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AMKR - Q2 2017 Amkor Technology Inc Earnings Call

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OVERVIEW:

Co. reported 2Q17 EPS of \$0.48. Expects 3Q17 revenues to grow roughly 9% sequentially.



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CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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 - VP*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Amkor Technology Second Quarter 2017 Earnings Conference Call. My name is Skyler, 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 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, Skyler, and good afternoon, everyone. Joining me today are Steve Kelley, our President and 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 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 the 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. - CEO, President and Director*

Good afternoon, and thanks for joining the call. Today, I'll discuss our second quarter results, our third quarter forecast and our acquisition of NANIUM. In addition, I'll update the status of our key growth initiatives with a focus on advanced SiP.

Second quarter revenues were up 8% sequentially. We experienced solid growth across nearly all of our markets. Communications led the way with 11% quarter-on-quarter growth.

In the third quarter, we expect to grow revenues roughly 9% sequentially, largely due to increased demand from customers in the iOS ecosystem. Overall demand from the Android ecosystem and from other markets is expected to remain stable.

In late May, we completed the acquisition of NANIUM, a leader in wafer-level fan-out package technology. The integration process is proceeding smoothly. We have expanded production capacity in Portugal and have begun to install the NANIUM process at our K5 facility in Korea. NANIUM



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is well known for high-yielding and reliable fan-out technology, shipping more than 1 billion fan-out packages to date. NANIUM's expertise in low-density fan-out complements Amkor's expertise in wafer-level CSP and high-density fan-out. For Amkor, wafer-level packages generated more than \$500 million in 2016 revenue. We anticipate growth of more than 15% this year.

Smartphone applications are driving growth, not only in the wafer-level packaging market, but also in the advanced system-in-package or SiP market. As a reminder, advanced SiPs include 2 or more dissimilar ICs, along with external components in an IC package. Advanced SiP products are expected to contribute nearly \$800 million to Amkor's top line this year.

Advanced SiPs are the primary vehicle for package-level integration, which allows customers to combine ICs from different process nodes and different foundries. The high cost of advanced silicon nodes are making advanced SiPs a good economic choice for many applications. Some customers turn to advanced SiPs primarily for performance reasons. For example, fusion MEMS products combine sensor, processor and wireless communication circuits in a single package. By moving all the system components closer together, performance improves and power consumption is reduced.

There are 3 important factors driving our success in advanced SiP. First, our enabling technologies; second, the Amkor engineers who work with customers to design robust packages; and third, our ability to invest in the necessary factories and equipment.

So let's talk first about our enabling technologies. We typically start with a substrate sourced from an Amkor-qualified supplier. Alternatively, we offer low-density and high-density fan-out platforms which have form factor and performance advantages over substrates. Our low-density fan-out platform comes from NANIUM. Our high-density fan-out platform, known as SWIFT, was developed in-house. SWIFT offers customers a very thin form factor for very high pin count ICs. We then work with our customers to squeeze a lot of circuitry into a very small space. We do that in such a way that performance is improved, power consumption is reduced and reliability is enhanced.

Some of the tools we use to maximize circuit density include double-sided assembly, embedded die in substrate, antenna on package and various types of RF shielding.

Over the years, we have built substantial SiP capacity, largely in a modular way. This allows us to easily modify the production line as product mix changes which improves utilization.

Today, our most complex advanced SiPs contain up to 200 electronic elements. Although most of these products are used in smartphones, we see increasing acceptance of SiPs in other applications, including automotive.

Now I'd like to briefly review the status of 2 other growth initiatives, automotive and Greater China. In the first half of 2017, automotive revenue grew 7% year-on-year and accounted for 26% of total Amkor revenue. Automotive is a stable market, characterized by long product life cycles and steady growth. Automotive customers value Amkor's consistent execution and quality as well as our financial stability.

In the first half of 2017, sales to Greater China fabless customers grew 55% year-on-year. Nearly all of our Greater China revenue comes from advanced packages, many of which are built in our Shanghai factory.

Balanced revenue growth remains the overriding objective for Amkor. We believe that engaging broadly with customers across multiple markets and regions is the best way to achieve consistent financial results, and we are executing to this plan.

I'd also like to note that consolidation trends in the industry are helping Amkor today and should continue to be positive catalyst in 2018. Bottom line, Amkor is positioned as a stable and reliable choice. We are focused on the basics, execution, quality, technology and customer service.

Before closing, I'd like to provide a brief update on K5, our new facility located in Incheon, South Korea. We believe K5 is the most advanced OSAT facility in the world, with class 100 particle control in a highly automated line. We use robots to move wafers in assembly lots from one machine to another, a first in the OSAT industry. Based on current qualification activity, we expect to generate meaningful revenue in K5 next year.



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Finally, we were honored to receive Qualcomm's Supplier of the Year award for the second consecutive year. This award recognizes the dedication and hard work of the entire team. It also reinforces Amkor's strategic alignment with one of the world's premier technology companies. Megan will now provide more detailed financial information.

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

Thank you, Steve, and good afternoon, everyone. Today, I will review our second quarter results, then provide some comments about our third quarter and full year activities.

Strong revenue growth in Q2 drove significant improvement in profitability. We earned \$0.48 per share in the quarter, including \$0.34 per share from the sale of our K1 factory. We also generated \$316 million of EBITDA in Q2 and a total of \$1 billion of EBITDA over the last 12 months.

Second quarter gross margin of 17.4% included approximately \$10 million or about 100 basis points of costs related to our factory consolidation plan in Japan. We expect to complete the consolidation activities by the end of 2017.

To give you an idea of the favorable impact we expect from this initiative, our 2017 Q3 forecast for gross margin would have been in the 20% area under the improved cost structure. This estimate reflects the elimination of \$10 million of onetime costs that we expect to incur in Q3 and the anticipated benefits from the factory consolidation. As expected, we completed the sale of our K1 factory in Korea in Q2. The sale price was \$142 million, and we recognized an after-tax gain of \$82 million.

In June, we received a credit-rating upgrade to Ba3 from Moody's. Moody's noted in their ratings action that the upgrade follows the resumption of consistent free cash flow generation with the completion of our new K5 facility and the successful integration of J-Devices. We generated \$43 million in free cash flow in Q2 and expect to be free cash flow positive for the full year at a substantially higher level than 2016. As of June 30, we had total debt of \$1.6 billion and debt-to-EBITDA of 1.6x. This is a significant improvement from our ratio of 2.4x only 18 months ago and reflects our sustained growth of free cash flow since 2015.

Our liquidity is solid. We had \$658 million in cash and around \$270 million in available undrawn loans at the end of Q2.

In July, we used cash on hand to complete the redemption of \$200 million of our senior notes due 2021. The annual interest savings from this transaction is approximately \$13 million.

Next, I will review our third quarter and full year activities. Driven by our strong Q3 outlook of around 9% sequential revenue growth, we expect operating income to increase by around 35%, excluding the gain on the sale of K1 in Q2. Operating expenses are expected to be around \$115 million for the third quarter. R&D expense includes labor, depreciation and other costs associated with K5. Beginning in the third quarter, we will start to see a transition of these costs to cost of goods sold as we bring lines up to production. This transition will continue into 2018 until our operating expenses return to more traditional levels.

2017 is a year of transition for our cost structure. Heading into 2018, we expect that the incremental fixed costs associated with K5 will be largely offset by the savings from the closure of K1 and the completion of our consolidation activities in Japan. We expect our 2017 full year effective tax rate to be around 25%, and our full year 2017 forecast for capital expenditures is now around \$525 million.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question is from Randy Abrams with Crédit Suisse.



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

Good results. I wanted to ask the first question on the CapEx, just if you could talk about the driver where it looks like a bit of upward bias, I think, from \$500 million to \$525 million. And maybe looking out to next year, maybe an initial feel, factoring in your near the end of the buildout of K5 at least the shell, but then starting the investment cycle on fan-out and continue to grow the SiP business. Maybe initial view to how CapEx looks for those types of investments.

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

Yes, Randy. Basically, as we look forward into 2018, my view is that we can keep CapEx under control. So my guidance would be similar to the guidance I gave for this year which is \$500 million to \$550 million. So that's going to be our target for next year. I think we could build out the fan-out capacity in a controlled way. I think most of the high-density fan-out applications won't get a high volume until 2019, but we'll see some applications ramp in low-density area next year.

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

Okay. And was there a small increase -- just to clarify, was there a small increase for this year or anything driving the CapEx for this year?

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

I think in general, we've seen a very strong demand environment, particularly for smartphones. So most of that incremental \$25 million is being spent in wafer-level and SiP areas.

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

Okay, great. And I guess, to see the mix shift, it looks like the driver like wafer-level packaging and SiP may continue to grow a bit faster. Could you talk about profitability on some of these areas, if it's like flip chip, we should think of it similar to your advanced packaging business versus corporate average or if anything different because these are investment stage.

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

I think in general, you could assume that all of our advanced packages are going to average out our profitability. They tend to be heavy on capital investment and also heavy on gross margin return to the company.

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

Okay. And the final question I wanted to ask. If you can maybe profile the demand, like within your guidance, how the different segments are doing. And if you're seeing any pockets of weakness or pretty broad like where you're guiding high-single digit close to 10% growth, just how that's faring across your different applications.

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

Yes, Randy, let me just answer that question in 2 parts. I want to go back and review Q2, what we saw there and then segue into Q3. So Q2 was very broad-based increase in demand. Every market we track was up at least 8%, except for networking which was flat. As we go into Q3 and we look at the 9% growth, most of that, I'm talking 80% to -- 90% of that growth is tied into the iOS ecosystem. So the rest of the business, the Android



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ecosystem as well as automotive and other markets, taken as a whole, they're up a little bit but not that much. But I think you need to think about that in the context of a pretty long period of strength in the general market for semiconductors.

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

Okay. If I could ask a quick follow-up. Just fourth quarter, I think normally, it can be flat, plus or minus. With some of the, I guess, project delays even in Android to change model specs, if you have an initial view on how things may be relative to that seasonal pattern.

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

Yes, Randy, right now, we think Q4 is going to be similar to Q3. We're not giving any hard guidance, but what we see is that the forecast from our customers in the iOS ecosystem show strength through Q4. In addition, we expect to see more strength out of the China smartphone ecosystem in Q4. And finally, we expect the general market to remain stable through the end of this year.

Operator

(Operator Instructions) We have a question from Sidney Ho from Deutsche Bank.

Shek Ming Ho - *Deutsche Bank AG, Research Division - VP*

I wanted to look at the gross margin for Q3. The incremental margin is probably around 30% -- 25%, 30%. It seems a little low to me. I wonder if there's any offset. I know Megan you talk about the \$10 million consolidation costs, but that also happens in Q2 as well.

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

Yes, Sidney. Yes, for Q3, you'd mentioned the specific consolidation activities that we'd already called out and correct, there would not be a change from Q2 to Q3. So there are some seasonal costs in there, but nothing that I would specifically call out to you from a modeling perspective.

Shek Ming Ho - *Deutsche Bank AG, Research Division - VP*

Okay. My next question is if you look at NANIUM, I don't know if you guys have disclosed how much revenue that is coming from. Just want to understand how big NANIUM is adding to the portfolio in Q3 and what kind of profitability does it bring to the table?

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

I'll make a comment here, Sidney. I would characterize the impact on Q2 as very modest as far as the impact of NANIUM revenue is on our overall total. We have included the revenues in our Q3 guidance. We're not breaking them out but I would refer you to our previous disclosure which detailed the fact that NANIUM generated about \$40 million in revenue in 2016. I think you can assume a similar run rate going forward.

Shek Ming Ho - *Deutsche Bank AG, Research Division - VP*

Okay, great. And then my last question is a follow-up to Randy's question. There is a lot of chatters about there are some inventories still in China from the smartphone market. Wondering if you guys are seeing that, because that's why Q3 is only seeing the iOS getting better. And Q4, I think you mentioned that the Chinese smartphone should get better than Q3.



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

Yes, Sidney. I believe that we are -- we certainly felt the weakness in China in Q2, and we're seeing some recovery in Q3 but it's not to the degree that we would like. Based on what we're hearing in the market and also what we're hearing from customers and peers, we believe that most of that excess inventory should be worked through this quarter. That's why we're hopeful for a stronger Q4 out of the China ecosystem.

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

There are no more questions, so that ends the Q&A portion today. I'd like to turn the call back to Steve for his closing remarks.

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

I'd like to recap our key messages. First, our second quarter revenue grew 8%, driven by gains in nearly all markets. Next, we expect third quarter revenues to grow roughly 9% sequentially, fueled by demand from the iOS ecosystem. And finally, our growth initiatives continue to gain momentum. 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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