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# EDITED TRANSCRIPT

IIVI - II-VI Inc at Nasdaq Investors Conference

EVENT DATE/TIME: DECEMBER 04, 2018 / 2:00PM GMT



DECEMBER 04, 2018 / 2:00PM, IIVI - II-VI Inc at Nasdaq Investors Conference

## CORPORATE PARTICIPANTS

**Chuck Mattera** *II-VI Incorporated - President & CEO*

**Mary Jane Raymond** *II-VI Incorporated - CFO*

**Meta Marshall** *Morgan Stanley - Analyst*

## PRESENTATION

**Chuck Mattera** - *II-VI Incorporated - President & CEO*

Good afternoon, everyone. It's a pleasure to be here today. I will make some brief remarks before our presentation. After which, Mary Jane Raymond, the II-VI, Chief Financial Officer will collaborate with me during the Q&A session that follows.

II-VI is an engineered materials company at its core. Our capital allocations process is [fuel], our technology platform and market-based growth strategy. We deploy our capital to R&D and innovation to capital equipment, to acquisitions and to share buybacks. We are facing large, irreversible megatrends that we believe will drive the sustainable growth that we aim for.

We believe that achieving target returns and long-term shareholder value depend on a number of factors, including having the right products at the right time and the right scale and the right price and of course the best quality. And we believe that having privileged insights to the roadmaps and to the requirements that derive from deep customer intimacy and trust are absolutely vital to driving returns on investment.

Some investors may wonder why Finisar and why now. Let me say upfront before my few slides and then the Q&A, after a rigorous process of deep reflection and diligence, we both concluded that we could be even stronger together than separate and best equipped to serve our growing customer base and to compete effectively as we drive to position the combined company to be best in class in our markets and to realize our full potential by the careful allocation of resource, the leverage of the endowment of world-class customers, increased scale and a broad technological and IP portfolio as well as unique talent. We have little overlap, lots of complementarity and the combination, I believe, will contribute to industry consolidation which is still needed to make the entire ecosystem increasingly healthy and competitive.

It will be our largest acquisition and we're aware of the lessons of the last 20 that we've done and the challenges that happen to coexist with all opportunities. But we're confident in our strategy, experience at managing complexity, believe in our people, responsible to all of our stakeholders and excited by the possibilities. So with that in mind, let me turn to the presentation and roll through it quickly.

Okay, let me say that II-VI at a glance as an engineered materials company, we have the company structure today in three reportable segments in the photonics segment, which is mostly an optical communications focused segment; and the laser solution segment, which is a combination of industrial materials, 3D sensing; and finally performance products, which is a -- where our military business resides as well as our engineered materials or specialty materials-based businesses reside.

If you look at the profile of the revenue, roughly 20% of our revenue, a little bit more than that in Europe, 39% in North America, 22% in China and then just a little under 10% in Japan, each and the rest of the world. Optical communications makes up about 40% of the sales, industrial about 30% today, military 11% and growing. And we have in the company today about 11,500 people, we operate in 52 locations in 14 countries and our first quarter which ended September 30, we generated \$314 million to sales.

We have three core markets that started out the company over the last 46 years or so. Optical -- well industrial lasers first then military and optical communications. We have been investing over the last few years to capture significant opportunity in both the extreme UV lithography market and silicon carbide substrates for 4G, LTE and 5G wireless-based stations and conducting silicon carbide. The highest quality conducting silicon carbide substrates at 6-inch diameter and even 8-inch diameter for electric vehicles and hybrid vehicles, industrial motor drives, in effect all electrical switching for the future.



DECEMBER 04, 2018 / 2:00PM, IIVI - II-VI Inc at Nasdaq Investors Conference

And the -- of course in the -- for 3D sensing, which is quite early in terms of the adoption of laser technology. As I said in my remarks, we have a track record for acquiring companies and the skill that we got better at, every time we do one as far as integrating companies go. We've done a large number in the last 5 to 10 years or so, including establishing a strong base in China. From which, we have grown substantially as a result and this obviously would be -- will be our largest acquisition.

We think every company makes maybe five big bets every decade. This will be -- this will surely be one of the five. When people who know Finisar and have looked back at the history, they pretty much asked the same initial questions that we were asked right after the Oclaro acquisition. That is the acquisition we did of the 980 pump, laser business and the optical amplifier business.

When we acquired the pump business, the operating model was use the components for the most part to serve the subsystem as the top priority, and not neglect the OEM market but surely not go out and develop the OEM market. When we acquired them, the operating margins were negative 45%. We went to work on it right away. We had a target model as a result of our due diligence and we stitched together other parts of our company and we began the -- we began quickly the process of improving the performance of the company.

Today on a standalone basis, that unit represents about 10%, a little under 10% of the company sales. It drives a substantial improvement and drives a substantial contribution to our operating margin. And it underpins a substantial part of the revenue and profit because it provides a feeder as part of our vertical integration strategy into the photonics segment. But the purpose of my showing it, is because we have in the past and willing to take on challenges where we think that we have an opportunity in combination to make the performance of the acquired unit even better.

Okay. I think I'll stop right after this slide I guess and Mary Jane and I will take your questions. The combination of Finisar and II-VI will generate a little more than \$2.5 billion in sales, just under \$600 million in pro forma EBITDA. It will be a little bit more complex because they have maybe 18 locations today. A larger focus in communications, that's true, but there's opportunity in it we believe.

And then between communications, automotive, consumer electronics, materials processing, semiconductor capital equipment and the military and life sciences, those are our seven core markets at II-VI today. We think the combination of the companies will address about 10% of the opportunity. We think that's opportunity for us to grow into the existing market and we would intend to do that as well as to grow with the market as well.

So with that, I think I'll have a seat and join Meta and Mary Jane.

## QUESTIONS AND ANSWERS

**Meta Marshall** - *Morgan Stanley - Analyst*

Great. So, maybe we'll kind of dive into four different subjects upfront and then if we have additional time, we can kind of jump into some additional. A lot of people here maybe interested in kind of the 3D sensing market. It's been a market that maybe has been slower to inflect than people have expected but I think there are some expectation that an inflection could kind of come soon. How do you think of that market developing and with the combination of both you and Finisar, how does the competitiveness of that market change?

**Chuck Mattera** - *II-VI Incorporated - President & CEO*

Okay. Well, first of all, our views of the world and the way in which we have our businesses is structured as a vertically integrated company and the full utilization of epitaxial wafer and semiconductor wafer fab operations make us a natural combination. We will not find any vision collision in my mind about the operation itself.

As far as the market goes, we think the market is very early and it may -- very early and relatively small compared to what we believe it will be in the next 5 or 10 years. We're excited about the widespread deployment of semiconductor lasers in consumer electronics, in the automotive space and as additional functionality into a broad-based of industrial tools as well.



DECEMBER 04, 2018 / 2:00PM, IIVI - II-VI Inc at Nasdaq Investors Conference

So for us this is -- what makes it the right time is that is no longer a secret and it's now well-known and clear that this is a longstanding future growth opportunity and we are two of the -- two of the early positioners or really pioneers. I view it as an exciting opportunity for customers as well.

**Meta Marshall** - *Morgan Stanley - Analyst*

Is there anything that you think kind of causes it to inflect maybe within the Android universe or were you, I guess, were you expecting to see that inflection or what could trigger it in your mind?

**Chuck Mattera** - *II-VI Incorporated - President & CEO*

Okay, when you say trigger it (multiple speakers) --

**Meta Marshall** - *Morgan Stanley - Analyst*

Trigger an inflection, so expansion beyond the Apple ecosystem, where it is today primarily.

**Chuck Mattera** - *II-VI Incorporated - President & CEO*

Well, first of all, there's a -- there's a cycle to innovation at the -- at the system level, the handset level, the consumer electronics level. This is a -- this is a big -- a most advanced, the most complex functionality that's being added to these consumer products. And this simply a lead time associated with R&D and so it started for sure. We have been engaged with over 10 customers. We can easily say over 30 customers but our focus is on those people that we believe will ultimately adopt the technology and be successful and for whom we already have a broad-based relationships with as well.

So I don't know, what else would you like to add, Mary Jane? I think the time is now but I'm not going to be in a position to say: Oh, this quarter or next quarter, there is an inflection coming.

**Mary Jane Raymond** - *II-VI Incorporated - CFO*

Actually, it's also fair to say that the advent of the ability to do augmented reality really changes the game. So, some of them may have been [new] but as early as December of 2016, we had investor saying to us: Okay, so we know there's two VCSEL arrays, ones in the front, ones in the back, tell us from there. And we obviously couldn't comment on that because we knew it wasn't the design. But if you can imagine what people were really getting at, they were really getting at the device early on being able to do augmented reality. And to do that, it needs a world-facing view.

That technology is very complicated. It's good, but it's very complicated. That's probably the thing that really provides an experience to people, just think about all of us, that we really haven't had before. Because in a virtual reality, the background is as it says, virtual, it's made up. When you can actually see it with the actual reality, the world facing view, it becomes a different game. Once individuals get that experience, you can imagine how that will start to snowball through their, for example, industrial applications or other workplace applications.

**Meta Marshall** - *Morgan Stanley - Analyst*

Agree. I feel like we're doing like a mic-off with this microphone going back and forth.

**Mary Jane Raymond** - *II-VI Incorporated - CFO*

(Inaudible - microphone inaccessible).



DECEMBER 04, 2018 / 2:00PM, IIVI - II-VI Inc at Nasdaq Investors Conference

**Meta Marshall** - Morgan Stanley - Analyst

Yes, no. Another market, industrial laser market in China has kind of tripped up some market participants this past couple of quarters. You guys had been able to really defy that weakness and divide -- because you have a broader customer base, because you serve different products. But how, if you could just kind of explain how you have been able to defy that and how you can kind of see yourselves still growing in that market if China grow slows a little bit?

**Chuck Mattera** - II-VI Incorporated - President & CEO

Okay, well it's a -- it's a great question and even with China slowing just a tad, my belief it will ultimately, a slower growth rate at the macro level, will be offset by increasing applications for the use of industrial lasers. The use case is very strong and very positive. The addressable market is large for industrial tools, new applications are being invented every year for new uses. So, I think there's a broad-based of people who are anxious to adopt laser technology for industrial materials processing, that's number one.

Number two, it's because they did not have access for a long time to enabling components, then the system makers and the subsystem and system makers in China who are indigenous Chinese had to go outside to acquire component technology. Now, they're building an infrastructure to have even component technology inside China, that's true, but a full line supplier like us that has a strong presence in China. And that can serve customers from within China has developed a portfolio of lasers and optics that allow us to be a full line supplier and so a kit in effect to someone who wants to build their own fiber laser.

We decided not to enter into the fiber laser market and to keep at the component level because we think the opportunity for us to grow there and utilize our resources there and leverage our fab capacity has been the best. So for us -- so I think it's still a very good market for us.

And the other thing I think is going to bring a change over the next 5 or 10 years, even though we're focus on this quarter and the next quarter in this fiscal year, there are a few of us that need to worry about the next 5 to 10. And among the changes I think will happen will be new materials will come in to the vehicle. And as new materials that are lighter weight, stronger that leveraged or enabled miles per gallon efficiency in a car, as new materials come, new lasers are going to be needed to process the new materials. And so that's partly why we stick to our core and why we're so interested even in alternative materials and enabling them to be prepared.

**Meta Marshall** - Morgan Stanley - Analyst

Got it. I must stay on the topic of China for a second, you mentioned before it's a 22% customer, you have a large presence there, you've acquired Chinese companies. We obviously have the G20 over the weekend if, I guess, maybe a question on how does your business change, have trade conditions improved and maybe how does it change, if trade conditions worsen kind of going forward after the standstill in three months?

**Chuck Mattera** - II-VI Incorporated - President & CEO

Okay. Mary Jane, do you want to make a comment right upfront? Then I'll --

**Mary Jane Raymond** - II-VI Incorporated - CFO

Yes.

DECEMBER 04, 2018 / 2:00PM, IIVI - II-VI Inc at Nasdaq Investors Conference

**Chuck Mattera** - *II-VI Incorporated - President & CEO*

Okay, thanks. Okay, so I was excited to hear the -- hear the news over the weekend but even before then, I said on November 9, I'm optimistic that we'll go through a process in China. I'm hopeful, there's no guarantee that will be the case, but our presence in China today is substantial. We serve from inside China a large number of Chinese players. We've been successful in the model that we have. Finisar have a large number of people and have made long-term commitment to China.

China is big and big matters. The scale matters in this business. If we have the opportunity to continue to invest and manage and grow in China, I think it will become a bigger part of our business overtime. What else -- what else do you [have in [mind]]?

**Meta Marshall** - *Morgan Stanley - Analyst*

I mean if trade conditions worsen, would you be in a position where you could spin off those operations [as if] -- like how do you think about in a worsening environment? You've kind of given the positive side. We can all hope for that but if trade conditions worsen, what does that look like?

**Chuck Mattera** - *II-VI Incorporated - President & CEO*

Well, I guess it depends on -- it depends on the degree and the sense that we have for how long. Stability -- taking care of the customers, employees, maintaining a world-class compliant organization is a priority for us. And not a lot of good examples that we know of people's spinning off companies successfully in China, at least foreign-owned companies like us. But I mean we're responsible for generating long-term shareholder value. We've cast the strategy that includes China and that has China as a central theme in it. And if we were somehow precluded from that, we would have to address what alternatives for the purpose of taking care of the investors as well.

**Meta Marshall** - *Morgan Stanley - Analyst*

Got it.

**Chuck Mattera** - *II-VI Incorporated - President & CEO*

Yes. And we would.

**Meta Marshall** - *Morgan Stanley - Analyst*

Yes. That's helpful. Maybe jumping back to Finisar for a second, I know you mentioned changes to operations you were able to make in past organizations to kind of improve margins, given the example of the Oclaro fabs. The Datacom market of which is large, called it, 60% to 80% of Finisar is business, is a very competitive market with a lot of growth but a very competitive market. How do you look at making that a more attractive market kind of under your umbrella?

**Chuck Mattera** - *II-VI Incorporated - President & CEO*

Okay. First of all, I want to -- I want to acknowledge and give credit to the Finisar team, I think is a world-class team. They are the leading transceiver maker with 30 years' worth of experience. They've selected a strategy to address the market at the subsystem level. And for the last 30 years, that's really been their focus. That means that they have a skillset and a competency that's unique, especially relative to what we have.

They know how to -- how to design lasers, integrate optics and integrate integrated circuits inside a box to provide functionality. I like that a lot. In the 3D sensing market, I'll come to your -- I'll come directly to your question, Meta, in a second, but I like to say in a 3D sensing market, those of



DECEMBER 04, 2018 / 2:00PM, IIVI - II-VI Inc at Nasdaq Investors Conference

us who are addressing the market today are largely addressing the market by selling [beer die]. We sell beer die to somebody who makes the module or puts them in a camera module.

I think as the automotive market evolves, that the economics will be attractive. The size of the market will be attractive, but I don't believe it will be addressable or accessible to a company that does not have a module capability. And one of the things -- one of the many things that I see that are really exciting about Finisar is their ability to do exactly that. And I think that the automotive market is a -- will be a new opportunity for the combined companies.

Okay, having said that, they have a large spend. So, part of our \$85 million in cost of goods sold synergies that we see and derived from what we believe to be the opportunity we will have as a combined company to improve the buying power and the leverage that we have in the supply chain and to be much smarter about how we design components and specify components.

So number one, I think the leverage of the supply chain will be significant. Number two, it's my expectation much like the case that we did with [MedLaser] Enterprise, we believe that -- some people can take the view that the Chinese transceiver makers like the Chinese fiber laser makers are simply competitors. There's another view that they are competitors and that's okay but they're also customers or at least potential customers. And for a company that sells at a materials level, components level and subsystem level, and is willing to segment the market and serve customers who actually are also competitors at another level and to do it in fashion that preserves the deep customer intimacy, even while competing vigorously in another arena.

We're accustomed to that and we think that -- we think that there's an opportunity to increase the sales of related components and combination with their lasers and our optics, our isolators and the like, we may -- we're counting that we will be successful in finding Chinese transceiver makers who would like to buy components from us just like Chinese fiber laser makers.

Now having said that in a \$6 billion transceiver market today that most the analysts expect will be about \$12 billion, maybe double the size in five or six years, not all of that \$12 billion is going to present us with the similar margin profile. And we'll be quite okay with being able to segment the market and aim toward the much higher target margin, part of the market itself. And we believe that we should have the right to do that because we intend to continue to invest and enable the development of world-class indium phosphide lasers both in Fremont and then [Europe], follow Sweden. And we think that they're so differentiated today and we intend to work together with them to make them even more so. We believe that we'll have a very good opportunity to carefully select the places where we want to compete. You have to decide that but we don't have to do all things to all people.

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**Meta Marshall** - Morgan Stanley - Analyst

Got it. And maybe Mary Jane, do you want to address kind of how you see the cost, Chuck started to give -- how you see kind of the synergies developing or how you have in the past try to look at timelines of getting businesses in purchase optimize?

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**Chuck Mattera** - II-VI Incorporated - President & CEO

That's a good question, yes.

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**Mary Jane Raymond** - II-VI Incorporated - CFO

So, there are probably five major ways that we would work on the margins financially. The first one is the one Chuck mentioned which is with centralized buying. From the supply chain management point of view, we would expect to see some optimization in just the supply chain itself. But the second one is in indeed, so today Finisar uses components that they buy partially from us but not entirely from us, those will be entirely from us. Actually, we buy one or two components from them where we do not buy 100% from them and we will capture all of those inside, which immediately eliminates the external margin.



DECEMBER 04, 2018 / 2:00PM, IIVI - II-VI Inc at Nasdaq Investors Conference

The second thing that -- the third thing that I would say is what Chuck also mentioned which is the willingness to look at a component strategy. So many, many -- as many, many people who make the transceiver for example cannot make the actual infeed components and we do. We obviously make them all and this is a -- similarly a contrast with Oclaro that they only make it at one level and if they sell the components, they're enabling all their competitors. But in fact, we have found as you can see as our very good progress during the recent optical downturn for inventory, we actually were not very much affected by that because a component strategy is very, very helpful.

The fourth thing we will do is look at the application of their technologies and they bring at least three major technologies to other end markets. We do not make any technology. We've never develop one material that only goes into one end market. The diversification of end market is very, very critical here.

And then thirdly, obviously one of the areas as we would work certainly on any duplicative cost. So with CoAdna for example, they had an office in Taiwan, we had an office in Taiwan, we moved into theirs because their footprint was larger and retained the vast majority of the people. In doing that, we just reduced the lease. So in cases where we have two or three sites in the same city, we probably won't have that persists.

We have been very, very careful about industry or location consolidation because not only are there people involved in that, there are also customers whose needs we need to respect. And in some cases, that might be a requalification but we would expect to be able to get on with that and part of that potential for some areas of requalification is what made the timeline 36 months as opposed to shorter than that. But at quite a few of them, we expect to be able to get after in the first year and we would expect the synergies to be realized \$50 million, then another \$50 million for a total of \$100 million, then another \$50 million for a total of \$150.

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**Meta Marshall** - *Morgan Stanley - Analyst*

And then maybe just a last question for you as we finish up, just a bit about the silicon carbide market. There are a number of competitors but you guys have kind of differentiated technology, just where you see your differentiation serving you and how you see that market developing?

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**Chuck Mattera** - *II-VI Incorporated - President & CEO*

Okay, the silicon carbide substrate market that we plan basically have two rails. One rail is a -- supports the RF powered device market, the GaN on silicon carbide market, if you will, penetrating into the silicon LDMOS market, now at 10% of the silicon LDMOS market rapidly becoming 20% of the silicon LDMOS market. And as the 4G, LTE and 5G wireless base stations come, most industry analyst expectations that penetration will continue and at a very fast clip.

We announced a few weeks back a strategic partnership with Sumitomo Electric Device Innovations, they are the largest provider again on silicon carbide components in the world. And we are in the process we have been developing GaN on silicon carbide devices. And our Warren, New Jersey fab investors were possibly confused when we acquired the fab and thought that we're only interested in one application, one customer but we're interested in building out compound semiconductor devices that we think will enable our growth.

And we had been working for -- from the beginning on GaN on silicon carbide. We have a strategic relationship with them. By the middle of 2020, I expect it will be in full production of GaN on silicon carbide devices for the commercial market for them. And we believe that there's a large and growing -- fast growing military radar market and we fully expect over the next three to five years to begin the investments required for us to diversify our portfolio to get into that market.

On the power electronic side, that silicon carbide substrate market will be the growth driver, the dominant driver and it's all about efficient switching, electrical switching. And it will touch -- in the beginning it's touching hybrid electric vehicles, inverters in electric vehicles, in [affordable tech] AC-DC or DC-AC conversion off the grid for grid for [affordable techs], for wind farms.

It was going to find a place as soon as the price comes down to a reasonable parity to silicon, it's going to displace them, basically all industrial motor drives, silicon overtime in my opinion. So, it's starting. I think it's a long-term bull market. That's it.



DECEMBER 04, 2018 / 2:00PM, IIVI - II-VI Inc at Nasdaq Investors Conference

**Meta Marshall** - Morgan Stanley - Analyst

Great. Well, we are in -- I had to cut it here but Mary Jane, Chuck, thank you so much for being here. And it's a complex story but reach out to me, Meta Marshall or them, if you have more questions. Thanks.

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