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# EDITED TRANSCRIPT

IIVI - II-VI Inc at Barclays Global Technology, Media and  
Telecommunications Conference

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## DECEMBER 12, 2019 / 9:00PM, IIVI - II-VI Inc at Barclays Global Technology, Media and Telecommunications Conference

### CORPORATE PARTICIPANTS

**Mary Jane Raymond** *II-VI Incorporated - CFO, Treasurer & Assistant Secretary*

**Vincent D. Mattera** *II-VI Incorporated - CEO & Director*

### CONFERENCE CALL PARTICIPANTS

**Blayne Peter Curtis** *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

### PRESENTATION

**Blayne Peter Curtis** - *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

I'm going to get started, I'm (inaudible) semiconductor analyst. Next up, we have II-VI. From the company, Chuck Mattera, CEO; as well as Mary Jane Raymond. Welcome.

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**Mary Jane Raymond** - *II-VI Incorporated - CFO, Treasurer & Assistant Secretary*

Thanks.

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**Blayne Peter Curtis** - *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

I thought maybe a good place to start, you've obviously closed Finisar deal in September. So I thought that maybe if we could start at a very high level, kind of just go over the strategy there. The wood you have to chop in terms of -- you've always been a good operator. You've already made some -- and we'll dive into some more of the pieces, but maybe just kind of just start, why this deal made sense and where -- what you have to do and where the opportunity is.

### QUESTIONS AND ANSWERS

**Mary Jane Raymond** - *II-VI Incorporated - CFO, Treasurer & Assistant Secretary*

Well, let's start out with the strategy. So we may have mentioned this to you in the past, and we've seen some of you. Many people think about Finisar as a transceiver company, but we think about them as a technology company. They had some really fantastic technology assets that were on our technical road map to develop. So the first one is the indium phosphide platform. The indium phosphide wavelength, the 1550 wavelength, is one of the most eye-safe wavelengths in the world, if not the most eye-safe wavelength. So it has tremendous applicability where it's used, for example, in DCI. But it also has applicability in LiDAR.

And if you think about the ability of a car to park itself. Basically, what it's doing in terms of not having a crash is gauging your bumper to the bumper of the cars in front or behind you. And if you think about where the bumper is in a car, it's exactly at the eye level of a child. So it really not only matters, eye safety in general, but particularly because there's an awful lot of small people that could be at that level. That's the first one.

The second thing is there's high port count switch. We make the low port count switch. And the high port count switch is very, very important as ROADMs become the whole ROADM system becomes deployed more extensively.

And then the third one is that they have a really fantastic integrated circuit design team. And that is very, very valuable for being able to anticipate how your customer will end up using your products. And so we're really pleased with that.

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In addition, they have some fantastic processes. For example, they have Oracle deployed throughout their whole company. We have not done that in our company. They have integrated back-office purchasing. There is an in-house offshore back office for finance in Malaysia. So I think, for us, as we think about what the combination can bring, we achieved what we like to find, which is a material-centric company where materials can be used in multiple applications where they can be used potentially in more applications than the company might be doing themselves and where we have the ability to leverage those assets pretty widely.

Lots to do, certainly on the integration. I mean, there's the planning for integration, and there's the no kidding, get on with it. They haven't had a history of reporting in business units, we do that. That's important to the profitability of the company. That's a pretty big, kind of retrofit, of their otherwise really excellent system. I would say that we probably bring to those very, very good processes perhaps a little bit stronger results orientation. And I'd say that we have some -- probably have made project management a key priority in our company. And I'm sure that if Finisar put their minds to it, they would have to, it's just not exactly where they focused.

So we're excited about it, and notwithstanding that 2 of the markets are perhaps a little bit less robust right now than we expected. We are very, very bullish on this.

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**Blayne Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

Can you talk about -- so now you have this combined entity and you're sorting through it as you look to next year, where are your opportunities? Where are the areas that you're looking at drivers for the company? And on the flip side, are there any areas, whether it's anything strategic that you need to handle the Finisar side, or anything else that's going the other way for you?

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**Vincent D. Mattera** - II-VI Incorporated - CEO & Director

Let me say, starting off with our ROADM business, our core ROADM business that we had before we started with our company. It's really, really been extremely steady for us. And I would say it's very robust. On our optics, on our passive optics that support it, our lines have been sold out, even with the expansion that we announced in Fuzhou a year ago. We're still sold out today. So we're adding capacity on a limited basis, but we are also about -- we have a very, very strong position in amplifiers, ROADMs and pumps and passives and our local account WSS.

The high port count WSS, we're going to ride along with that. The 5G deployments in China for the calendar year 2000. It's clear, the market is inflecting, and we are extremely well positioned in the supply chains of everybody.

So that's pretty exciting. 5G is going to pull us in from -- we think the data center market will be, maybe sideways a little, as it is for at least the next 6 months. There are some indications that the second half of the year, the adoption and the ramp, not only on 200G for PAM, but 400G Z-block for the data center is coming, for sure.

And our coherent transceiver business that we acquired from Finisar is extremely well positioned. We talked about over a dozen design-in activities. There's a lot of interest for that. Our strategy to sell laser components, in addition to selling the transceiver modules itself, we talked about it. We've been clear about that, how we see the differentiation. There's a lot of excitement from customers today. And that's going to play out over the next 6 to 18 months and be a real nice opportunity for us, we think, for revenue synergies, which we haven't sized yet. Okay.

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**Blayne Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

I'm going to ask you, all this year, I mean, wouldn't have foreseen all the trade tension, Huawei bans and such, how has it impacted your business? And then when you look at some of the strength you see in something like a ROADM, has that actually pulled in any orders? Is there any way you can ascertain what exactly is the impact from China has been, both positive and negative?



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**Vincent D. Mattera** - *II-VI Incorporated - CEO & Director*

Okay. Well, we'll do it in 2.

**Mary Jane Raymond** - *II-VI Incorporated - CFO, Treasurer & Assistant Secretary*

Sure. So let me start with the basics. From a tariff point of view, the tariffs have not had much of a material effect on the former II-VI really at all. And as Finisar [carries] transceivers aren't actually on any of the 3 lists, so it hasn't for them either. Now you have 1, 2, 3 immaterial things, that can still be immaterial. 4, 5, 6, 7 immaterial things, it starts to be material. But so far, it really hasn't. The Huawei ruling, which I think all of you know, is actually not a ban, is -- also, we put a press release out on the Monday following that announcement on Thursday, back in May, but we also didn't expect it to have a material effect that it did.

And then the reason is, so companies all have different business models, right? It has never been the II-VI business model to repatriate all the IP back to the United States. We just really didn't do it.

And consequently, not all of our IP is owned in the United States. We have been a U.S. military contractor for a long time. So we know all about -- we can't ship control technology. We can't do it anyway. And then for shipping into things that, for an end customer, for our customer, well an intermediate customer, going to their end customer in China, we have worked a lot with them to understand whether or not our component trips it above 25% content. And I would say that we've read those rules carefully.

And then there was a lot of very, very, very large semi company that, when they said they could ship to China, again, they talked about how it took them months to figure it out, and it took up the weekend. But we spent a lot of time doing it, because I happen to have an investor conference on the Tuesday, and I was going to have to say something.

So -- but we were careful about what it said, but we did read what it said. And it wasn't an all-out ban. An all-out ban looks like trade with North Korea. You can't get a visa there, you can't even walk 1 toe over the border, so. And so far, no.

Now if that were to accelerate, things could change. I would say that what we saw with some customer behavior is that they thought that they really might accelerate, might become stricter. And as a result of that in the 6/30 quarter, we did see some pull to the quarter that was between \$10 million and \$20 million. And that just related to our Q1 growth in optical communications, it's been a little bit closer to \$8 million than what it had been, in the mid- to high teens. But we are absolutely still seeing the optics communications market very strong, and we are assuming it's strong there.

But again, different day, different time, it could all go in the other direction. But right now, we have been trying to very, very carefully to follow the rules, and I'd say our customers are also behaving inside what they see as their swim lane too. Go ahead, Chuck.

**Vincent D. Mattera** - *II-VI Incorporated - CEO & Director*

Yes. We had a press release out this morning with regard to a couple of awards that we got from inside of China, the optical electronics industry, #1 in an important category. The market itself value, extremely value the II-VI supply chain inside China. We're just extremely well positioned. The executive engagement, customer engagement, has been high, and they love the security of the supply chain that exists in China, I think. And those of our customers who are outside China, they like the diversification of our footprint in the Philippines, in Malaysia, in Europe. And they just like the fact that we're a global company.

And as the largest optoelectronics components company in the communications market, we have full line supply, technology and then platforms inside and outside China and the U.S. We're extremely well positioned, I would say.

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**Blayne Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

Relative to 5G as being a driver, and I think it's across several components. Maybe you can walk through the exposures, optical, GaN and such.

**Vincent D. Mattera** - II-VI Incorporated - CEO & Director

Yes. I'll start. We just announced a, it's \$100 million plus quarter for silicon carbide substrates. That's the largest order in the company's history. And it's further evidence of the scale that we have, in particular, investors don't seem to really understand or appreciate. And that's extremely valuable. So there's one.

We have a -- we announced in November of last year a partnership with Sumitomo Electric. Sumitomo's a leading supplier of GaN HEMT devices for both 4G and 5G wireless base stations. Through our partnership with them, we're in the process of installing a fab capacity, qualifying the line. By this time next year, we should be qualified and begin ramping to make GaN on silicon carbide HEMT devices for them in the U.S.

The whole WSS, low port count, high port count, our ROADM business and our transceiver business basically put us as a full line supplier at the front haul, the backhaul and the middle haul, you name it, electronics and lasers and optics and switches with it.

**Blayne Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

You mentioned the supply constraints. You had capacity that's already booked out. I mean, we're still early days in this deployment here. So maybe walk us through why is it so strongly booked out? And what's the future capacity?

**Vincent D. Mattera** - II-VI Incorporated - CEO & Director

Okay. Number one -- number one, most of that capacity we have is in China. Number two, we have a very large scale for pass-through components, we're really one of the largest in the world. We have facilities in Guangzhou, in Fuzhou, in Vietnam and even in California. Our ability to add capacity and to scale it with a few thousand employees and the differentiated technology, there isn't anybody else who can do that. So if you're a large 5G operator, you're asking the supply chain by name, to come to us. That's really great. Plus, we just added a whole new building just to get ready for 5G. We may have to add another one. So it's very, very exciting.

I mean, 2020, it's going to roll into 2021 for sure, right? Taking our whole board here in February, so they can see the scale of what we've done and what we need.

**Blayne Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

Interesting. I want to ask on the [PA] side. I mean, you're a substrate supplier, Sumitomo, you mentioned is a customer. It does seem like LDMOS made efficiency gains and going to get a big piece of this China. But I'm just kind of curious, just being part of this ecosystem, what your perspective is on GaN flow cell.

**Vincent D. Mattera** - II-VI Incorporated - CEO & Director

Okay. All right. Actually, thanks a lot for your most recent report where I read the 30% improvement in LDMOS. Here's what I think about it. First of all, we're entering into this from the materials side. So we're not experts in RF. We're not experts in LDMOS, but we pay close attention to it. We think the LDMOS market has gone sideways for a long time, but its growth rate has been low to mid-single digits. And that the GaN on silicon carbide HEMT devices has been eating into the market share. I think to the extent that there's adequate supplier of GaN on silicon carbide, the performance, price, quality, ability to run at higher operating conditions keep the towers further and further apart.



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I don't think -- my understanding is from our customers' customer is, there's nothing that can beat it. But if there's any shortage of supply, somebody's going to have to make a trade-off. And I don't know how that equation goes. That make sense?

**Blayne Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

. Yes. Maybe the other thing I want to talk about VCSELS and 3D Sensing. You kind of come at it 2 ways. You're the current supplier and so you bought an operation that would have -- has been trying to get into the other part of that equation on the fund side. And let's just say that there will be a [flow] facing sensor. There's more opportunity. What's the progress with the Finisar asset in terms of...

**Vincent D. Mattera** - II-VI Incorporated - CEO & Director

Okay. Let me repeat it for those who didn't hear it here in November. We were not allowed to see the operation until after the closing, because we compete with them. So if we discover that they're still in the qualification process, finalizing the development and the process integration that needs to be done, our guess is it would not be done in this quarter. My best judgment then, is still is today that it will be finished in the March quarter. So there's more work to be done. I think the place is largely underutilized, except for completing the development and qualification.

On the other hand, our operation in Warren, New Jersey that we've been investing in is going extremely well. We have, in the last 15 to 20 weeks, achieved record output, a staggering amount of lasers, extremely high yields, extremely good reliability. And we've demonstrated a capability that we set out to do, which is extremely competitive. So we're going to keep it that way.

With that said, we're utilizing -- we're reserving some capacity. We'd like to take on a little more 3D Sensing, but we're reserving some fixed capacity, because a year from now, we're going to need it for GaN on silicon carbide. And if that market takes off for 5G, as much as we think it could on the high side, we're going to end up with a heck of a GaN on silicon carbide business too, in 12 to 24 months.

**Blayne Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

So just to be clear, I want to make sure I understand. So the Sherman facility, you said you're working on by March quarter, hopefully you have got something. And then would you have to go through a call process? And so would that still be in the envelope of time that you could actually get into something next year?

**Vincent D. Mattera** - II-VI Incorporated - CEO & Director

I believe so.

**Blayne Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

Okay. And the other side of the equation is, what's your visibility into anything that's in the Android world, and...

**Vincent D. Mattera** - II-VI Incorporated - CEO & Director

It's -- I can say that since we acquired Finisar, it's a lot better than what it was for us, yes. And that's a really good thing. And one of the reasons is because, you've got to remember, what we liked about Finisar, they're a module company. They know how to integrate lasers, optics and electronics. And they offer modules to customers. That's what they do. Our lead into this marketplace was to offer die. We're not a high-volume consumer electronics module maker. We don't have a skill set for that. So we were equipped to sell die. The Android makers, not everybody has the same supply chains, right? What we're finding out is, more and more Android makers, as you say, they want to sell or completely buy a die, they say,



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come back with a module. Finisar is already positioned. We have more work to do, but they were already well positioned in the supply chain, and the discussions with the Android makers and the relationship with their customers and the design team. That's going to come.

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**Blayne Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

Why don't you revisit the Datacom business, and I think you would you say flat.

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**Vincent D. Mattera** - II-VI Incorporated - CEO & Director

I think sideways, maybe.

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**Blayne Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

Or you'd see that sideways largely? In terms of, you saw a lot of vendors exit the module business and be a component supplier. It went through a period where there was a lot of competition and price compression. What's your assessment of what you have? Is there any further headwinds in that business, soft -- tailwinds?

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**Vincent D. Mattera** - II-VI Incorporated - CEO & Director

I think -- well, first of all, you get organized. Everybody learns this ultimately in business, get organized to fight the next war, not the last one. And so that's number one.

Number two, in getting ready to work -- in getting ready to fight the next one, some absolutely key components are required to do that. And we think that we have the capability to deliver those components to the market, including to our transceivers. And ultimately, we intend to be highly competitive.

And we think the market's kind of going through segment on the high end for a certain part of the market, based on the laser technology and the [IRC] technology. We're positioning ourselves in both of those to take advantage of a lot of doubt.

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**Blayne Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

I want to touch on the industrial market. It has been weak and [the same old] companies, and they're saying real -- no better, right? I mean, it seems like stabilized. Curious to your perspective, what you're seeing from your products in that?

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**Vincent D. Mattera** - II-VI Incorporated - CEO & Director

Well, we reported 8% to 10%. 8% -- 8% down. That's just the first time in these last 90 days, 100 days that we begin to feel it.

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**Mary Jane Raymond** - II-VI Incorporated - CFO, Treasurer & Assistant Secretary

Actually, years.

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**Vincent D. Mattera** - II-VI Incorporated - CEO & Director

Yes.

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### **Mary Jane Raymond** - *II-VI Incorporated - CFO, Treasurer & Assistant Secretary*

Years, actually. I mean, it was the first downturn we've seen in industrial in literally, I think, longer than 12 quarters.

### **Vincent D. Mattera** - *II-VI Incorporated - CEO & Director*

But I track the -- among other things, the China PMI Index, the Caixin index. That has been going up from the high 40s, 46, 47, 48. It's currently, at the end of November, I think at 52.5 or 53. There's an indication, that's a manufacturing index, that's an indication to me that since I've been tracking it, to the industrial market in China, it's really -- is favorable. And we're seeing that in our industrial business in China.

### **Blayne Peter Curtis** - *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

Maybe just touching back on China. I wanted to ask, and just remind me, for China, the -- you've seen this trade war, whatever you want to call it, it's my view that some of this is going to be more permanent. But the focus on domestic components is not going away. There's a trade deal the next week, so. I'm just kind of curious, as you look across your portfolio, where are you seeing efforts? Obviously, competition is not new to you, so you'll have to fight your fights. But just kind of curious, from your perspective, have you seen anything change this year on that front?

### **Vincent D. Mattera** - *II-VI Incorporated - CEO & Director*

I -- my -- we've been -- let me be clear, Blayne, we -- you know that we've been operating in China since 2010, January, in this mode. When we started with a \$60 million revenue company, Photop, we were #26 position in the optical communications components and subsystem market. Today, we're #1. We have access to -- the strategic plan is for virtually every company.

For a long time, people have all been saying from -- Made in China 2025. It's been going on for a long time that people want to have the supply chain security and continuity. That's not different to us.

So today, I think quality and continuity are absolutely key. But that's true for everybody. So that's not new. I think we have to be competitive. And I think almost every company in China would prefer to buy everything made in China, and that's clear now, especially in the last 6 months. But I mean, we're receiving award after award after award in China in the last 6 months. Our relationship with our Chinese customers is extremely good.

### **Mary Jane Raymond** - *II-VI Incorporated - CFO, Treasurer & Assistant Secretary*

And then keep in mind, we mentioned this back at the time when we were waiting [SANA] approval. When we bought the Photop acquisition in 2010, since that time, we've made \$500 million of investments in China. We were at 7,000 people there. The newly combined company has 12,000 people there. It's the only thing that we're dealing with was made in China 2025, we would almost have to be the best positioned non-Chinese company in the world. We have done -- we always believe in the end market of China. I mean, it's the world's second largest economy. They have to go a long way to have an opinion that we were not making good on that view. Now bans and all that stuff, that complicates things quite a lot. If the only thing we were dealing with was just made in China, I think we'd have to be very well positioned.

### **Vincent D. Mattera** - *II-VI Incorporated - CEO & Director*

There's room in our business model for both. And the markets outside China are going to grow. They're going to be enabled by the differentiators that we can offer. We're excited about it.





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**Blaych Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

All right. It closes in about a minute, maybe any questions? Do you think I -- all right. Appreciate to that.

**Mary Jane Raymond** - IIVI Incorporated - CFO, Treasurer & Assistant Secretary

Thank you for coming to see us, and we appreciate you very much inviting us again, too. It's a very good conference call.

**Blaych Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

As always, thanks.

**Vincent D. Mattera** - IIVI Incorporated - CEO & Director

Thank you.

**Blaych Peter Curtis** - Barclays Bank PLC, Research Division - Director & Senior Research Analyst

Thanks very much.

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