Conference Call Prepared Remarks
First Fiscal Quarter Results

Bret DiMarco – EVP, General Counsel and Corporate Secretary

Thank you and good afternoon everyone. Welcome to today's conference call to discuss Coherent's results from its first fiscal quarter ended December 28, 2019.

On the call with me are John Ambroseo, 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 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, uncertainties and assumptions that are difficult to predict and may cause actual results, performance or achievement to materially differ from those expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to: risks associated with global demand, acceptance and adoption of our products, the worldwide demand for flat panel displays and adoption of OLED for mobile displays, the pricing and availability of OLED displays, the demand for and use of our products in commercial applications, our ability to generate sufficient cash to fund capital spending or debt repayment, our successful implementation of our customer design wins, our and our customers' exposure to risks associated with worldwide economic conditions, in particular in China and the Eurozone, our customers' ability to cancel long-term purchase orders, the ability of our customers to forecast their own end markets, our ability to accurately forecast future periods, 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, our ability to have our customers qualify our products, worldwide government economic policies, including trade relations between the United States and China, our ability to integrate the business of Rofin and other acquisitions successfully, manage our expanded operations and achieve anticipated synergies, our ability to successfully manage our planned site consolidation projects and other cost reduction programs and to achieve the related anticipated savings and improved operational efficiencies, the impact on global trade arising from coronavirus-related actions by world governments 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 John Ambroseo, our President and Chief Executive Officer.

John Ambroseo – President and Chief Executive Officer

Thanks Bret and welcome, everyone, to the call.

There are several encouraging takeaways from our first fiscal quarter of 2020. The book-to-bill was well above one due to strong demand from multiple applications. The full year outlook is improving in certain key markets and competitive dynamics in China, while still aggressive, are mostly unchanged.

The news was positive across the microelectronics market. Display orders were up significantly for linebeam systems and service. The system orders were for Linebeam 1000s destined for China. This is the third consecutive quarter that we have received new system orders, which aligns well with prior industry commentary on phase 2 investments. The increase in service orders reflects higher demand for OLED-equipped smartphones in the fourth calendar quarter of 2019. In addition to the ELA orders, bookings for OLED cutting using short pulse and CO_2 lasers were also up as the industry prepares for a projected 60% ramp in flexible OLED units in 2020. There is a small contribution from foldable displays in the 2020 ramp, but penetration is likely to remain low for 2-3 years as manufacturers and suppliers lock down the specs and material sets.

Following CES, the number of predictions and questions regarding microLED displays has, to no one's surprise, gone up. The demos at CES from the likes of Samsung, Sony and others were impressive. Samsung's wall covered 292" and tiles could be added while the display was running. The technology clearly has potential, but costs remain prohibitive. It will take years for microLED to achieve mass market viability.

The full year outlook for semi capex spending changed dramatically in the last 90 days, with TSMC and Samsung both announcing higher capex spending. TSMC is reportedly adding capacity at 5nm and 7nm for AI, servers and 5G chips. Samsung is purportedly seeing renewed demand for memory. Our OEM integrator partners responded by raising their build plans for a variety of inspection and metrology tools. Consequently, our laser orders for semi applications were up sharply on a sequential basis. Our service bookings benefitted from sustained, high utilization rates and the timing of annual service contracts.

Rounding out the microelectronics picture is API, which also enjoyed double-digit sequential growth in orders arising from increased service demand and marking subsystems for semiconductor chips. We are also seeing an uptick for 5G-related technology due to Chinese government programs to drive adoption. Printed circuit board designs for 5G are currently trending towards 45-50 micron HDIs that support 20+% higher circuit density. These requirements should drive a double-digit increase in HDI tool demand during calendar 2020. We also expect to see a corresponding demand uptick in upcoming quarters for lasers used to manufacture 5G antennas.

The material processing market appears to be stabilizing. PMIs in North America signal modest expansion. China's PMI moved into positive territory on the strength of domestic demand, although exports are still lagging. Europe still faces headwinds, partially due to a depressed global market for autos. Germany's PMI is well below the Eurozone average.

The data for our business reflects a stabilizing market. The book-to-bill was one for our seasonally-adjusted first fiscal quarter and bookings were within a few percent of the prior year period. Within the various submarkets, orders for high-power CO_2 lasers used in cutting outperformed the broader cutting market. Medical device manufacturing systems held up well following a very strong prior quarter. Orders for automotive applications were up sequentially, but the overall market conditions remain challenging due to weak auto demand and the shifting sands of portfolio mix from internal combustion engines to electric vehicles.

Competition in the Chinese market is rising for components and lasers. Chinese laser manufacturers are sourcing more pump diodes domestically due to pricing and to a desire or directive to become independent from Western suppliers. We have heard from end users that domestic Chinese fiber laser manufacturers are taking share at the 3-6 kilowatt power level. As output powers increase, manufacturers will shift to longer pump wavelengths, which currently favors Western diode suppliers.

Instrumentation and OEM components bookings were lower following a record-setting performance in the prior quarter. This is neither surprising nor indicative of a change in long-term demand or market share. Bioinstrumentation applications, like flow cytometry, are experiencing greater clinical adoption. One of the capabilities that is driving this trend is the ability of UV-activated reagents to study small particles that are critical to cell functionality. Our OBIS™ platform is the leading laser solution for exciting ultraviolet reagents and we expect multiyear growth for this product platform. Our medical OEM business is also in solid shape. One of our OEM integrators is making inroads in China for cataract therapy. The aesthetic business saw good demand from new and legacy procedures. The aerospace and defense business is on-track for strong double-digit, annual growth, mostly in conjunction with North American prime contractors.

I'll now turn the call over to our Chief Financial Officer, Kevin Palatnik.

<u>Kevin Palatnik – EVP & Chief Financial Officer</u>
Thanks, John.

Today, I'll first summarize fiscal first quarter 2020 financial results then move to the outlook for fiscal Q2 2020. 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 and 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 first quarter 2020 financial results for the company's key operating metrics were:

- Total Revenue of $320.8 million dollars,
- Non-GAAP Gross Margin of 38.0%,
- Non-GAAP Operating Margin of 9.4%,
- Adjusted EBITDA of 14.3%, and
- Non-GAAP EPS of $0.86.

Sales

Total revenue for the fiscal first quarter was $320.8 million dollars and came in above the midpoint of our previously guided range due primarily to moderate stability rather than significant weakness in the Materials Processing end market.

Our revenue mix by market for Q1 was Microelectronics 41%, Materials Processing 27%, OEM Components and Instrumentation 22% and Scientific & Government 10%. Geographically, Asia accounted for 51% of revenues in the fiscal first quarter, the US 24%, Europe 20% and rest of the world 5%. 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 first quarter revenues.

Other product and service revenues for the fiscal first quarter were $117 million dollars or approximately 36% of sales. Other product revenue consists of spare parts, related accessories and other consumable products and was approximately 32% of sales. Revenue from services and service agreements was approximately 4% of sales. Total service revenues increased sequentially by approximately $3 million dollars as our integrators and end users replenished their service stock.

Gross Profit, Gross Margin, Operating Margin, Adjusted EBITDA

Fiscal first quarter non-GAAP gross profit, excluding stock-based compensation costs, intangibles amortization, and restructuring was approximately $122 million dollars. Non-GAAP gross margin was 38% for Q1 and came in at the midpoint of our previously guided range. Non-GAAP operating expenses increased by approximately $2 million dollars, primarily due to factors relating to our new fiscal year including merit and fringe increases and other miscellaneous expenses. This resulted in a non-GAAP operating margin of 9.4% for the fiscal first quarter and also came in slightly above the midpoint of our previously guided range. Adjusted EBITDA was 14.3% in fiscal Q1.

Balance Sheet

Turning to the balance sheet, non-restricted cash, cash equivalents and short term investments were approximately $350 million dollars at the end of fiscal Q1, an increase of approximately $44 million compared to the end of last quarter. We did not make any voluntary payments against our term loan, and at the end of fiscal Q1, the outstanding amount of the term loan, in USD, was approximately $405 million dollars.

Accounts receivable DSO was 66 days, compared to 72 days in the prior quarter.
The net inventory balance at the end of the fiscal first quarter was approximately $450 million dollars, an increase of $7 million, primarily due to foreign exchange, from the prior quarter.

Fiscal second quarter 2020 guidance

Now, I'll turn to our outlook for our second fiscal quarter of 2020.

Let me say at the outset, that like other multinational corporations with sales, service and operations in mainland China, we continue to monitor the rapidly evolving situation related to the coronavirus. The Chinese government's actions, particularly from quarantining individuals in and around major commercial hubs, such as Wuhan, and restricting the opening of businesses, will likely have an impact on our ability to sell our products and service our installed base in impacted areas. We continue to monitor the situation in China as well as actions being discussed and rolled out by other world governments. Our second fiscal quarter outlook attempts to reflect these uncertainties and includes an approximate $20 to $25 million dollar reduction in revenue at the mid-point and a wider than normal revenue range.

Having said that, revenue for fiscal Q2 is expected to be in the range of $290 to $330 million dollars.

We expect fiscal Q2 non-GAAP Gross Margin to be in the range of 35% to 39%. Non-GAAP gross margin excludes intangibles amortization of approximately $11.2 million dollars and stock compensation costs estimated at $1.4 million dollars.

Non-GAAP Operating Margin for fiscal Q2 is expected to be in the range of 4% to 8%. This excludes intangibles amortization estimated at a total of $12.5 million dollars and stock compensation expense of a total of approximately $9.5 million dollars. As you work through your models, you'll note that operating expenses show healthy sequential growth. This increase is primarily due to the our fiscal Q2 being a 14 week quarter vs. the typical 13 week quarter as well as less holiday and vacation in our March quarter .

Other income and expense is estimated to be an expense in the range of $2 to $3 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 Q2 non-GAAP tax rate to be in the range of 24%-25%.

We are assuming weighted average outstanding shares of approximately 24.3 million for the fiscal second quarter.

And finally, we have also received board authorization to repurchase up to $100 million in the company's common stock over the next year.

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