Advanced Semiconductor Engineering, Inc.
1st Quarter 2016 Earnings Conference & Conference Call
April 29, 2016
3:00p.m. Taiwan Time

Kenneth Hsiang, Head of IR of ASE Group:
Hello I'm Ken Hsiang, the Head of Investor Relations for ASE. Welcome to ASE Group's first quarter 2016 earnings release. All participants consent to having their voice and questions broadcast via participation of this event. Please refer to page 1 of our presentation, which contains our Safe Harbor Notice. I would like to remind everyone on this call that the presentation that follows may contain forward-looking statements. These forward-looking statements are subject to a high degree of risk and our actual results may differ materially from these forward-looking statements. For the purposes of this presentation, dollar figures are generally stated in New Taiwan Dollars unless otherwise indicated. For the earnings release, I'll be going over the financial results and then Joseph Tung, our CFO, will be answering questions during our Q&A Session. Following the event, our VP in charge of public relations, Eddie Chang, will be addressing the media in Chinese.

If we look back at the year, 2015 was a challenging downturn environment for our core IC ATM business. For us, much of the weakness in 2015 was driven by market-share moves within the smartphone sector. For 2016, we see indications that Android-related smartphones are rebounding from their suboptimal 2015 product cycle. Inventory looks fairly healthy. Customer forecasts appear reasonable. End markets are okay. There are still challenges for the industry and us this year. However, we believe we're in the midst of a modest V-shaped recovery. The first quarter generally performed as we expected. From an IC ATM perspective, after a typical seasonally soft January and February, sales picked up during March, driven by smartphone inventory restocking. Our IC ATM business ended the quarter declining a modest 7.5% sequentially. The sales result is on the higher end of our expectations, especially given that our SiP product performance within IC ATM was somewhat sluggish. Our SiP products' sluggish performance impacted our EMS business to an even larger degree. As such, our EMS business's performance was on the lower end of our expectations, declining 37% sequentially. Our focus during 2016 continues to be rebalancing and optimizing our SiP portfolio, instead of placing emphasis on SiP sales growth during 2015.

This year our focus will be on improving returns. Improving returns may include actions to reduce, eliminate or replace some or all of our SiP devices. It also means readdressing how we look at new incoming SiP business. We will be significantly more selective in our decision process. From such actions we believe we can improve the overall profitability of our services while demonstrating and leveraging technological barriers to entry. At this time, our discussions with our customers continue.

Quarter-over-quarter consolidated P&L. On a fully consolidated basis for the first quarter, the company delivered fully diluted EPS of 43 cents and basic EPS of 54 cents. Our packaging, testing, and EMS businesses were down 4, 6, and 37 percent respectively. Our direct materials business was up 12%. During the quarter, we booked other revenues of 2.7 billion dollars related to real estate sales. Gross profit declined 14% from 13.3 billion to 11.4 billion. Consolidated gross margins improved 80 basis points from 17.6% to 18.4%. Operating expenses decreased by 200 million dollars. Our operating expenses as a percentage of sales increased by 1.4 percentage points to 10%. As we indicated during our last earnings release, this operating expense percentage increase was primarily attributable to lower sales and an increase in professional fees related to our tender offer. Operating profit for the quarter was 5.2 billion dollars, down 1.6 billion dollars from 6.8 billion dollars in Q4. Operating margins declined 0.7 percentage points to 8.3%. During the first quarter, we had a net non-operating gain of 500 million dollars versus a net non-operating loss of 200 million dollars in the fourth quarter. The change from the fourth quarter to the first quarter was primarily attributable to our ECB. Our estimation of SPIL's contribution in this number for the quarter was 401 million dollars. Pre-tax profit for Q1 was 5.7 billion dollars. Income tax for Q1 was flat at 1.3 billion dollars. The higher effective tax rate this quarter was principally tied to higher tax rates related to China real estate sales. For the second quarter, we do expect to book our annual undistributed net earning tax. Net income for Q1 was 4.2 billion dollars, down 0.8 billion. Net margin improved to 6.7%, up from 6.6% in Q4.

Quarterly results on a yearly basis - on a year-over-year basis. Here you can more clearly see the impact of last year's downturn. There were declines across our packaging, testing, and EMS businesses, declining 4, 3, and 13 percent respectively. This was principally driven by our SiP business being slower than last year. Our direct materials business was a highlight, growing 4%. On a year-over-year basis, our consolidated net revenues declined by 4%. Our first quarter gross profits were down 7% with gross margins down 0.6 percentage points from the previous year. Operating profits were down 17% with operating margins down 1.4 percentage points. Net profits were down 7% with net margins declining slightly by 0.2 percentage points.

IC ATM P&L. Please note the inter-company revenues including the SiP technology business performed by our IC packaging business unit on behalf of our EMS business unit are eliminated during consolidations. Our IC ATM net revenues declined 2.9 billion dollars, or by 7%, during the first quarter to 35.5 billion dollars. Revenues for our IC packaging and testing businesses decreased 8 and 6 percent respectively. Our direct materials business increased 2%. The declines within our packaging and test businesses were of a seasonal nature. However, our SiP business within IC ATM was somewhat more sluggish than our traditional IC ATM business itself. NT dollar depreciation had a 1.19% favorable impact on revenue, and a 0.62% favorable impact to gross margins. Gross profit was down 2.1 billion dollars to 7.8 billion dollars. Gross margin declined 4 percentage points. The gross margin decline was principally the result of the seasonally soft first quarter. The margin decline was the result of product mix, shift and lower seasonal revenues in a semi-fixed cost structure. Operating expenses were down 50 million to 4.6 billion dollars. Operating expense percentage was up 0.9 percentage points to 13% from 12.1%. As anticipated, our OPEX percentage increased during the first quarter with regards to professional fees related to the tender offer. Operating margin was down 9.1% from 13.8%. Operating profit was down 2.1 billion to 3.2 billion.

Here you can see our year-over-year comparison for our IC ATM business. We don't really have much to add. So please take a gander at that.

Our packaging operations. In Q1, our packaging revenue declined 8.1% sequentially and 9.4% year over year to 28.6 billion dollars. Our packaging gross margin decreased 4.4 percentage points to 19.1% sequentially. The margin decline was caused by typical seasonality during the first quarter, resulting in lower revenues in a semi-fixed cost structure. Raw materials were flat at 8.7 billion dollars, up 2.3 percentage points of sales. Labor was 5.6 billion dollars, down 0.1 billion, up 1 percentage point of sales. Depreciation, amortization, and rental expenses were up - were at 4.4 billion, up 1.4 percentage points of sales. Factory supplies were 2.5 billion dollars, down 0.2 percentage points of sales. Utility was 0.9 billion dollars, up 0.1 percentage points of sales. During the quarter, capital expenditures were US 62 million dollars, composed of wafer-bumping flip-chip equipment at 30 million US dollars, common and SiP equipment at 28 million US dollars, and wire-bond-related equipment at 4 million US dollars. During the quarter, we added 68 and retired 7 wire bonders. We exited the quarter with a total of 15,629 wire bonders in operation. 8-inch bumping capacity remained unchanged at 95,000 wafers per month, and 12-inch bumping capacity increased 6,500 wafers to 89,000 wafers per month.

Segment share within packaging. Within our packaging product breakdown, our advanced packaging including SiP decreased to 29%. Our IC wire-bonding business increased to 62% and our discrete and other segments remained flat at 9%. The quarter's performance is predominantly the result of lower SiP order flows within our packaging business.

Test operations. Test revenues of 6 billion dollars were down 5.7% sequentially and 3% year over year. Gross margin was sequentially down 4.7 percentage points to 32.9%. The changes in gross margin were principally the result of lower seasonal loading, and a semi-fixed cost environment. Overall, cost of services for test stayed flat at 4 billion dollars. Our testing utilization rate declined to the low--mid 70%. Capex for the test business was 47 million US dollars in Q1. We added 73 and retired 55 testers during the quarter. At the end of Q1, our total tester count stood at 3,453.

Revenues for our materials business of 2.3 billion dollars were sequentially up 14.6% and 4.5% year over year. This result in particular gives us an extra cause for optimism as our materials business may be viewed as a leading indicator for our other lines of business within IC ATM. During the quarter, 892 million dollars was from sales to external customers. Our internal self-sufficiency rate increased to 31% from 25% by value. Gross margins were sequentially up by 3.9 percentage points to 16.9%. The gross margin increase was principally the results of higher loading and more favorable product mix as compared to the fourth quarter.

IC ATM market segments. During the first quarter, our communications market segment share percentage declined from 55% to 51%. Our computing market segment stayed flat at 12%. Our automotive, consumer and others increased to 37%. The changes in our segment share generally relates to the seasonal decline in communication products and, to a lesser extent, lower loading within SiP.

EMS. During the first quarter, revenues for our EMS business unit were sequentially down 37% to 24.8 billion dollars from 39.3 billion dollars. Revenues year over year were down 12.5 % as compared to 28.3 billion in Q1 of 2015. Revenues within our EMS business unit decreased primarily as a result of seasonality, but also as a result of lower order flow related to SiP. Gross margins increased 0.8 percentage point to 8.1%. The margin increase was principally the result of product mix. EMS gross profit decreased to 2 billion dollars. Capex for EMS business unit was 2 million US dollars during the first quarter.

EMS business segment mix. During the first quarter, our communications product segment decreased its segment share, from 64% to 51%. We also saw segment share increases within our computing and consumer segments. During the quarter, our industrial EMS segment increased from 5% to 7%, and our EMS automotive segment share increased from 4% to 7%.

Looking out into Q2, we believe that the shape of things to come will most likely resemble that of the previous year, where the communication segment share continues to decline until the third quarter.

Balance sheet. At the end of the quarter, we had cash and cash equivalents and current financial assets of 49 billion dollars, decreasing from 59.1 billion dollars of the previous quarter. We also had our interest-bearing debt decline slightly from 120.4 billion dollars to 118.7 billion in the quarter.

During the quarter, we spent an additional 13.3 billion dollars on the purchase of SPIL common stock. As of March 31st, we owned 1.029 billion shares, or 33.02% of SPIL, 48.3 billion dollars-worth. This amount is recorded in "investments - equity method."

We still have 173.2 billion dollars in unused credit lines. EBITDA declined to 13.2 billion dollars from 14.2 billion dollars during the seasonally down quarter.

Capital expenditures for the first quarter totaled 115 million US dollars, of which 62 million US dollars was used for packaging, 47 million US dollars for testing, 2 million US dollars for EMS, and 4 million US dollars for inter-connect materials. EBIDTA for the first quarter amounted to 400 million US dollars. The cash flow environment here remains very healthy for the company.

Looking out into Q2, we feel that we are in the midst of recovery of our IC ATM business. The recovery looks to be fairly broad-based with all sectors involved. The recovery also looks to be gradual. We're not seeing a sudden uptick; however, the trend is up. The rate and extent to which the business declined during 2015, we should see a recovery of equal proportions in 2016. Our SiP business should remain seasonally soft through Q2. Historically speaking, SiP typically picks up during the latter half of the year. Our EMS business is much more tied to our SiP products. We would expect inventory control of SiP products to remain tight during the second quarter. Our traditional EMS business, excluding our Wi-Fi module business, should see a moderate recovery. For IC ATM, we see our Q2 business approaching our fourth quarter 2015 levels, with our SiP business remaining seasonally soft. Given that, the Q2 product mix will be significantly different than that in Q4 of 2015. We expect our gross margins to improve meaningfully from Q1, but our gross margins may end up being a bit lower than Q4 2015 levels. For our EMS business, we see a moderate decline from Q4 levels. We will attempt to hold EMS margins steady during the quarter.

Joseph Tung, CFO of ASE Group: You're supposed to say you're concluding the presentation (chuckles).

Kenneth Hsiang, Head of IR of ASE Group: I'm concluding the presentation.

Q&A session with Joseph. Randy?

Randy Abrams of Credit Suisse: Okay. Thank you. For the second quarter outlook, you have up here, looks like a decent recovery. Could you talk about the areas - across your business in ATM, if it's across end markets that you were covering? I guess, moderate to approach fourth quarter would be about 8% growth. Is there any degree of pricing...like your competitor highlighted or flagged more pricing. If you're seeing like an annual price reset, or across any parts of your business, you're seeing more price pressure?

Joseph Tung, CFO of ASE Group: I think it's very typical that at every latter part of the year, there will be a round of price re-negotiation. And most of the price adjustments were done at that point. So going into second quarter, I think the pricing environment is supposed to be stabilizing. So, whatever we're seeing in second quarter that's gonna happen is in a stable pricing environment.

Randy Abrams of Credit Suisse : How was this year compared, like the annual reset this year, versus the last couple of years? Was there any difference?

Joseph Tung: I think because of the softness in the second half of last year, we're seeing a bit more severe pricing pressure, last year. I think that's very typical. There's nothing that's really abnormal. And I don't think it's the results of any transaction that is taking place.

Randy Abrams of Credit Suisse: Then I wanna to ask on the SiP business, where you are rebalancing projects. Maybe...If you talk about moderate decline, if that would be double digit? I mean, just a rough framework for how to think about a moderate decline in the EMS? And then for full-year, your view for kind of an approximate decline? I mean, just given some projects going, what you might expect full-year, a ballpark range for how that looks? Also for gross margins, if you stay around this level?

Joseph Tung: I think as mentioned this year we're focusing on rebalancing. We'll be very, very selective, in terms of choosing what to do and what not to do. If we're looking at the current portfolio, I think there will be projects that we'll be holding steady. There will be projects that we will strive to improve its overall margin and also return. There will be projects that we may gradually wind down because of the low margin perspective and also there's not that much value add we can provide. And also, there will be projects that we may see second supplier coming in. But at the same time, we will continue to build our pipeline for new devices or new projects with new customers.

So, all in all, I think it will be a challenging year in terms of SiP for us, not because of the overall...Of course, one is the whatever portfolio that we're having now is going through some difficult time, and we're gonna, we have to wait until second half of the year to see how things will shape up. So, at this point, I think it's a bit early to tell that how the overall SiP business for us, particularly from the EMS perspective, will shape up for the whole year.

Right now, I think we're at the very bottom, in the first half. And that's a combination of, first of all, we had an exceptional year last year - first half of last year, combined with the overall softness in particular products.

Randy Abrams of Credit Suisse: And I guess, is there a way to think about moderate? Like the type of decline? Because down 37 in Q1, a rough range for what moderate…

Joseph Tung: It will be single digit.

Randy Abrams of Credit Suisse: Okay, single digit. The last question, I wanna to ask on the Deca, the deal you signed. That gives you fanout packaging. Maybe talk if that's exclusive with Deca, and how it compares to others in the market, like you licensed Infineon before? How it compares to InFO, or the eWLB, and positions you for fanout business?

Joseph Tung: I think the Deca transaction is really one of our continuing efforts to expand our overall technology portfolio, particularly in the fanout area. I think this is one we see as a lower-cost solution addressing a different market segment or customer base from InFO. I think the licensing...It conducts, it's composed of two parts: one is of course technology transfer; and also there will be an equity investment in Deca itself, so that we enjoy whatever upside there is, once the technology is fully developed.

Randy Abrams of Credit Suisse: How does the sales channel work? Like Deca has their own sales team, and ASE would have a sales team?

Joseph Tung: No. After the arrangement, I think most of the mass-production capacity will be set at ASE, and Deca remains as a research center, or R&D center for the technology itself.

Randy Abrams of Credit Suisse: I guess, roughly when would you expect revenue from that…?

Joseph Tung: I don't think there will be meaningful revenue this year because we are in the phase of having the technology transferred over. And there will be a lot of further development for us to get it to the panel fanout. And also it involves capex for set up the capacity. So, I think the overall revenue would only be meaningful maybe next year.

Randy Abrams of Credit Suisse: Thank you.

Kenneth Hsiang: Name and company, please.

Bill Lu of UBS Securities: Hi, Bill Lu, UBS. So, I think Randy asked the same question, but I'm sure that I heard the answer. If you look at the moderate growth in 2Q, what segments are doing well? Is it China smartphones? What are the outperformers?

Joseph Tung: I think it's pretty much across the board, except, maybe we can see further strength - a bit more strength in the industrial and automotive. But communication will continue to be relatively weaker for us, because, largely because of the SiP movement.

Bill Lu of UBS Securities: Can you give us the number of bonders added and testers added this quarter?

Kenneth Hsiang: Bonders added were 68; 7 retired. Testers added, 73; 55 retired.

Bill Lu of UBS Securities: And then just the last question on the pricing adjustment this year. Again, is that pretty much across the board, or is it within a certain vertical?

Joseph Tung: First, I think it's across the board. It's a normal business arrangement that we... Typically last quarter of the year, there will be a round of pricing re-negotiation. But there are some with very little adjustments, some with larger adjustments, depending on the customers.

Bill Lu of UBS Securities: So SPIL cited the competition from China as one of the reasons. Do you see the same thing?

Joseph Tung: Yeah, I think China's competition is always there, and after the acquisition of STATS ChipPAC, I think it allows JCET to be more aggressive, because there will be more technology offerings that they can provide. Yeah, but I think the overall competition is there, and the market unfortunately is softer, so it looks a bit keener last year. But I think things are starting to stabilize as we see the overall market starts to recover.

Bill Lu of UBS Securities: Sorry, one last question. Can you tell us the expectation for capex and for capacity increases in 2Q?

Joseph Tung: I think for the...well I'll be answering that. Capex as a whole for this year will be higher than last year. I think last year we had overall equipment and machinery about close to 600 million dollars. I think this year will be a notch higher. But I don't think it will go over our depreciation, the total depreciation amount.

Bill Lu of UBS Securities: I guess I'm just a little bit curious because that the tone that I hear, is sort of, you know, cautious on the demand, and yet you guys, SPIL, JCET, everyone's adding equipment or bonders. How do you explain that?

Joseph Tung: Well, I think wire bonding, we still have the largest copper wire bonder installed base, and I think SPIL is really the second largest in that space. So I think I should say both of us are gaining shares in terms of wire bonding; therefore there's still some further investments in wire bonders required for the year. Although it's not going to be at the same kind of magnitude as before.

Bill Lu of UBS Securities: Thank you very much.

Kenneth Hsiang: The rate of capex investment is actually still below depreciation and amortization, so it's actually not that significantly high.

Coordinator: To all of the participants over the phone, please press Star followed by the number one, and record your name as prompted if you want to ask a question. Thank you.

Kenneth Hsiang: Name and company, please.

Rick Hsu from Daiwa Securities: Yeah, Rick Hsu from Daiwa Securities. Just want to elaborate a little bit more about Bill Lu's - some housekeeping questions. Regarding your Q1 wire bond testing and also your bumping, can you give us your utilization rates?

Joseph Tung: In terms of Q1, I think...let me put it on...In Q1 in terms of wire bonding, we are about low 70's, and advanced packaging were mid-70's, testing at low 70's, substrate at high 70's. I think, going into second quarter, in terms of packaging, it will all be increased to a high 70's, while testing will also improve from low to mid-70's.

Rick Hsu from Daiwa Securities: Alright, so second quarter will be high 70's for your wire bond and advanced, mid-70's for testing, right? Okay, just to make sure. And one more question. What about your capacity increase for second quarter? Any plans for capacity increase for second quarter across the board?

Joseph Tung: I think we will start to shift some bonders, and I think right now the wire bonding is pretty full. And there will be some investment starting from second quarter, I think, going into bumping and fanout.

Rick Hsu from Daiwa Securities: Okay, thank you, that's all.

Joseph Tung: I think, to put things into perspective, I think the overall distribution of our capex for the year, it will be roughly 60% in packaging, roughly a quarter into test, I think, evenly spreaded out between material and EMS.

Kenneth Hsiang: Any additional questions? We don't have any questions online.

Kenneth Hsiang: Name and company, please.

Sebastian Hou of Credit Agricole Securities (Taiwan): Thank you. Sebastian from CLSA. So my first question is to follow on the first quarter margin. Because I recalled that in the last conference, Joseph, you guided that the margin of IC ATM would be similar to first quarter 2014, so that's around 24%; but then the margin is 22%, so there's a 2 percentage miss. And then on your EMS margin side, you guided to down sequentially, but you’re up sequentially in the end. So can you explain to us, what's the discrepancy here? Thank you.

Joseph Tung: It's the same answer for the...ah...two different...with two different results. On the IC ATM, I think the margin is a bit lower because the overall SiP revenue decline is larger than expected; therefore it created further pressure on the margin for IC ATM itself, so...for the same reason, because most of the...some of the SiP projects, or EMS side is only looking after the logistics part of it, so it's really based on a fee kind of arrangement. And therefore the margin, if you have a look at the fee as a margin, then the margin is lower. So with the lower SiP revenue in EMS, it actually helps the product mix in terms of the margin - in terms of gross margin. For one is lower, the other is higher for the same reason.

Sebastian Hou of Credit Agricole Securities (Taiwan): Okay. Thank you. And going forward, can we have this expectation for your structural margin on the EMS side to be better, to improve? Because in your prepared remarks, that you mentioned that you're going to be more selective on the SiP projects, so supposedly we could expect the margin on that side can improve so that the overall EMS structural margin may likely improve. So, can we assume that?

Joseph Tung: Yeah, that's the game plan. Yes.

Sebastian Hou of Credit Agricole Securities (Taiwan): And my third question is on the...Joseph, can you give us some update guidance on your expectation for the IC ATM business and SiP businesses this year? Because I recall three months ago, I think, the COO mentioned that IC ATM will be flat or slightly up or...and SiP is also flat to slightly up. So what's your expectation now, after three months?

Joseph Tung, CFO of ASE Group: In terms of the overall IC ATM, I think we remain the way we look at the overall business. I think our view remains the same, except the composition may be a little bit different. I think the traditional IC ATM could be a bit stronger than we originally expected for the year; whereas in terms of SiP, as I mentioned, we're really in the mode of rebalancing the whole business. So we're not aggressively trying to increase the volume to take on more projects unless the return or profitability is justifiable. Also, I think one of the factors that we have to look at is really how the end market would be, or the sell-through would be, come the later part of the year, in terms of the SiP products. So I think overall it will be a bit challenging for us to keep the saying, "SiP revenue from EMS perspective as last year". IC ATM, I think, is still...We’re still keeping the same view on it.

Sebastian Hou of Credit Agricole Securities (Taiwan): Okay. So yesterday SPIL, they talked about they expect the overall OSAT business to grow 7 to 8 percent year-on-year this year. That's even higher...higher than overall semiconductor growth, and even higher than the foundries' growth. Foundries were guidance given by TSMC and UMC. And I'm not sure, what do you think?

Joseph Tung: I obviously can't speak for him, but...

Sebastian Hou of Credit Agricole Securities (Taiwan): What is your expectation for this group?

Joseph Tung: Well, as I mentioned, we're keeping the same view as we see before. We're seeing good potential of, first of all, sequential growth on a quarterly basis, and also a moderate growth for the year. Whether 8% is moderate or not, it depends on how you view things.

Sebastian Hou of Credit Agricole Securities (Taiwan): So on the SiP side - sorry I want to dig into more detail - because earlier the guidance was flat to slightly up. So does this still hold?

Joseph Tung: No, as I mentioned, it will be challenging.

Sebastian Hou of Credit Agricole Securities (Taiwan): So it will be more challenging than three months ago?

Joseph Tung: Yes. But there is...I think it's...I think it's still...the reason I said this is because we're seeing first and second quarter of the year seems to be weaker than we originally expected for very obvious reason. But then again, it's even harder to tell how second half is shaping up. It really depends on the sell-through of the next generation products that we're going through.

Sebastian Hou of Credit Agricole Securities (Taiwan): Okay. Sorry, I have another questions on the Deca - your cooperation with Deca. So I noticed that in your official announcement, because you're paying the fixed licensing fee up front, and then there will be a royalty following when you sell the products. So I wonder what's the margin of this look like, because you sell the products, and then you need to pay the royalty to Deca. So would this fanout technologies from Deca, when you sell this, the margin would be higher, or similar, or below your IC ATM average?

Joseph Tung: Of course when we get into this and we look at the technology, we believe that it will generate very reasonable or healthy return for us to get into it. When we are kind of evaluating this, of course we would put the payment of royalty into consideration to decide what kind of margin or return - overall return or margin we should be having.

Sebastian Hou of Credit Agricole Securities (Taiwan): Thank you.

Kenneth Hsiang, Head of IR of ASE Group: Anymore questions? No questions on line? Okay, thank you very much for attending the ASE earnings release.

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