Advanced Semiconductor Engineering, Inc.
3rd Quarter 2016 Earnings Conference & Conference Call
Oct 27, 2016
3:00p.m. Taiwan Time

Kenneth Hsiang, Head of IR of ASE Group:
Hello. I am Ken Hsiang, the Head of Investor Relations for ASE. Welcome to ASE Group's third 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 will be going over the financial results. 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 Mandarin Chinese.

Before we get into the numbers, I would like to give you a quick update on our transaction with SPIL:

1. As of September 19th, our case was accepted as registered with the TFTC.

2. The TFTC indicated they would be holding a hearing on the transaction before its decision on the proposed transaction.

3. As reported in our last earnings release, we have also filed our case with China's anti-trust authority and are awaiting the official registration of our filing.

4. ASE has determined that the proposed transaction does not trigger a U.S. HSR filing, but notes that even without such HSR filing, the US FTC retains the ability to review such transaction. The US FTC is investigating the said transaction and ASE is fully cooperating.

5. We have also completed our purchase price allocation assessment as required by IFRS in which the purchase price is allocated into the various assets and liabilities acquired. The allocation effectively results in an asset revaluation which will incur a non-cash expense of $281 million for 4Q, 2015 & 1Q, 2016, and $351 million for 2Q, 2016, and each quarter thereafter. During this time, such amount will be netted against SPIL's earnings reported in our non-operating section.

From the business perspective, during the third quarter, we saw strong performances from all of our business units. For our IC-ATM business unit, our factories were well loaded with bumping and certain wirebond packaging lines near or at capacity. The IC-ATM business strength was driven primarily by smartphone-related products and a seasonal ramp in our SiP-related business. For IC-ATM, the third quarter generally represents the seasonal peak, as Android-related devices start ramping down and as other devices go through their product launch cycles.

We continue to make progress with our SiP rebalancing efforts. We are beginning to see some of the impact as we are seeing improved financial results within our wearable S.I.P product. We will continue to shape our SiP margin profile. We will also continue to focus on SiP in which we have a technological advantage.

For our EMS business unit, our sales came in slightly behind where we were expecting. Certain product order flow did not materialize to the extent expected. However, that didn't have a negative impact on our results with the EMS business unit delivering healthy gross and net profits. During the quarter, our EMS unit had more favorable product mix along with an improved margin profile relative to our SiP product. With such, we were able to improve our gross margin and gross profit for the quarter.

Page 2, group quarter-over-quarter consolidated P&L. On a fully consolidated basis, the third quarter, the company delivered fully diluted EPS of $0.64 and basic EPS of $0.72. Our packaging and testing businesses were both up 11%. Our direct materials business was up 6%. Our EMS business grew 25%.

We booked other revenues of $0.1 billion related to real estate sales versus—sorry, $0.3 billion in the second quarter. Total revenues for the Consolidated Group increased to $72.8 billion. Gross profit increased 15% from $12.3 billion to $14.1 billion.

Consolidated gross margins dipped 0.2 percentage points from 19.6% to 19.4% as a result of increased EMS product mix. Operating expenses edged up by $0.4 billion.

Our operating expenses, as a percentage of sales, decreased to 9.2%. Operating profit for the third quarter was $7.4 billion, up $1.5 billion from $5.9 billion in Q2. Operating margins increased 0.7 percentage points from 9.5% to 10.2%.

During the third quarter, we had a net non-operating loss of $0.6 billion as versus a net non-operating gain of $0.2 billion the previous quarter. The current quarter's non-operating loss includes the following: ECB loss of $0.3 billion, net foreign exchange loss of $0.1 billion, our estimation of SPIL's contribution for the current quarter of $472 million. This amount consists of our percentage ownership of SPIL's earnings less incremental depreciation and amortization recognized as the result of revaluing SPIL's assets due to the purchase price allocation mentioned previously. Net interest expense of $0.5 billion, and the remainder is related to asset disposition gains and losses and other non-operating costs.

Pretax profit for Q3 was $6.9 billion, up 12% from $6.1 billion in Q2. Income tax expense for Q3 was $1.0 billion down from $1.5 billion in Q2. The effective tax rate normalized as the tax on undistributed earnings was recognized in Q2. Net income for Q3 was $5.5 billion, up $1.2 billion from $4.3 billion in Q2. Net margin improved to 7.6% from 6.9% in Q2.

Page 3, group quarterly results on a year-over-year basis. Comparing the current quarter's results versus the same quarter last year, our packaging and test businesses grew 13% and direct materials grew 6% while EMS declined by 14%. On a year-over-year basis, our consolidated net revenues were effectively flat. With our product mix being more heavily weighted towards IC-ATM, our gross profits were up 9% with gross profit margins improving 1.6 percentage points from the previous year.

Operating profits were up 17%, with operating margins improving 1.4 percentage points from 8.8% to 10.2%. Total non-operating gain last year of $1.4 billion versus a $0.6 billion loss this year. The variance is almost entirely attributable to an unusually large non-operational gain in the third quarter of last year related to our ECB and foreign exchange. And as a result, net profits from a year-over-year perspective were down 14%.

Page 4, IC-ATM P&L. Please note the intercompany 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 improved by $4.5 billion, or 12%, during the third quarter to $43.0 billion. Revenues for our IC packaging, testing and direct materials businesses increased 12%, 11% and 15%, respectively. NTD appreciation had a 1.25% unfavorable impact on revenue with average exchange rate of 32.402/USD to 31.781/USD. Gross profit was up 15%, or $1.4 billion, to $11.0 billion.

We had some unexpected items that impacted our gross margin for the quarter as follows: 1) typhoons hit Taiwan causing increased labor costs and overall factory efficiency disruptions and 2) both NTD and gold price were stronger than anticipated. We estimate these items impacted our IC-ATM gross margin by at least 0.9 percentage points.

Even with such impacts, gross margin improved 0.7 percentage points. The gross margin improvement was the result of relatively lower D&A plus rental and labor (to a smaller extent), offset by relatively higher raw materials expenses.

Raw materials were $10.0 billion in Q3, up $1.6 billion, and was 23.3% of total net revenues, up 1.3 percentage points compared to last quarter. Labor cost was $8.0 billion in Q3, up $0.6 billion, and was 18.7% of net revenues, down 0.7 percentage points compared to last quarter. D&A plus rental was $6.5 billion in Q3, up $0.1 billion, and was 15.2% of total net revenues, down 1.4 percentage points compared to last quarter. Factory supplies were $4.2 billion in Q3, up $0.4 billion, and was 9.7% of total net revenues, down 0.1 percentage points compared to last year.

Utilities were NT$1.5 billion in Q3, up $0.2 billion, and was 3.6% of total net revenues, up 0.2 percentage points. NTD appreciation had a 0.6 percentage point unfavorable impact to gross margins. Gold price movement during the quarter had a 0.13 percentage point unfavorable impact to IC-ATM gross margins.

Operating expenses increased from $4.6 billion to $4.8 billion while operating expense percentage declined 0.9 percentage point to 11.1% from 12.0%. Operating margin for the third quarter was up to 1.5 percentage points to 14.4% from 12.9% in Q2. Operating profit was up 25%, or $1.2 billion, to $6.2 billion.

Page 5, IC-ATM year-over-year. Here you can see our year-over-year comparison for our IC-ATM business. Our packaging and testing businesses were up 7% and 13%, respectively. Our direct materials business was down 1%. During the current year's quarter, raw materials and factory supplies increased as a percentage of COGS while D&A + rental and utility decreased.

Gross profit was up 3% while gross margin was down 1.2 percentage points. Gross profit margin decline from a year-over-year perspective was principally the result of NTD appreciation and typhoon issues discussed earlier along with product mix with this year having higher module and flip chip content. Operating income is up 10% from $5.6 billion to $6.2 billion.

Page 6, our packaging operations. In Q3, our packaging revenue increased 12% sequentially and 7% year-over-year to $34.8 billion. Our packaging gross margin of 22.2% increased 0.7 percentage points sequentially and down 2.6 percentage points year-over-year. The sequential margin improvement was primarily caused by higher loading as compared to the second quarter. This resulted in higher revenues in a semi-fixed cost structure. This impact was offset by relatively higher raw material costs as a result of product mix and higher costs due to typhoon holidays and NTD appreciation.

Raw materials were $10.7 billion, up $1.5 billion, and as a percentage of sales, was 30.8%, up 1.0 percentage point of sales. Labor was $6.2 billion, up $0.5 billion, and as a percentage of sales, was 17.9%, down 0.7 percentage points of sales. D&A and rental expenses were $4.5 billion, up $0.04 billion, and as a percentage of sales, was 12.9%, down 1.3 percentage points of sales.

Factory supplies were $3.3 billion, up $0.4 billion, and as a percentage of sales, was 9.6%, up 0.2 percentage points of sales. Utility was $1.1 billion, up $0.2 billion, and as a percentage of sales, was 3.1%, up 0.2 percentage points of sales.

During the quarter, capital expenditures were US$112 million, composed of: wafer bump, fanout and copper pillar equipment at US$64 million, common & SiP equipment at US$47 million, and wirebond related equipment at US$1 million.

During the quarter, we added 10 and retired 25 wirebonders. We exited the quarter with a total of 15,905 wirebonders in operation. 8-inch bumping capacity remained unchanged at 95,000 wafers per month, and 12-inch bumping capacity including fanout and copper pillar increased 11,000 wafers to 111,000 wafers per month.

Page 7, testing operations. Test revenues of $7.2 billion were up 11% sequentially and 12.5% year-over-year. Test gross profit margin of 38.9% was up 2.1 percentage points sequentially and 2.8 percentage points year-over-year.

The changes in gross margin were principally the result of higher seasonal loading in a semi-fixed cost environment. Overall, cost of services for test increased $0.3 billion to $4.4 billion. Our testing utilization rate improved to around 80%.

CAPEX for the test business was US$57 million in Q3. We added 126 and retired 30 testers during the quarter. At the end of Q3, our total tester count stood at 3,725 testers.

Page 8, materials. Revenues for our materials business of $2.3 billion were sequentially down 5.4% and up 20% year-over-year. During the quarter, $805 million was from sales to external customers, up 6% as compared to Q2. Our internal self-sufficiency rate decreased to 27% from 37% by value. Gross margins were sequentially down 4 percentage points to 14.8%.

Page 9, IC-ATM market segment. During the third quarter, the market segment share stayed relatively unchanged, representing all market segments performed relatively similarly. Our communications market segment share increased from 52% to 53%. Our computing market segment remained flat at 12%. And our automotive, consumer and others declined to 35%.

Page 10, EMS business unit. During the third quarter, revenues for our EMS business unit were sequentially up 25% to $31.2 billion from $24.9 billion. Revenues, year-over-year, were down 14% as compared to $36.2 billion in Q3 of 2015, primarily as a result of lower SiP revenue during the current quarter.

Gross margins decreased sequentially 0.3 percentage point to 10%. Margins were stronger than anticipated primarily as a result of product mix and rebalanced SiP related business. EMS gross profit increased to $3.1 billion. CAPEX for our EMS business unit was $10 million USD during the third quarter.

Page 11, EMS business segment mix. During the third quarter, our communications and consumer product segments increased their segment share 5 and 2 percentage points respectively, while our computing, industrial and automotive EMS segments decreased segment share 4, 1 and 2 percentage points respectively. These moves are largely in line with our SiP product cycle seasonality.

Page 12, balance sheet. At the end of the quarter, we had cash, cash equivalents and current financial assets of $39.6 billion, decreasing from $40.5 billion the previous quarter. We also had our interest-bearing debt increase from $110.4 billion in Q2 to $119.9 billion in Q3. Our investment in SPIL of $45.6 billion is recorded in investments - equity method. As of September 30th, 2016, total unused credit lines amounted to $169.5 billion. EBITDA improved to $14.7 billion from $14.0 billion during the current quarter.

Page 13, CAPEX. Capital expenditures for the third quarter totaled $184 million USD, of which $112 million USD was used for packaging, $57 million USD for testing, $10 million USD for EMS, and $5 million USD for interconnect materials. EBITDA on an USD basis was $463 million USD for the third quarter.

For the industry and us, smartphones continue to be the product that is driving overall unit volume. The mass adoption of smartphones has brought about new industries for servicing such devices such as music streaming and payment processing services.

However, if we look a little bit beyond the horizon, we are excited as even more and smarter electronics blend into the home and automobile. We are also excited by the sheer amount of data that will be involved. Data will be generated, transferred and processed once, and then multiple times over. This means bigger, better and more powerful hardware. This means chips and subsystems connected in different ways as with our SiP offering, and it means the need for higher densities of I/O’s necessitating more bumping, Cu Pillar and fanout processes. The future continues to look bright for ASE.

For the near term, we continue into the fourth quarter with capacity tight in certain product lines, which is typical for this time of year. The overall environment still looks reasonably healthy. We are carefully monitoring for signs of overbuild and double-booking and, at this point, nothing gives us any specific concern. We believe that the coming quarter should follow in a seasonal pattern for both our IC-ATM & EMS business units.

Our IC-ATM capacity should stay flat. Our IC-ATM blended utilization rate should stay flat to declining 5%. Our IC-ATM gross margin should be similar with the prior quarter. Our EMS capacity should stay flat. Our EMS blended utilization should improve by 10-15%. Our EMS gross margin should be consistent with our gross margin during the first half of 2016.

Time for Q & A. Any questions? No questions? Randy? Name and company, please.

Randy Abrams of Credit Suisse: Okay, yes, I'm Randy Abrams from Credit Suisse. First question, on the CAPEX. Year-to-date...it's about $550 million. Just want to see your full-year CAPEX now. It looks like it's tracking a little bit below depreciation, but just want to get a sense on fourth quarter, and if you can give an initial view on 2017's priorities.

Joseph Tung: I think the overall CAPEX for the year remains the same as we earlier reported. I think it will still be between the total D&A and our CAPEX last year. As far as fourth quarter is concerned, I think it would be much a notch lower than $184 million we spent in quarter three. For next year, we are still in the reviewing stage, and after we have come up with the annual plan for next year, we'll have a better picture on what kind of CAPEX budget we're gonna make.

Randy Abrams of Credit Suisse: Okay. I want to ask a question on material business. The internal self-sufficiency rate declines from 37% to 27%, and the gross margin by a few points. If you could talk about the trends in that business, anything going on to drive those changes?

Joseph Tung: Well, I think what happened in Q3 was a bit unique because in the period we experienced a bit of a hiccup on our yield. That is already resolved, and I think we are back on track. I think the normalized self-supply rate should be around 33% and above.

Randy Abrams of Credit Suisse: Okay. And the last question is just on the gross margin guidance. The EMS margin seems like held up again, at about 10%. Were there more of these engineering project fees in there to keep the margin holding up? Like I think in second quarter, at 10%, there was engineering to drive the better margin? But just which of the better EMS margin?

Joseph Tung: I think by and large, the better-than-expected margin at the EMS is really due to product-mix change, but there is some engineering fees that we collected in the quarter. But I think aside from product-mix change, I think another very important factor is really, as we see results from our rebalancing the SiP business at EMS level.

Randy Abrams of Credit Suisse: A follow-up to that. Could you give a view then...the SiP business. How it's looking now for projects? If you see any new ones, just whether your core customer or diversification in traditional customers? How that's playing out now?

Joseph Tung: Well, for the existing four projects, the used-to-be existing four projects we had, we are maintaining two of them, discontinue one, and another one, we just kind of exit it because we don't feel we have that much value adding to it. But we did add one more project, and that will start mass-production, starting from quarter three.

Going forward, I think the rebalancing effort is continuing. We are positive on the increasing trend of modularization, so we believe that there is going to lead to quite a bit of SiP opportunities going forward, and we do have multiple engagement with multiple customers at this point in different phases. But I think right now the focus will still be on...we want to stay selective in choosing these projects. We want to focus on the one that has healthy financial profile, as well as we do have a technology advantage on them.

Randy Abrams of Credit Suisse: One follow-up for the two that you are maintaining. Do you have confidence or your expectation to continue those through the next generation? Like are those the types you want to keep with here when you said rebalance continue? There could be changes with the first two?

Joseph Tung: I think we will continue to stay very, very closely engaged with the new products coming in. But like I said, unless the product is financially justifiable, and also we do have the technology advantage in it. We want to be cautious in putting additional investment to it.

Randy Abrams of Credit Suisse: Thank you.

Kenneth Hsiang: I want to go with the...name and company please, sir.

Bill Lu of UBS Securities: Yeah, thanks. Bill Lu from UBS. Could I start with a clarification? Ken talked about the purchase price allocation. Was it 281 (million$) for 4Q and 1Q of next year? Is that what you said?

Kenneth Hsiang: 4Q and 1Q. 4Q last year, 1Q this year.

Bill Lu of UBS Securities: And then 351 (million$) for the subsequent quarters?

Kenneth Hsiang: Correct.

Bill Lu of UBS Securities: How long does that last?

Kenneth Hsiang: That number will probably last until the combination is completed.

Joseph Tung: Well, let me elaborate a little bit. I think 281 (million$) is because at that point we hold 25% of SPIL, and the number increases to 351(million$) because we raise our ownership to 33(%) and above. That number should maintain as we continue to hold 33%, but upon closing up the deal when we will be holding 100% of the company, then there will be a reevaluation. We will re-do the PPA, and the final results will depend on the then SPIL's financial condition.

Bill Lu of UBS Securities: Okay, understand. We’re now a few months into…the two sides’ going to this deal. I think I asked this last quarter as well, but in last several months, as you’ve talked to the customers, can you let us know what the feedback you’re getting as far as you know people looking at your combined market share? Do you think pricing environment has got a little bit better because of this potential move? What are the feedback you’re getting from customers?

Joseph Tung: I don't think the pricing has anything to do with this transaction itself. With or without the transaction, customers have options and there's plenty of alternative capacity around. So you know everybody's still on the same page and competing not just on pricing but also on technology, quality and so on so forth. So I don't think that in terms of customers' reactions to it, I think there's a…you know…we get mix of different customers. And some of them are very, very supportive to us; some of them may have some hesitations. But all in all, I think you know the endgame is that we will continue to have a healthy dose of competition among the two companies although there will be collaborations on resources, and therefore improving our overall efficiency, which is to the benefit of our customers eventually.

Bill Lu of UBS Securities: Great. Um…on the SiP business, going to next year, there's some talks of you know leading handset makers going to substrate like PCB, which I understand is kind of a modularization of the HDI board. Do you consider that to be an opportunity for SiP? And if so, what is your advantage over the other competitors?

Kenneth Hsiang: Actually yes, when the substrate gets more complicated like that, I believe that actually is a trend towards SiP. Right? It gives system houses more of a capability to put multiple devices together. And substrate is just one of the tools—so to say—in part of the "SiP-ization" of electronics.

Joseph Tung: Well I think that's the…uh…that's the very reason why we have this TDK venture with the…which we want to develop what we call the embedded substrate, which is gonna be an essential part of the overall SiP effort.

Bill Lu of UBS Securities: Yeah, that was my follow-up question. You know, to capture that business, you have all the necessary pieces now in terms of the…you know the substrate, the EMS—what else do you need?

Joseph Tung: What else do we need? I think the whole technology is evolving, right? We just need to keep up with the technology development and really have a very, very close engagement with potential customers. We need to put the technology roadmap in sync with them. We also need to have a better feel of what the going trend is. You know the SiP—the whole SiP business is a new effort actually. So we're still on the learning curve, and some of the projects we did pay some prices on that. So, I think one of the effort that we need to continue is really to find the right business model for it. And that's part, that's what the rebalancing…what we call the rebalancing of SiP business is all about.

Bill Lu of UBS Securities: One last question. On the wearable SiP, you said that margin has improved from last year, but I think that's pretty low bar. Is it close to the division average now? Or can you just give me a sense of where it is?

Joseph Tung: Well I can't give a direct comment on that. I'm saying, what we're saying is uh through different efforts, including the change of business terms, our capacity, so on and so forth, I think we're seeing very, very positive results from the effort. That's really shown in the overall EMS margin in third quarter.

Bill Lu of UBS Securities: Thank you.

Kenneth Hsiang: Uh, Rick over there? Name and company, sir?

Rick Hsu from Daiwa Securities: Yeah, hi, this is Rick Hsu from Daiwa Securities. I got a few questions here. Again the housekeeping question. Regarding your bumping capacity, I think Ken talked about the number. I missed that part. Can you remind me? The bumping capacity for Q3.

Joseph Tung: At end of fourth quarter last year. We have 12-inch bump of 82,500 pieces.

Kenneth Hsiang: So our 8-inc…

Joseph Tung: It has now grown to 111. I think by end of the year, it will grow to 116. 12-inch. 8-inch—I think we remain the same.

Kenneth Hsiang: 8-inch is at 95,000.

Rick Hsu from Daiwa Securities: 95…as of Q3, right?

Kenneth Hsiang: Correct. For 8-inch. 12-inch is 111,000.

Rick Hsu from Daiwa Securities: And 8-inch will be the same toward the end of this year. Am I right?

Kenneth Hsiang: One more time?

Rick Hsu from Daiwa Securities: 8-inch will remain the same toward the end of this year?

Kenneth Hsiang: Yeah, I don't believe we have plans to increase 8-inch throughout this time.

Rick Hsu from Daiwa Securities: Okay, cool. What about the UT—utilization rates—for Q3 across the board of the uh…

Joseph Tung: Q3 packaging is around 85, which is pretty much at capacity. And for test, we're about 80. I think going to Q4, it will be a little bit lower as we guided.

Rick Hsu from Daiwa Securities: Okay. So that leads to my third question. If I recall the guidance from TSMC and UMC, I think roughly across the board but the foundries who have already reported about flat-ish Q4. How come there's a gap between your IC-ATM guidance and front-end foundries?

Joseph Tung: Well, they're not the only business source that we have. So we have a very diversified customer base. And each has very different situation or condition. But all in all I think we're just experiencing a normal seasonality. In our business we typically peak at third quarter. I will say, from what we're seeing for fourth quarter is actually a quite healthy fourth quarter for us.

Rick Hsu from Daiwa Securities: One last question. Can you give us some more color about your, sort of like, InFO development?

Joseph Tung: I think the overall fanout—I think that's what you're referring to, right?

Rick Hsu from Daiwa Securities: Yeah.

Joseph Tung: I think our strategy is still to focus on what we call mass-market type of solutions and lower cost solutions. So from that I think right now we do have some capacity and some mass production on fanout, but not yet at a meaningful level. But going into next year, the investment…both investment and revenue growth will be very, very substantial. I think we do see quite a bit of a…quite good an opportunity in that area. I think the difference between us and TSMC or InFO is like what I just said our focuses is really on multiple customers and mass market with lower cost solutions, which include maybe today the 12-inch bumping capacity that we're installing and increasing. And also going forward, there will be the DECA effort will also start to play out. That will be a panel-based solution, which is…we believe it will give a much better cost structure to our customers as well.

Rick Hsu from Daiwa Securities: Okay, thank you so much.

Joseph Tung: Thank you.

Kenneth Hsiang: Our next question comes from Steven Pelayo, who's online.

Steven C Pelayo of HSBC: Yeah, hi. I guess I get three primary long-term questions from investors on ASE. The threats: people are nervous about the China threat, nervous about the turnkey threat from the foundries consuming more, keeping more packaging internally, and they're nervous about the combination in kind of second-sourcing risk - in fact, I think Amkor's suggested that they've been gaining share on the second sourcing. So I wonder if you could talk a little bit about each one of those potential headwinds and —I don't know—hold our hands a bit here to suggest this is actually something we should be worried about.

Joseph Tung: I think the uh first of all the China threat…I think you know China threat is no difference from any other threats. You know this is a competitive industry and we are in it. And so far I think we've done pretty good in competing with all the major competitors in the industry. I think the name of the game going forward is really economy of scale, the technology investment that we will continue to make. And I think also one particular strength or competitiveness that we have is really our footprint in the SiP business. I think although we are in the rebalancing phase, but we're still very, very confident and positive about the going trend in the SiP business and we do have, you know, the unique and also the most advanced foundation for…to capture that business opportunity.

China—they have been aggressive. Funding is certainly not a problem for them. But I think, you know, we have 30 years, 30-some years of experience behind us, and the technology or the work experience, and so on and so forth, the overall management know-how, we still have the leading position. We'll continue to leverage on that to expand our competitiveness going forward. In terms of foundries going into backend, I think what TSMC is doing—or I shouldn't even say the name—but what the foundry is doing is really to offer a total solution as we go down the node of their wafer.

All the chips that are made need to be packaged and tested, and if the most advanced technology in terms of packaging is toward more wafer level-type of processes, I think it's only natural for the foundries to take the lead on it. So once the technology is well-defined and matured, I think same thing happens like the wafer probe or bumping, I think there's eventually gonna be eventual natural division of works among the OSATs and the foundries. So I don't think we are in such a pure competition mode with the foundries. It's more like a collaboration among the two.

I'm not sure I understand your third question about second sourcing?

Steven C. Pelayo of HSBC: There're some concerns or fears that the combination of ASE and SPIL creates an even large player out there and kicks out maybe somebody second-source, so they have to go looking elsewhere.

Joseph Tung: Well, I think with or without the transaction, or with or without the combination, I think the competition is always there. As I said, the customer always has options to go somewhere else and there's always plenty of capacity to go about. Besides, the two of us put together, well, it's not gonna be...size-wise, we're not gonna be a monster. So, I don't think that's gonna change the competition landscape that much. So, you know, we'll just continue to do whatever we do. We'll continue to stay competitive. And in the short run, some of the customers may have some concerns that they want to diversify a bit more, but you know eventually the real swing factor is really how well a job you can do for your customers, cost-wise, quality-wise, technology-wise, and that's something we'll be focusing on. Eventually, as long as we can create value to our customers, I don't think that would be that big of a concern going forward.

Kenneth Hsiang: I have a little to add….

Steven C. Pelayo of HSBC: I just want to follow up...(Kenneth Hsiang: Hey, Steven?) if I could. On China, could you help me understand what percentage of revenue it is for you today, maybe more importantly, specifically to Chinese fabless and system house —what percentage of revenue is that for ASE today?

Joseph Tung: Right now, I think our business from Chinese customers is about 4% of our overall IC-ATM business. In terms of production, our China site has about 15% of our overall.

Kenneth Hsiang: Hey, Steven, just to follow up on your previous question...

Steven C. Pelayo of HSBC: You think...the 4% number. Can that double? Or, what do you think it can do?

Kenneth Hsiang: Steven, hello? Are you there? I wanted to...

Steven C. Pelayo of HSBC: Yes, I was asking...

Kenneth Hsiang: Ya, I wanted to reply to one of your previous questions. We are actually capacity-constrained at this time, so that could be a rationale for the comment that you're getting from a competitor of ours.

Steven C. Pelayo of HSBC: Their point**...**I drop off guys...they cut me off.

Kenneth Hsiang: No, go. You're still on. We can hear you.

Steven C. Pelayo of HSBC: Oh. Ha ha. Sorry. Had a follow-up there. Had China, China —4% of IC-ATM, your thoughts for from today to second half of next year. Do you think this could grow significantly to maybe approach 10% of your revenues?

Kenneth Hsiang: Um...

Joseph Tung: I don't wanna comment on it.

Steven C. Pelayo of HSBC: (Chuckle) Okay, fair enough. Thanks, guys.

Kenneth Hsiang: Thank you. Do we have any more questions in the room?

Sebastian Hou from Credit Agricole Securities: Thank you. Sebastian Hou from CLSA. First question is, Joseph, you mentioned about your EMS, or Ken, you mentioned about your EMS business didn't perform as you expected because some products didn't materialize as you earlier expected. So, can you give us some more colors on what happened exactly? And what type of the products or applications was that?

Joseph Tung: I think what we said is our third-quarter EMS revenue came a little bit short from expected. The main reason for that is one particular or certain products. The order volume was less than expected.

Sebastian Hou from Credit Agricole Securities: Okay. So, that is also the reason leading to your better-than-expected gross margin in the EMS segment?

Joseph Tung: Partially yes.

Sebastian Hou from Credit Agricole Securities: Okay.

Joseph Tung: More so on the existing...Aside from the SiP business, the so-called higher-margin product mix is getting higher.

Sebastian Hou from Credit Agricole Securities: So is that product SiP-related?

Joseph: No. I guess, outside of SiP.

Sebastian Hou from Credit Agricole Securities: Oh, okay. And, do you expect that— because you said that it's came shorter than expected in 3Q—Is that because of the production timing impacts, or just because of the total lump-sum volume of the order is smaller? So, do you expect that to pick up in 4Q, or no, it's just that the total order is smaller?

Joseph Tung: I can only say for Q3, yes, the order volume is less than expected. I'm not gonna speculate on quarter four.

Sebastian Hou from Credit Agricole Securities: Okay. Can you give us more ideas or colors about your SiP business outlook for next year? Earlier you mentioned about you dropped one project because the profit doesn't make sense. But you added a new project. How do you see this new project will materialize in next year, in terms of how that will progress and progress in the next generation of phone, or etc.?

Joseph Tung: I'm leaving this to Ken.

Kenneth Hsiang: Can you repeat your question?

Sebastian Hou from Credit Agricole Securities: I mean, in terms of your SiP outlook for next year, you're adding one project, as you mentioned for this year. So, can you give us more colors on how this project will go into next year?

Kenneth Hsiang: This project?

Sebastian Hou from Credit Agricole Securities: Yes.

Kenneth Hsiang: I don't think we're gonna comment on specific projects at this time, especially in this context here.

Joseph Tung: I think so far this particular project is, meets our criteria, so I think it's gonna be maintained.

Sebastian Hou from Credit Agricole Securities: How about the other ongoing projects that haven't really contributed to your revenue right now? Do you see more of the SiP products or projects that will contribute to your revenue next year in total?

Joseph Tung: I think the effort is continuing in terms of engaging with multiple customers and multiple devices. Really we need to see how things go. Right now, I don't think we can make a prediction on that. I think the effort will continue.

Sebastian Hou from Credit Agricole Securities: Okay, but not much visibility? Can I say that?

Joseph Tung: Like I said, we have multiple customers, multiple projects in different phases. Some are near mass production; some are still at the design stage. But, having said that, it really depends on how the market will go to see how that business will grow to be like.

Sebastian Hou from Credit Agricole Securities: Thank you.

Kenneth Hsiang: Any additional questions? No questions on line also? Thank you very much for coming to the third quarter. See you next quarter.

Joseph Tung: Thank you.

<End of Conference>