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ESIO - Q2 2017 Electro Scientific Industries Inc Earnings Call

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CORPORATE PARTICIPANTS

Brian Smith *Electro Scientific Industries, Inc. - Director of IR*

Michael Burger *Electro Scientific Industries, Inc. - President and CEO*

Ed Grady *Electro Scientific Industries, Inc. - Director*

Paul Oldham *Electro Scientific Industries, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Tom Diffely *D.A. Davidson & Co. - Analyst*

David Duley *Steelhead Securities LLC - Analyst*

James Ricchiuti *Needham & Company, LLC - Analyst*

PRESENTATION

Operator

Greetings, ladies and gentlemen, and welcome to the ESI Fiscal 2017 Second Quarter Earnings Conference Call. My name is Sheena, and I will be your operator for today. (Operator Instructions)

I would now like to turn the conference over to Mr. Brian Smith. Sir, you may proceed.

Brian Smith - *Electro Scientific Industries, Inc. - Director of IR*

Thank you, Sheena, and good afternoon, everyone. My name is Brian Smith, Director of Investor Relations at ESI. With me today are Michael Burger, our CEO; Ed Grady, our former CEO and Board member; and Paul Oldham, our Chief Financial Officer. For today's call, Michael will discuss his initial thoughts about the company, Ed will cover the highlights of the second quarter and Paul will review the financials and the outlook. This call will cover our fiscal second quarter of 2017 results.

Before we begin, I would like to remind you that some of what we say on this call will include forward-looking statements concerning customer orders, shipments, revenue, gross margins, expenses and earnings. These statements are subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements include a number of risks and uncertainties that are discussed in more detail in today's press release and our filings with the SEC. Actual results may differ materially from those forward-looking statements. This call also contains time-sensitive information that we believe to be accurate as of today, November 1, 2016, and which could change in the future. This call is the property of ESI.

Now, I'd like to turn the call over to Michael.

Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

Thank you, Brian. Good afternoon, and welcome to our second quarter conference call. Before I begin, I'd like to take the opportunity to share with you how thrilled I am to be joining the ESI team. ESI has a wonderful combination of technology, leading-edge products and talented people who are dedicated to innovation. My initial impression is that we have significant opportunities available to ESI. ESI's core competencies are the answer to many of the technology issues facing our customer base today. I am excited and humbled by the opportunity to lead the company to its next chapter of evolution. In these times of rapid technology change, my initial efforts will focus on our go-to-market strategy, acceleration of new product adoption and innovation while returning the company to sustained profitability.

I would also like to take this opportunity to thank Ed Grady for his leadership of the company over the last 2.5 years. Ed's leadership and style will be missed by all. Again, I'm excited by the prospects for the success here at ESI, and I'm anxious to work with the ESI team and Board of Directors to move the company forward.

With that, I'd ask Ed to provide a brief overview of the quarter.

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Thanks, Michael. Before I begin, let me reiterate how pleased I am that Michael has joined the company. We initiated our search process for the transition early this year, and we're thrilled when Michael became available and then accepted our offer to take the CEO role here at ESI. He and I have spent considerable time together, focused on a smooth and orderly transition. I'm excited at the skill set, relevant experience and energy level that he brings to the company, and I'm confident in his ability to drive profitable growth for ESI.

Looking at the quarter, Q2 was clearly a challenging one with continued slow demand for tools in the flex and micromachining markets, leading to lower revenues and below breakeven bottom line. Clearly disappointing in terms of our timing of our turnaround. However, at the same time, we did continue to make progress on our new product deployment, and we have completed the acquisition of Visicon which we believe will provide new opportunities for growth and product differentiation.

Looking at the dynamics of the quarter, flex via drilling capital equipment demand remained weak during Q2 as we expected and mentioned in the last conference call. The market is still digesting the capacity added earlier this year, and we expect that to continue for at least another quarter. Industry analysts continue to project high growth in the flex circuit market over the next several years, driven by new technologies, miniaturization, increased flex content in our end devices and subdued but overall continued device growth which supports our expectation of a recovery.

Our competitive position in this market is very strong, following a record year last year driven by GemStone, and is enhanced by two new products we added to the portfolio in Q2, LodeStone and RedStone. These products bracket this market at the ultra high end and at the entry-level, and initial customer reaction to both has been favorable despite weak demand environment.

On the new product front, we are in the final stages of customer acceptance for the first CornerStone unit which we shipped in the summer. In addition, we shipped our second unit to a new customer in early October. We're also making good progress with customer pull in providing initial qualifications for a second material set within the IC packaged market which will allow CornerStone to address the needs of an additional set of ICP manufacturers and grow our addressable market.

Turning to our HDI market segment. We shipped multiple nViant Series 1 tools for on-site evaluation and qualification during Q2, and we are fully subscribed in our general centers. We also received a conditional order from a Tier 1 manufacturer, this is a significant milestone. Customer interest continues to be strong, although it is clear that evaluations and qualifications will take longer than we initially expected as these qualifications tend to have multiple steps, various process parameters and several parties involved in the final decision. As a result, we're focusing on completing evaluations at current installations and believe that by focusing on the larger opportunities, we'll be better positioned to participate in the buy cycle going forward.

Turning to our micromachining business. We are beginning to see improved quote and design activity. We identified two unique market segments with several new applications where our technology provides compelling differentiation. As a result, during Q2, we secured two design wins in these applications, using our new Garnet platform. While the initial orders will be small, we believe we have the opportunity for further traction in these markets.

In addition, the acquisition of Visicon is opening up several new business opportunities for inspection and metrology applications in both consumer electronics and medical devices for ESI. As expected, customers are expressing increasing interest in an integrated solution that combines both laser processing and automated verification.

The remainder of our product lines remained on track. We won an initial order for laser subsystems in the OLED market. Component test and laser ablation product lines continued and booked new orders for new tool configurations which we believe will continue to drive incremental growth and profitability in these smaller markets.

With that, I'll turn the call over to Paul for an overview of our financial results.

Paul Oldham - *Electro Scientific Industries, Inc. - CFO*

Thank you, Ed, and good afternoon, everyone. The following information includes results from our second quarter of fiscal 2017 which ended on October 1, 2016. To improve comparability, we are also providing earnings per share and related income statement results on a non-GAAP or adjusted basis, excluding the impact of purchase accounting, equity compensation, acquisition cost, restructuring and other items.

For the quarter, orders were $28 million. The low bookings are the result of continued overcapacity in the flex via drilling market and weakness in micromachining. In addition, although we continue to see good customer activity and engagement, commercial adoption of our new products has not yet begun to produce significant topline contribution.

In our component processing segment, orders in our interconnect business were down sequentially. Slightly higher system orders were more than offset by lower service orders due to timing of contract renewals. Orders for component test products were slightly below last quarter on timing of system bookings and orders for our semiconductor product group fell slightly following a strong Q1 on timing of demand for specialty lasers we make for the flat-panel display market. Overall, revenue in these two product areas were about flat.

Demand in our micromachining segment was slow again in Q2. We did receive additional orders for our new Garnet platform and secured two small design wins, as Ed mentioned. Shipments were $31.5 million and the backlog decreased by $2.8 million to $34.3 million. Our book-to-bill ratio was 0.9 to 1.

Revenue for the quarter was $29.7 million, driven by the lower order levels, down 38% from last quarter and 36% from last year. Systems revenue was $21.4 million, down 44% from last quarter. Service revenue also decreased sequentially to $8.2 million on lower on-demand activity.

GAAP gross margin was 37% and included about $360,000 of purchase accounting and equity compensation in cost of sales. On a non-GAAP basis, gross margin was 38.2% compared to 46.7% last quarter, primarily on lower sales volume and less favorable product mix. Looking forward, we expect gross margins to be a little lower in Q3 on favorable other cost of sale items in Q2 that we do not expect to repeat.

GAAP operating expenses were $20.9 million, about $400,000 higher than last quarter, primarily on higher stock compensation and Visicon acquisition expenses. Operating expenses included $1.6 million of purchased accounting and stock compensation. On a non-GAAP basis, operating expenses were $18.9 million, flat with last quarter and down over $0.5 million from a year ago, despite including two months of expenses related to our acquisition of Visicon.

Looking forward, we expect non-GAAP expenses in Q3 to be up $500,000 to $800,000 on a full quarter of Visicon and timing of expenses. On a GAAP basis, operating loss was $9.9 million and included approximately $500,000 of Visicon acquisition and integration costs, partially offset by a small credit related to the recovery of a portion of the Topwin acquisition price we discussed last quarter.

Non-GAAP operating loss was $7.6 million. GAAP net loss was $9.7 million or $0.30 per share. This compares to breakeven earnings last quarter and a loss of $0.10 per share last year. On an adjusted basis, net loss was $7.7 million or $0.24 per share toward the low end of our guidance range compared to net income of $3 million or $0.09 per diluted share last quarter and a loss of $1 million or $0.03 per share last year.

Turning now to our balance sheet. Cash and investments decreased to $59.1 million. We used the $7.5 million of operating cash during the quarter, primarily on negative EBITDA and higher working capital. Accounts receivable decreased by $4.5 million to $29.9 million. DSO was 92 days on timing of shipments in the quarter. Inventories increased by $2.4 million to $61.9 million, primarily due to the acquisition of Visicon inventory. Inventory turns were approximately 1.2 times. Accounts payable decreased by $5.4 million on the timing of inventory receipts and payments.

Capital expenditures were $1.2 million, down from $1.5 million last quarter. Depreciation and amortization, excluding purchase accounting, was $1.9 million. Finally, we paid approximately $2 million in cash and expect to issue approximately $637,000 shares of stock for the Visicon acquisition.

In summary, overcapacity in our markets and timing of traction in our micromachining business has significantly impacted our orders and revenues. Additionally, qualification and adoption rate of new products continues to take longer than expected, given our customers' qualification and investment cycle. In light of these conditions and the traditional seasonality in our business, we remain cautious in our outlook for the third quarter. While visibility remains limited, we are however, beginning to see increased quote activity and potential new product opportunities. In the near term, we will continue to focus our investments on the highest priority growth opportunities, manage our spending carefully and look for innovative ways to improve our operating efficiency. Based on Q2 orders and backlog, we expect third quarter revenues to be approximately flat with Q2 levels and non-GAAP loss per share to be between $0.25 and $0.30.

Now, I'll turn the call back to Michael.

Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

Thanks, Paul. As I mentioned, I'm excited about the opportunity to lead ESI. Although we are experiencing a difficult market environment, the core competencies of ESI remain intact. And I look forward to working with the ESI team to improve our shareholder's return. This concludes our prepared remarks and at this time, we'd be pleased to take your questions. I'll turn it now back to the operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of David Duley from Electro Scientific Industries (sic - see website, "Steelhead Securities"), you may proceed.

David Duley - *Steelhead Securities LLC - Analyst*

Thanks for taking my question. Ed, thanks for all the work you've done there. And Michael, congratulations on the new position.

Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

Thank you.

David Duley - *Steelhead Securities LLC - Analyst*

So my first question has to do with the core business and going into the seasonally slower, typically December quarter. When would you guys think -- which is understandable that your guidance is somewhat flat. When would you guys think your core business starts to recover? And what are some of the things in the end markets that we should look for to help us understand when it will recover?

Paul Oldham - *Electro Scientific Industries, Inc. - CFO*

Yes, it's a good question, David. I'll take a cut at it. We said last quarter that we expected our core business to be down two to three quarters, and that's still the case. And it's looking like two -- it's at least two or at least three and maybe a little bit longer. But the factors that we think will impact the recovery are the same. Certainly, as we look into next calendar year and our next fiscal year, we expect to see new designs coming that would impact the flex circuit business. We expect to see potentially more volume in devices based on new introductions of devices across the world. And the capacity that is pretty much been sold out for this year should start -- we should start to see some additions to that again. Right now, it's hard to tell exactly when that will be but we could start to see that in our fourth quarter or into the first quarter.

David Duley - *Steelhead Securities LLC - Analyst*

And maybe help us understand what the utilization rates are in some of those markets that you were referring to.

Ed Grady - *Electro Scientific Industries, Inc. - Director*

So David, the feedback we have against where our service organization, looking at the tools installed, we're seeing utilization rates in pretty much every geographic area except Korea at nearly 100% utilization. We're seeing 99%, 98%, 99%, 100% utilization. Korea still is a little bit overcapacity but that was driven from an investment, I'd say, four, five years ago that still has that market a little bit behind. What's interesting about that is that some of these same suppliers who have overcapacity or have underutilized capacity in Korea are actually moving shop and setting up new shops in other geographic areas. And we have seen some demand, incremental indications of demand as the new factories appear to be being built in other geographic regions.

David Duley - *Steelhead Securities LLC - Analyst*

Okay. And as far as on the new product front, the IC packaging product and the HDI product, it sounds like you're having a lot more evaluations and people looking at the nViant and the IC packaging product. But anyway, which one would you expect to kind of turn on first and what would you expect the timing to be to see, I guess, more significant levels of revenue and orders?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

They're both about in parallel right now, David. I would say that from our interest as a company perspective, we are very interested in deployment of the IC package product because it tends to be the best cost of ownership for that application. Again, what we're seeing is the configuration of the tool, the average selling price is a little bit of a change for the customer base. So they have to get in and run the samples and check and do their cost of ownership analysis. So once they get through that, it's actually quite a compelling opportunity.

What's also interesting is, in the IC package market, there are different material sets. And our first deployment was a material set that was driven by a large customer's supply chain base. And what we're seeing now is a different material set, as I mentioned in the remarks, that we're seeing tremendous customer pulls for this alternate material set which I think, both of those we'll start to deploy over the next six to nine months, and we should see -- begin to see more and more traction in that set.

We have great traction in the HDI market. The issue we've run into in the HDI market is the qualification cycles are really much longer than we expected. So even to the extent, I think, we said at one point that we thought the qualification cycle in HDI might be a little faster. And as it turns out, it's absolutely not. It's more like the six- to nine-month qualification cycle just because of the complexity of that. So we're in different phases. I'd say CornerStone is a little bit ahead but HDI is close on its heels.

Operator

The next question comes from the line of Tom Diffely from D. A. Davidson. You may proceed.

Tom Diffely - *D.A. Davidson & Co. - Analyst*

And first, Michael, it's really good to hear you on these calls again. It's been a few quarters.

Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

Thanks. Good to see you.

Tom Diffely - *D.A. Davidson & Co. - Analyst*

So I want to dig into the nuances of the flex drilling business a little bit more. And hopefully, you can maybe explain what it was -- what was it with the consumer products in 2016 that didn't drive incremental demand? And what is it about the products that you see coming in 2017 that will drive some incremental demand?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Tom, I think that the answer is a little bit different than your question. So we actually did see significant incremental demand but it was all in one big pop that came through last year. Remember last year, we said was a record year for us in the flex drilling market, driven by GemStone which is very much the high-end, newer, more complex smartphone application. And all of that capacity, as I said to David, is running at 100% -- basically 100% capacity right now.

There is a -- I would say there's a reticence on the part of customers in the market to make further capital investments at this time, given the unknowns of the next generation of products that are coming out at the high end. So I guess, what I'm trying to get to is there's really not that we didn't see the demand this time. We saw it, it just came in a big lump.

Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

And now it's getting absorbed through.

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Right.

Tom Diffely - *D.A. Davidson & Co. - Analyst*

All right. That makes sense. So what's the cycle time and how long can these guys wait to order equipment? Could you -- I assume you could get some pretty quickly at this point.

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Yes. It's hard to say. Our visibility is no better than theirs. There tends, as I said, to be some reticence in the customer base about buying capital equipment 'til they have a little bit higher level of uncertainty. Most of the customers have gotten with thought around in the past, and they just tend to be more conservative in capital investment. But it's the cycle of lead time for the next generation high-end smartphones that really is going to drive the next level of investment. And I suspect that will stay on track with what it's been in the past several years, of being kind of a, what is an October type release for some of these new products and -- September, October and capacity prior to that.

Paul Oldham - *Electro Scientific Industries, Inc. - CFO*

Historically, we've seen our strongest demand in the flex business in the March and June quarters. Then they're seasonally lower on the demand side in the fall and winter. And that's -- we saw that last year for sure, it's just at an exaggerated level because of all the capacity that was put in.

Ed Grady - *Electro Scientific Industries, Inc. - Director*

And we saw it a little earlier last year.

Paul Oldham - *Electro Scientific Industries, Inc. - CFO*

We actually saw it a little early, it started in September. So I think it's a similar pattern. What we don't know as much of is what will be that pace this year as people look at that capacity and those technical demands for next year's. But we don't have any concerns that the underlying dynamics of the industry are somehow changed. This could -- the flex market continues to be a healthy market, it's going to see growth in units for sure.

Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

And we don't believe there will be lost share either.

Paul Oldham - *Electro Scientific Industries, Inc. - CFO*

Yes, we haven't lost share. So it's just a question of the timing as people get ready to look at next year's buying cycle and where that will be and what it will consist of.

Tom Diffely - *D.A. Davidson & Co. - Analyst*

Okay. Well, I guess, I'd like to rephrase my first question then. Is there anything about next year's -- anything about next year's designs that could drive incremental growth over what you typically see?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

I don't think so. I think it's going to be kind of a slow grow -- kind of claw your way back out as these guys start to get the orders placed from their customers. And I just might -- if I go back in history and look at years ago when we had the big lump that came out of Korea, we kind of had the big lump that came out of Japan and Vietnam this last time and now, we're looking at the future and it's a similar cycle. It's going to be where you kind of claw your way back out from an overcapacity situation. And quite honestly, with things at 100% utilization right now, I'm not sure we're at a significant overcapacity. I think we're really balanced. So in reality, the new drive is going to come from the more functionality in these newer smartphones.

Tom Diffely - *D.A. Davidson & Co. - Analyst*

Okay, it sounds good. And then moving over to the CornerStone. Obviously, a nice second order during the quarter. But curious, what is the revenue opportunity on a per customer basis for a product like this?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Average selling price for this tool ranges from $1.2 million to $2 million, depending on tool configuration. And the market size for this type of tool is in kind of the 50 to 75 per year range. And we're not going to have 100% market share.

Tom Diffely - *D.A. Davidson & Co. - Analyst*

Okay, all right. And then finally, when you look at the HDI business, you were obviously saying that qualification's taking a little longer than expected. Can you put any timeframe on it? Is it months longer, quarters longer?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

It's at least one quarter longer than we had initially anticipated. And again, it's customer by customer. It's interesting in the HDI space, that you've got some big HDI customers, Tier 1s and we were really pleased and it was a real milestone for us to get an order from a Tier 1 HDI customer this last quarter. But we have also been working with the second and third tier suppliers in that space. And as you get further down the supply chain, you can imagine you qualify at the, let's say, a third tier supplier, you qualify with them who then qualifies with the next person up the supply chain who then qualifies with actually, the user.

So it's very highly dependent on where you are in the supply chain base. And our initial entree into the market was more with the second and third tier players. And what we have really done is move to dealing pretty much all with the second and first tier suppliers now because again, the length of the qualification cycle and we just -- we've got to move forward and get better positioned for the high-volume order placements.

Tom Diffely - *D.A. Davidson & Co. - Analyst*

Okay. Is it access to capital that's the issue or just obviously, timing of new products and when they need actual capacity adds?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

It's timing, timing of when they need to add capacity. The interesting thing is that in the HDI market, while printed circuit board generally is growing kind of in the low single-digits, you have to look at -- for capital equipment, it's not that growth rate, it's more the tools that are needed are laser tools that are replacing mechanical drills because mechanical drills are running out of gas. Some of the CO2 drill capability is getting utilized fully. And so it's really pushing the edge of the envelope to the smaller [BUs] higher densities in the HDI space that's driving the pull for our products.

Tom Diffely - *D.A. Davidson & Co. - Analyst*

Okay. And then finally, if you just look across the new product portfolio, although timing has been pushed out a little bit, has anything changed in your view of the market size, your position in that market and your long-term potential?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Not in terms of the market size, not in terms of the long-term potential. As a matter of fact, I think we believe it's equally as strong. Timing-wise again, that's the biggest issue we've had. It's more timing than anything else, so the answer from my perspective is I think we're -- it's just a matter of timing. And market size remain as they are. We characterize the number of tools per year that are being purchased. We pretty know and understand that. We understand who the big customers are, we understand who -- it's just I don't know how to say it, Michael, other than timing.

Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

Yes, and timing of the deal.

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Tom, I did miss one thing, I'm sorry. The change in technology in the board is actually an interesting other piece that will help drive. It's the thinner copper, thinner materials, different materials that are interesting and it's added to some of the complexity to the qualification cycle. But I think it's ultimately going to be to our benefit that these changes are happening.

Operator

Your next question comes from the line of Jim Ricchiuti from Needham & Company. You may proceed.

James Ricchiuti - *Needham & Company, LLC - Analyst*

Michael, welcome to ESI.

Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

Thank you very much, good to be here.

James Ricchiuti - *Needham & Company, LLC - Analyst*

I guess, the question I have initially is just on the flex market in Korea. I'm just wondering if there's been any additional disruption in that market just from the large recall in the smartphone market. Is that playing into any of the issues you're seeing in that market?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Not that we can tell, Jim. This has been more of a historic thing. It really hasn't been driven by that. Actually, Michael and I were in Korea a week ago and the implications were that that's basically been pushed back through the supply chain, and we -- if anything, I think there are companies in China and in other smartphone manufacturers who have reaped the benefits, but it hasn't created demand for incremental capital equipment.

James Ricchiuti - *Needham & Company, LLC - Analyst*

Okay. And Ed, I think you alluded to some design activity, design wins in the smartphone market, I think, from a micromachining application. Are these applications for some of the Chinese smartphone manufacturers?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Let's see. We have had -- the two that I referenced in the conference call are not. In both cases, they are domestic companies. That's probably all I can say about it at this point.

James Ricchiuti - *Needham & Company, LLC - Analyst*

Okay. So you also alluded to, I think, an order for a laser subsystem in the OLED market. I'm just wondering, is that more of just kind of an opportunistic or I mean, obviously, there's a significant investment cycle underway in that market. Do you guys see yourselves participating in that?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Yes. Jim, the decision we made a couple of years ago was to avoid getting into the large glass handling business. We just didn't have the capability. Remember the old glass business that we talked about years ago? And we've decided that we can play as a supplier to those people who do large panel handling. So this was a win as a subsystem into large -- basically an integrator who puts us into their system.

James Ricchiuti - *Needham & Company, LLC - Analyst*

Okay. Do you see the opportunity for follow-on business? Could this be generate any meaningful incremental revenue for you?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

I'd say yes, but not to the extent of the CornerStone and nViant and flex tools.

James Ricchiuti - *Needham & Company, LLC - Analyst*

Fair enough. Also, with respect to the acquisition of Visicon, can you say what it added in terms of revenues? Or Paul, maybe can you give us a sense as to what the dilution might have been and what you're anticipating over the next quarter or so as you begin to integrate this?

Paul Oldham - *Electro Scientific Industries, Inc. - CFO*

Yes, we had it for two months and so, it was a small amount of revenue. We talked last quarter that we thought it would be dilutive in Q2 by between $0.02 and $0.03, it was right in that range. The integration itself is going really well, and we're seeing, as Ed mentioned, opportunities not only on a stand-alone basis for Visicon products but also a lot of interest for integrated products with micromachining. So I'd say it's early days at this point but so far, everything that we expected that the acquisition could bring seems to be on track.

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Jim, the only other thing I would add to that is that -- it's interesting, they had a very good channel into the medical device market because of the products they provide for stent inspection. And interesting insights that we're learning about applications for laser and laser-based systems that could add incrementally, a slight fit to that micromachining capability in the market or addressable market.

James Ricchiuti - *Needham & Company, LLC - Analyst*

Okay. And then just as you look out over the next couple of quarters, how do you see this acquisition contributing? Do you see -- is there going to be a six- to nine-month period where you begin to incorporate the technology and integrate it in before we see some more obvious benefits of the acquisition?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Yes. Jim, I'd say the first thing you will see is standalone tool sales in metrology and inspection. It takes time to get these things integrated into the laser tools, so that's probably a third order effect at this point. So I'd suggest to you that first thing you'll see is standalone tools and you'll also see is a continued contribution from the medical side. And then, I guess, the third order is the integrated tools. While we see a lot of pull for it, it still takes time to integrate that stuff, get it designed in and get the software and algorithms to work together with the laser platform. So the impact on revenue is probably going to be one, two, three. Does that help you?

James Ricchiuti - *Needham & Company, LLC - Analyst*

Yes, no, that's helpful. And just last question for me is when I hear -- you talk about the utilization rate -- capacity utilization rate being as high as it is outside of Korea. It would appear that it may not take much for the flex business to turn on again. And I mean, do you find it a little unusual that you're seeing those kind of utilization rates and yet, the business is as weak as it is outside of Korea?

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Me from my perspective, the answer is yes. But I also, in talking with our customers, understand why they're doing it. They've been, I guess, given signals of they're going to win business and then not win the business. And they're just really hesitant to make capital equipment investments until they actually get commitments from whoever the downstream OEM is going to be.

Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

Yes, I think it does smell like there's a lot of confusion, particularly with the Samsung situation and others about the overall demand, the end phone demand on the high end. And I think that has caused some, perhaps, stutter steps. It sounds like, at least, from a customer perspective.

Paul Oldham - *Electro Scientific Industries, Inc. - CFO*

And I think for this fall production season, they're just saying, look, I'm going to run full on with what I have and then we'll look at next year --

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Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

Still I'm forced to do something else.

Paul Oldham - *Electro Scientific Industries, Inc. - CFO*

I see how that's going to shake out. So it is a little surprising in that regard because typically, we would see a little spill over due to the tools, a few tools there. But I think people are just sort of sitting tight, running full out and then will recalibrate as they go into calendar year.

Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

We're hopeful.

Ed Grady - *Electro Scientific Industries, Inc. - Director*

As we said in the call, Jim, we are seeing incremental RFQs and indicators but I think that's people positioning for what if they get something.

Operator

(Operator Instructions)

Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

Well, it doesn't look like we have any more questions, so I want to thank everybody for attending our conference call. And once again, I want to thank Ed for his leadership, and it's a rare thing to find a board member that basically gives up has life and says, yes, I'll pitch in for a while, and it's very much appreciated. So thank you, Ed.

Ed Grady - *Electro Scientific Industries, Inc. - Director*

Thanks, Michael. I appreciate it.

Michael Burger - *Electro Scientific Industries, Inc. - President and CEO*

All right. We'll talk to you next quarter. Thank you.

Brian Smith - *Electro Scientific Industries, Inc. - Director of IR*

Sheena, back to you.

Operator

There are no questions in queue. Ladies and gentlemen, this concludes today's conference. Thank you for your participation. You may now disconnect, and have a great day.