor Technology, Inc. - CFO

Thank you, Steve, and good afternoon, everyone. Our third-quarter revenue of nearly \$1.1 billion was up 18% sequentially. Revenue for advanced products increased 22%, driven by notable strength in smartphones and growth in Greater China, and advanced SIP.

Our revenue for mainstream products increased 16%, driven primarily by growth in automotive and consumer electronics. Our gross margin of 19.7% was at the high end of guidance, due to strong sequential revenue growth. Excluding J-Devices, third-quarter revenue was the second best performance in Amkor's history, behind only the fourth quarter of 2014.

In addition, our fixed manufacturing costs, which consist of labor, depreciation, and factory overhead, held steady. This discipline allowed us to deliver a third-quarter gross margin consistent with our performance in the second half of 2014.

In the third quarter, we incurred \$3 million of incremental earthquake costs that reduced gross margin by 30 basis points. In the fourth quarter, we expect to receive insurance payments of JPY3 billion or about \$30 million. Including these payments, we anticipate that the net impact of the Japan earthquakes on our full-year 2016 results will be minimal.

Operating expenses in the third quarter were \$100 million. For the fourth quarter, we expect operating expenses to be around \$105 million. The increase is driven by facilities-related costs.

We are exercising discipline and continue to control costs and spending. On a combined basis with J-Devices, operating expenses have been steady for the past several years.

Interest expense in the third quarter was \$23 million, and we expect it to remain around this level in the fourth quarter. We expect our effective tax rate to be about 30% for both Q4 and the full year. On a combined basis, Amkor and J-Devices generated approximately \$740 million of adjusted EBITDA over the past 12 months.

At September 30, we had total debt of \$1.6 billion, and debt to combined adjusted EBITDA of 2.1 times. Our liquidity is solid, with \$550 million in cash, and \$300 million in available undrawn loans.

We generated over \$100 million in free cash flow for Q3, and we expect to be free cash flow positive for the full year. With our strong cash position, bolstered by free cash flow, we anticipate using cash on hand to pay down around \$50 million of debt in the fourth quarter.

Our full year 2016 capital expenditures forecast of around \$650 million remains unchanged. With that, we will now open the call up for your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)



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Our first question comes from the line of Randy Abrams with Credit Suisse.

Randy Abrams - *Credit Suisse - Analyst*

Good results. My first question, and maybe welcome, Megan, but it's a couple on the balance sheet and CapEx. And I was curious in the initial view on CapEx into next year, factoring in the K5 now largely complete, and I think the follow-up is on the free cash flow where you're starting to generate some -- and looks like with K5 complete, you may continue that. So the priorities for some of the cash flow if you start turning free cash flow positive in terms of if there's opportunities to deleverage a bit or any other priorities on the CapEx?

Steve Kelley - *Amkor Technology, Inc. - President & CEO*

Randy let me make a comment about the CapEx, and I'll turn it over to Megan to talk about the free cash flow. The last earnings call I guided to roughly \$500 million in expected CapEx for 2017. I still feel good about that number. \$500 million plus or minus. I think the one potential pivot point next year could be a faster adoption, potentially for wafer-level packaging, particularly our SWIFT packaging. So if that demand starts to materialize before 2018 we would have to probably pull some investment forward into K5 but right now, I still feel good about the \$500 million.

Megan Faust - *Amkor Technology, Inc. - CFO*

Randy, with your question about free cash flow, yes, it looks like we'll continue to have free cash flow moving forward. As historically has been our practice, we'll primarily invest that or look at the needs for the business, and then of course we would opportunistically look at ways that we may be able to manage our cost of debt.

Randy Abrams - *Credit Suisse - Analyst*

Okay, thank you. And the second question, I wanted to ask on the test operation with Qualcomm, that you're starting up in China, and maybe talk about the model for test. If there's a change in the economics running the facility, or leasing the space, versus the traditional way they did test? And if this is something you expect unique to one customer or if there's a business model change you may see change the way test is done at some other customers?

Steve Kelley - *Amkor Technology, Inc. - President & CEO*

Sure, Randy. I think it's multi-dimensional deal. I think the obvious advantage of having the test center co-located with the assembly center is, obviously there's cycle time advantages to doing that.

The location in China also helps Qualcomm, and increases their China content, and brings them closer to their customers in China. From an economic model standpoint, it's about a wash for Amkor. If you look at test only, we end up not passing on depreciation charges, because Qualcomm owns the testers, but we do have some management fees and greater volume that offset most of the loss of that depreciation recoupment.

Randy Abrams - *Credit Suisse - Analyst*

Okay, thank you. The last question I wanted to ask, just on the Galaxy Note recall, where you've traditionally had a lot of content to both of the flagship models. Just trying to see if there's any disruption in order rates, or if you're seeing it balance out with other customers? And the follow-on is you're guiding a little bit of seasonality after a strong third quarter, but if there's anything from that factor or you're seeing a slowdown in some parts of the business in the fourth quarter?

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Steve Kelley - Amkor Technology, Inc. - President & CEO

Sure. Yes, so first let me address the Note 7, and I'll talk about Q4 in general. So I think the Note 7, I was fairly worried when I heard about that myself, but after our analysis was complete, what we figured out was that the net impact to us was going to be between \$3 million and \$5 million for the quarter and that was factored into our guide.

And the way we came to that number was we looked at the absolute impact of the Note 7 cancellation, and then we looked at the offset by increased short-term demand for other high-end phones, where we also have good content. So most of the replacements for the Note 7, we already have very good content so we're basically exchanging one set of revenue for another set of revenue. So \$3 million to \$5 million is the answer for Q4 impact of the Note 7 discontinuance.

If I take a look at Q4, I would say I'm pretty bullish on Q4. If we look at our factories today, they are humming along at a very high rate right now. I think Q3, we saw the build up for the launch of the latest iPhone, and we're seeing continued strong demand there, but obviously you always see the biggest demand in the first quarter of the build.

If I look across the business, the only place where I see small seasonal declines would be in consumer and networking. I've done a check of channel inventories, and right now, we believe that the channel inventories are in balance. The feedback that I have is that those inventories went down significantly in Q3, and what that means for the industry, I think is, we should finish strong in 2016.

Randy Abrams - Credit Suisse - Analyst

Okay great. Thanks a lot, Steve and Megan.

Operator

Thank you. Our next question comes from the line of Sidney Ho with Deutsche Bank.

Sidney Ho - Nomura Securities International, Inc. - Analyst

So just to follow-up to Randy's question, can you talk about the dollar content per phone between iOS, the high end Android in China? And related to that, you have done a really good job increasing the content per phone, especially in the iOS ecosystem. Can you talk about how much headroom do you have, especially when SWIFT is ready, and in the past you've said 2018, but it sounds like it may happen in 2017.

Steve Kelley - Amkor Technology, Inc. - President & CEO

Let me just make sure I understand your question, Sidney. So you're asking to try to do a comparison between our content in the iOS ecosystem versus Samsung ecosystem?

Sidney Ho - Nomura Securities International, Inc. - Analyst

In China.

Steve Kelley - Amkor Technology, Inc. - President & CEO

In China, okay. So as we take a look at the Note 7 versus its substitutes, which include the iPhone and other phones from Samsung, what you'll find is that the content is pretty similar. So I think our best content is in iOS, and we still have strong content in the Samsung phones through our



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cooperation with Qualcomm, in particular. So that's why we didn't see as great impact an revenue in Q4 from the Note 7 discontinuance, as I feared originally.

If I take a look at China, we do surprisingly well in China, but it's through a combination of business that's served from international vendors, and it's also business from local vendors. We have a lot of upside locally, so we've made some initial progress in China, particularly in the fingerprint sensor area and also in the baseband area and the apps processor are. So we're working hard there. We think there's a fair amount of upside in China for Amkor.

Sidney Ho - *Nomura Securities International, Inc. - Analyst*

Great, and then my follow-up question is similar questions, but on the automotive side. What's the dollar content for you per car today, and what is the potential opportunity looking forward?

Steve Kelley - *Amkor Technology, Inc. - President & CEO*

Yes, Sidney, I don't really have a great number for you on dollar content per car, but what I can do is comment on the general trend. Automotive is growing quite rapidly for us. Right now it's 25% of our business.

And if you look at our run rate in Q3, it was over \$250 million, so that means we're running at \$1 billion run rate. I originally forecasted that to happen about two years from now. So we're seeing two things happen. Obviously, the content in the automobile is going up tremendously, so a lot of new sensors, new microcontrollers and communications products in particular.

The second thing that's happening is we're seeing a lot of leverage based on our existing capabilities, not only in Japan, but also in our factories in Korea and the Philippines, where we've been doing automotive business for many years. So we're qualified within our customer base, and also qualified within our customers' customer base. So I think we're in a pretty good position to continue growing that revenue.

Sidney Ho - *Nomura Securities International, Inc. - Analyst*

Okay, if I can get a last question. Q1 if you look at Q1 seasonality, it's typically down 8% for you on a standalone basis. Do you have enough visibility today to tell how we should think about Q1? And I think we don't have a history of how J-Devices' seasonality is. Just want to get a sense of seasonality on J-Devices on a standalone basis, or if you prefer a blended basis of your new seasonality, per se?

Steve Kelley - *Amkor Technology, Inc. - President & CEO*

Yes, Sidney. Let me just provide some general commentary. Obviously, we can't guide specifically for Q1 yet. But I think the best place to start is with J-Devices, now roughly 60% of our revenue in Q1 will be tied to non-mobile device markets such as automotive, industrial, PC, consumer, and networking.

So we don't see any major demand swings in those non-mobile device markets, swings up or down. We also don't see significant inventory build up today. So I think that foundation we have of non-mobile device business should hold up fairly well in Q1.

So the wild card is the mobile device business. That's the other 40% of our business in Q1. If you take a look at the ecosystems, I think from a seasonal standpoint, we expect iOS and Samsung ecosystems to be at steady state run rates. So I'm not aware of any major launches in Q1, so it won't be as robust as second half, but it should be okay.

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We expect those ecosystems from the iOS and Samsung ecosystems to start to really bloom in Q2 and Q3, with the launch of major new platforms. The other ecosystem is the one of interest in Q1. That is the China ecosystem. We expect that will be stronger in the first quarter, and we'll offset some of the weakness we expect from iOS and Samsung.

Sidney Ho - *Nomura Securities International, Inc. - Analyst*

Okay, great. Thank you very much.

Operator

(Operator Instructions)

Our next question comes from the line of Atif Malik with Citigroup.

Atif Malik - *Citigroup - Analyst*

First question, Megan, so the guidance includes the \$30 million insurance from the earthquake. Can you talk about the gross margins without that contribution, on a normalized basis, for the fourth quarter?

Megan Faust - *Amkor Technology, Inc. - CFO*

Sure, happy to do that. So normalizing for the \$30 million in insurance proceeds that we're expecting, we would anticipate a gross margin of around 19%.

Atif Malik - *Citigroup - Analyst*

Okay. And then how do you think about gross margins longer term? In the past, you've talked about maybe doing 25% gross margins at \$1.5 billion revenue levels. Just wanted to see if you still feel confident about hitting those numbers?

Steve Kelley - *Amkor Technology, Inc. - President & CEO*

Yes, I'll make a comment here. I think that we're on the right track. I think if you look at our gross margin in the second half of 2016, it's right around 20%.

So I think once we get to a point where it factors reasonably full, we can get to 20% to 25% gross margins, and that's where we aim to be over the medium to long term. It's an incremental process, and so there's quite a bit of work being done to improve our efficiency, and to improve our ability to accept more business. And I think we did a good job of that in the second half this year. We'll continue that approach in the coming years.

Atif Malik - *Citigroup - Analyst*

Steve, another one for you. Can you just talk about what's your differentiation on the fan out wafer level packaging, TSMC is starting to ramp production in the fourth quarter, and we have another large foundry in the lead So as we look at all those other foundries trying to rollout this new technology, how should we think about your differentiation, or if you can talk about your costs versus your peers?



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Steve Kelley - Amkor Technology, Inc. - President & CEO

Yes, maybe first, I'll talk about the current situation and then I'll talk about our plans. Obviously, TSMC has gone in and made a major investment in high density fan out, which they call INFO. And we're actually very happy about that, because they've been able to create -- this is a mainstream technology. And what we're seeing is that even though this is one customer technology today with TSMC, we're seeing demand start to percolate at other customers. So they are seeing this in the market place and they want something similar.

That sets the table very nicely for our technology, which is called SWIFT. Again the same form factors TSMC's INFO. And where we're going to play there is really trying to appeal to more than just the high end market, but also the mid range market, and we're doing that by reducing costs and maximizing yields. We've been working on the Swift technology for at least the last three or four years, and this will be the first technology we install into K5.

One of the keys in this technology is to have a very clean environment. We believe K5, our new facility in South Korea, is if not the cleanest, among the cleanest environments in the back end. It's a Class 100 facility, and we think it's ideal for producing this type of product.

The other leverage we have here is that I think we're well suited to dealing with die from many different foundries. I think wafer foundries tend to prefer to build with their own die, and we're used to gathering die from various suppliers and packaging them up. So I think between our optimization of cost and yield, and our ability to handle die from multiple foundries, we have a good value proposition.

Atif Malik - Citigroup - Analyst

Thank you.

Steve Kelley - Amkor Technology, Inc. - President & CEO

Your other question was more generally wafer level fan out? If you go to the low density wafer level fan out, this is typically single die fan out. One advantage that we see with the wafer based technology, again TSMC is using wafers as their base and so are we is this technology is very flexible, it uses equipment that's basically off the shelf, and it leverages the install base. So when I say flexible, the equipment we're using to build the SWIFT products is also used to build low density fan out products, and wafer level CSP. So when demand decreases in one area, we could fill that capacity with demand from a different area. So we think that's a basic advantage of the wafer based approach, with just much more flexibility.

Greg Johnson - Amkor Technology, Inc. - VP of Finance and IR

Okay thanks very much, Atif. There are no more questions so that ends the Q&A. I would now like to turn the call back to Steve for his closing remarks.

Steve Kelley - Amkor Technology, Inc. - President & CEO

I would like to recap our three key messages. First, we completed a strong third quarter, with revenue and gross margin at the high end of our guidance. Second, our fourth-quarter outlook is solid. And finally, we are making important gains in our focus areas including advanced SIP, automotive, Greater China, and J-Devices. 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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