Conference Call Prepared Remarks
Fourth Fiscal Quarter Results

Bret DiMarco – EVP, Chief Legal Officer and Corporate Secretary

Thank you and good afternoon everyone. Welcome to today's conference call to discuss Coherent's results from its fourth fiscal quarter and fiscal year ended October 3, 2020. All of us here at Coherent hope that you and your family are staying healthy and safe during these challenging times.

On the call with me are Andy Mattes, our President and Chief Executive Officer and Kevin Palatnik, our Executive Vice President and Chief Financial Officer.

I would like to remind everyone that some information provided during this call may include forward-looking statements, including, without limitation, statements about Coherent's future events, anticipated financial results, business trends, global economic trends and the expected timing and benefits, if any, of such trends. These forward-looking statements may contain such words as "project," "outlook," "future," "expects," "will," "anticipates," "believes," "intends" or referred to as "guidance." These forward-looking statements reflect beliefs, estimates, and predictions as of today, and Coherent expressly assumes no obligation to update any such forward looking statements.

These forward-looking statements are only predictions and are subject to substantial risks. Factors that could cause or contribute to such differences include, but are not limited to: risks associated with the recovery of global and regional economies from the negative effects of Covid-19 and related private and public sector measures, global demand, acceptance and adoption of our products, including but not limited to adoption of OLED displays, the demand for and use of our products in commercial applications, continued timely availability of products and materials from our suppliers, our ability to timely ship our products and our customers' ability to accept such shipments, worldwide government economic policies, including trade relations between the United States and China, and other risks identified in the Company's SEC filings.

For a detailed description of risks and uncertainties which could impact these forward-looking statements, you should review Coherent's periodic SEC filings including its most recent Form 10-K, Form 10-Q and Forms 8-K, including the risks identified in today's financial press release.

I will now turn the call over to Andy Mattes, our President and Chief Executive Officer.

Andy Mattes – President and Chief Executive Officer

Thank you, Bret, and thank you to everyone for joining our earnings call today.

While fiscal Q4 was still overshadowed by the impacts of COVID 19, I am happy to report that on just about every metric our performance exceeded the fiscal low of Q3. But before I discuss our results and market trends in more detail, I want to take a moment to acknowledge the tireless efforts and dedication of all our teams around the globe who are actively embracing the "new normal" of either getting business done remotely or working in our labs and manufacturing sites by adhering to our strict "stay safe and healthy" rules. It is exciting to see that innovation and our "customer-centric focus" continue to flourish even in these unusual circumstances.

Looking at our top line, we improved bookings and revenues sequentially from last quarter's low. And even though full FY 2020 top line was lower than the previous fiscal year, we finished the fiscal year with a positive book to bill ratio and an improved backlog position that increased approximately 10% year over year.

To add a little color, three of our four end markets saw solid double-digit percentage increases in bookings over the prior quarter. As anticipated, our OEM Components and Instrumentation as well as our Scientific businesses saw the fastest recovery, as research labs and non-COVID related hospital utilization drove a sequential increase in clinical testing and laser-related medical procedures.

Micro-Electronics

As you know, this market is made up of three sub-markets: Flat Panel Display, Semi and Advanced Packaging & Interconnect.

Our FPD business is primarily driven by mobile demand, and although worldwide sales of new handsets remains depressed relative to pre-COVID levels, we saw a clear upturn in factory utilization of our ELA installed base from the prior quarter, as consumer spending recovered and several SmartPhone manufacturers ramped production on new 5G enabled models. We were especially excited to see the entire new iPhone12 line up from Apple adopt flexible OLED displays, which together with the new foldable models from Samsung, LG and several Chinese manufacturers, should continue the trend towards flexible OLED becoming the technology of choice. We continue to be cautiously optimistic that we are at the front end of a multi-year 5G driven SmartPhone upgrade cycle, which together with announcements of more than 20 laptops having OLED screen options, including the new Lenovo ThinkPad X1 Fold, and the recently introduced Samsung Galaxy Tab S7+ tablets, all bodes well for further utilization of our ELA installed base, which drives a healthy service business.

Published reports have noted that one or more display makers other than the historical incumbent may now be supplying flexible OLED displays into Apple, even if only in limited volumes for replacement screens. Similarly, other published reports have noted that several Chinese OLED manufacturers have reached a yield inflection point where they are actively allocating production capacity for larger screens for “IT” devices (such as tablets, laptops and monitors). We believe that these changes in the competitive landscape will help drive OLED price points lower in all mobile screen formats, and reduce the premium over LCD, which is the stimulus required to drive the next round of new capacity and Fab investments. In that regard, I am also happy to report that since our last call we have several new orders from multiple customers in China.

In Q4 we also saw a significant increase in the level of investment and bookings related to MicroLED displays, where we enjoy an industry leading position. This is reflected by sales and active engagement with more than 25 customers, all working on process development as a precursor to a mass production solution. Our MicroLED customer base includes almost all current OLED & LCD manufacturers, as well as many well-known MicroLED specific start-ups and display industry integrators. We are uniquely positioned with multiple UV solutions for four separate MicroLED processes – ELA for high performance / low power consumption backplanes, Laser Lift Off for customers using sapphire carriers, Laser Transfer and Laser Repair.

The appeal of MicroLED is reduced electrical consumption for improved battery life and higher absolute brightness relative to OLED. We are continuing to accelerate our efforts and investments in UV MicroLED solutions to help our customers develop the laser processes of record, so we can, in turn, develop the laser-based capital equipment systems needed for mass production. We will further discuss our new process development product offerings with you later in fiscal 21. We see a co-existence of the two technologies in the years to come, with flexible OLED remaining the dominant choice for mobile in the long term, and MicroLED becoming the new entrant in high end TV, where brightness is a key advantage, and devices where battery size is at a premium, such as watches, or future smart glasses. We believe we are well positioned to remain the laser solutions display industry leader for all display technologies.

Moving onto the semiconductor market – consistent with widely reported industry news, we are seeing sustained strength and increasing demand both for new systems for semiconductor inspection, as well as for service demand from our installed base. The outlook for Q1 is up and in general fiscal 21 looks positive. To that end, we recently had a significant design win, at an industry leader, displacing a legacy competitor.

In API (Advanced Packaging & Interconnect) we see 5G driving increased demand in smaller geometries, better power management and next generation HDI PCBs, which is playing to our strength in our CO2 laser "via hole drilling" business. As a result of the continuous drive in SEMI innovations, including miniaturization and energy efficiency, lasers are gaining share from traditional mechanical drilling solutions. We are well positioned with China's leading HDI laser drilling equipment supplier, who appears to be taking share from the historical industry leader. We have taken more CO2 laser orders in the first four weeks of this quarter than all of Q4, and appear to be at the front end of a 5G driven multi-quarter expansion, across the entire API space, similar with that seen in FPD and Semi.

Materials Processing

Consistent with the September Manufacturing PMI, which indicated an expansion in the index across all major economies, materials processing orders in Q4 increased double digit percentages vs Q3. A few highlights: we saw improvements in medical device manufacturing orders for marking, cutting and welding applications as well as orders driven by the return of elective surgeries. Our machine tool, or systems orders, also improved sequentially primarily due to micro-machining and general marking and engraving applications.

The main priority for our Material Processing business is to continue the turn-around in profitability which we began last fiscal year with our withdrawal from the commodity KW fiber laser market.

Going forward, we will focus on Precision Manufacturing, a subset of the Materials Processing market, where we participate well both in terms of market share and margins on all three levels of components, lasers and systems. We will be focusing our R&D and our manufacturing capabilities towards new products that will serve higher margin, defendable markets. Examples in our Systems business include medical device manufacturing, semiconductor wafer marking and precision welding. Later this fiscal year, in the components space, we will be launching a whole new category of laser diode products that will allow us to address completely new applications and customers, dramatically increasing the size of our servable market – we will give you more color on a future call.

OEM Components & Instrumentation

This recovery in the medical area also extends to large parts of our OEM Components & Instrumentation business, where orders increased double digit percentages from Q3. The principal driver was a rebound in flow cytometry. Demand, as reported by several of the flow cytometry industry leaders is back up to some 90% of pre-Covid levels, although still constrained due to reduced hospital utilization, lab testing and research lab openings. Customers halted their medical consumables production for a time in Q3 and have now started to replenish inventories as hospital utilization improved. Discretionary procedures benefited from the US Consumer Confidence increasing sharply in September, after back-to-back monthly declines. We continue to lay the foundations for OEM volume growth in flow cytometry with several design wins with our recent UV product offerings at 360nm and 320nm, enabling completely new applications. Similarly, we received several new design wins from industry leaders, with our industry leading CellX laser light engines opening up an expanded servable market. Our customers want to work with us not just to supply them the lasers, but also all the beam delivery optics in an integrated sub-system. These design wins are foundational for revenue growth later in 21 as our customers ramp to volume.

Scientific

The Scientific business is the smallest of our market segments and represents sales of laser equipment to universities and national labs. These activities are funded by central or local government organizations, university endowments and private foundations. This segment was hit hard during the COVID shut downs in Q3 and, as expected, bounced back noticeably as soon as universities and research institutes reopened. Not only did we experience double digit percentage booking increases, we nearly reached our 2019 run-rate order volumes in this segment.

Aerospace & Defense

An early decision of our strategy work has been to double down on our small but successful defense business that has largely been operating in stealth mode for many years – and to declare our intent to focus on and serve this market much more decisively and publicly. Let me expand in some detail.

Coherent currently serves aerospace and defense applications such as Directed Energy weapons, as well as technology for target designation, countermeasures, fiber optic gyroscopes, specialty large diameter optics and entire telescope payloads for intelligence, surveillance & reconnaissance. To give you some specifics, we've shipped more than 700 Directed Energy Amplifiers in total. This equates to well over a MegaWatt of laser power. We sell products to a significant number of US Defense Contractors that serve all branches of the armed forces. We have recently been awarded with some exciting design wins in the defense space, which will boost our revenue in this market in FY22 and 23. What sets us apart in this market is a US based supply chain for all critical components, many of which are vertically integrated within Coherent, which we believe is unique in the industry. Our US Defense customers have made it clear that a secure, US based supply chain is and will be required moving forward. We not only make our own laser diode epi and packaged diodes in the US, but we also supply the specialty single mode amplifier fiber, critical for every Directed Energy amplifier. We own several other businesses that make critical components and today we are announcing that we have entered into an agreement to acquire EOT, a privately held, highly-specialized US component maker of optical isolators and other specialized fiber components, which are supplied to the US Directed Energy market. This acquisition supports our US-based supply chain with further vertical integration of critical components. Once we clear regulatory approvals, we expect the transaction to close in our second fiscal quarter.

The megatrend that is driving this opportunity in Aerospace & Defense, is related to asymmetrical threats from relatively cheap drones, drone swarms and the potential to counter other threats such as mortars, where there are no current defensive solutions. Coherent has been working on this technology for well over a decade, and it's only in the last year that the technology has reached Technology Readiness Levels 6 & 7, meaning successful prototype demonstration in relevant/operational environments, based on the Department of Defense's 9-level Technology Readiness Levels. Several US programs are slated to progress to TRL 8, meaning full system qualification and hence higher volumes in the next 3-5 years, with deployment beyond that timeline.

To focus our resources and our expertise effectively and to demonstrate our commitment to the defense space, we have moved the management reporting of all Aerospace and Defense related sites under a single Senior Vice President reporting directly to our COO, and we are staffing up the entire organization for growth.

Strategy

As indicated on our last call, we wanted to give you an update on where we're heading and our priorities. We've spent the past six months laying the foundation for our mid and long-term growth strategy and our good to great transformation. You've already heard many near-term specifics of what we plan to do woven into the end market commentary above, including our newly publicly declared focus on Aerospace & Defense. Our approach to strategic growth is two-fold. On the one hand, we will align our business around end markets that are supported by global industry megatrends. One example would be Healthcare – driven by the confluence of low-cost clinical instrumentation, AI, genomics, an aging population and unsustainable cost. Our objective is to hold or obtain a no1 or no2 position in all major markets that we participate in. In parallel we will strengthen our operational excellence to optimize the enterprise, more of which you will hear in our Q1 call.

Going forward, we will be focusing our efforts on four end markets:

- Microelectronics (which captures the 3 sub-categories of Display, Semi and Advanced Packaging & Interconnect API)
- Instrumentation (which captures the 3 sub-categories of Bio-Instrumentation, Therapeutics & Research)
- Precision Manufacturing (which captures non-Microelectronics / non-commodity KW fiber Industrial applications)
- Aerospace & Defense

We will explore opportunities to move up the tech stack and offer, wherever possible, subsystems to our customers that will enable them to go to market faster. By doing so we believe we can more than double our addressable market over the next 2-3 years.

FY 21 is a foundational year for us. Our continued focus on operational excellence will take us from good to great. Putting it in a simple formula for FY 21: we will transform our ILS business while driving new investments in our OLS business. And as we will continue to report these two segments, you will be able to see our progress each quarter.

If you look at our good to great transformation more holistically, we are kicking off projects that will

- Transform the operational efficiency of all our processes
- Reduce the complexity of our portfolio
- Focus our investments on growth opportunities
- Enhance the focus and alignment with our customers even further

New product introductions and strategic design wins will be early proof points on the go to market side. Looking at our P&L, you will see us return to a GM with a "4-handle" by the end of 21. We will keep you updated on our progress at our upcoming earnings calls and we are planning to hold an investor day in the summer of 21.

With that, let me turn the call over to Kevin.

Kevin Palatnik – EVP & Chief Financial Officer

Thanks, Bret/Andy.

Today, I'll first summarize fiscal fourth quarter 2020 financial results then move to the outlook for fiscal Q1 2021. I'll discuss primarily non-GAAP financial results and ask that you refer to today's press release for a detailed description of our GAAP results, as well as a reconciliation between GAAP and non-GAAP financial results. The non-GAAP adjustments relate to stock-based compensation expense, amortization of intangible assets, restructuring costs, the related tax adjustments and tax adjustments for stock based compensation. The full text of today's prepared remarks and trended GAAP and non-GAAP supplemental financial information will be posted on the Coherent Investor Relations website. A replay of this webcast will also be made available for approximately 90 days following the call.

Highlights of the Quarter

Fiscal fourth quarter 2020 financial results for the company's key operating metrics were:

- Total Revenue of $316.8 million dollars,
- Non-GAAP Gross Margin of 37.0%,
- Non-GAAP Operating Margin of 8.4%,
- Adjusted EBITDA of 13.2%, and
- Non-GAAP EPS of $1.01.

Sales

Total revenue for the fiscal fourth quarter was $316.8 million dollars and came in at the high-end of our previously guided range. The Scientific and OEM instrumentation markets were the key drivers of revenue this quarter as a result of many University and Research labs re-opening.

Our revenue mix by market for Q4 was Microelectronics 45%, Materials Processing 25%, OEM Components and Instrumentation 20% and Scientific & Government 10%. Geographically, Asia accounted for 52% of revenues in the fiscal fourth quarter, the US 26%, Europe 18% and rest of the world 4%. Asia includes two territories with revenues greater than 10% of sales.

We had one customer in South Korea, related to large flat panel display manufacturing, that contributed more than 10% of our fiscal fourth quarter revenues.

Revenue from other product and service for the fiscal fourth quarter was $105 million dollars or approximately 33% of sales. Other product revenue consists of spare parts, related accessories and other consumable products and was approximately 28% of sales. Revenue from services and service agreements was approximately 5% of sales. Total service revenues increased sequentially by approximately 8.5% primarily due to increased utilization in our ELA tools for flat panel display manufacturing.

Gross Profit, Gross Margin, Operating Margin, Adjusted EBITDA

Fiscal fourth quarter non-GAAP gross profit, excluding stock-based compensation costs, intangibles amortization, and restructuring was approximately $117 million dollars. Non-GAAP gross margin was 37.0% for Q4, a sequential increase of 390 bps and came in above the midpoint of our previously guided range due primarily to a myriad of items: increased volumes, lower inventory write-offs and lower warranty costs. Although, non-GAAP operating expenses increased to approximately $91 million dollars, non-GAAP operating margin increased 250 bps to 8.4% for the fiscal fourth quarter and came in virtually at the midpoint of our previously guided range. Adjusted EBITDA was 13.2% in fiscal Q4.

Balance Sheet

Turning to the balance sheet, non-restricted cash, cash equivalents and short-term investments were approximately $476 million dollars at the end of fiscal Q4, an increase of approximately $55 million compared to the end of last quarter. Given our continued focus on cash preservation, we did not repurchase any shares in Q4 pursuant to our current buyback authorization. We also did not make any voluntary payments against our term loan, and at the end of fiscal Q4 the outstanding amount of the term loan, in USD, was approximately $420 million dollars.

Accounts receivable DSO was 63 days, compared to 60 days in the prior quarter.

The net inventory balance at the end of the fiscal fourth quarter was approximately $427 million dollars, a decrease of $22 million in spite of a currency headwind and resulted from our continued focus on optimizing our inventory balances and increasing our turns.

Fiscal first quarter 2021 guidance

Now, I'll turn to our outlook for our first fiscal quarter of 2021.

Revenue for fiscal Q1 is expected to be in the range of $300 to $320 million dollars. This revenue range reflects the current uncertainty in Europe with regard to the impact of the COVID resurgence and many countries in the region implementing some form of a lockdown.

We expect fiscal Q1 non-GAAP Gross Margin to be in the range of 36% to 39%. Non-GAAP gross margin excludes intangibles amortization of approximately $1.9 million dollars and stock compensation costs estimated at $1.7 million dollars.

Non-GAAP Operating Margin for fiscal Q1 is expected to be in the range of 7% to 10%. This excludes intangibles amortization estimated at a total of $2.5 million dollars and stock compensation expense of a total of approximately $11.9 million dollars.

Other income and expense is estimated to be an expense in the range of $4 to $5 million dollars. We do not include transaction gains and losses related to future changes in foreign exchange rates in our OI&E outlook.

We expect our fiscal Q1 non-GAAP tax rate to be in the range of 24% - 25%.

And finally, we are assuming weighted average outstanding shares of approximately 24.4 million for the fiscal first quarter.

I'll now turn the call back to the operator for a Q&A session.