

# COHR Earnings Call Transcript

**Date: 2025-02-05**

**Quarter: 2**

Operator: Greetings and welcome to the Coherent Fiscal Year 2025 Second Quarter Earnings webcast. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Paul Silverstein, Senior Vice President of Investor Relations for Coherent. Please go ahead.

Paul Silverstein: Thank you, operator, and good afternoon, everyone. With me today are Jim Anderson, Coherent CEO, and Sherri Luther, Coherent CFO. During today's call, we will provide a financial and business review of the second quarter of fiscal 2025 and the business outlook for the third quarter of fiscal 2025. Our earnings press release can be found in the investor relations section of our company website at [coherent.com](http://coherent.com). I would like to remind everyone that during our conference call today, we may make projections or other forward-looking statements regarding future events or the future financial performance of the company. We wish to caution you that such statements or predictions based on information that is currently available and that actual results may differ materially. We refer you to the documents that the company files with the SEC, including our 10-Ks, 10-Qs, and 8-Ks. These documents contain and identify important risk factors that could cause the actual results to differ materially from those contained in our projections or forward-looking statements. This call includes and constitutes the company's official guidance for the third quarter fiscal 2025. If, at any time after this call, we communicate any material changes to this guidance, we intend that such updates will be done using a public forum, such as a press release or publicly announced conference call. We will refer to both GAAP and non-GAAP financial measures during this call. By disclosing certain non-GAAP information, management intends to provide investors with additional information to permit further analysis of the company's performance and underlying trends. For historical periods, we provided reconciliations of these non-GAAP financial measures to GAAP financial measures that can be found on the Investor Relations section of our website at [coherent.com](http://coherent.com). Let me now turn the call over to our CEO, Jim Anderson.

Jim Anderson: Thank you, Paul, and thank you, everyone, for joining today's call. I'd like to start by thanking my coherent teammates for the strong execution in our fiscal second quarter and the continued focus and great progress on driving market-leading innovation. For our fiscal second quarter, revenue increased by approximately 6% sequentially and 27% year-over-year to a record \$1.43 billion. This was driven by growth in multiple areas, including strong AI-related datacom transceiver growth, a second quarter of sequential growth in our telecom revenue, and sequential growth across multiple key industrial end markets. As I mentioned when I first joined the company, in addition to growing the top line, expansion in our gross margin would be a strategic focus area for the company, driven by parallel initiatives on both pricing optimization, as well as product cost improvements. During our fiscal second quarter, we made solid progress towards our goal of achieving durable company-wide gross margin of over 40%. Q2 non-GAAP gross margin of 38.2% marks strong improvement on both a sequential and year-over-year basis. While we have a lot more work to do on gross margin, I'm pleased with the team's focus and progress in this area. While we continue to invest in strategic R&D; to fuel the long-term growth of the company, we remain focused on driving greater operational leverage and efficiency across the company. With revenue growth, gross margin expansion, and disciplined OpEx

management, we drove significant expansion and profitability in Q2, with non-GAAP EPS growing over 40% sequentially and more than tripling on a year-over-year basis. Again, we have much more work ahead of us, but we remain focused on driving long-term shareholder value. Let me shift gears and share some thoughts on our products and end markets. Starting with our data center and communications market, Q2 revenue increased 6% sequentially and by 58% year-over-year. The sequential and year-over-year increases were driven by another strong quarter of growth in our datacom revenue and a second quarter of sequential growth in our telecom revenue. We achieved record Q2 datacom revenue, which grew 4% sequentially and by 79% year-over-year due to ongoing strong AI data center demand. We continue to see expansion in the number of customers adopting and ramping our 800 gig transceivers. And in addition, revenue from our 400 gig and below transceivers remains strong. We also continue to make solid progress on our 1.6T transceiver products as we move through key engineering milestones with our customers. After delivering initial samples of our 1.6T datacom transceivers to customers last year, we remain on track to begin ramping sales in calendar 2025, and we are seeing continued expansion of our customer engagements on 1.6T. Even as we focus on the 1.6T ramp, we are investing and innovating for the future. We are both developing our 3.2T transceivers and investing in the key ingredient technologies that underlie our transceiver roadmap and that can support a variety of form factors of optical data transmission. We have the broadest and deepest portfolio in the industry of photonic technologies required for high-speed optical data transmission. Our customers view our technology portfolio as an important competitive advantage of Coherent and optical data transmission applications. For example, one of the key capabilities that we've had in-house for over 20-years is our indium phosphide platform, which is the key technology behind our EML and CW lasers. The U.S. Government recently announced plans to use CHIPS Act funding to help with the expansion of indium phosphide capacity at our Sherman, Texas facility. In our fiscal Q2, our indium phosphide production output tripled on a year-over-year basis. This enabled rapid year-over-year growth in our 800 gig transceiver products, some of which are EML-based and some of which are based on CW lasers combined with our silicon photonics solution. We expect to continue to expand our indium phosphide capacity over the coming quarters to support our long-term growth in both EML and CW laser capacity. We also continue to execute on a roadmap of important ingredient laser technologies, such as our 200 gig differential EMLs; 200 gig VCSELs, and high-power CW lasers for our silicon photonic solutions. In addition to our key laser technologies, we're investing and innovating across a broad spectrum of important enabling technologies for our optical data transmission, including optical lens arrays, garnet, isolators, micro-optics, and thermal management solutions. Beyond transceivers and ingredient technologies, our new data center Optical Circuit Switch, or OCS, platform is progressing well and our customer engagements are expanding. This platform enables significant expansion in our data center addressable market, and I'm very pleased to announce that in Q2 we received our first customer order for this differentiated new platform. Unlike other mechanical MEMS-based solutions, our platform uses field-proven digital liquid crystal technology that provides tremendous advantages to our customers. We expect initial OCS revenue in calendar 2025, and we'll share more details about this innovative product and its revenue potential over the course of the coming quarters. In telecom our Q2 revenue increased by 16% sequentially and by 11% year-over-year. Q2 is the second quarter in a row of sequential improvement. Revenue growth in Q2 was driven primarily by data center interconnect, with some improvement in the traditional transport market as well. We saw continued growth in the ramp of new products, including our 100 gig, 400 gig, and 800 gig ZR, ZR+ Coherent transceivers, and expect these products to continue to ramp over the coming quarters. In our remaining markets, which are primarily industrial-related applications, aggregate revenue increased 7% sequentially and was flat year-over-year. We saw sequential growth across multiple industrial end markets. In particular, display capital equipment grew on both a sequential and year-over-year basis. Ongoing display strength is being driven by demand for our highly differentiated Excimer lasers for OLED screen manufacturing, resulting from expanding OLED adoption in smartphones and the beginning of OLED adoption in larger format devices like new laptop and tablet, computers. We also saw healthy sequential and year-over-year growth in the semi-cap equipment market, where our lasers and advanced materials are critical enabling technologies for our customers. While we are still taking a cautious near-term outlook on the broad-based industrial end markets, we

expect the industrial market to be an important long-term secular growth driver for the company as the broader end markets eventually recover and as our new products continue to ramp. Before wrapping up, I'd also like to provide a brief update on our strategic portfolio optimization. We've made good progress on implementing the strategic portfolio assessment that we completed in the September quarter. As part of the process of divesting or shutting down product lines and assets that are non-strategic, we announced in December that we are evaluating strategic alternatives for our advanced lithium-ion battery recycling technology. This announcement follows the sale of our Newton Aycliffe facility and our announcement that we are evaluating strategic alternatives for our lithium-sulfur battery platform, as well as other portfolio optimization activities that are well underway. As we optimize our portfolio over the coming quarters, we'll provide further updates, including at our upcoming Investor Day this May. In summary, I'm very pleased with the progress we've made in our fiscal second quarter. While some near-term softness persists in our industrial-related end markets, we expect fiscal 2025 overall to be a strong growth year for the company. I'll now turn the call over to our CFO, Sherri Luther.

Sherri Luther: Thank you, Jim. In the second quarter, we drove continued sequential improvement in our financial results with strong revenue growth and gross margin expansion, driving strong profitability. In addition, we strengthened the balance sheet by paying down \$132 million in debt. Now, I will provide a summary of our results. Second quarter revenue was a record \$1.43 billion, an increase of approximately 6% sequentially and 27% year-over-year. From a segment perspective, networking revenue increased 7% sequentially and 56% year-over-year, driven by ongoing strong AI data center demand and the continued recovery in telecom. Laser segment revenue increased 8% sequentially and 6% year-over-year, driven primarily by demand for our Excimer annealing lasers in our display capital equipment business, as well as strong demand and semi-cap equipment. The material segment revenue increased 3% sequentially and decreased 4% year-over-year. The year-over-year decrease was primarily due to weak automotive and market demand. Our second quarter non-GAAP gross margin was 38.2%, an increase of 146 basis points compared to the prior quarter, and an increase of 363 basis points, compared to the year-ago quarter. The improvements in gross margin were driven by higher revenue volume, as well as cost reductions and improvements in manufacturing yields offset somewhat by unfavorable product mix. Second quarter non-GAAP operating expenses were \$283 million, compared to \$278 million in the prior quarter and \$239 million in the year ago quarter. The sequential and year-over-year increases were primarily driven by increased R&D; investments in our product portfolio. SG&A; decreased sequentially as a result of our disciplined approach to managing our SG&A; expenses, while ensuring that we invest in our product portfolio. Our second quarter non-GAAP operating margin was 18.5%, compared to 16.1% in the prior quarter and 13.5% in the year-ago quarter. Second quarter non-GAAP tax rate was 17.4%, compared to 20% in the prior quarter, due to the distribution of income earned across the jurisdictions, as well as non-recurring one-time items. Second quarter non-GAAP earnings for diluted share was \$0.95, compared to \$0.67 in the prior quarter and \$0.27 in the year-ago quarter. We paid down \$132 million in debt during the quarter using cash from operations. I will turn now to our guidance for the third quarter of fiscal 2025. We expect revenue to be between \$1.39 billion and \$1.48 billion. We expect non-GAAP gross margin to be between 37% and 39%. We expect total operating expenses of between \$285 million and \$305 million on a non-GAAP basis. We expect the tax rate for the quarter to be between 17% and 19% on a non-GAAP basis. We expect EPS of between \$0.75 and \$0.95 on a non-GAAP basis. In summary, I am very pleased with our progress in the quarter. We will continue to focus on improving profitability through gross margin expansion, as well as operational efficiency. It is important that we make investments for the long-term growth of the company, while driving operating leverage and efficiency. Cash and capital allocation will continue to be key focus areas to further strengthen and deleverage our balance sheet. As a reminder, we will host an Investor and Analyst Day in New York on May 28 at the New York Stock Exchange. At that event, we will outline our overall strategy, including our end-market growth opportunities, product and technology roadmap, and long-term financial model. That concludes my formal comments. Operator, please open the call for Q&A.;

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Samik Chatterjee with JPMorgan. Please proceed.

Samik Chatterjee: Yes. Hi, and thanks for taking my questions. And congrats on the strong results here.

I guess, Jim, I wanted to get your thoughts firstly on the telecom market. You've been up sequentially in that end market now for two quarters, but I think last quarter also you were sounding a bit more cautious relative to your outlook for that market. So if you can just share with sort of this second sequential quarter of growth? Is your outlook for -- in terms of sustainability of that improvement, has that changed? What are you hearing from your customers on that front? Or are you still sort of cautious in terms of the pace of improvement here? And I have a quick follow-up after that. Thank you.

Jim Anderson: Yes, thanks for the question, Samik. I think our view is we moved from cautious to cautiously optimistic. We were really pleased with the results that we saw in telecom in our fiscal Q2, you know, the 16% sequential growth and 11% year-over-year growth in fiscal Q2. As you noted, that was the second quarter of sequential growth. And we are expecting the telecom revenue to be up again sequentially in our fiscal Q3. So given all of that, we are cautiously optimistic that we've moved beyond the bottom of the valley in terms of the telecom recovery and demand and we're on the upslope within that market. Maybe just a little bit more commentary on what drove the sequential growth that we saw in fiscal Q2 is one of the main drivers was growth in data center interconnect, and we expect that growth to continue into the current quarter. We also saw improvement in kind of traditional telecom transport market, which we viewed that sequential improvement as a really positive indicator for the overall underlying market health. And then we were really pleased with the continued ramp of our new products as well. So our 100 gig, our 400 gig, and 800 gig ZR/ZR+ Coherent transceivers ramping nicely. We expect that to continue over the coming quarters as well. So yes, quite pleased with the telecom results and looking forward to another sequential improvement in the current quarter.

Samik Chatterjee: Got it. Got it. And for my follow up, the OCS first orders that you're highlighting, that's an exciting announcement. If you can give us a bit more color in terms of how to think about the addressable opportunity here? And I know you've said probably the revenues are in calendar '25, but just how to think about the pace of the ramp with the customer and how material it will be in calendar '25? And what the longer term opportunity there could be?

Jim Anderson: Thanks, Samik. Yes, really happy to talk about this product line. I love the differentiated technology of this product line. In fact, this was when I first joined the company, I guess that's about eight months ago. This is one of the product lines that the team showed me early on. And when they explained to me the technology differentiation, I was quite impressed and we've since increased R&D; investment in this area to expand and accelerate the roadmap on this technology. I'm really, really pleased with the progress here. Maybe just to explain what OCS does for the customer is rather than when they're transmitting data from one computing node to the other computing node, rather than having to go through an electrical switch and switch the data from the optical domain into the electrical domain, by using an optical circuit switch, they're able to keep the signal in the optical domain through the transit from one computing node to the other computing node. And that has great latency and power efficiency advantages, so that's the advantage of OCS. And then for our platform in particular, it's a non-mechanical technology. It's based on digital liquid crystal technology that is much, much higher reliability than the other solutions that are out there that are essentially mechanical-based and based on MEMS-based solutions. And so we have very differentiated technology. We're seeing really good customer engagement and momentum here. We're really pleased to get the first customer order in our fiscal Q2. On the revenue ramp, we remain, our view remains that the revenue, we should start to see first revenue in this current calendar year. We'll probably get better, you know, quantification of that as we move throughout the year, but I think given that we would start to see revenue this year would be more of a contributor in calendar '26 and '27 and beyond. And in terms of the addressable market, we'll probably talk about that more at our Investor Day in May. We'll give a better quantification of the revenue and market opportunity when we talk at our Investor Day in May. But yes, really pleased with the progress on this product.

Samik Chatterjee: Got it. Great, thank you. Thanks for taking my questions.

Operator: Our next question comes from the line of Simon Leopold with Raymond James. Please proceed.

Simon Leopold: Thanks for taking the question. I wanted to discuss the topic of co-package optics or CPO. Given that the noise level on this has definitely increased recently, how does Coherent envision this technology affecting its business in both the intermediate term, as well as the long-term? Thanks.

Jim Anderson: Yes, thanks Simon and thanks for asking the question and maybe to answer the question what I'll do is I'll break it into two parts. Let me first just talk about our view of the market evolution, how we expect the market to evolve over the coming years, and co-packaged optics placed within that market evolution. And then I'll come back to the other part of your question, which is, what is Coherent's opportunity within that landscape? But if I start with the first part, just on the market evolution. So first of all, we believe that the TAM for optical networking and the data center, that we're going to see robust growth over the coming years and over the long-term. And that's really driven by two things: number one is just the raw bandwidth increase that's required to support the computing capacity expansion that the market is expecting. So if you look at the data center expansion plans, that drives tremendous growth in the number of computing nodes across the data center, and that drives a tremendous number of -- or amount of growth in the connections between those computing nodes and the bandwidth that's required between those computing nodes. And so that alone, we think, drives a really good robust growth in data center over the long-term. But the second effect that we think that we're expecting, and this is kind of where CPO plays into, is we're expecting there to be a greater proportion of those interconnects between the computing nodes that switch from what are today electrical connections towards optical connections moving forward. And so think about it as the proportion of electrical versus optical, the proportion of optical connections, we believe increases over the coming years. And the reason for that is if you look at the bandwidth that's required to support the connections between these computing nodes, and those computing nodes could be GPUs, CPUs, or XPU's, some sort of accelerators, the bandwidth is ramping up significantly. And optical connections can provide a much higher level of bandwidth than an electrical connection. And we think CPO is one of those enabling technologies. There'll be other enabling technologies that help enable the TAM expansion or the replacement of electrical connections with optical connections. And we see this CPO primarily, we believe the biggest sort of area of application for it over the long-term is in scale up. So within the rack or within the box connections between the computing nodes is where we believe we'll see the most prevalence over the long-term. And so the net is we believe CPO is a net accelerator of the overall TAM for optical networking and the data center. But again, driven by both the combination of the total raw bandwidth that's needed, as well as this conversion from electrical to optical. And then back to the kind of second part of your question, what does that mean for Coherent? We believe we're very well positioned to, you know, continue to drive growth in pluggable transceivers, which is the dominant form factor today, but also to participate and drive growth in these newer potential form factors over the coming years. First of all, in pluggable transceivers, we've got a great roadmap of pluggable transceivers. This year we're ramping, beginning the ramp of 1.6T, we've got 3.2T pluggable transceivers in development and products beyond that on our roadmap as well. And we believe pluggable transceivers will continue to grow especially in the scale out domain over the coming years. And so we believe we're well positioned to grow not just, because the TAM is expanding, but because we believe we're well positioned for share gain as well. And then in other form factors like CPO or there's other types of form factors that'll be introduced as well, it's important to remember that Coherent is not just a supplier of transceivers, but we invest and innovate in all of the key ingredient technologies that go into those transceivers in terms of the optical ingredients. So things like indium phosphide platform, the EML and CW lasers that are built off our indium phosphide platform, silicon photonics, which we've had in production for years and have been developing for over a decade, and a number of other key enabling technologies that are not just relevant to pluggable transceivers, but would go into -- would be key enabling technologies for things like CPO and other form factors. So we believe we're very well positioned to continue to grow in this what we see as a rapidly expanding TAM. And we'll -- at our Investor Day in May, we'll provide sort of more, you know, more thoughts on how the market evolves and we'll quantify that and give a better idea of Coherent's opportunity, but we feel well positioned for the long-term growth of the company.

Simon Leopold: That's great. I appreciate the thorough response. And just a very brief follow-up, please is just wondering if there's any customer concentration or vertical concentration you could quantify in the quarter, whether it's the amount from any 10% customers or sort of the AI consumption, whether direct or indirect to web scale. Anything you could help us with in terms of that quantification, I'd

appreciate.

Jim Anderson: Yes, we have a broad range of customers, both hyperscaler customers, as well as enterprise customers. The hyperscaler customers represent the vast majority of the datacom revenue, but we have multiple hyperscaler customers and are well distributed across those key hyperscalers. So yes, I would call our revenue in datacom as well diversified. And then the other point that I would make is on 800 gig transceivers, which I mentioned in the prepared remarks, is one of the really positive things that we've seen over the past year is the number of customers that are ramping 800 gig continues to expand. And so I mentioned this in our last quarter's earnings update and we saw expansion in the number of customers again over the past quarter. So we view this as very positive as our overall 800 gig revenue is very highly diversified.

Simon Leopold: Thank you.

Operator: The next question comes from the line of Vivek Arya with Bank of America. Please proceed.

Michael Mani: Hi, this is Michael Mani on for Vivek Arya. Thanks for taking our questions. To start, just wanted to get your thoughts on how the market landscape is evolving across VCSELS, EMLs, and Silicon photonics. You stated that obviously a breadth of needs is required across these customers. But as you get closer to the 1.6G ramp, do you have a better sense of which platform might be seen relatively more pulled from these customers? And how does that inform your buy versus make decision framework around internal production? Thank you.

Jim Anderson: Yes, thanks Michael. So, first of all, maybe I'll start with kind of our strategy and philosophy around the ingredient technologies is I think it's well recognized by our customers that, you know, when it comes to the ingredients that go into optical networking technology, that Coherent certainly has the broadest and deepest portfolio of ingredient technologies. So we don't just assemble the transceiver. We bring to our customers a very broad and deep and expansive roadmap in terms of all the underlying key technologies. So whether that's a VCSEL laser, an EML laser, a CW laser, EMLs and CWs of course based on indium phosphide platform, which I mentioned in the prepared remarks, silicon photonics, which we've had in production for a number of years. We're able to bring a wide array of technology, and that's one of the key competitive advantages that our customers really appreciate, because when they work with us and when they partner with us in a strategic multi-generational fashion, they know they're working with a company that brings a very complete portfolio of optical networking technology. And so, our approach is to invest in all those key technologies. And what we do is we work with our customers to field the particular technology that best fits their application and their needs. And so what we do is we pick out of our portfolio what we think is the most optimal technology. And so that's our approach. And that's the same approach we've taken on 800 gig. And you mentioned you asked about 1.6T. We've taken the same approach on 1.6T as well. And then in terms of the make versus buy, I think was the last part of your question. Again, our philosophy on make versus buy is we want to make where it provides a genuine competitive advantage to our customers. And where it doesn't provide a genuine advantage, then we should be buying that or sourcing that from the ecosystem. So where we invest our R&D; or invest our CapEx dollars, that's where we believe we're either generating a significant technological advantage for our customers or we're creating a significant cost structure advantage. So that's where we focus and concentrate our resources. Otherwise we leverage the ecosystem. And sometimes we mix and match as well. In the case of, for instance, EML lasers, we both source those internally, but we use external partners as well, and we have a number of really good external partners for EML lasers. So we'll sometimes use a mixture for supply chain resiliency as well. So that's kind of our overall philosophy and strategy around that.

Michael Mani: Great, thank you. And just for my follow-up, what are the puts and takes for gross margins this year? You know, the nice upside, this past quarter, so what initiatives worked well to deliver that? And I guess as we look throughout the rest of this year, what are some of the low-hanging fruit that you'd be able to tackle, whether it's improving product cost on the transceiver side, divesting non-core assets that could help us move upwards from here. Thank you.

Sherri Luther: Thank you, Michael. So, when you look at the results that we achieved for Q2, you know, 150 basis points, sequential improvement and 360 basis points year-over-year, very pleased with the results there. The, you know, the elements that drove that, certainly volume was a contributor, but we saw improvement as well on the cost side. In particular, in datacom, we continued to see improvement,

yield improvements. We saw lower cost as well as improvements in the manufacturing process that all generated improvements in gross margin. And if you recall back when we -- several quarters ago, when we put out our long-term gross margin targets of greater than 40%, we talked about our gross margin expansion strategy and the elements that comprise that. Product cost or cost reductions rather are part of that, but also pricing optimization. And so, you know, those areas continue to be, you know, areas of focus for us as we drive toward the long-term model of greater than 40%. And so pleased to see the results in Q2 and, you know, and we'll continue to focus on that going forward. You know, you asked about the remainder of the year, and I guess I would really direct you to look forward to our Investor Day in May and we'll give you more color on the various elements of our gross margin expansion strategy. And look forward to sharing that with you at that time.

Operator: And the next question comes from the line of George Nader with Jefferies. Please proceed.

George Nader: Hi guys, thanks very much. I wanted to ask about tariffs. Obviously, there's been a lot of news on that front in the last few days and weeks, but you guys obviously have a Chinese manufacturing footprint in some areas of the business, and it does seem like that 10% tariff isn't as bad as imagined previously, but could you talk about what the effect of those tariffs would look like on Coherent? And then what sorts of things could you do to mitigate those effects on the business? And then I guess the other part of this question is, is it possible that some of the strength you're seeing is a pull forward of demand, you know, customers trying to get ahead of the tariffs. But yes, those are the questions. Thanks a lot for your help.

Jim Anderson: Yes, thanks, George. So on the first part of your question, you know, obviously dynamics situation around tariffs right now, and we, you know, continue to analyze it and make sure we're adapting as necessary. But if we look at the current quarter of fiscal Q3, we don't expect a significant impact to the current quarter results. And the guidance that Sherri provided in her prepared remarks factored in any impact that we expect from tariffs. And in the second part of your question around mitigation, I think one of the things that the company has done really well over the past years is building a very resilient supply chain. And there's been a very good strategic focus on this over the past years by the team. And they've done a really great job of that. And I think that's built a lot of resilience into our supply chain and a lot of flexibility and adaptability. And by the way, I think our customers definitely recognize that as well. Supply chain resiliency is becoming increasingly important to our customers and they recognize that we have a very resilient supply chain. And I think within the optical networking industry, I would say it's world-class supply chain resiliency. Now, I'd flag a couple specific areas in particular that we have really great resiliency in our supply chain. One is geographic diversity in our manufacturing base, and that gives us great flexibility in terms of being able to shift the location of production to different geographies depending on the needs of our customer. And then the second thing is, which our customers appreciate, is vertical integration, where we've strategically chosen to invest in key technologies, which are very important from an innovation perspective or from a capacity perspective. And so that vertical integration of key enabling technologies is another source of strength in terms of our supply chain resiliency and another area that our customers really value in our overall resiliency. So we're focused on continuing to build supply chain resiliency, but I would say we have a tremendous amount of flexibility and adaptability already built into our supply chain strategy. And then on the last part of your question, which was, you know, did we see any sort of pull forward of demand? We didn't see any indications of that. In our fiscal Q2, I would say the data center demand materialized very much as we had expected at the beginning of the quarter. So we didn't see any signs of any pull forward in demand.

George Nader: Super. Thank you very much.

Jim Anderson: Thanks, George.

Operator: The next question comes from the line of Meta Marshall with Morgan Stanley. Please proceed.

Meta Marshall: Great. Thanks, and congrats on the quarter. Maybe first question, you know, you did see improvement in lasers this quarter, but had noted kind of staying kind of more cautious about that market. I just wanted to get a sense of if you could give kind of how you're viewing that maybe, you know, on Telco where you said you were going from cautious to cautiously optimistic, just how you're viewing kind of the prospects throughout the year for that business. And then I have a follow-up.

Jim Anderson: Yes, Meta. And first of all, thanks for the question. On lasers, maybe I'll address it in the context of the market. So laser's business is primarily industrial-related applications, as is our materials business's significant industrial exposure as well. And for the industrial and industrial related markets, if we look at the sub-markets, it's -- from our perspective, it's just really a mixed bag in terms of the sub-markets where we see some of the subsegments as seeing some improvement and then others as, you know, really not seeing much improvement. So overall, we continue to take in the near-term a cautious outlook on the overall industrial-related markets. We do believe that over the long-term this is a key growth area for the company, but in the short-term we're taking a more cautious view. Now that said, I will point out a couple particular sub-segments that we are seeing good growth signs from. The first of which is the display capital equipment and that's where our Excimer lasers are used for OLED screen manufacturing. And what's happening there in the end market is OLED screens are traditionally been used on smaller device screens, like mobile phones are now being used on larger device screens, like laptops and PCs. And so that represents a dramatic expansion in the total surface area of OLED screens, and it's our Excimer lasers that are a key enabling factor of the manufacturing of high quality OLED screens. And so we're seeing really good growth there. We saw growth on both a sequential and year-over-year basis. And then the second area that I would flag for some improvement that we're seeing is in semi-cap equipment. We're seeing stronger orders from some of our semi-cap equipment customers, and those stronger orders are coming on their anticipated improved demand over the coming quarters. And so that's a positive sign as well. But overall, I would say in the near-term, we're taking more of a cautious outlook.

Meta Marshall: Got it. And maybe same on materials. You know, I believe you guys mentioned automotive as kind of an ongoing headwind, but just as you look at some of the prospects for that business for the remainder of the year?

Jim Anderson: Yes. Yes. Thanks, Meeta. The -- on materials, very similar comments to lasers. A lot of the materials business is related to those same industrial end markets. So for instance, materials get used in semi-cap equipment as well. So very similar outlook on kind of just cautious demand outlook around materials going into the industrial-related segments as well. In particular, a particular area of weakness for us in materials has been around the automotive sector. And so again, here with materials, taking a more cautious outlook.

Operator: The next question comes from the line of Papa Sylla with Citi. Please proceed.

Papa Sylla: Thank you for taking my question and congrats for the strong result. I guess my first question is maybe more for Jim, I guess Coherent previously announced kind of seeing strong improvement on 200 gig per lane VCSEL. Just wanted to have kind of additional update on where you are in the process? And is the expectation that 200 gig per lane VCSEL could be available at some point for 1.6V cycle or even more of a 3.2T story?

Jim Anderson: Yes, thanks Papa. So We continue to progress well on our engineering efforts around not just 200 gig VCSELs, but I also mentioned in the prepared remarks, 200 gig differential EMLs, and also we're building a robust roadmap of CW lasers based on our indium phosphide platform as well. So again, we invest across a range of technologies and then the approach that we take is we deploy the laser technology or any other particular technology that we think is best suited for that application, whether that's a 1.6T transceiver or 3.2T or, you know, we have products on the roadmap beyond that as well. So I probably won't go into the details right now of what specific technology that we're selecting for any particular transceiver product just for competitive reasons, but our strategy and our approach is to build a very robust roadmap of ingredient technologies and to pick the 1 that's most optimal for a particular customer application.

Papa Sylla: Got it. Thank you. That's very helpful. And maybe my follow-up is around the datacom kind of margin. I believe previously you mentioned it being mostly in line with company level margins, but as you continue to improve yield and benefit from increase [Technical Difficulty]

Jim Anderson: Operator did we lose Papa's line?

Operator: Yes, Papa's line has dropped.

Jim Anderson: Maybe I'll try to answer. I think I got the gist of his question, so I'll try to answer it. I think it was around datacom margins. And let me step back at a broader company level and I'll come back to

datacom margins. So when I first joined the company on the first earnings call, made it clear from my perspective that the company needed to improve its gross margins, right? And so we've been very focused on that over the past months and quarters. And on gross margin, we're approaching it from basically two parts, and Sherri touched on this earlier. One is pricing optimization, and the other is product cost. And on product cost, I think that there's opportunity to improve product cost across the company, not just in datacom, but also in telecom and all of our industrial products, whether that's materials or lasers. I think we have a lot of work to do to drive improvements on product costs. And one of, I think Papa was asking about yields, I thought I heard him say yield at the end, but one of the key areas that we're driving improvements, for instance, in datacom margins is by improving yields. And I mentioned this on the prior earnings call a quarter ago and so that's one of the key product cost areas that we're focused on. There's others as well. But definitely gross margin is a key focus area of the company. We have a lot of energy devoted to that effort right now and I'm quite pleased with the progress that the team has made, but also we have a lot of -- lot more work to do and we have a lot more work ahead of us, but we're very focused on that gross margin improvement goal.

Operator: And the next question comes from the line of Karl Ackerman with BNP Paribas. Please proceed.

Karl Ackerman: Yes, thank you. I have two questions if I may. To start, Jim, is your AI transceiver opportunity this year gated by your current indium phosphide wafer capacity? I ask because some investors are contemplating how important laser wafer capacity is when you and peers discuss your transceiver roadmap with hyperscalers? And then I'll follow-up please.

Jim Anderson: Yes, thanks Karl. So what I would first say on supply chain and capacity is, look, I want to take the opportunity to thank my supply chain and manufacturing team for doing an outstanding job of increasing capacity and supporting our customers. If you look at our data center, datacom revenue, it grew 79% year-over-year in the most recent fiscal quarter. And I think the team's done a great job of supporting our customers. And we've been both ramping internal capacity, for instance, in datacom of the assembly of the transceivers, but also in the ingredient technologies. I mentioned you asked about indium phosphide. One of the things I mentioned in the prepared remarks is if you look at our fiscal Q2, on a year-over-year basis we tripled our indium phosphide capacity. And it's our intention to continue growing indium phosphide. And the U.S. Government recently announced plans to help us with the expansion of indium phosphide capacity at our Sherman, Texas plant. So indium phosphide platform, which we've had in-house for over 20-years, we view as a key technology and we expect to continue to ramp, you know, ramp volume of indium phosphide technology for EML lasers, CW lasers, et cetera. Now we do also use a multi-source strategy, for instance, on EML lasers where we have, you know, good external partners as well. But we certainly are focused on continuing to ramp capacity given the demand signals that we're seeing from our customers over the long-term.

Karl Ackerman: Very clear, thank you. And then if I may, just on OpEx, how should we think about OpEx in March and throughout '25? I guess do you anticipate growing OpEx in line with sales growth before and restructuring some of the initiatives that you've already previously laid out, but are still at the forefront? Thank you.

Sherri Luther: Yes, thank you, Karl. So from an OpEx perspective, when you look at Q2 in terms of our OpEx results there, you saw that we increased our R&D; spend sequentially, and that's really as a result of our philosophy that we want to make sure that we are investing our R&D; dollars for the long-term growth of the company and really those projects that have the highest ROI. So from an R&D; perspective, that's what drove the sequential increase in Q2 and when you look at the midpoint of our guide for total OpEx for Q3, that's also a key driver of the increase going into Q3. From an SG&A; perspective, in Q2 you saw that we actually reduced our SG&A; spend, in particular the G&A; part of that, and that again is part of our philosophy that we want to drive greater leverage and efficiency in the business. And so, you know, the increases in OpEx going into Q3 are really driven by R&D; spend. Now, on a quarterly basis, you can always see fluctuations, whether it's in terms of the timing of the benefits that we're able to achieve on the SG&A; leverage front or the timing of spend of R&D; programs. But that's our philosophy in terms of investing and with respect to OpEx. When you look to the rest of the year and you know that really is an invitation for you to listen to our Investor Day in May as we give more perspective on our long-term model and how we're thinking about that, but that will

give you that's just a perspective on Q3 and how to think about that.

Karl Ackerman: Very clear. Thank you.

Operator: The next question comes from the line of Thomas O'Malley with Barclays. Please proceed.

Thomas O'Malley: Hey, guys. I have a short-term one and then a long-term one. Just briefly, for the March quarter, do you think you could walk through? Obviously, revenue is flat and it sounds like communication continues to be cautiously a bit better than you had originally expected it. But any color on just the broader segments what gets you to that flat guidance into March is the first question?

Jim Anderson: Yes, thanks Thomas. It's pretty straightforward. We expect datacom and telecom to be up sequentially. And we expect the rest of our industrial related businesses to be down sequentially. And that net at the midpoint to be flat.

Thomas O'Malley: Gotcha. Super helpful. And then I just wanted to talk strategically longer term. As you look at the dynamic for the transceiver market, particularly in the datacom, are you starting to see, you know, a change in behavior from some of the hyperscalers as it relates to the domestication, domestic, I don't even know how to say the word, but the move to domestic producers of transceivers. And, you know, are you seeing changes in ordering behavior at this point? Or is that all kind of headline news and no real changes yet? I'd just love to get a feel for, you know, if you're already starting to see a move to move supply chains onshore? Thank you.

Jim Anderson: Yes, thanks Thomas. What I would say is that I definitely believe that we have the opportunity to gain share over the coming quarters and years, and we're certainly focused on that. And when we talk with customers, it almost always, discussion revolves around two things. Number one, it always starts with the roadmap of technology, and not just our transceiver roadmap, but the underlying ingredient technologies. And I think our customers recognize the, you know, the breadth and the depth of the technology that we can bring to them and I think that's a big competitive advantage. But I think more to your question, the second part of the discussion, which always is part of the customer discussion as well, is around supply chain resiliency and the fact that we have great resiliency in both geographic diversity, in the flexibility and adaptability that, that provides us, as well as the vertical integration. And they see that as -- that supply chain resiliency as a tremendous advantage. And so that's another benefit beyond just our raw technology roadmap. And so I would say that both of those are very much appreciated by our -- certainly by our big strategic customers.

Operator: The next question comes from the line of Christopher Rolland with Susquehanna International Group. Please proceed.

Christopher Rolland: Hey, thanks for the question. This one's for Jim. And Jim, you're a bigger picture thinker, so this is a bigger picture question, I think. It's really around networking intensity and also timing of either the peak in 800G or the beginning of 1.6. And there's kind of two parts, the first part is DeepSeek. Obviously all the connectivity guys were down big that Monday. Do you think that impacts connectivity at all, the outlook for it? And then perhaps there are pushouts of key AI products. Do you see that affecting either 800 or 1.6 for you guys this year?

Jim Anderson: Yes, thanks Chris. So on the first part of the question around DeepSeek and the outlook, you know, first of all, say that we've seen no significant changes in our customers' outlook, both in terms of the orders that they're placing or the long-term forecast that they have been providing to us, we've seen no significant change there. And, you know, I would say in terms of longer term, I think we share the view that many others do in the industry, which is that to the extent that any technology, whether it's DeepSeek or any other technology, makes AI more pervasive that propagates AI in a wider way, makes it easier to adopt or cheaper to adopt, we view that as providing underlying growth for the market over the long-term. So we view that as a long-term positive market trend. But in the shorter term, we've seen no significant change in customer forecasts or ordering patterns. And because of that, I also don't see any impact that it has on 800 gig peak or 1.6T ramp. I don't believe it will have any effect on that. And just more specifically on that part, you know, we believe 800 gig will continue to grow over the coming quarters, even as 1.6T is introduced. Because if you look at the customers, actually the customers, it really depends on the customer on what specific data rate they're currently on. We still have a number of customers that are primarily on 400 gig and still have yet to transition to 800 gig. We have customers that are just at the beginning of their 800 gig ramp. So I think it's you know 800 gig continues to grow while we start to ramp 1.6T.

Christopher Rolland: Excellent, thank you Jim. And then secondly you know there are a bunch of Chinese guys with really big capacity ramps coming. I'm just wondering if you're seeing anything in terms of transceiver pricing, pressure on, on your own gross margins in this area? And how much more cost cutting there is to do on the gross margin side or efficiencies on transceiver as well?

Jim Anderson: Yes, thanks Chris. I would call the transceiver pricing that we've seen as pretty stable. I don't end as predicted as we would expect. I don't think there's been any unusual pricing changes that we've seen. And then on the second part of the question around gross margin efficiency, you know, and I kind of addressed that a little bit earlier in the questions around at a company level, I think we have a lot more work to do on driving product cost efficiency in our gross margin line. So a lot more work ahead of us. And that includes for transceivers as well. I think there's improvements that are still in front of us in terms of improving product cost structures, yield being one of them, but I think input costs are an opportunity for us as well. So yes, a lot more work to do. Good progress, and I appreciate the progress from the team in fiscal Q2, but both Sherri and I are not yet satisfied with the gross margin and we continue to make sure the company is focused on it.

Christopher Rolland: Great to hear. Thanks, Jim.

Operator: The next question comes from the line of Jack Egan with Charter Equity Research. Please proceed.

Jack Egan: Great. Thanks for taking the question. I was hoping you could talk about the yield improvements in datacom a bit. So I was wondering where exactly it came from, like whether it was materials or on the manufacturing or backend side? And then are they coming from kind of the typical development process where you can just continually squeeze out improvements or have these been more like discrete one-time improvements?

Jim Anderson: I would say it's a range of things, right? There's a number of different places that we're focused on yields. I would say some of them are one-time improvements. Some of them are things that we believe are ongoing improvements that we're sort of at the start of ongoing improvements. I think it's a range of things. We're certainly looking at the entire expanse of any yield improvements we can drive. But also, as I mentioned just a minute or two ago, we're definitely looking at input costs, on overhead costs, anywhere where we can drive cost efficiency, we're focused on that. So I think it's a range of activities.

Sherri Luther: Yes, I would just add that, just a reminder that from Q1, going into Q1, we saw improvements in yield as well. And we continue to see that in Q2. So as Jim mentioned, it's in different areas, different products, different parts of the process, but we're focused on all those areas and we're really pleased to see continued yield improvements in Q2 in the datacom business.

Jack Egan: Great. And so, for my follow-up then, you've given a lot of color on your strategy from the product portfolio and efficiency standpoints. And I know you'll probably share more on this during the Investor Day, but have you made or are you looking to make any major changes when it comes to kind of the sales and marketing or the distribution side, because Coherent has the very broad footprint with vertical integration, as you mentioned. So I was just curious if there were any synergies there?

Jim Anderson: Yes, thank you. So that is another area that we've been driving improvement in. What I would say is kind of similar to the activities we were driving in R&D; is we're trying to make sure that, first of all, that the resources around sales and marketing are applied in the area of greatest opportunity. And so we have made changes where we've reduced resources and sales resources in some areas and we've increased resources in other areas. And so we are shifting resources to where we believe is the greatest long-term growth opportunity and margin growth opportunity for the company. And so yes, we are, there's a number of changes we've already driven and that's someplace where we'll continue to drive improvements moving forward.

Jack Egan: Great. Thanks, Jim.

Jim Anderson: Thank you.

Operator: Thank you. We have reached the end of our time for Q&A.; I'd now like to turn the floor back to CEO Jim Anderson for closing comments.

Jim Anderson: Yes, thank you operator and thanks everybody for joining us on the call today. So as we wrap up here, I first of all want to thank all of my Coherent teammates for the great hard work and the

dedication and the really good solid execution in our fiscal Q2. And thanks for everybody on the call today. Thanks for your support and looking forward to continuing to update you on our progress. Operator, that concludes our call. Thank you.

Operator: This concludes today's conference. You may now disconnect your lines at this time. Enjoy the rest of your day.