

# FINAL TRANSCRIPT

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## **ESIO - Q4 2010 Electro Scientific Industries, Inc. Earnings Conference Call**

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## CORPORATE PARTICIPANTS

**Brian Smith**

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

**Nick Konidaris**

*Electro Scientific Industries, Inc. - President & CEO*

**Paul Oldham**

*Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

## CONFERENCE CALL PARTICIPANTS

**David Duley**

*Steelhead Securities - Analyst*

**Jim Ricchiuti**

*Needham & Company - Analyst*

**Bill Freerich**

*Ratten Award Capital - Analyst*

**Shawn Boyd**

*Westcliff Capital Management - Analyst*

## PRESENTATION

**Operator**

Good day, ladies and gentlemen and welcome to the ESI fiscal 2010 fourth quarter earnings conference call. (Operator Instructions). I would now like to turn the conference over to your host for the day, Mr. Brian Smith, Director of Investor Relations for ESI. Please proceed, sir.

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

Thank you, Cathy, 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 fourth 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.

The 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 contain time-sensitive information that we believe to be accurate as of today, May 11, 2010, and which could change in the future. This call is the property of ESI. Now I will turn the call over to our CEO, Nick Konidaris.

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

Thank you, Brian. Good afternoon, and welcome to our fourth quarter conference call. This was a very good quarter for ESI, with revenues up 50%, higher gross margins and a return to (inaudible) profitability. Consumer and business spending around the (inaudible) equipment drove capacity expansion at our customers' factories. Our market leading-solutions have continued to hold or gain share, and our new product development engine is running full steam, creating new products that contributed to this outstanding quarter and will allow us to enter adjacent growth markets and applications.



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Finally, we opened the new state of the art manufacturing facility in Singapore which will enable us to be more responsive to our customers and improve our manufacturing efficiency. Revenues grew 53% from last quarter to \$59.6 million, reflecting four consecutive quarters of growth from last year's fourth quarter. Non-GAAP earnings per share came in at \$0.16 compared to a loss of \$0.03 last quarter. Orders came in at \$54 million compared to \$61 million last quarter. Excluding the large order received last quarter, overall orders grew almost 50% sequentially. We show strong results in passive component test, LED wafer scribing and flex interconnect. On the other hand, our memory repair business remained weak as DRAM manufacturers still have excess capacity in laser yield improvement systems. Revenues in our semiconductor business were down 43% sequentially due to a lack of system sales from our memory repair products. Orders were about flat.

The LED and LCD end markets continue to show healthy demand and are both benefiting from the strong demand for LED backlit displays and TVs. Looking forward in our semi business, we expect the LED scribing and LCD repair business to remain healthy. In our DRAM wafer repair business, we have begun to see customer activity, which we expect to result in orders this quarter. We expect the recovery of this business to be choppy, as each of our customers has a different level capacity utilization and quantities of spare equipment. However, our DRAM customers are seeing strong (inaudible) growth and even stronger pricing profitability, and we are confident that we will start seeing demand for laser repair solutions. Our interconnect and micromachining group had a record setting quarter, with records of nearly \$44 million and sequential 47 million.

The flex interconnect business is showing an early season of rebound and will continue to add new customers, driven by the shift towards the need for [sub-70] (inaudible). Looking forward into fiscal 2011, we expect solid growth in the flex business, driven by demand for smartphones and other complex handheld devices. Of course, the biggest contributor to our results were strong revenues from our advanced micromachining business. During the quarter, we shipped and recorded revenue for the large order received in Q3 for the new model ML5900. This was a brand-new product, and I want to thank our engineering and operations groups for their extraordinary efforts in meeting the customers' delivery time lines. We also had another quarter of good orders in this business, though not as large as Q3.

Looking forward in advanced micromachining, we will continue to pursue new applications and new customers, and we are excited about our long-term growth potential. This potential includes applications to drill, route and narrow structure in a wide range of materials, including metals, organics, dialectics, semiconductors and hybrid engineered parts. Our passive components group also had a very good quarter, with sales and bookings about flat with a strong Q3. We again saw good demand for our newest [high capacitance testers], but also excellent demand for our consumable products, such as carrier plates and (inaudible). Looking forward, orders in this business may be a little lumpy, as capacities have shored in the market, but we believe that overall growth will continue to be driven by the trend toward more and higher capacitance (inaudible) and new electronic devices.

Turning now to the outlook for ESI, we continue to be encouraged by the improvements we have seen in most of our markets. And we are starting to see activity now DRAM application, which we expect to result in orders this quarter. Once DRAM fully recovers and our new product penetrate new markets and applications, we should see revenues rise significantly above current levels. Until then, given that these new growth drivers will take time to take effect, revenues are expected to remain at or around what we saw this quarter. As a result, we expect revenues in the first quarter of fiscal 2011 to be the low to mid \$50 million range, and non-GAAP earnings per share of \$0.01 to \$0.06. Now we will turn the call over to Paul for a detailed discussion of our results for the fourth quarter.

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**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Thank you, Nick, and good afternoon. The following information includes results from our fourth quarter of fiscal 2010 which ended April 3. 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 for the fourth quarter were \$54.2 million compared to \$61.2 million in the prior quarter and \$16.1 million in the

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prior year's fourth quarter. As Nick mentioned, our third quarter included a large order for our ML5900 micromachining system, which did not repeat.

Although we received some follow-on orders for this system, we saw strength in many of our other product areas, resulting in almost 50% growth excluding the impact of the large order. Overall, we saw good demand in flex via drilling, advanced micromachining, LED scribing and passive component tests. As expected, memory repair orders continued to be weak but are showing signs of recovery. Shipments in Q4 were \$66 million, nearly double the \$34 million from the previous quarter, and included the shipment of the large micromachining order received in Q3. Ending backlog decreased by \$12 million to \$40.6 million due to the strong shipment level. Deferred revenue increased by \$5.9 million, with the increase spread across all product groups.

Revenue for the fourth quarter was \$59.6 million, up 53% sequentially. This sequential increase came from our interconnect and micromachining group due again to the large order that shipped and was accepted in Q4. Gross margin for the fourth quarter was 43%, including \$531,000 in cost of goods sold for purchase accounting and equity compensation. On a non-GAAP basis, gross margins were 44%, up from 39% last quarter, reflecting the higher sales volume.

GAAP operating expenses were \$23.2 million, up from \$20.7 million in the previous quarter. Included in the fourth quarter's operating expenses were purchase accounting and amortization of approximately \$225,000, and a stock compensation of \$1.4 million. Excluding the impact of these items, non-GAAP operating expenses were \$21.6 million, up \$2.6 million from the prior quarter, reflecting the elimination of most of our temporary cost reduction measures, increased project expenses and higher variable pay associated with improved performance and a return to profitability. On a GAAP basis, operating income was \$2.4 million, or 4% of sales, compared to a loss of \$5.9 million last quarter. Non-GAAP operating profit was \$4.6 million, or almost 8% of sales, up sequentially from a loss of \$3.7 million in the prior quarter.

Other income was impacted by a \$1.3 million writedown in our auction rate securities, primarily due to lower credit spreads and the suspension of dividend payments on one of our securities. We continue to hold approximately \$5 million in fair value of auction rate securities. Income tax for the quarter was a benefit of 51%. On a non-GAAP basis, the tax rate was 10%. The improved rate was primarily a result of credits to true up estimated annual results and successfully completing our 2008 IRS tax audit. Based on accounting rules for income taxes, some of the benefit for these items was recognized in Q3 and some in Q4. Around these income levels, the tax rate is difficult to project, but longer term we expect our non-GAAP tax rate to be in the low 30s.

On a GAAP basis, fourth quarter net income was \$2.1 million or \$0.07 per diluted share. Non-GAAP net income was \$4.4 million or \$0.16 per diluted share compared to the net loss of \$.9 million or \$0.03 per share in the prior quarter. Turning now to our balance sheet, cash and investments, including restricted cash, were \$166 million, up 3.5 million from the prior quarter. Cash flow from operations was \$4 million for the fourth quarter, as earnings from operations and lower inventory levels were partially offset by working capital increases, mainly in receivables. Inventories decreased by \$6.5 million, reflecting good execution in our ongoing inventory reduction efforts. Inventory turns were 1.8 times, which is an improvement over last quarter.

Accounts receivable increased to \$38 million on the higher shipments, but still reflects excellent DSO performance at 58 days. Capital expenditures were approximately \$1.3 million, and depreciation and amortization, excluding purchase accounting, was \$2.6 million. We were pleased that despite the difficult environment over the last two years, our efforts to improve profitability and working capital enabled us to be cash flow positive for the year. Looking forward, we are encouraged by current business activity and market forecasts. However, risks in the macro environment remain, causing some customers to continue to be cautious. As a result, we expect near-term results to be around our current levels, with longer term growth driven by continued economic recovery, improvement in our DRAM markets, and new products we expect to bring to market over the course of this fiscal year.

Based on our current booking and backlog levels, we expect revenues in the first quarter to be in the low to mid \$50 million range, as increases across our business mostly offset the large order shipped last quarter. Stock compensation expense is



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expected to increase approximately \$1 million, primarily due to accelerated vesting of our annual board grants. However, non-GAAP operating expenses should stay about flat. As a result, we expect positive non-GAAP earnings, excluding stock compensation, purchase accounting and other nonrecurring items of \$0.01 to \$0.06 per share. Now I will turn the call back to Nick for a brief summary.

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

To summarize, we completed a very successful quarter. Since the market bottomed in 2009, we have delivered four quarters of solid sequential revenue growth. Over that time, the markets have taken a step up. Where they go from here is still not clear. Most of our markets are strong, while DRAM remains weak. But we are looking for that market to begin to recover this quarter. Overall, I feel very good as we enter fiscal year 2011, and we expect to see strong revenue growth year-over-year, driven by DRAM recovery and new products. I would like to thank the many ESI employees and teams who put in tremendous effort to make this a great quarter. This concludes our prepared remarks. We are ready for your questions. Cathy?

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions). Our first question comes from the line of David Duley of Steelhead Securities. Please proceed.

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**David Duley** - *Steelhead Securities - Analyst*

Yes, congratulations on a nice quarter.

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**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Thanks, Dave.

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

Thanks, Dave.

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**David Duley** - *Steelhead Securities - Analyst*

And just a couple of questions from me, just a clarifying one at first. Did you say your GAAP net income would be positive and you guided to non-GAAP of \$0.01 to \$0.06?

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**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

I'm sorry, we guided to non-GAAP of \$0.01 to \$0.06, and didn't give GAAP guidance.

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**David Duley** - *Steelhead Securities - Analyst*

Okay, so I guess I heard you wrong then. Okay. Just wanted to make sure. Thank you for the clarification. Could you talk a little bit about the gross margin progressions sequentially in the quarter? I realized we had big revenue growth, but the revenue growth came from -- I wouldn't say at your highest gross margin business, but you were still able to achieve this 43% target,

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which is better than you have done in a long time. So maybe talk a little bit about why you were able to get to that gross margin number.

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**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Gross margin was a function of several things. First is that we were able to see higher volume, and with those higher volumes we were able to operate that largely on the lower cost structure that we put in place. So we got good leverage out of that. We also saw good mix overall in our business. That isn't exclusively related to the large order we saw, but we saw good mix in other parts of our business. And those were the primary two items. There is always a lot of pluses and minuses in gross margin, as you know, David; but those are the two primary drivers.

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**David Duley** - *Steelhead Securities - Analyst*

I guess what I was driving at is it just appears over time that the gross margins of the other businesses outside of the memory repair business have been improving.

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**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Yes, that's true. For example, in our component test business, we had seen improving gross margins there as we brought out new products and worked to reduce the cost of those products. Also, we did open our Singapore factory this quarter, and we did have some shipments out of that factory, and we think that that will be a contributor to improved gross margins as we look forward.

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**David Duley** - *Steelhead Securities - Analyst*

Okay. And were there any 10% customers in the revenue or the order front, or whatever you are comfortable disclosing to us?

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**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

We did have one 10% customer in the revenue number.

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**David Duley** - *Steelhead Securities - Analyst*

And without mentioning the name, can you give us the percentage?

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**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

We typically don't talk about the percentage of a customer for a quarter related to that. But we mentioned that we shipped the large order that we received last quarter, and you can get to a rough number from there.

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**David Duley** - *Steelhead Securities - Analyst*

Okay, one final one from me and I will step back in the queue is, I guess you came up with a new product. You received a big order for it. You delivered all of that product to this customer. I thought typically new products had a revenue recognition issue that it might take a quarter or two to get the revenue from it. So I was wondering how you were able to speed up revenue recognition on this wonderful new product?

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**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Well, our new products do require customer acceptance; but I think to Nick's point earlier, I think our engineering and operations and service teams around the world did an excellent job getting this product deployed in the customer's hands to meet their time lines and to have it be accepted for revenue recognition.

**David Duley** - *Steelhead Securities - Analyst*

So it was execution by you guys getting it to the customer, getting up and running in production that allowed you to recognize the revenue so rapidly?

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Absolutely.

**David Duley** - *Steelhead Securities - Analyst*

Okay, thank you.

**Operator**

The next question comes from the line of Jim Ricchiuti of Needham & Company. Please proceed.

**Jim Ricchiuti** - *Needham & Company - Analyst*

Thank you, good afternoon.

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

Good afternoon.

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Hi, Jim.

**Jim Ricchiuti** - *Needham & Company - Analyst*

I was wondering if you could give us a little better sense as to the bookings in the business unit. Nick, can you tell us if the book-to-bill -- some feel for the book-to-bill in the passive component area?

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

Yes. Basically, I would say in the passive component area, the book-to-bill was in the neighborhood of 1.5. The general theme I would give you is that in the semi sector we did better than expected in LED scribing; we did okay in LCD. No business in DRAM. In flex, we had excellent results, primarily because of early season of rebound. In micromachining, we had good demand through

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follow-on business to the very large order from last quarter. And in passives, we had strong demand for bulk systems and tooling and consumables.

**Jim Ricchiuti** - *Needham & Company - Analyst*

Okay, now with the large order that you delivered on last quarter, can you tell us if you have been able to target new customers for these applications? Any momentum in that area where we might see some broadening out of the customer base for that type of application?

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

Yes. As indicated, we are very excited about the opportunities that we see with additional customers in the micromachining.

**Jim Ricchiuti** - *Needham & Company - Analyst*

And is that something, Nick, you think you might see that order -- those orders come in in the next one to two quarters? Or is there still a fairly long sales cycle?

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

It's very difficult to forecast at this point in time. It's a long cycle. But in the middle of the cycle, we could be surprised by accelerating customer demand.

**Jim Ricchiuti** - *Needham & Company - Analyst*

Now on memory repair, you sound a little bit more optimistic about a pick up in bookings in this area. You are anticipating orders this quarter mostly technology driven?

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

That's what we said. We anticipate orders that are going to be driven by both technology and capacity. And they are going to be focused on our payload (inaudible) recent product introductions that basically provide tremendous flexibility to the user of that equipment in processing advanced (inaudible).

**Jim Ricchiuti** - *Needham & Company - Analyst*

And Nick, relative to where you were looking at the markets say three, four months ago -- and I'm talking about DRAM -- is it fair to say you are more optimistic about what you are seeing and what you are hearing from customers?

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

That's fair to say. I think three or four months ago we were thinking about the second half of the year. That's what we were talking now. We see an acceleration. We still think, however, that moving forward for a while things are going to be choppy, for reasons that we have fewer customers that have synchronicity in terms of their demand profile and technology situation. But over a longer period of time, we really see that this thing is going to come back almost to the levels that we have enjoyed prior to the crisis, and I think we are going to start seeing that this quarter. That's what we expect.



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**Jim Ricchiuti** - *Needham & Company - Analyst*

Okay, and just switching gears for a second, on the passive component side of your business, sounds like your customers are seeing pretty good business conditions and we are even hearing some tightness in certain supplies of capacitors. What's your sense as to the kind of order activity you might see out of those customers over the next one to two quarters?

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

Yes, well, the main driver for these [MFCCs] usually is the consumer that is buying smartphones across the globe. And smartphones not only increase as percent of Vodophones, but they have more [MFCCs] per unit. What we see at this point in time is those customers who really address smartphones, they are either doing very well, and we either -- we satisfy their demand and that's what we see in our numbers. But of course, we have other customers who may have focused in automotive and other things and for a while, and they are not ordering. So we don't see them across all customers demand that is uniform, but see selective demand around few customers, again, driven by smartphones, PCs and LCDs.

**Jim Ricchiuti** - *Needham & Company - Analyst*

Okay. Paul, can you perhaps quantify that the amount of the temporary cost reductions -- cost savings that were restored in the quarter in terms of in your OpEx line?

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Yes. It was probably between \$1 million to \$1.5 million. And if you include the variable pay increases, it was somewhat more than that. If you look at our cost structure on a going forward basis, we would expect our cost structure with all of the temporary items restored to run probably around \$20 million. We are choosing to invest at a higher rate than that, as we discussed last quarter, because we see a lot of new product opportunities in front of us over the coming year.

**Jim Ricchiuti** - *Needham & Company - Analyst*

So your R&D, we could see that move up from Q4 levels as we go through the year.

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

I would say it would certainly going to stay at our around those levels, which are higher than they have been, as you can see.

**Jim Ricchiuti** - *Needham & Company - Analyst*

Okay, and is there -- you showed very nice margin improvement this past quarter. And is there any feel for how you see margins based on the mix that you are anticipating this quarter?

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Well, margins bounce around a little bit every quarter based on mix and volume. We are projecting volumes a little lower. And as I did say, we had healthy mix this last quarter, which may moderate a bit this quarter.

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**Jim Ricchiuti** - *Needham & Company - Analyst*

Okay. Thanks very much.

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

Thank you.

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Next question.

**Operator**

The next question comes from the line of Bill [Freerich] of [Ratten] Award Capital. Please proceed.

**Bill Freerich** - *Ratten Award Capital - Analyst*

Good afternoon, gentlemen.

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

Good afternoon, Bill.

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Hi, Bill.

**Bill Freerich** - *Ratten Award Capital - Analyst*

Something I caught in the script which I would like to clarification on. You mentioned accelerated (inaudible) vested of the annual Board grant. What is the logic behind that?

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

This is something that we started a year ago. Historically, our Board grants would vest over three years. However, the Board really consider those to be compensation not really termed vesting; so starting with last year, when the annual grant came up, those vest immediately and therefore we recognize the expense immediately. So we are doing the same thing this year. I think that's pretty standard practice for a lot of Boards to have those vestings vest immediately. Expenses will go up for next quarter, but they will moderate back down for the following.

**Bill Freerich** - *Ratten Award Capital - Analyst*

Okay, so it's a seasonal thing and it's not a new wrinkle?



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**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Correct.

**Bill Freerich** - *Ratten Award Capital - Analyst*

Okay, thank you.

**Operator**

We have a follow-up question from the line of David Duley of Steelhead Securities. Please proceed.

**David Duley** - *Steelhead Securities - Analyst*

Just a couple more questions from me. Can you talk just from a 20,000-foot perspective about, let's just say, two new products that you guys are most excited about -- stuff that you have already announced? I don't want you to give us the skunk works or anything, I'd just like to know which new products are you most excited about to provide growth in 2011?

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

Yes, clearly the winner that we are very excited is the ML5900. We did enjoy a big revenue quarter in Q4 of fiscal year 2010, and we expect to see additional business on that product in this quarter and in the following quarters. But things that are coming out from the pipeline that we are very excited would be -- and I will not take sides right now -- will be basically four products. The four of them are going to contribute this year. One would be thin wafer dicing program, which is based on technology that we have developed internally and technology that we acquired with the Excel acquisition. We have identified the beta sites, and we think that we will be offering a solution for very thin wafers that is not available today by any other possible competitor.

Another product in the area of micromachining -- or two products in micromachining -- would be the laser direct ablation. This is a new -- it's based on technology that we developed internally. We have already received an order for a demonstrator product of that. We expect to get follow-on orders. And the net effect of this product to the customer is it allows to really shrink already very dense PCPs known as either high density interconnects or IC packages. The other product that is based on technology that we have developed both internally and through acquisition of the company called Applied Photonics. It's a product that will allow us to basically cut glass, both in small dimensions for (inaudible), as an example, and large (inaudible) like LCDs. And the last product that every time we look and we get surprised by the robustness of the marketplace is the LED tester. All of these products we expect to be contributing -- start contributing revenues this year, and of course keep growing next year and beyond.

**David Duley** - *Steelhead Securities - Analyst*

Final question from me is, the new ML5900, I think you called it a micromachining system. What exactly does that mean? What does that system do?

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

Well, that system is able to basically do some [nano structuring] of materials, so it can work materials, and at the same time it can nano structure the material, not (inaudible) but alter the characteristics of the material. The system is a very flexible platform. It allows both the micromachining and inspection what you do at the same time. Has [rotary stakes] that as you load the objects you can you can micromachine and at the same time do the inspection. And again, it's a very flexible platform that basically -- there's no comparable product to it when it comes to the accuracy or the net effect to the materials.

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**David Duley** - *Steelhead Securities - Analyst*

So when you say alter the characteristics of the material, what does -- I don't understand what that means, so sorry I'm a little dense here. But I can understand that you can inspect and look at what you cut, I guess, but I'm trying to figure out what exactly you are cutting.

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

I know that you are trying to figure that out. Unfortunately, I'm not at liberty to really talk.

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**David Duley** - *Steelhead Securities - Analyst*

Okay. Thank you.

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

Thank you.

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**Operator**

Our next question comes from the line of [Shawn] Boyd of Westcliff Capital Management. Please proceed.

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**Shawn Boyd** - *Westcliff Capital Management - Analyst*

Good afternoon, and congrats on the quarter.

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

Thank you.

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**Shawn Boyd** - *Westcliff Capital Management - Analyst*

On the ML5900 order that you received last quarter and shipped -- or I guess two quarters ago and then shipped in the March quarter, was that a single system or was that several units in one large order to one customer?

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

It's a single system in a large order; but there is -- associated to that order there are other kinds of -- there are two systems in a way in a big order.

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**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

This was really multiple units. It's one system, but it's multiple units of that system.

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**Shawn Boyd** - *Westcliff Capital Management - Analyst*

One system, multiple units. Okay. (Multiple Speakers). Excuse me?

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Probably tens of units.

**Shawn Boyd** - *Westcliff Capital Management - Analyst*

Tens of units, okay. So when we think about the market size for that product going forward, can you help us quantify that a bit on -- and also how many potential customers out there?

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

What we are working today with a minimum of three customers, the applications are novel applications. It's very difficult to quantify. The more we talk with those customers plus new customers, we find out additional applications. But one way of thinking about the potential of that product is that product picks up where an old tradition [CMC] machine runs out of steam and takes it from there, and can do more things that the CMC machine does, on top of that can do other kinds of things that there is no other way of doing them.

**Shawn Boyd** - *Westcliff Capital Management - Analyst*

Got it. So would you say that in the three customers you are talking to, that an initial order with each of them could be of similar size to this original --

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

No, I would not.

**Shawn Boyd** - *Westcliff Capital Management - Analyst*

You would not? Was that first order twice as big as what we might see? Can you give us some magnitude?

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

Well, I know in case of one out of the three we talked about a tenth in one customer. I know of another customer that could be tenths also. But it's not immediate, but that's the potential of what a machine like that could do.

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

This business is characterized of being lumpy, because it tends to be bought when people are trying to implement new applications that they can't do on traditional types of machines. So we will see an order when we get a design win, if you will, which will allow us to see anywhere from a few units to many units sold in, and then that will sort of level off at some capacity level in the future. So it's really dependent on our ability to continue to win new designs, new applications on this product. And as Nick mentioned, it's a very flexible platform that will allow you do many different things with the laser drill that you historically have done with mechanical tools.

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**Shawn Boyd** - *Westcliff Capital Management - Analyst*

Got it. Okay, that's very helpful. And I know you hit this earlier, I think on Jim's question, but in terms of follow-up on the existing customer that purchased that initial system, have we sort of met their needs for now on potentially their new application, or is that still in process and could potentially create follow-ons?

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

As we said, there was follow-on orders. There would be for a while, until we meet the need for that particular application, and then there's other applications.

**Shawn Boyd** - *Westcliff Capital Management - Analyst*

Got it. Okay, and if I could, just moving over for a minute, in general -- and this is across your entire business -- can you talk a little about lead times and visibility at this stage in terms of that backlog?

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

Yes. Lead times are in the neighborhood of about three months in average. We have worked a lot with our suppliers over the last two years to improve the lead times. At the same time, we have learned in the downturn that what happens is that your inventories grow, and that's what happened with us, and we are trying to really rationalize the supply chain so that we have a more robust supply. But basically, lead times are in the neighborhood of about three months, and depending on how much partnership we have with customers, that can vary a little bit. But it's around three months.

**Shawn Boyd** - *Westcliff Capital Management - Analyst*

Got it. Okay. That's helpful. And Nick, when you speak to -- or you use the comment of the forward outlook being a bit choppy perhaps but a fairly high revenue level -- can you speak just to what you currently -- how you currently see the fiscal year laying out? Meaning, you have given guidance low to mid-50s on the June quarter. Do you see it's actually dipping a bit in September and then reaccelerating, or staying at a fairly constant rate and then maybe starting to move up to a new level later in the year?

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

Well, that's part of the choppiness. We see that the fiscal year is going to be significantly better than last year, year-over-year. We provided guidance for the first quarter. We are not providing guidance for the other quarters. But it's fair to say that we are going to see choppiness from quarter to quarter.

**Shawn Boyd** - *Westcliff Capital Management - Analyst*

Okay. Very helpful. And if I could, going back to the Company's longer term model for a second, I have got the Company at roughly 42% gross margins at a \$50 million run rate. As that moves up, the gross margins move up. So thinking about 50% to 60% incremental gross margin beyond that, is that correct?

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

That's right.

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**Shawn Boyd** - *Westcliff Capital Management - Analyst*

Okay, very good. And I think we have already covered the operating expenses, but just to hit it one more time to make sure I'm on the same page, we are at roughly 21.5 million, a little over that, on a quarterly basis non-GAAP operating expenses. If I heard you correctly, we probably stay there and maybe walk them up a little, but for the most part 21.5 million and maybe 22 million is ample room for the Company at this point?

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Yes, that's right. And it will vary a little bit quarter to quarter depending on timing of the expenses and project timing and things like that. But that's the right range.

**Shawn Boyd** - *Westcliff Capital Management - Analyst*

Got it.

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

21 to 22 basically.

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Yes.

**Shawn Boyd** - *Westcliff Capital Management - Analyst*

Got it. Okay, thank you so much.

**Paul Oldham** - *Electro Scientific Industries, Inc. - CFO, VP of Administration & Corporate Secretary*

Thanks a lot.

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

Thank you.

**Operator**

With no further questions, I would now like to turn the conference over to Mr. Nick Konidaris, CEO of ESI, for closing remarks. Please proceed.

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

To reiterate, in our fourth quarter we delivered excellent sequential and year-over-year revenue growth and saw the profitability. We are executing very well in delivering innovative systems to our customers and developing our next generation of products



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that will expand our addressable market and fuel profitable growth. 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. Thank you for your interest in ESI.

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**Operator**

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect and have a great day.

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