

Conference Call Prepared Remarks Second 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 second fiscal quarter ended April 4, 2020. All of us here at Coherent hope that you and your family are staying healthy and safe.

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, May 27, 2020, 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 the recovery of global and regional economies from the negative effects of Covid-19 and related private and public sector measures, the impact of Covid-19 on our businesses, 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, 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 our 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, 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 welcoming me to Coherent. I am still measuring my time here in weeks, and this marks my 8th week.

Joining a company as a CEO during a time when the world is fighting a pandemic and most of us are under "stay in place" orders is a truly unique experience and uncharted territory.

Getting my arms around our company in a virtual world has made for long days, but is amazingly productive and effective.

I have spoken with most of our top 20 customers, visited many of our sites through virtual tours, connected with Coherent's "top 100 managers" and have held "virtual coffee talks" with employees of all levels around the globe.

I am very energized by the customer feedback I received about the quality of our service, the performance of our products and the high degree of collaboration that our customers value when they design process solutions with Coherent.

I must admit I am extremely impressed with the talent, the dedication and, most of all, the level of engagement that our colleagues around the world display in the "new normal" of working remotely.

As a leadership-team we focused our energy during the last weeks around

- The health of our employees,
- The financial health of our company,
- And the health of our partnership with our customers and suppliers.

We established a central nerve center, the COVID steering committee, or CSC, under the leadership of our newly appointed COO, Mark Sobey. All executives of the company video-meet multiple times a week to stay on top of the ever-changing situation and safety protocols around the globe, to synchronize our actions and responses, to ensure a stable supply chain and logistics, discuss inventories of critical parts and to meet desired customer delivery dates. For most of April and May we have maintained manufacturing at approx. 85%-90% of capacity, while adhering to all social distancing rules. The CSC is now shifting its focus towards bringing our employees back to work safely, how to incorporate remote working into the "new normal" of our company, and how to accelerate best practice sharing around collaboration, flexibility, inclusion and accountability.

Before I talk more about the road ahead of us, let me hand the mike over to Kevin to discuss our Q2 results and guidance.

Kevin Palatnik – EVP & Chief Financial Officer

Thanks, Andy.

Today, I'll first summarize fiscal second quarter 2020 financial results then move to the outlook for fiscal Q3 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, goodwill and other long-lived asset impairments, 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 second quarter 2020 financial results for the company's key operating metrics were:

- Total Revenue of \$293.1 million dollars,
- Non-GAAP Gross Margin of 36.2%,
- Non-GAAP Operating Margin of 8.0%,
- Adjusted EBITDA of 11.9%, and
- Non-GAAP EPS of \$0.61.

Sales

Total revenue for the fiscal second quarter was \$293.1 million dollars and came in at the low end of our previously guided range. Sales were negatively affected by the Covid-19 pandemic primarily in Asia during Q2 and began impacting Europe and North America later in the quarter. We estimate the impact to revenues was approximately between \$30 and \$35 million during the quarter.

Our revenue mix by market for Q2 was Microelectronics 42%, Materials Processing 29%, OEM Components and Instrumentation 22% and Scientific & Government 7%. Geographically, Asia accounted for 48% of

revenues in the fiscal second quarter, the US 25%, Europe 22% and rest of the world 5%. Asia includes two territories and Europe includes one territory 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 second quarter revenues.

Revenue from other product and service for the fiscal second quarter was \$99 million dollars or approximately 34% of sales. Other product revenue consists of spare parts, related accessories and other consumable products and was approximately 29% of sales. Revenue from services and service agreements was approximately 5% of sales. Total service revenues decreased sequentially by approximately \$18 million dollars primarily resulted from the inability to service our installed base due to shutdowns and travel restrictions in coronavirus impacted areas.

Gross Profit, Gross Margin, Operating Margin, Adjusted EBITDA

Fiscal second quarter non-GAAP gross profit, excluding stock-based compensation costs, intangibles amortization, and restructuring was approximately \$106 million dollars. Non-GAAP gross margin was 36.2% for Q2 and came in slightly below the midpoint of our previously guided range due primarily to higher manufacturing costs related to lower volumes.

Non-GAAP operating expenses decreased by approximately \$9 million dollars from a myriad of items. The significant items were decreases in variable spending, travel related spending and a benefit to expense related to our deferred compensation plan. This resulted in a non-GAAP operating margin of 8.0% for the fiscal second quarter and came in at the high end of our previously guided range. Adjusted EBITDA was 11.9% in fiscal Q2.

Balance Sheet

Turning to the balance sheet, non-restricted cash, cash equivalents and short-term investments were approximately \$369 million dollars at the end of fiscal Q2, an increase of approximately \$19 million compared

to the end of last quarter. Given our focus on cash preservation during this period of relative uncertainty in the global economy, we did not repurchase any shares in Q2 pursuant to our current buyback authorization. We also did not make any voluntary payments against our term loan, and at the end of fiscal Q2, the outstanding amount of the term loan, in USD, was approximately \$390 million dollars.

Accounts receivable DSO was 62 days, compared to 66 days in the prior quarter.

The net inventory balance at the end of the fiscal second quarter was approximately \$457 million dollars, an increase of \$7 million, primarily due to an increase in finished goods as a result of closures in the shipping and receiving departments of some of our customers due to Covid-19.

Fiscal third quarter 2020 guidance

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

Let me say at the outset, that there is no clarity with what will happen with global demand in the coming weeks and months. This uncertainty makes forecasting our business challenging in the near term. However, our strong balance sheet and cash position provide us significant flexibility in responding to continued coronavirus related disruptions going forward.

Having said that, revenue for fiscal Q3 is expected to be in the range of \$265 to \$305 million dollars.

We expect fiscal Q3 non-GAAP Gross Margin to be in the range of 30% to 34%. Non-GAAP gross margin excludes intangibles amortization of approximately \$2.2 million dollars and stock compensation costs estimated at \$1.7 million dollars.

Non-GAAP Operating Margin for fiscal Q3 is expected to be in the range of 1% to 5%. This excludes intangibles amortization estimated at a total of \$2.9 million dollars and stock compensation expense of a total of approximately \$16.1 million dollars.

Other income and expense is estimated to be an expense in the range of \$5 to \$6 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 Q3 non-GAAP tax rate to be in the range of 17%-18%.

And finally, we are assuming weighted average outstanding shares of approximately 24.2 million for the fiscal third quarter.

I'll now turn the call back to Andy.

Andy Mattes – President and Chief Executive Officer

Thank you, Kevin. In addition to the financial data let me give you a little color on the main markets we serve:

Micro-Electronics: Two distinct dynamics at play: 1) weakness in SmartPhones (driven by slowing of consumer spending) which is providing headwinds in Display / OLED impacting our near-term service revenues, as Fab utilization slows and 2) strength in Semiconductor due to Telecom, Cloud & Datacenter investments (Zoom economy), and a shift in business spend towards Laptops.

Specific to display we are encouraged by recent announcements from multiple Laptop manufacturers that they are now including OLED displays as options for their high end models, we believe this is a trend that is likely to continue, especially as the yields of our Chinese customers improve and they have the ability to move pricing more in line with LCD over time. We remain optimistic around the pending upgrade cycle to 5G

enabled mobile devices, as the linkage between thin flexible OLED screens and 5G capability seems high, driven by the need for larger batteries to occupy more of the device volume as a requirement for powering the shorter range / higher frequency antennas.

Materials Processing: Even prior to the recent COVID pandemic, there was a widely reported slowdown in the German automotive and machine tool industry, and overall the market is seeing further weakness related to the COVID impact on consumer demand. There have been mixed reports about an early recovery in China, we remain cautious to see how that plays out. In general Coherent has less material processing exposure to China than in the US & Europe markets, and our core strength is in more specialized segments of the industry, in the non-metal cutting and welding applications, where our strength in CO₂ and Diode lasers remains a differentiator.

Instrumentation: Overall our instrumentation business remains robust, as we are diversified over a range of applications across life science research, clinical diagnostics and therapeutic procedures (both elective and insurance based). We've been excited by the use of many of our life science customers' high-end instruments in the development of vaccines and immunological advances in the fight against COVID, as well as clinical applications. We've seen demand at that end of the spectrum for certain customers go through a two-fold increase. Conversely the same customers sell the same instruments to research labs across the world for non-COVID related studies and many of those labs / universities have been closed and for those customers new system demand has slowed. We are seeing a nice rebound from our therapeutic medical customers now that COVID related restrictions to non-urgent medical procedures are being eased across the world.

Scientific: this market segment basically took a "time out" as Universities and Labs have been largely closed. We expect this segment to recover as the scientific institutions re-open and pent up demand from unspent Research grants begins to flow.

Defense: has been unaffected and remains an area of investment for Coherent. We are well positioned across multiple opportunities from laser amplifiers for Directed Energy applications, to specialty lightweight aerospace optics. We have secured key design wins with well-known prime contractors that supply to the armed forces, and we see this as an area of strength going forward for the company.

Our Q2 book to bill was significantly above one and our backlog exiting the quarter is up from previous quarters. Nobody knows how long COVID 19 will impact the global economy, but between our backlog and our balance sheet we see COHR to be in a stable position for quarters to come.

Having said that, we are concentrating our near-term actions on cash generation. While we have not made any final decisions, we are currently analyzing a variety of key steps and going forward we will initiate our “Good to Great Transformation” which will encompass some actions that are already in-flight as well as incorporate new ones, including:

- Apply a strategy to our business that we will only participate in a market segment if we have line of sight to achieve a No1 or No2 position otherwise we will refocus our energies;
- Consistent with this strategy, we will not be participating in the KW fiber market “price race to the bottom” game and therefore we will complete our move out of the commodity Fiber laser market;
- Focus on areas where our technological advantage will get rewarded by the market (e.g. Micro-Electronics, bio instrumentation and medical device manufacturing);
- Double down on the OLED market and use our pole position to enable advancement of technologies like micro LED displays, knowing that these are still in the future, but will be based on many laser processes steps.

And finally, “simplifying” our company – from an organizational set up to the number of locations, to the way we run and report our financials. As you can see we have quite some “summer homework” ahead of us. We

will have more to share around our “Good to Great Transformation” on our next call in a few months and more when we announce our Q4 results and move into the new fiscal year in October.

With that I’ll turn the call back to the operator for a Q&A session.