Coherent, Inc.

Conference Call Prepared Remarks Rofin-Sinar Closing/Q1'17
Bret DiMarco – EVP, General Counsel & Corporate Secretary

Thank you and good afternoon everyone. Welcome to today's conference call to discuss Coherent's recent acquisition of Rofin-Sinar Technologies, Inc.

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.

Before we begin, I would like to remind you that on November 7, Coherent issued a press release announcing the completion of its acquisition of Rofin-Sinar and yesterday filed a Form 8-K with a description and copy of the related credit agreement. You may access both the press release and Form 8-K 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, including integration and synergies, 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 9, 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, Coherent's President and Chief Executive Officer.

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John Ambroseo - President & Chief Executive Officer

Thanks, Bret.

Good afternoon everyone and thanks for joining us on the call today. As you know, we officially closed the Rofin-Sinar acquisition on Monday morning of this week and the formal integration has begun. I am going to cover a number of topics including the strategic intent of the Rofin acquisition, the new operating structure, and integration. Kevin will discuss synergy timing, costs and benefits as well as provide a guidance update.

Coherent participates in four end markets: microelectronics, instrumentation, scientific and materials processing. On a stand-alone basis, we have leading market positions in the first three and a trailing position in materials processing. I would also like to point out that we separate microelectronics from materials processing because the governing dynamics of these markets are very different. Most notably, customers expect a very high rate of innovation with microelectronics. The rate of change in materials processing is relatively slower and there is much more emphasis on cost containment. In terms of market size, materials processing is the largest with projected sales of ~$3 billion this calendar year followed by microelectronics, instrumentation and scientific. Rofin has long been among the market share leaders in materials processing. Using our historical definition, we expect that the combined company would hold the number two position for laser sales into the materials processing market, which diversifies and balances existing revenue sources, as well as revenue opportunities going forward. Incidentally, if we were to use the market definition for materials processing used by some of our competitors, Coherent would hold the number one position in this market.

The combined company boasts the broadest and deepest laser portfolio in the industry, which makes customer engagement about the best solution for their application. Two product categories really stand out: fiber lasers and turn-key systems. Fiber lasers have been a game-changer in the materials processing market. Their reliability, efficiency and ease-of-use are currently beyond compare. Coherent and Rofin pursued similar technology paths to field a competitive product. Rofin's design is more advanced and will be the platform that we move forward with. We will transfer all relevant technology to Hamburg and terminate development activities in Santa Clara effective immediately. Vertical integration is also an important aspect of the fiber laser product strategy. The combined company has all the elements to be vertically integrated including semiconductor chips. We have begun capital upgrades to our epitaxial growth facility that will facilitate insourcing of the pump chips. The capital project will be completed in approximately six months and first articles for qualification testing will quickly follow. We expect to ship vertically integrated fiber lasers with fully-qualified chips in fiscal 2018.

Another trend that has been developing in the materials processing market for many years is vertical integration for end user workstations. It started when integrators developed their own CO_2 and lamp-pumped lasers before transitioning to diode-pumped lasers and most recently to fiber lasers. The OEMs have three main reasons for pursuing this course: (1) the ability to optimize tool performance through laser performance, (2) to independently own customer support, and (3) to eliminate margin stacking with their vendors. This trend is unlikely to end anytime soon. In fact, just last week, a major Chinese OEM acquired a fiber manufacturer, presumably to become self-sufficient in fiber lasers. Over the next five to ten years, more of this vertical consolidation will occur, which will limit the market for OEM lasers. We believe that Rofin's tool business provides Coherent with optionality in the materials processing tool space.

As a result of the combination of the two companies we are changing our segment structure of Coherent but will still operate with two segments. OEM laser systems or OLS will be largely focused on microelectronics, instrumentation and scientific. Mark Sobey will run this segment. Industrial lasers and systems or ILS will predominantly support the materials processing market. Thomas Merk, the CEO of Rofin-Sinar, has joined Coherent and will run the ILS segment. Based upon a *pro forma* analysis of fiscal 2016, OLS was 55% and ILS was 45% of combined company revenues.

Coherent's practice when acquiring and integrating companies is to manage a single brand. While that is the longer term goal in this case, we recognize that the Rofin, Dilas and Nufern brands have strong recognition with the customer base. For the next two to three years, we will dual brand each of these as Coherent-Rofin, Coherent-Dilas and Coherent-Nufern before transitioning them to a consolidated brand structure. All of the other Rofin subsidiaries will be rebranded Coherent as soon as practical.

We have already announced a number of integration actions including:

1. The previously mentioned fiber laser program consolidation will be completed this quarter.
2. The consolidation of laser diode packaging in Mainz, Germany requiring the transfer of designs and processes from Santa Clara will take 18 months. This transfer will also allow us to exit a 90,000 square foot leased facility in Santa Clara within 24 months.
3. The consolidation of 15 (or 16) worldwide sales office over the next six months.

These actions combined with the elimination of redundant corporate expenses accounts for roughly 80% of the previously announced projected $30 million in synergies. There are other projects that are being vetted. We will announce them once the plans are completed. I'll now turn the call over to Kevin Palatnik, Coherent's Executive Vice President and CFO.

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Kevin Palatnik – Executive Vice President & Chief Financial Officer

Thanks, John.

As John mentioned, I'll first discuss Synergies; their timing, costs and benefits, then talk briefly about financing the transaction and finally move to an updated outlook for the combined company for fiscal Q1 2017. Similar to the outlook provided in the Q4 earnings call, the fiscal Q1 2017 outlook will be a non-GAAP forecast and will be net of all purchase accounting impacts. Non-GAAP adjustments relate primarily to stock-based compensation expense, amortization of intangible assets, acquisition expenses, advisory and legal fees, non-recurring debt-related expenses and the related tax adjustments. The full text of today's prepared remarks 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.

Synergies; Timing, Benefits and Costs

As you know, we previously announced a total of $30 million dollars of synergies to be realized annually within an 18 to 24 month period following the closing. The implementation planning teams have completed the majority of their work and we now have very detailed plans to support the top down $30 million estimate. We also previously announced that we would be making investments into Rofin's administrative infrastructure. Following our integration planning process, we believe that these investments will be larger than initially thought and impacts the timing of realizing synergies to approximately 10% in the first full year, 55% in the second full year and the total run rate benefit as we exit year two. We will also incur restructuring costs to realize these synergies. Examples of restructuring costs are severance, lease contract terminations, facility restorations, et cetera… We expect to incur approximately $35 million dollars of restructuring costs that are skewed approx. 45% in year one and 55% in year two.

Financing

As you may have seen from our 8-K filing, the company has entered into a credit agreement that provides for a 670 million Euro senior secured term loan facility and a 100 million dollar senior secured revolving credit facility. The term loan was drawn in full and its proceeds combined with cash on the balance sheet were used to finance the merger and pay related fees and expenses incurred. Specific to the term loan facility, we borrowed at the Euro Interbank offered rate, also known as Euribor, plus an initial rate of 350 basis points. Euribor has a floor of 75 basis points. The facility also has the provision for a reduced rate, in the range of 300-350 basis points dependent on the consolidated total gross leverage ratio at the time of determination. There are other details, including applicable margins to the revolver, scheduled payments, affirmative and negative covenants, and others, related to the credit agreement which can be accessed via the exhibit to the 8-K.

Fiscal First quarter of 2017 guidance

Now, I'll turn to our outlook for our first fiscal quarter of 2017 as a combined company. The following outlook excludes revenue and expenses for the period of October 1st through November 7th, commonly called the stub period prior to close. This is an important point since we will yield approximately 55% of a full quarter's revenue and expense. The outlook also excludes revenues and expenses related to the Hull operation that we are holding separate for divestiture. I'm also widening the outlook range given increased uncertainty related to Q1 seasonality.

Revenue for fiscal Q1 is expected to be in the range of $305 to $320 million dollars.

We expect fiscal Q1 non-GAAP Gross Margin to be in the range of 44% to 47%. Non-GAAP gross margin excludes expected 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 20.5% to 23.5%. This excludes intangibles amortization estimated at a total of $2.1 million and stock compensation expense of a total of approximately $6.4 million. And finally, it also excludes advisory and legal fees of approximately $10 - $15 million dollars for the combined company.

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 31%.

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

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