Coherent, Inc.
Conference Call Prepared Remarks Q4'16
Bret DiMarco – EVP, General Counsel & Corporate Secretary

Thank you and good afternoon everyone. Welcome to today's conference call to discuss Coherent's fourth quarter fiscal 2016 results.

On the call we have John Ambroseo, our President and Chief Executive Officer and Kevin Palatnik, our Chief Financial Officer.

Before we begin, I would like to remind you that shortly after the market closed today, Coherent issued a press release announcing its Fourth Quarter and Fiscal Year 2016 Financial Results. You may access the press release on the Investor Relations section of our website.

During the course of today's call, management will make forward-looking statements, including statements regarding Coherent's anticipated financial results, our expectations for future revenue growth and the growth of our business and the expected completion, timing and benefits of the Rofin-Sinar transaction. These forward looking statements may contain such words as "expects," "will," "anticipates," "intends," or "forecasts." These statements are based on current expectations and beliefs as of today, November 2, 2016. Coherent disclaims any obligation to update information contained in these forward-looking statements whether as a result of new information, future events or otherwise.

These forward-looking statements involve a number of risks and uncertainties, some of which are beyond our control that could cause actual results to differ materially. For a description of risks and uncertainties which could impact these forward looking statements, you are encouraged to review Coherent's periodic SEC filings including its most recent Form 10-K, Form 10-Q and Forms 8-K.

I will now turn the call over to John Ambroseo.

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John Ambroseo - President & Chief Financial Officer

Thanks, Bret.
Good afternoon everyone and welcome to our fourth fiscal quarter conference call. Fiscal 2016 was an extraordinary year for Coherent. We celebrated our 50th anniversary, which is a meaningful milestone for a Silicon Valley tech company. We set new records for orders, revenue, EBITDA, EBITDA% and *pro forma* EPS. We also announced the acquisition of Rofin-Sinar, which just cleared the last regulatory hurdle. Let me provide some color on the quarter.

Quarterly Results
Bookings of $251.8 million decreased 35.6% sequentially and rose 22.6% versus the prior year period. The book-to-bill for the fourth quarter was 1.01.

Scientific

Scientific orders of $34.9 million increased 36.7% sequentially and 4% compared to the prior year period.

Seasonality, product performance and market share gains led to very good sequential order growth. The fourth quarter usually benefits from year-end spending in the U.S. and a rebound in European spending following summer holidays. Our Astrella™ ultrafast amplifier is the leading solution in the research marketplace based upon performance and unit volumes. The Astrella did particularly well in China, where funding for applied physics and physical chemistry appears to be on par with the U.S. The Chameleon Discovery™, our most advanced light source for multiphoton imaging, posted record unit and dollar bookings in the fourth fiscal quarter.

Instrumentation and OEM Components

Instrumentation and OEM components orders of $42.5 million decreased 3.1% versus the previous quarter and were up 2.7% versus the prior year period.

All submarkets in bioinstrumentation are enjoying very good demand. In flow cytometry, market adoption of the test protocols and the proliferation of desktop instruments from existing and new market entrants are fueling growth. Bookings for confocal microscopy were solid. Our efforts in high-speed gene sequencing are paying off. Orders continue to grow as we secure more design wins.

The medical OEM market is being affected by M&A activity and reorganizations within existing customers, which is causing changes in demand, inventory practices and R&D spending. From historical experience, these are mostly transient factors. By contrast, the consumables business is robust, suggesting the number of procedures being performed is stable to up.

Microelectronics

Microelectronics orders of $146.3 million declined 48.4% sequentially and increased 50.2% compared to the prior year period.

Semicap orders posted double-digit, sequential and prior period gains. The increases are primarily tied to investments for mobile logic chips. Fab utilization rates were generally positive, which helped service orders and revenues. Finally, we saw favorable inventory corrections at certain customers that appear sustainable. We do not anticipate any fallout from the recent collapse of two proposed mergers in the semicap space since they were largely complementary with respect to our ongoing business.

A teardown analysis of the newest smartphones illustrates an increased use of SiPs, or system in package, which increases the number of interconnects and functionality in a smaller footprint. This approach will maintain pressure on the via drilling market in the near term, but it appears to be a temporary reprieve since new applications like VR need large amounts of processing power.

After building significant FPD backlog over the prior three quarters, system orders temporarily returned to a more modest pace while FPD service orders and revenue ran at a record pace. The fourth quarter was our first full shipment quarter of large format systems. The combination of FPD systems and service had a stunning impact on our P&L and was the main reason that we set a number of fiscal records for the most recent quarter and the full fiscal year. I am also

pleased to report the pipeline is very robust. Some customers are adding capacity to take a larger share of the first wave of OLED adoption. Others are convinced OLED will replace LCDs everywhere from handsets to mobile computing to TVs and signage. They are securing capacity to capitalize on these potential trends. As a result, we have already booked $100 million of new orders in the current quarter, which fills out most of our existing fiscal 2018 capacity. We are very mindful of how our lead time may affect customers. Increasing capacity above the current plan would require a modest investment in our optics fab in Richmond. We'll provide an update during our next conference call.

Materials Processing

Following two quarters of outstanding orders, fourth quarter materials processing orders were $28.2 million representing decreases of 25.6% sequentially and 15.0% versus the prior year period.

Q4 notwithstanding, it was a record year for orders and sales in our materials processing business. A number of applications contributed to our success including thin metal cutting in consumer electronics packaging, additive manufacturing and short pulse processing for the automotive, medical device and machine tool industries.

Acquisition Update

On October 26, 2016, the European Commission on Competition cleared our acquisition of Rofin-Sinar, which requires us to divest Rofin's low-power carbon dioxide laser business headquartered in Hull, England. The Hull business produced about £23 million (approximately $30 million dollars) of revenue in fiscal 2015 or roughly 6% of Rofin's total fiscal 2015 sales. Given prior European rulings in this space, we were not surprised by the decision and had excluded Hull from our original synergy estimate. The commission is allowing us to close the transaction and hold the Hull business separate. We have to satisfy certain administrative matters before we can formally close. We expect to have this completed in the next couple of weeks. We will provide more granularity on the combined business and the integration after closing.

I'll now turn the call over to Kevin Palatnik, Coherent's Executive Vice President and Chief Financial Officer.

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Kevin Palatnik – EVP & Chief Financial Officer

Thanks, John.

Today, I'll first summarize fiscal fourth quarter 2016 financial results then move to the outlook for fiscal Q1 2017. 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 primarily to stock-based compensation expense, amortization of intangible assets, acquisition expense and the related tax adjustments. 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 2016 financial results for the company's key operating metrics were:

- Bookings of $251.8 million dollars,
- Total Revenue of $248.5 million dollars,
- Non-GAAP Gross Margin of 46.8%,
- Non-GAAP Operating Margin of 23.7%,
- Adjusted EBITDA of 26.7%, and
- Non-GAAP EPS of $1.65 cents

Bookings

John talked about our bookings for the quarter of approximately $252 million dollars in detail, so I'll move on to the P&L and Balance sheet.

Sales

Net sales for fiscal fourth quarter of $248.5 million dollars is a record for the company. This is an increase of $29.7 million dollars or approximately 14% sequentially. $27.7 million of Q4's sequential increase was in the Microelectronics market, primarily driven by FPD applications. Geographically, Asia accounted for 64% of the company's revenues for the fourth quarter, the US 20%, Europe 12% and rest of the world 4%. Asia includes two territories with revenues greater than 10% of total sales. Specifically, South Korea and Japan representing approximately 35%, and 21% of fourth quarter revenues, respectively.

Total backlog of $890 million at the end of the fourth quarter is also a record for the company. The shippable backlog, defined as shippable within the next 12 months, is approximately $605 million. This includes $382 million or approximately 63% of shippable backlog related to flat panel display applications. The comparable shippable backlog at the end of fiscal third quarter was $565 million, of which, $356 million or approximately 63% was related to flat panel display applications.

Other product and service revenues for the fiscal fourth quarter of 2016 were $70 million or approximately 28% of sales. Other product revenue consists of spare parts, related accessories and other consumable products and was 23% of sales, representing growth of 11% compared to last quarter. Revenue from services and service agreements were approximately 5% of sales, virtually flat sequentially.

We had two customers, one in Japan and one in South Korea, both integrators to large flat panel display manufacturers, that contributed more than 10% of the company's fiscal fourth quarter revenues.

Gross Profit, Gross Margin, Operating Margin, EBITDA

Fiscal fourth quarter non-GAAP gross profit, excluding stock-based compensation charges and intangibles amortization was $116.4 million dollars. At 46.8% of sales for the quarter, non-GAAP Gross Margin came in at the high end of the guided range.

Non-GAAP Operating Margin was 23.7% for fiscal fourth quarter, also at the high end of guidance for Q4. Adjusted EBITDA was 26.7% in fiscal Q4, exceeding our long term goal of 19 to 23%. It's also a new record for the company and was primarily driven by the positive impact of increased deliveries of ELA tools.

Balance Sheet

Turning to the balance sheet, cash, cash equivalents and short term investments was $400 million at the end of fiscal Q4, an increase of approximately $26 million compared to the end of last quarter. International cash, primarily in Europe, was $331 million or approximately 83% of the total cash and short term investment balance. Approximately 77% of the total cash and short term investments is denominated in dollars…And we ended the quarter with $20 million of short term borrowings.

Accounts receivable DSO was 60 days, an improvement of 2 days sequentially. As I mentioned last quarter, we expect to see fluctuations in our DSO based on the timing of our larger flat panel display systems shipments during future quarters.

The net Inventory balance at the end of the fourth quarter was approximately $213 million dollars. This is a sequential increase of $13 million and was primarily due to increased WIP levels to support the flat panel display demand ramp up.

Capital spending for the quarter was $21.0 million or 8.5% of sales. This is higher than our historical averages and is a result of finalizing the additional manufacturing capacity put in place for our ELA machines.

Fiscal First quarter of 2017 guidance

Now, I'll turn to our outlook for our first fiscal quarter of 2017. Since the Rofin transaction is expected to close within a few weeks, this outlook represents Coherent as a standalone company. This outlook also does not include any debt-financing related costs for the same reason. We will update our fiscal Q1 outlook once the transaction closes.

Revenue for fiscal Q1 is expected to be in the range of $255 to $265 million dollars.

We expect fiscal Q1 non-GAAP Gross Margin to be in the range of 46% to 48%. Non-GAAP gross margin excludes intangibles amortization of $1.4 million and stock compensation costs estimated at $600K.

Non-GAAP Operating Margin for fiscal Q1 is expected to be in the range of 22.5% to 24.5%. This excludes intangibles amortization estimated at a total of $1.8 million and stock compensation expense of a total of approximately $5.5 million.

Other income and expense is estimated to be immaterial. We do not include transaction gains and losses related to future changes in foreign exchange rates in our outlook.

We expect our non-GAAP tax rate for fiscal Q1 2017, to be approximately 30%.

And, finally, we are assuming weighted outstanding shares of 24.7 million for the first quarter.

With regard to our participation at upcoming conferences, we'll be presenting at Stifel's Midwest conference on November 10th in Chicago, the Mizuho Investor Conference in New York on November 14th and the Barclays Global TMT conference in San Francisco on December 8th.

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