Conference Call Prepared Remarks
Third 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 third fiscal quarter ended July 4, 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. This was my first full quarter at Coherent and as you can imagine, I am still on a steep learning curve about our company, our customers, our product portfolio and our people.

I had never imagined how much one can get done in a solely virtual world. And I must say I am extremely excited to see how all our employees 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. I am pleased to report that both the number of active COVID cases as well as necessary quarantines in our workforce were de minimis. Under the leadership of our COVID Steering Committee we have been able to safely ramp up our manufacturing readiness from some 80% back in April to over 90% today.

Looking at our topline, we were able improve our revenues sequentially from last quarter, although our book to bill ratio dropped below 1, as we saw the effects of COVID slowing demand in several markets.

To add a little color, Q3 was the first quarter that was fully overshadowed by COVID, with substantial headwinds as most of Europe and the US were under "shelter in place orders". This impact was seen much more on the bookings side than on revenue. On average, our proposal activity level in Q3 was more than 10% below the previous quarter. The month of April marked the low point with proposal activity more than 40% below Q2 average. We are encouraged to see that both June and July proposal activity rebounded to levels north of the Q2 average. To be clear when I say "proposal" I am referencing quote, RFQ, RFP and similar activities. If we do not experience another “shelter in place” environment in the months to come, this should be an early sign of recovery that could manifest itself in our Q1 bookings.

Now let’s take a closer look at our market segments:

a) MICRO-ELECTRONICS: As you know, this market is made up of three sub-markets: FPD, Flat Panel Display, Semi and API. All three markets have been impacted by COVID-19 but there are bright spots.

   In quarter FPD revenue was aided by increased Line-Beam shipments destined for Chinese customers. Fab utilization by our customers was still down in Q3 and our corresponding service revenue was off for a 2nd quarter in a row by more than 20% from our pre-COVID run-rate. However, we experienced strong service bookings, which together with consistent reporting of higher Fab utilization in July, bodes well for increased service revenues in the future.

   Reports of many new 5G and Flexible OLED enabled SmartPhone launches in the next quarters, gives us confidence that the recovery should be sustainable, as these products are expected to drive an upgrade cycle.

   If you look at the microelectronics market more broadly, we continue to capture mind and market share in the Laser Lift Off (LLO) technology for Flexible OLED with our UVBlade 750, which continues to out-perform our solid-state laser competitor. And we have won significant repeat ultra-fast business in Korea, related to Flexible OLED cutting and ultrathin glass for foldable phones

   Semiconductor Inspection remains a bright spot with strong demand across all nodes – driven by strength in cloud computing & data centers. Our Fiscal Q3 saw a historic high demand.

   In API (Advanced Packaging & Interconnect) we see 5G driving increased demand in smaller geometry and next generation PCBs, which is driving strength in our CO2 laser “via hole drilling” business. We are well positioned with China’s leading equipment supplier, who appears to be taking share from the historical industry leader.

With consumer spending and habits world-wide being impacted by COVID, we would expect to see a somewhat quicker recovery for mobile electronics compared to big-ticket items such as, for example, cars. We therefore expect a faster recovery across Micro-Electronics than we would for Materials Processing

Looking at:

MATERIALS PROCESSING: Machine tool demand remains depressed, especially across Europe and to a lesser extent the US. Bookings are down more than 25% from pre-COVID levels. This trend already started in the German Automotive sector before the pandemic, but has been exacerbated by the impact of COVID.

With our recently announced exit from the commodity KW fiber laser business, we chose to have a more limited participation in the China Materials Processing market.

However, we continue to see strength in non-metal applications such as Converting (packaging), Medical Device Manufacturing and Specialty Semiconductor marking.

We expect a slow recovery in the overall European & US marking, welding & cutting markets given the big-ticket nature of the sector, but are using the opportunity to re-tune & invest in our Industrial Systems & Component Sales organizations, ahead of some key new product launches, which we believe will position us for share gains even in a relatively flat market in our upcoming fiscal year

Our OEM Components & INSTRUMENTATION business is made up of 3 important sub- markets – Life Science Instrumentation, Medical Diagnostics and Therapeutics and Defense.

Life Science is down more than 15% from pre-COVID run-rates as many, non-COVID related research labs have been closed. This was partially offset with reasonably robust demand for clinical applications. In the last few weeks, we've seen some upturn in sales activity, which feels like the beginning of a recovery but we need another month or two to verify if this is truly the case.

In Medical Therapeutics, we definitely experienced an upturn in sales activities, as pent up demand for mainly elective procedures starts to rise.

Similarly, we see many Research scientists now returning to their labs and the proposal pipeline for sales in Ultrafast laser research and ground based astronomy looks robust, after a very weak Q3 when few labs were open.

As part of the OEM Components & Instrumentation end market, DEFENSE is emerging as an attractive sub-market for us, where we are very well positioned in Amplifiers for Directed Energy, Countermeasures as well as specialty optics for Aerospace, and continue to see strong bookings. We see this as a multi-year growth opportunity and will expand further on our plans in this market in future calls.

Early in the pandemic we recognized the need to enhance our go to market approach as the world around us is changing at an unprecedented pace. As announced yesterday, it is therefore that for the first time in our history, we added the position of CMO to the executive staff. With David Gee, I am excited to welcome a digital marketing expert to Coherent.

Upskilling our leadership skills on multiple levels, is one part of our good to great initiative that we launched in Q3. Operational excellence, increased efficiencies and best practice sharing across all parts of our global organization is another important pillar of our “Good to great” transformation. It is therefore, that I asked Mark Sobey, our Chief Operating Officer, to oversee both our ILS and OLS business units.

One area that clearly underlines the fact that operational excellence is a team sport and requires ongoing and continuous improvement on all levels of an organization is cash generation. I am therefore very excited to report that as a company our focus on cash is starting to manifest itself in a noticeable improvement of our cash position from Q2 to Q3. And with that I’ll turn the call over to Kevin.

Kevin…

Kevin Palatnik – EVP & Chief Financial Officer

Thanks, Bret/Andy.

Today, I'll first summarize fiscal third quarter 2020 financial results then move to the outlook for fiscal Q4. 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 third quarter 2020 financial results for the company's key operating metrics were:

- Total Revenue of $298.3 million dollars,
- Non-GAAP Gross Margin of 33.1%,
- Non-GAAP Operating Margin of 5.9%,
- Adjusted EBITDA of 9.6%, and
- Non-GAAP EPS of $0.52.

Sales:

Total revenue for the fiscal third quarter was $298.3 million dollars and came in at the high end of our previously guided range. Although we were high in the range, sales were negatively affected by COVID-19. We estimate the impact to revenues was approximately $9-10M dollars during the quarter.

Our revenue mix by market for Q3 was Microelectronics 48%, Materials Processing 27%, OEM Components and Instrumentation 18% and Scientific & Government 7%. Geographically, Asia accounted for 54% of revenues in the fiscal third quarter, the US 22%, Europe 19% 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 third quarter revenues.

Revenue from other product and service for the fiscal third quarter was $97 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 were virtually flat sequentially with a bit of a rebound in display offset by decreases in Materials processing.

Gross Profit, Gross Margin, Operating Margin, Adjusted EBITDA:

Fiscal third quarter non-GAAP gross profit, excluding stock-based compensation costs, intangibles amortization, and restructuring was approximately $99 million dollars. Non-GAAP gross margin was 33.1% for Q3 and came in above the midpoint of our previously guided range due primarily to a stronger mix of our ELA tools, partially offset by higher manufacturing costs related to lower volumes.

Non-GAAP operating expenses decreased by approximately $1 million dollars. This resulted in a non-GAAP operating margin of 5.9% for the fiscal third quarter and came in above our previously guided range. Adjusted EBITDA was 9.6% in fiscal Q3.

Balance Sheet:

Turning to the balance sheet, non-restricted cash, cash equivalents and short-term investments were approximately $421 million dollars at the end of fiscal Q3, an increase of approximately $52 million compared to the end of last quarter. Given our focus on cash preservation during this continued period of relative uncertainty in the global economy, we did not repurchase any shares in Q3 pursuant to our current buyback authorization. We also did not make any voluntary payments against our term loan, and at the end of fiscal Q3 the outstanding amount of the term loan, in USD, was approximately $406 million dollars.

Accounts receivable DSO was 60 days, compared to 62 days in the prior quarter.

The net inventory balance at the end of the fiscal second quarter was approximately $449 million dollars, a decrease of $8 million, resulting from our continued focus on optimizing our inventory balances and increasing our turns.

Fiscal fourth quarter 2020 guidance

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

Revenue for fiscal Q4 is expected to be in the range of $290 to $320 million dollars. You'll note that we tightened the guided range as a result of our improved visibility in certain end markets.

We expect fiscal Q4 non-GAAP Gross Margin to be in the range of 34.5% to 38.5%. Non-GAAP gross margin excludes intangibles amortization of approximately $2.3 million dollars and stock compensation costs estimated at $1.2 million dollars.

Non-GAAP Operating Margin for fiscal Q4 is expected to be in the range of 6.5% to 10.5%. This excludes intangibles amortization estimated at a total of $2.9 million dollars and stock compensation expense of a total of approximately $13.2 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 Q4 non-GAAP tax rate to be in the range of 20% - 21%.

And finally, we are assuming weighted average outstanding shares of approximately 24.3 million for the fiscal fourth quarter.

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