

FINAL TRANSCRIPT

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ESIO - Q1 2010 Electro Scientific Industries, Inc. Earnings Conference Call

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CORPORATE PARTICIPANTS

Brian Smith

Electro Scientific Industries, Inc. - Director, IR

Nick Konidaris

Electro Scientific Industries, Inc. - CEO

Paul Oldham

Electro Scientific Industries, Inc. - CFO

CONFERENCE CALL PARTICIPANTS

Jim Ricchiuti

Needham & Co. - Analyst

Matt Petkun

D.A. Davidson & Co. - Analyst

David Duley

Merriman Curhan Ford & Co. - Analyst

David Nierenberg

Nierenberg Investment Management - Analyst

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the ESI fiscal 2010 quarter one earnings release conference call. My name is Peggy and I will be your operator for today. At this time, all participants are in a listen-only mode. We will conduct a question and answer session toward the end of this conference. (OPERATOR INSTRUCTIONS.) As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the call over to Mr. Brian Smith, Director of Investor Relations. Please proceed.

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

Thank you, Peggy, and good afternoon, everyone. My name is Brian Smith, Director of Investor Relations for ESI. With me today are Nick Konidaris, our CEO, and Paul Oldham, our Chief Financial Officer. This conference call will cover our fiscal 2010 first quarter results.

Before we go into the details of the call, 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, July 23rd, 2009, and which could change in the future. This call is the property of ESI.

Now, I'll turn the call over to our CEO, Nick Konidaris.



Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Thank you, Brian, and good afternoon, everyone.

The first quarter was very encouraging on many fronts. Financial results rebounded from the unprecedented trough levels we saw in the previous quarter. Orders and revenues exceeded our expectations, as customers began to resume their capital spending.

Capacity utilization also continued to improve throughout the quarter, although below the levels that drive significant capacity purchases. The higher revenues combined with continued effective control of our operating expenses enabled us to deliver sequentially improved financial results.

Finally, we continue to invest in new technology and were qualified at Tera Probe, a subsidiary of Elpida, for our latest generation memory repair solution.

For the first quarter, orders of \$28.7 million were up 79%. Virtually all of our end markets showed some signs of improvement. Sales also improved to \$22.6 million, and loss per share was \$0.23 on a non-GAAP basis. Paul will provide more details on the financials in a moment.

At the macro level, market conditions seem to be improving but are still well below normalized levels. In addition, there are still significant macroeconomic headwinds impacting our markets.

On the bright side, we feel the worst is behind us and the fear that gripped our markets in our fourth fiscal quarter has subsided. Although it is unclear how long it will take for the economy in our markets to fully recover, we are encouraged by recent improvements in capacity utilization, investments in new technology, and increases in demand.

Orders in our semiconductor segment more than doubled sequentially. As we announced in June, our new model 9850 Tailored Pulse System was qualified and selected by Tera Probe for their 68 nanometer and future DRAM wafer repair applications. Also, our LED wafer scribing business showed very good sequential growth.

Looking forward, we continue to believe that capital spending in the DRAM market will be weak. We expect that through 2009 capital spending in the DRAM market will be driven by the technology transition to smaller nodes in DDR3, not capacity expansion. However, we are well positioned in this market, and the Tera Probe qualification illustrates our ability to help our customers migrate to higher performance in smaller dimensions.

In addition, our LED scribing business should show growth in the coming quarters as the demand for LED devices and capacity utilization increase.

Let me focus now on to the Interconnect and Micromachining Group. Orders increased sequentially with solid results from both Interconnect and General Purpose Micromachining applications. Our Flex Interconnect business achieved several multisystem orders due to growth in applications for sub-70 micron vias and early seasonal demand from customers who had delayed capital spending.

Geographically, we saw relatively strong orders from Korea, whose manufacturers appear to be benefitting from a weak currency.

Our Micromachining business also bounced back from a slow fourth quarter to show good sequential growth in orders. Looking forward, orders in this business will continue to be lumpy especially in our Micromachining business, which can be driven by large orders and customer specific applications.



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In our Passive Components group, orders for our electrical and optical systems improved from the prior quarter driven by increased consumer demand and low channel inventory. This quarter, we received a large multisystem order for our Model 5550 High Capacitance Tester.

In addition, we saw increased orders for our consumable and tooling products, driven by increased capacity utilization and our introduction of a new higher density carrier plate to improve the effectiveness of handling [MFCCs].

Turning now to the overall outlook for ESI, although we are cautiously optimistic that business conditions have begun to improve, the timing and trajectory of recovery remain uncertain. However, we are encouraged by the increased level of activity we have seen from our customers. As a result, we are targeting increased revenues and better non-GAAP operating results in the second quarter, and we are cautiously optimistic that our markets will continue to show improvement in the coming quarters.

In this environment, we continue to lay the foundation for profitable growth by partnering with our customers, investing in critical new technologies, and carefully managing our operating expenses.

Now, I will turn the call over to Paul for a detailed discussion of our results for the first quarter.

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

Thank you, Nick, and good afternoon. The following information includes results from our first fiscal quarter 2010, which ended June 27th, 2009. To improve comparability, we are also providing earnings per share and related income statement results on a non-GAAP basis, excluding the impact of purchase accounting, equity compensation, restructuring expenses, and nonrecurring items.

Orders in the first quarter were \$28.7 million, up from \$16.1 million in the prior quarter. Orders in all three businesses increased sequentially. As Nick mentioned, we also saw improvement in consumables and service activity as customer utilization rates improved from trough levels seen last quarter.

Shipments in Q1 were \$23.1 million, up sequentially from \$17.3 million in the prior quarter, driven by stronger order activity. We also saw pull-in of some demand that had been scheduled to ship in future quarters. Ending backlog was \$23.3 million, up \$6.5 million from last quarter.

Revenue for the first quarter was \$22.6 million, up 25% from the fourth quarter. Although all three businesses showed sequential improvement, the increase was driven primarily by strong demand and shipments in our Interconnect and Micromachining group for both flex circuit via drilling and general micromachining applications.

Gross margin for the first quarter was 26.4% and included \$500,000 in purchase accounting and equity compensation reflected in cost of goods sold. On a non-GAAP basis, gross margins were 28.6%, up from 27.9% last quarter as the benefit from higher sales volume was partially offset by a return to more normalized mix compared to the prior quarter.

GAAP operating expenses were \$14.9 million, down from \$26.3 million in the previous quarter. Q1 expenses declined primarily due to the recognition of the net benefit of \$4.5 million from the termination of the merger agreement and several one-time expenses incurred in the fourth quarter which did not repeat.

Also included in operating expenses were purchase accounting amortization of approximately \$500,000 and stock compensation of \$2.1 million. Stock compensation increased approximately \$1.2 million from the prior quarter driven by changes to the vesting schedule of current year board grants, incremental cost of the Company's annual stock grant, and lower expense recognized in the previous quarter based on reduced achievement against existing performance grants.



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Excluding the impact of the one-time items, purchase accounting, and equity compensation, non-GAAP operating expenses were \$16.9 million, down approximately \$400,000 from the prior quarter, reflecting the continued implementation of our temporary cost reduction measures and the timing of project expenses between quarters. For the second quarter, we expect non-GAAP operating expenses to be up slightly as program expenses normalize.

First quarter interest and other income was \$342,000, up from \$200,000 last quarter as lower interest income was more than offset by improved foreign currency results. Our yields on cash continue to be pressured by the drop in rates for short term, high quality securities.

On a GAAP basis, the first quarter net loss was \$5.5 million, or \$0.20 per share. Excluding equity compensation, purchase accounting amortization, and merger termination proceeds, non-GAAP net loss was \$6.2 million, or \$0.23 a share, down from the net loss of \$17.1 million, or \$0.26 per share, in the prior quarter.

Income tax benefit for the quarter reflected a tax rate of 36%. On a non-GAAP basis, the tax rate was approximately 38%, consistent with our expectations. Looking forward, we expect the non-GAAP tax rate benefit to range between 35% and 40%.

Turning now to our balance sheet, cash and short-term investments were \$155 million, roughly flat with the prior quarter. In addition, we continue to hold auction rate securities currently valued at approximately \$7 million.

This quarter, we implemented new accounting guidance related to the accounting for other than temporary impairments. As a result of this implementation and slight improvements in the credit markets, we increased the value of our auction rate securities by approximately \$1.1 million and made the corresponding adjustments to other comprehensive income and retained earnings.

Cash used in operations was approximately \$900,000 for the first quarter, as losses from operations were offset by the net proceeds from the merger termination and reductions in inventory. Inventories declined by \$6 million in the quarter, reflecting increased demand and our ongoing inventory reduction efforts. We continue to manage inventory closely, and expect the balance to continue to decline over the next few quarters. Inventory turns were 0.8 times, an improvement over last quarter.

Accounts receivable increased by \$1.2 million. However, DSO decreased by 14 days to 81 days, as strong cash collections during the quarter offset the impact of higher shipments.

Capital expenditures were approximately \$400,000, and depreciation and amortization, excluding purchase accounting, was \$2.5 million. Also during the quarter, we spent approximately \$550,000 to repurchase roughly 65,000 shares of stock at an average price of \$8.52 per share.

Looking forward, visibility continues to be limited. However, we are encouraged by the recent activity we have seen from our customers. As a result, we are targeting shipments and revenues in the second quarter of \$25 million to \$30 million and a non-GAAP loss, excluding stock compensation, purchase accounting, restructuring, and other nonrecurring items, of between \$0.15 and \$0.20 per share.

Now, I will turn the call back to Nick for a brief summary.

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

To summarize, we are making our way out of an extraordinarily difficult market and economic environment. In this environment, it is wise to be cautious, so we will continue to monitor our business and our spending carefully.



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Yet, we see new opportunities and are still investing in new products and technologies that will be the drivers of growth as the market improves. We are prepared for recovery at any speed, and our business model will leverage our top line growth into higher earnings and cash flow.

This concludes our prepared remarks. We are ready for your questions. Peggy?

QUESTIONS AND ANSWERS

Operator

Thank you. (OPERATOR INSTRUCTIONS.) Our first question comes from the line of Jim Ricchiuti. Please proceed.

Jim Ricchiuti - *Needham & Co. - Analyst*

Thank you. Good afternoon.

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Good afternoon, Jim.

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

Hi, Jim.

Jim Ricchiuti - *Needham & Co. - Analyst*

I wonder if you could give us a little bit of help just in terms of how we should think about the bookings that you recorded in the quarter. Pretty strong certainly relative to the fourth quarter. Can you give us some flavor as to how they might have -- bookings might have broken out among the three businesses' units?

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Yes. We usually do not break down bookings. But, as a general directional statement, I would say that the Interconnect and Micromachining group was the biggest contributor in bookings, followed by the Passive Components group and Semiconductor.

Jim Ricchiuti - *Needham & Co. - Analyst*

Okay. That's helpful, Nick. In terms of the Interconnect Micromachining, from a revenue standpoint, that also was the biggest driver to the revenues this past quarter. Where do you see that business going, and can you talk a little bit about what you're seeing in the market?

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Yes. The market, clearly at this point in time, it's very difficult -- it has, as a main driver, the consumer, especially in China, who wants to buy high end wireless devices, followed by also some other consumer devices and netbooks.

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But, those require that -- all of those have, as part of their components, two things that are of interest to us. One is flex circuits and the other is passive components. Also, they do have DRAM, and that is the main driver for this new business that we have identified so far.

I'd also like to add that the consumer in the US also is showing an uptick. Whether that's going to continue or not, we need to probably wait until the end of the year. But, that's here also in the US.

The other thing in terms of Micromachining is the general micromachining where we continue to discover new applications. We will continue to invest in new systems, and will continue to see that this thing is going to be a growth driver moving forward.

Jim Ricchiuti - *Needham & Co. - Analyst*

And one final question. You had some good success with the 5800 Micromachining system with a high profile customer in the computer consumer electronics area. Is there anything you could tell us about either the application or whether you think or you've been able to leverage that success perhaps with some other companies similarly in that market?

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Yes. We cannot, unfortunately, talk about the application. The customer is now well known. But, we do -- we are leveraging that success into other applications because we find out a number of applications, not in consumer devices but also medicals, that we are actively developing a relationship with customers and do a lot of evaluation work, some of which we think may, if we perform well, end up to be high volume business.

Jim Ricchiuti - *Needham & Co. - Analyst*

How were the bookings for the 5800 in the quarter?

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

We don't provide guidance in bookings. But, as I said, Micromachining has been the main contributor of bookings.

Jim Ricchiuti - *Needham & Co. - Analyst*

Okay. Thanks very much.

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Thank you.

Operator

Our next question comes from the line of Matt Petkun. Please proceed.

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Matt Petkun - D.A. Davidson & Co. - Analyst

Hi. Good afternoon. A couple of questions. First, just from a cost structure standpoint, Paul, can you talk about where you think breakeven is directly for you guys, and kind of how, as business starts to improve, you'd pull the costs down dramatically? What would we see come back?

Paul Oldham - Electro Scientific Industries, Inc. - CFO

Yes. Matt, our breakeven point we've talked about is between \$40 million and \$45 million in revenue, with a cash breakeven point probably between \$35 million and \$40 million.

Now, the low end of that range includes the temporary measures that we've put in place, which include pay reductions and furloughs and some other things. How long those will stay in place we'll have to assess. But, that essentially is what makes up the majority of that range is those temporary items.

And so, if we looked at what types of things could come back, we would expect our cost structure sort of to stay in the range it's been, let's say the low \$17 million range, while those temporary measures are in place. As those temporary measures come off and as we see variable pay start to increase, we would probably see our cost structure naturally move up to sort of, I'd say, \$18 million to \$19 million just with those temporary things coming back in.

Matt Petkun - D.A. Davidson & Co. - Analyst

Okay. Great. And then, Nick, on the memory repair side, I was wondering if you could maybe provide a little more detail about the technology transitions you see going on right now, how you believe your installed base will serve maybe in the 5X node and even in the 4X node, and then what new products you think your customers will be adding when they do capacity ramps of these new nodes.

Nick Konidaris - Electro Scientific Industries, Inc. - CEO

Yes. The transition that's happening now is that customers basically are moving to below 70 nanometer nodes. But, in addition to that, there is transitions in the materials they use for the fuses. They become copper. And there is transition in terms of the shape of the fuses. They become closer together, more dense, and smaller, a smaller footprint. All of these things requires that -- and, by the way, in their process, they increase the metallization layers in the wafers.

All of those things mean that you need to have basically flexibility to go down the wavelength so you can address the smaller fuse footprint with a better depth of focus, and we have that.

But, in addition, it requires that we cleverly now engineer the shape of the pulse from a temporal point of view in terms of the energy distribution of the pulse during the duration of the pulse. And while until recently we had kind of a standard distribution of that pulse that we call the Gaussian distribution, now we have developed this proprietary technology that allows us to do a tailored pulse. That's what we mean that we tailor a scheme to the particular device and process of the customer.

So, we believe that we have the technology to move down to the 5X and 4X nodes. We are very much encouraged by the verification of this thing from Elpida. And as we said, we expect that this is going to be a year of technology activity primarily, to hopefully be followed by capacity activity.



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Matt Petkun - D.A. Davidson & Co. - Analyst

Okay. And do you -- your existing installed base, then, of IR tools and, to a certain extent, UV tools, do you -- will customers be able to retrofit with the pulse shaped technology, or will there be full sale new -- full-scale adoption of the new pulse shape?

Nick Konidaris - Electro Scientific Industries, Inc. - CEO

Yes. Because of the recent overcapacity, customers are using these tools. They have excess of these tools, and temporarily they are going to be using these tools at a subpar performance to their requirement. But, as the business rebounds, then they will have to basically buy new tools.

Matt Petkun - D.A. Davidson & Co. - Analyst

Okay. Great. A few other housekeeping questions for me. Paul, I noticed the stock comp, especially in the SG&A side, was up pretty meaningfully this quarter, if you could talk to that.

Paul Oldham - Electro Scientific Industries, Inc. - CFO

Yes, there were really three things that were happening there. The first is that the timing of vesting for stock grants to our board members was changed from a three-year vest to an immediate vest, essentially reflecting our view that that's really compensation and not retention. That's disclosed in our proxy. But, that causes sort of a one quarter spike in the expense that won't be repeated in the next three quarters.

The other two factors which are much smaller is that in our fourth quarter, we did see a reduction in stock comp mainly because of performance, our estimated performance, which was lower again for the previously issued performance share. So, that number was a little lower.

And then, the third thing is that in our first quarter is when we do our annual stock grant. And given the way that we adopted the accounting rules for stock compensation expense, we essentially add a new year -- the beginning of a new year of expense into the mix. And I think we have one more year where that will stair step up before we lose a year at the same time we add a year. But, I think this year and next year, we'll still see an increase just as the annual grant rolls around due to the adoption of FAS 123R.

Matt Petkun - D.A. Davidson & Co. - Analyst

Okay. Great. And then, just a final question for both of you guys. When you were going through the potential deal with Zygo, you had suggested that upon closing that deal you would consider buying back stock. How are you viewing that now that maybe the market's stabilizing and you still have more cash than it appears you may need?

Nick Konidaris - Electro Scientific Industries, Inc. - CEO

Well, we -- without question, we are going to provide a solid foundation for the Company to enable profitable growth. Even today, while things improved, raising money, if that were to be needed, would be extremely difficult.

At the same time, the current environment, for all the obvious environmental reasons, provides potential opportunities for growth. And as a Company, we want to retain dry powder in order to take advantage of these opportunities as they are presented to us.



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As you know, the board has set a \$20 million stock buyback program, against which we expensed in excess of \$5 million right now. This is an opportunistic program that is in place with the primary purpose of offsetting dilution.

And the last point I would make is that we'll continue to monitor conditions and enter the market to do a stock buyback, we did a little bit last quarter, as Paul said, as appropriate.

Matt Petkun - *D.A. Davidson & Co. - Analyst*

Okay. Great. Thanks so much.

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Thank you.

Operator

Our next question comes from the line of David Duley. Please proceed.

David Duley - *Merriman Curhan Ford & Co. - Analyst*

Yes, I was wondering. Did you have any 10% customers in the quarter?

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Good question. We might, I just don't have the data in front of me. But, we can follow up with you.

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

We'll have to check, David. I'd say that there were none that were obviously over 10%. There might be a couple that are close to 10%. It would probably be more than one in this case.

David Duley - *Merriman Curhan Ford & Co. - Analyst*

Okay. And I was wondering if you might be able to talk about progression in gross margins. From this level of revenue that you just did in the current quarter, what kind of incremental drop rate can we expect on incremental revenue going forward? Will the gross margin on that incremental revenue be above 50% or below, or can you help us with that?

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

Yes. I would say our incremental gross margin as we go forward probably is in, I would say, the 45% to 50% range as we go forward from this level. Now, that'll vary quarter-to-quarter, depending on the mix that we see.

It'll also vary somewhat depending on how much comes out of inventory versus how much production we actually have. For example, this quarter, we took quite a lot of revenue out of inventory and that caused us to still have -- not absorb some of the fixed costs, if you will. So, it'll vary a little bit, but I think that's in the right range.

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David Duley - Merriman Curhan Ford & Co. - Analyst

Now, if your target is gross margins of 50%, wouldn't at some point or another your drop rate have to be more than 50% to achieve that target?

Paul Oldham - Electro Scientific Industries, Inc. - CFO

Yes, it would, and we believe that it will be, I think. But, balancing off these low levels, just looking at, again, how much is coming out of inventory and how much is coming out of kind of new production, is what causes us to be probably a little light on that number.

David Duley - Merriman Curhan Ford & Co. - Analyst

Okay. Now, I think Nick mentioned there were signs of life in the memory market, that orders had doubled there. I'm assuming orders went from like \$1 million to \$2 million and we're really not seeing a huge uptick as far as the overall business goes. But, I would like you to talk about that a little further and tell me what -- perhaps give us some more color on what is going on on the order front in the memory market. And do you expect that doubling to continue off a very low base, or what?

Nick Konidaris - Electro Scientific Industries, Inc. - CEO

Okay. Before I answer this thing, we did not have 10% customers in the past quarter.

David Duley - Merriman Curhan Ford & Co. - Analyst

Okay.

Nick Konidaris - Electro Scientific Industries, Inc. - CEO

It was broad based.

But, now on the memory, what I would say is that your suggested numbers are more or less reflective of reality. However, memory is -- but, while the numbers may be small, they are significant from the point of view of what it means when volume production for capacity takes place. And as we said, we see that for the calendar year, most of the activity is going to be in the technology buy, and then later on was going to be followed in -- by capacity buys.

I -- during SEMICON, I would summarize a sentiment hearing from a customer that sometime in 2010, this lack of droplets to the Kalahari Desert is going to be followed by a shower. It was his term, not mine.

David Duley - Merriman Curhan Ford & Co. - Analyst

Okay. So, it sounds like we're going to see some technology, spotty technology buying, this year and then hopefully capacity buying in calendar 2010. And is there any reason to think -- or let me ask a different way. What do you think your market share is in this business, even though no one's selling anything? Do you think you've maintained your 65% or 70% market share of this segment that you've always had, or have there been events that were up or down?



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Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Good question. We think that we maintained market share. And in addition to that, as a result of the recent announcement on Elpida/Tera Probe, we think that as the market becomes more volume oriented, it's going to hopefully enhance that a little bit, although we're already at a high level and it's very difficult to improve substantially the market share.

David Duley - *Merriman Curhan Ford & Co. - Analyst*

So, you can't really tell because there's no spending. But, you're now the number one position at Tera Probe, which was better than where you were before.

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

That's correct.

David Duley - *Merriman Curhan Ford & Co. - Analyst*

Okay. Thank you.

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Thank you.

Operator

Our next question comes from the line of David Nierenberg. Please proceed.

David Nierenberg - *Nierenberg Investment Management - Analyst*

Guys, I wanted to congratulate you on so far managing to come through the worst recession of our careers while maintaining the excellent strength of your balance sheet.

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

Thank you, David.

David Nierenberg - *Nierenberg Investment Management - Analyst*

I also wanted to note for the record that your share price is pushing \$12.00, and Zygo closed today at \$5.53. Those folks left a lot of money on the table, but we'll leave it to their shareholders to reward them appropriately.

I would like to invite you to share with us any information you feel comfortable providing at this time about other growth initiatives, because my sense is that you have a large number of arrows in your quiver. For instance, perhaps you could tell us a bit about what you're intending to do now that you've substantially enlarged your intellectual property in the area of wafer singulation.



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Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Yes. Dave, back on the first point, thank you for the words of encouragement. From my point of view, I'm very enthused to have Paul on my side as CFO and the entire team at ESI. All of us are really working very hard here in a very difficult environment. And the motivation is high and we feel very good.

Back on what else we're doing. We have a major drive, as you know, the laser singulation drive. And as a result of the acquisition of the IP and assets from XSil, we have really refocused the area into memory customers whom we know very well, to really do thin wafer dicing by utilizing a combination of our technology and their technology.

Meanwhile, we are maintaining our focus in the scribing, which is different than dicing. But, that is a little bit on the back burner right now because we want to take advantage of the opportunities we see in memory.

In addition, we have introduced a system, the Silicon Si5330, that is focused on micro via formation. And we believe that combination of those three applications, dicing of thin wafers, scribing of low K wafers, and via formation for 3D packaging, do represent a growing opportunity at the level, over the next few years, of memory repair.

In addition, in micromachining, we are -- as I said, we are discovering a number of new applications, and we're having a big drive into another application that we believe is going to allow us -- is going to allow our customers to be able to take a high density interconnect PCB, which is in every form, to become, for the same volume, either denser or, for lower volume, equally dense. That would be a breakthrough in technology. The industry is moving, and we are focused on this thing. We believe that's going to be another big opportunity.

And through the acquisition, as you know, of NWR, we are now participating in scribing of LED sapphire wafers. Our customers, as a result of them -- a lot of the customers that we have in passive components are entering also the LED market, and we do think that the LED market is going to be another very big driver. By all means, everything we see, especially in general lighting, that's going to become a big industry.

So, we have a lot of interest from our customers to introduce as soon as possible, using our proprietary small parts handling expertise, a tester, a photonic tester for LEDs, because these need to be tested in terms of their light output. That industry is very sensitive in terms of pricing to the light output of an LED.

So, we have -- it's fair to say we have drives in every one of our divisions to really grow. And we think that all of those, in addition to the ongoing R&D for the existing applications, are going to present a foundation for growth as we come out of this recession.

David Nierenberg - *Nierenberg Investment Management - Analyst*

That's a lot of good stuff going on at the same time that your historical competitor in memory yield improvement is going through a lot of self-inflicted trouble. I remember that nearly two years ago at the Analysts' Day in August 2007 before the world changed, you talked to the investment community about your hope that over the next three or four years you could once again double the size of the Company's total addressable market. In light of what you've just mentioned, that claim still sounds quite plausible.

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

No, this is -- it sounds plausible, and this is a foundational claim to our strategic plan.

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David Nierenberg - *Nierenberg Investment Management - Analyst*

Go for it.

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Thank you.

David Nierenberg - *Nierenberg Investment Management - Analyst*

Thank you.

Operator

We have a follow up question from Mr. Jim Ricchiuti. Please proceed.

Jim Ricchiuti - *Needham & Co. - Analyst*

Paul, I think you alluded in your presentation that you saw -- thank you. Paul, you mentioned that there might have been some pull-ins in terms of shipments. Can you talk a little bit more to that, where you saw that coming from in the quarter?

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

Yes. I think a couple of quarters, we talked about some backlog that we'd removed from our books because we didn't have line of sight to a shipment date. That was primarily in our passive component business, and we did see some customers in that business come back and give us shipment dates, and in fact want shipments of those systems this quarter.

Jim Ricchiuti - *Needham & Co. - Analyst*

Okay. And I guess this speaks to the point you made, Nick, about utilization rates moving up for some of your passive component customers. Where are the rates at this point, the utilization rates, for some of these guys?

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Yes. Right now, they are in the 80%. That's what we hear from our people and the customers. And keep in mind that a quarter ago, they were in the 60%.

Jim Ricchiuti - *Needham & Co. - Analyst*

Where would you -- where might we see a bigger uptick in order activity from -- do we need to see rates get up to around the 90% area, or are folks starting to talk about more aggressive expansion before we get to that point?

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

I think we need to see two things. We need to see utilization in the 90% range, and the other thing is you need to see some more confidence that the uptick is sustainable.

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Jim Ricchiuti - *Needham & Co. - Analyst*

Okay, fair enough. Okay. Thanks a lot.

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Thank you.

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

You bet.

Operator

I show that we have no further questions at this time. (OPERATOR INSTRUCTIONS.) I show that we have no further questions at this time, so I would like to turn the call back to Mr. Nick Konidaris.

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Thank you, Peggy. To reiterate, we believe that the worst of the economic downturn is behind us, but uncertainty remains about the pace of market improvement.

In the long term, we are confident our markets are healthy and will return to their previous demand levels. In the near term, we are focused on operating efficiently and executing at a high level to quickly return us to profitable and cash positive operations.

Thank you very much for joining us. You are welcome to call Paul, Brian, or me if you have further questions. This concludes our call. Thanks for your interest in ESI.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Have a good day.

Nick Konidaris - *Electro Scientific Industries, Inc. - CEO*

Thank you.

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