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ESIO - Q4 2018 Electro Scientific Industries Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the ESI FY '18 quarter 4 earnings call, hosted by Michael Burger. My name is Shelley, and I'm your event manager. (Operator Instructions) Now I would like to hand the call over to Brian Smith. Please go ahead.

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

Thank you, Shelley, and good afternoon, everyone. My name is Brian Smith, Director of Investor Relations for ESI. With me today are Michael Burger, our CEO; and Allen Muhich, our Chief Financial Officer.

This call will cover our fiscal fourth quarter 2018 results. To improve comparability, we are also providing earnings per share and related income statement results on a non-GAAP or adjusted basis, which excludes the impact of purchase accounting, equity compensation, restructuring and other items. Before we go into the details of the call, I would like to remind you that some of what we say will include forward-looking statements. These statements are subject to 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 these forward-looking statements. This call also contains time-sensitive information that we believe to be accurate as of today, May 8, 2018 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 D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Thank you, Brian. Good afternoon, and welcome to our call. We had a very strong fourth quarter with revenues of over $113 million, adjusted gross margins of nearly 50% and adjusted EBITDA margins of 34%.

Bookings were $111.8 million as continued strength in demand for our Flex drilling products pushed bookings over $100 million for the third quarter in a row. For the year, our bookings were over $451 million or just shy of 2.5x the $185 million we booked last fiscal year. The demand environment over the last 12 months has been extraordinary, especially in the flexible circuit market. That said, we've been clear that at some point our customers demand would pause while they absorb the massive amount of new drilling capacity. And in fact, early indications over the last couple of months indicate a softening of demand for new Flex drilling capacity in certain geographies.

While our visibility into the near-term need for future capacity expansion remains limited, our belief in the underlying dynamics for long-term growth remains strong and unchanged. The proliferation of flexible circuits in smart phones and other new consumer electronic devices, coupled with new application drivers, such as 5G networking and self-driving automobiles, all require higher circuit density, which drives more electrical interconnect and ultimately more holes.

Our laser drilling systems are crucial to enabling the increases in density and complexity driven by these products, applications and markets. To ensure we maintain our dominant share in the Flex drilling market space, we expect to introduce our new flagship platform this summer. This product will continue to distance us from our competition and further raise the barriers to entry into this market.

Demand for our semiconductor and component test products was also strong. As a group, revenue for these products grew over 50% in fiscal year 2018. Within the component test, demand for MLCC testers has accelerated throughout the year, reflecting the explosion in ceramic capacitor demand.

As a result, our revenue is up 47% year-over-year. As previously discussed, we will introduce a new large chip format tester this summer, which expands our offering in this dynamic market.

Demand for our semiconductor products, which includes, wafer scribe mark and trim tools has also been strong for the year, with revenues up nearly 90% and up almost 200% in Q4 as compared to the fourth quarter in 2017. This market has been driven primarily by China's investment in building semiconductor manufacturing capacity. While these products will continue to grow, we do not expect that they'll repeat this year's growth rate in the short term.

Finally, one of our key growth initiatives is moving into the rigid HDI circuit board drilling market. This market is large with strong growth drivers, and today, we have virtually no market share. We continue to make good technical progress on our next generation HDI tool, which we expect to announce later in the calendar year. This tool will possess the key technical capabilities that differentiate our Flex drilling tools. We are convinced that these same capabilities will also differentiate us in the HDI space.

We are confident our strong and growing product portfolio, combined with the technology trends I mentioned earlier, will enable us to grow over the long term. In March, we held an Analyst Day event in New York, where we outlined our financial expectations to achieve an annual revenue of $500 million within the next 3 years.

While we still operate in a cyclical business and quarters are likely to see the revenues cycle up and down, depending upon the timing of customers, capacity additions, the long-term growth drivers are good and we are well positioned. In New York, we also announced a new success model, which sets annual targets of 49% adjusted gross margins and 29% adjusted EBITDA margins.

This year, we had quarters both above and below, but overall, we came in very close to our new our success model. We will focus on these annual metrics as we manage our business over the long term.

As we enter new markets, we expect the cyclical swings to dampen over time. However, we are pleased that we have demonstrated the scalability of our business model and expect it to deliver excellent profits in all market conditions.

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

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

Thank you, Michael, and good afternoon, everyone. Bookings in the fourth quarter were $111.8 million, up 36% from a year ago. The order levels reflected the strong demand environment for our Flex drilling tools Michael discussed earlier. Bookings in semi and component tests were also up sequentially, particularly in semiconductor with strength in scribe, trim and wafer mark.

Revenue for the quarter was $113.4 million, up 127% from a year ago and up 2% sequentially. Revenue was above the high end of our guidance range due to the extraordinary efforts of our operations team who have successfully ramped our Flex unit output by 5x as compared to a year ago with greater than 90% on-time delivery and without compromising on quality.

We exited the year with over $148 million in backlog that we expect to primarily shift in the first half of fiscal 2019, and our book-to-bill ratio was about 1:1. GAAP gross margin was 48.3% and non-GAAP gross margin was 49.2%, increasing sequentially by 30 basis points and well above the 45.7% from last year, demonstrating over 50% flow through on the gross profit line. Looking forward to next quarter, we expect non-GAAP gross margin to approximate 47.5% at the midpoint of the revenue range.

GAAP operating expense was $20 million and included about $1.3 million of equity compensation and purchase accounting amortization. On a non-GAAP basis, operating expense was $18.8 million, representing a sequential increase that resulted from additional investments in our product roadmap.

We expect first quarter operating expenses to remain relatively flat when compared to the fourth quarter. Non-GAAP operating income was $37 million or 33% of revenue compared to $2.7 million of income in the same quarter last year. Adjusted EBITDA was $38.6 million or 34% of sales. The GAAP tax provision was a $40.7 million credit as the company's strong financial performance over the last 12 months resulted in a cumulative 3-year profit that triggered the reversal of our valuation allowance.

I should also note that after further review of the provisions of the 2017 Tax Reform Act, we expect our GAAP effective tax rate to approximate 15% to 17%, beginning in fiscal 2019. This rate does not apply to our fiscal 2019 non-GAAP rate, where we continue to expect approximately $500,000 in quarterly cash tax expense as a result of the profitability we have in the various task jurisdictions in which we operate. GAAP net income was $75.1 million or $2.10 per diluted share compared to a loss of $0.54 per share last year, in part due to the reversal of the valuation allowance I've just mentioned.

Adjusted net income was $36.5 million or $1.02 per diluted share compared to net income of $2.9 million or $0.09 per diluted share a year ago.

Turning now to the balance sheet. Total cash and investments were $125 million at quarter end, up from $100 million last quarter and nearly double the value of 12 months ago. We generated $26.6 million of operating cash during the quarter. Our noncash working capital increased approximately $10 million, primarily due to the application of customer deposits and increased inventory levels.

DSO fell sharply to 51 days, reflecting strong customer deposits in the third quarter that became revenue in the fourth quarter without flowing through to accounts receivable. We would expect DSO to return to historical rates of approximately 60 to 65 days in the future.

Inventory increased by $13.2 million to $88 million, as we built inventory ahead of expected first half fiscal '19 customer shipments. Inventory turns in the quarter were 2.9x. Capital expenditures were approximately $1.7 million for the quarter, most of it related to the addition of factory capacity in Singapore.

I should also mention the version of SAP in which we are presently running our business is no longer meeting our needs and approaching end of life. As a result, we have made the decision that, over the next year, we will upgrade to a cloud desk-based SAP solution. We believe that staying with SAP is the lowest risk path to cost effectively gaining the required functionality to efficiently run our business.

We expect the SAP capital investment in fiscal '19 to approximate $6 million, which would be incremental to the normal 2% to 3% of revenue.

Turning to Q1, we expect revenues of between $97 million and $111 million, given the strength of our backlog position, and non-GAAP earnings per diluted share between $0.75 and $0.95.

I'll now turn the call back over to Michael.

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Thanks, Allen.

In summary, our fiscal 2018 was a fantastic year. One of our key takeaways from this year is that we now have a cost model that will enable us to remain nicely profitable through the expected cycles in our business and deliver exceptional financial results when the market is strong, as we've done this year. This new dynamic for ESI will allow us to continue to invest in our roadmap, enter the new markets we've outlined today and drive toward our target of $500 million in annual revenue within 3 years.

This concludes our prepared remarks. And at this time, I'd be pleased to take any of your questions.

Shelley?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from the line of Jaeson Schmidt.

Jaeson Allen Min Schmidt - *Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst*

Just first I want to start off with wondering if you could comment on if your visibility and lead times have changed significantly over the past 3 months here?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Not really. Our lead times are still running where we were when we talked in New York in December. Visibility is pretty much the same as well. We -- we're running at about -- on average about 4 months lead time.

Jaeson Allen Min Schmidt - *Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst*

Okay. And then are you guys seeing anything out of the ordinary from a pricing standpoint in any of the product lines?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Nothing dramatic. We do battle with some of the local manufacturers. In the Flex space, we do battle with a Korean manufacturer. And occasionally, price becomes an issue. We have found, frankly, through this last cycle that we, certainly in the Flex space, have not had to discount at all. In some of the MLCC products, we have a -- we share a market with another manufacturer where we, at times, depending on the level of business, do need to actually think about pricing. But in general, it's not really changed much recently. So I think the answer would be, nothing's really changed.

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

And by and large, we generally do not need to compete on price because of the functionality of our products, and we tend to think about it more from a price per unit of output. And again, given the higher performance generally of our products, that enables us to garner higher SAPs and, again, we generally don't have to discount.

Jaeson Allen Min Schmidt - *Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst*

Okay, that makes sense. And then Allen, looking at OpEx, how should we think about the need for it to potentially ramp as we get beyond the June quarter?

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

Yes, good question. Again, we guided essentially for relatively flat operating expenses from our fourth quarter into the first quarter, into our June quarter. I think through the balance of the year, we would expect it to continue to remain relatively flat. There will be some mix changes within it based upon certain variable pay practices, et cetera. But by and large, we think it should remain relatively flat. I mentioned capital expenditures on our SAP investment. There will be a little bit of -- that's one of the mix changes that I might refer to is that we might have a little bit there, but it's very de minimis. So I think by and large, relatively flat.

Operator

And your next question comes from James Ricchiuti.

James Andrew Ricchiuti - *Needham & Company, LLC, Research Division - Senior Analyst*

I wonder if you could comment, Michael, just on what you're seeing in terms of utilization in some of the Flex customers?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Yes. Actually, utilization is still pretty high. We mentioned that we did see a little bit of softening in a couple of regions. But in general, utilization is really high. And frankly, I think, that's reflected in our backlog position. We still have strong demand through Q1 and Q2. And I think that it goes hand-in-hand. As utilization stays high, demands stays relatively strong.

James Andrew Ricchiuti - *Needham & Company, LLC, Research Division - Senior Analyst*

Okay. I'm trying to figure out what the seasonality of this business looks like. It has changed over -- clearly over the past year. So normally, wouldn't you see some seasonal pickup in the June quarter and September quarters? Just given what's happened this past year, how do we think about that?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

It's a great question. We're definitely trying to figure it out ourselves. I think, clearly, there's been an inflection point in the last 2 quarters in terms of material change and technology change. And I think, coupled with introduction of some several phones that have been relatively successful, I think it's really kind of thrown the seasonal pattern that we've seen, actually, for the last 3 years, pretty religiously out the window. So I think we're in the same boat. We do believe that in our Q2 -- end of Q2, early Q3, we may see a slowing in terms of bookings. But we do believe that toward the end of the year, as new phones get introduced, we should see that pick up again.

James Andrew Ricchiuti - *Needham & Company, LLC, Research Division - Senior Analyst*

Okay. And I think back in New York, you had talked about an opportunity in the Flex market. We're seeing a lot of investment. It sounds like in the LCP area, the flex PCB market, are you seeing -- or how do you see that unfolding for you?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Yes. Actually, there's been a lot of external analyst reports, primarily from Asia being written recently that actually have done, I think, a pretty good job explaining what's happening in LCP. LCP seems to be adopted primarily for 5G antenna applications, at least initially, and in RF modules. And it's primarily shared between 2 major manufacturers. Murata's one of the big guys that actually does the LCP material. Another one is called -- and I may mispronounce this, I think it's (inaudible), also, out of Asia. Both of these guys are the resin and foil producers. As you know LCP has been in limited supply. And I think that's kind of caused some consternation in some of the channel. But I think that's beginning to open up. And as a result, we're seeing wider adoption of LCP-based processing in our customer base beyond kind of the usual 2 or 3.

James Andrew Ricchiuti - *Needham & Company, LLC, Research Division - Senior Analyst*

And last question for me. I keep hearing anecdotally about shortages of resistors and ceramic capacitor chips. Are you seeing it on the MLCC side in terms of bookings? It just -- we keep hearing it, and I'm just wondering what's the investment cycle looking like from some of the bigger players in that market.

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Yes, we've actually -- I think, we said in our script, we've seen that business grow almost 50%, I think it's 47% year-on-year. We have very strong and accelerated backlog in the MLCC tester business. I don't believe that the testers are the long pole in the tent, however. I think material seems to be the shortage. We have several customers that have raised pricing multiple times throughout the last year, which I think is indicative of a short supply. We are seeing great demand on our existing allegro platform. And as I mentioned in the script, we're announcing a new product here, which actually expands our TAM in that marketplace. So we're pretty excited about it. And it looks like the fundamentals are such that we don't see that slowing here in the next -- or certainly in the short term.

Operator

And your next question comes from David Duley.

David Duley

Just to follow up on that previous question in the capacitor space, you said you had a new MLCC product that will expand your TAM. Is that referring to a new tester, or are you expanding into another product line?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

No, no, it's a new tester. Today, we handle some of the ultrasmall packages 02s and 04s. And our new product will actually expand into the large chip format, which is a part of the market, David, that we've not participated in the past. So we'll actually -- and I probably misspoke it, it won't actually increase the TAM, but it should increase our SAM.

David Duley

Okay. And okay, and I think you mentioned that gross margins would be down sequentially from 49.2% to 47.5%. What was the reason for that?

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

The main reason -- David, this is Allen, the main reason is simply around the revenue reduction that we're pegging at the midpoint of the range. And given the flow through that we've demonstrated, I think you'll find that the margin pretty much works out. We do have a little bit of backlog that is relatively low margin, that is going out this next quarter. It's expected to go out this quarter, and so the numbers will be a little bit off from what I just articulated. But by and large, it's the revenue reduction at the midpoint of the range relative to what we just delivered in Q4.

David Duley

Okay. And do you guys expect to capture revenue from the HDI product in calendar '18? Or when would we expect our first revenue? And how do you think it ramps from there?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

I think mid-calendar year '19 is when we should see some revenue. '18 will be release in beta. We'll see some -- I would expect onesie, twosie types in '18 depending on how well the betas go. But my expectation from a meaningful revenue perspective should be mid-19 calendar.

David Duley

Okay. And you talked about this new material in the Flex circuit area. How widely adopted is that? Just help us to understand where the adoption curve is? Is that really only in high-end phones, in the RF module? Or is it going to expand into other modules or move from other -- from one phone to more phones on the RF module side? Or just help us understand kind of where the adoption curve is there.

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

It's early days. I think LCP is in its early adoption. It's been driven by, I would say, the ultra high end phone today. And we expect that it will move into other consumer devices within the consumer electronics space and ultimately into other manufacturers of cellphones, as 5G becomes more of a reality, the -- there's the low frequency band and the high frequency band, and there's a lot of speculation, but the high-frequency band will -- could center around something north of 20 gigahertz. And so RF loss would become a big deal. And LCP is well-suited for low loss, high-frequency applications. And so we expect that LCP is in early days adoption and will expand.

Operator

Your next question comes from Patrick Ho.

J. Ho - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD of Technology Sector*

Michael, first off, on some of your -- hello?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Hey, Patrick.

J. Ho - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD of Technology Sector*

First off, in terms of your commentary regarding semiconductors in China, is it fair for me to assume that the business strength in China was coming from the multinationals and not yet from the local Chinese semiconductor market?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Yes, that is correct.

J. Ho - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD of Technology Sector*

Great. And as my follow-up question. On the rigid HDI, the product that you just mentioned and talked about. In terms of the drivers that you're looking at, is part of it due to the market demand, the interest that's out there? Or is there some key product differentiator that you're going to be able to offer that will drive the traction and demand you talked about that will begin some time in mid-2019?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

I think it's a bit of both. I think, frankly, right now lead times in the drilling equipment business are relatively long, so there is a great deal of demand. Actually, if you look at the HDI market growth in -- over the last 12 months, I think it's been double digits. So we've seen reports that say, 10, up to 14% growth in the HDI space. And so, that's a large market that's going relatively rapid. So I think that, from a market perspective, is what has got our interest. From a technical perspective, the things that we have been able to demonstrate in the flexible drilling space are exactly the same traits that are required to win, in our view, in the HDI space. We have carved out, I would argue, a franchise in the flexible drilling space, by virtue of our approach. We're taking a very similar approach in the HDI space. And therefore, we believe, we should and can be successful. We've told The Street that a 10% market share within 3 years is feasible. And I think that's kind of what we've got our short-term sights set on.

J. Ho - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD of Technology Sector*

Great. And actually final question for me in terms of the flexible PC market environment itself. You've talked for a few quarters now about a potential capacity digestion period that's likely on the horizon. But given that the PCB demand, especially for flex PCBs, is so high right now, do you see any potential capacity digestion period as being relatively short and brief relative to, say, the cyclical patterns we've seen in semiconductors in the past, where it could last a year, 4 to 6 quarter type of period. Could you see the PCB environment bouncing back relatively quickly because of the overall demand environment and the adoption of flexible PCB?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

We think, there's potential for that, absolutely. We -- again, our visibility is not that great beyond arguably, Q1, Q2, but we do believe that the fundamental -- the strength and the momentum that we've seen and, frankly, read about. There's been a lot of new analyst reports out of Asia talking about, for example, LCP material as an example, but flexible circuit in general. And we've stated in the past that we thought that, that market was going to grow at a CAGR of around 12% a year. Clearly, this last year, it grew much faster. And there's no reason to believe that, while I don't think it's going to grow at the rates that we saw in fiscal year '18, but it will be much greater than what we saw in '16 and '17. So it's just broad-based adoption, Patrick. And the number of applications, frankly, are coming out of the woodwork. So we're -- I think, we're really well positioned. And I will say I think our customers are very well positioned to take advantage of that. Again, the visibility is relatively low. We're not saying that we're going to grow at the same rate that we did in FY '18. In fact, I think there will be retractions at some point during fiscal '19. We just don't think it's going to be anywhere near to the levels that we saw in '16 and '17, nowhere near. But that being said, I think, even with the retraction and our new cost structure, I think our earnings will be an improvement.

Operator

Your next question comes from J.D. Delafield.

John Dennis Delafield - *Delafield Hambrecht, Inc. - Chairman of the Board, CEO, President, and Portfolio Manager*

So I had a question on services and then on the used machine market. The service revenue hasn't really grown in line with the systems revenue. And I'm curious, if you could talk more about that and what the next -- the outlook for services is? And then I don't recall if you have a initiative to recapture these machines that you're replacing? Or if there's some local Asian operations that are grabbing those and repurposing them? And if you could comment on the margin profile or either one of those segments, if appropriate.

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Sure. So I'll take the first section, I'll let Allen comment on the margin side of it. The way the service business works is we sell a new machine, and depending upon the service, the warranty that we negotiate in the purchase agreement, and typical, is just -- if you were to average at all, it's a little bit over the year. So if warranty goes out a year, and through that period, the cost of service is really covered in the selling price of the machine. As the product comes off of warranty, we have an opportunity to either sell time and materials, which is kind of on an as-needed basis, or service contracts. And we've been relatively successful in selling service contracts, and that's our aim. And so that's kind of the way the business works. From a -- if you look at what has been installed over the last year, which has been a large number of machines that we've shipped unprecedented, frankly, most of what we've shipped, certainly, most of what we've shipped over the last fiscal year is still in warranty. So we would expect that as the service, as these machines roll off of warranty, it's a huge opportunity for service revenue. So the way I kind of think about it is, it's a year to 14-month lag on average from the time we sell a machine to the time that we actually start recouping either time and materials or warranty contracts.

Let me talk a little bit about used machines and then I'll have Allen comment on the margins. We are diligently exploring whether that is a play for us. We -- I do believe that there is a market for us in used machines. We have not formalized that. We are in the early stages, and I would expect that we should have some determination of what we're going to be doing here in the next quarter or 2, and which we could -- we'll talk about it in the call. But right now, it's an exploratory. But I do believe there's some opportunity there.

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

So based on the -- so back on the service question. So it's an area that we are very focused on because, as you well know, that while it's roughly 10% to 11% of our revenue today, it's a recurring bit of our revenue. And so having that continue to increase as a percentage of the total, certainly will help us offset some of the inherent cyclicality that we have in the rest of our business. So obviously, very focused on it. The other comment that I would maybe add to Michael's is that, yes, it will come in after this, call it, 12 to 16 to 18-month time horizon as new contracts are sold on products that we've sold over the last 12months. But it will happen slowly because we recognize it 1 month at a time as opposed to all up front. Finally, from a margin standpoint, you'll probably note that in our press release, if you do the math, that our margins in service stepped down to about 45%. As we completed the restructuring activities over the last 12 months, we have reassigned some of the resources within there. And therefore, we have seen a reduction in our service margin, but we think that is appropriate. And we think, frankly, it's a very attractive business to remain to be in. But that's probably a new level, new watermark that we should expect, doesn't change anything about our 49%, 29% success model. It's simply just a reassignment of resources.

Operator

Your next question comes from Jason Ursaner.

Jason Ursaner

Congratulations on a strong finish to the year. You've been discussing the expectation for the Flex market to see, I guess, some pause or this retraction for a few quarters just given the capacity congestion. And just given that there are a lot of fears around the cycle right now, is there anything else you could maybe characterize it more specifically? And I guess at a high level, is it any different -- and I know that you have limited visibility, but is it different than what you had kind of been talking about? Or this is what you've been talking about?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

This is what we've been talking about. I think we feel really good about where we are right now. We just finished the year with arguably the highest backlog we've had in over 10 years. So we feel really good about kind of the near-term revenue opportunities. We did mention in the script that we're in some geographies. We're seeing utilization has dropped a little bit and, as a result, bookings have waned a little bit. And I think that's the beginning of a sign that some of these countries and some of these companies are literally digesting all these machines that we've shipped to them, which is part of the cycle. And as we've said all along, we think this is traditional. That being said, we think the fundamentals of the flexible circuit market are probably stronger than they've ever been. And we are now in a position -- better -- we probably have higher market share than we've ever had. And we do believe that with the introduction of this new platform that will be coming this summer, it just puts an exclamation mark on our leadership position. So we're defending at all cost our position in Flex. And I don't think, as I mentioned, I think, in the previous question, even if there's a pause, it will not -- we don't believe retract back to the levels that we saw in -- at the end of fiscal year '17. So we think we're in an exceptionally good space. We talk a lot about Flex, but I don't want to -- I want to bring everybody's attention back to that the other markets that we're in, all of these markets have been up and sustained for some period of time. And that gives us, again, at a corporate level, a lot of confidence around this fiscal year. So we're starting with the highest backlog we've started a year with. And again, we do smell that there's been a lot of capacity add, but the other product lines are also kind of hitting on all cylinders. So we feel like we're set up pretty good for this year.

Jason Ursaner

And maybe just separating the cycle from the long term, obviously, you had a lot of confidence that you're basically going to be expanding the TAM over time and having higher highs and higher lows to it. Just maybe go over again for Flex, what you see really driving that TAM expansion?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Well, it is amazing. We -- the cellular phone, the consumer electronics associated with that, which are iPads and notebooks, et cetera, the usage, the number of flexible circuits per phone has grown dramatically. The density and the complexity of the circuits that are currently being used in those cellphones has grown immensely. The geometries and the number of VIAs per flexible circuit have continued to shrink, which makes the complexity higher which, frankly, creates a larger barrier to entry. And so all of those dynamics, coupled with now new application drivers, 5G, which there's a lot of talk about, I think, has taken the world relatively by surprise, as it relates to the speed at which this is coming on. And a lot of our customers are now being asked to support 5G antenna development, et cetera, et cetera. And so that, I think, just adds to the acceleration factor of this consumer electronics flexible circuit usage. The other thing that we're seeing is that other markets like automotive, as an example, are utilizing flexible circuits because, frankly, they're cheaper -- it's cheaper in many respects and actually much more pliable and frankly much more -- or much less obtrusive. So the applications for flexible circuits beyond the traditional consumer electronics market seems to be growing. And that, actually again adds to the confidence around the underlying, the underpinning need for flexible circuit drilling. That being said, we've shipped a lot of machines. And our customers are -- there are a lot of factories that bring it online. And I think at some point, there will be some digestion going on, but we don't expect it will last very long, and we don't think it will be very deep.

Jason Ursaner

And just looking at the new target model or success model, what type of capital investments, either Flex or HDI machines or acquisitions or what type of investment do you think it would take to get there?

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

The beautiful thing about our financial model is it does not require a significant amount of capital to expand and ramp capacity. Essentially, we're talking about additional square footage, additional talent to be able to assemble our products and then some black screens to make sure people don't shoot their eyes out with lasers. So it's a pretty low cost model. I think 2% to 3% of revenue that I outlined in our prepared remarks will cover us from a capital investment standpoint.

Jason Ursaner

Okay. And assuming I'm looking at the math right, I mean, it's approaching $3 a share in earnings or like $3.50 a share in earnings with 20% of your market cap in cash today, what would be the priorities for capital allocation?

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

As Mike indicated, we had an Analyst Day call, we had an Analyst Day in New York back in March, and we talked about 3 different uses of our capital. The first is making sure that we can continue to fund our organic growth, that's obviously job #1. Another way that we think about it is, we do have an authorized share repurchase program, either something like $18.2 million of remaining available. We have not been in the market. Frankly, we don't have any short-term plans to be in the market. But if something happens to our stock price and it happens to dip below our intrinsic value, we likely would be in the market. And so that's another way we think about it. And the third is on M&A. We think that there are compelling things that we could go look at, that would be very accretive to our profitability, that would accelerate our strategy, that -- at some point in time in the future, may make sense for us to do. But at this point in time, there is certainly nothing imminent.

Operator

Your next question is from Arnie Ursaner.

Arnold Ursaner

Jason actually asked the key question I was focusing on. But could you comment -- your $500 million market model, to be clear, does not include any announced -- unannounced acquisitions? That would all be organic, is that correct?

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

That's correct.

Arnold Ursaner

Okay. Again, you have ample cash to do lots of ways to enhance shareholder value. Keep doing what you're doing.

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Thank you. I appreciate it very much. Thank you for your interest.

Operator

Thank you. Now I would like to hand it back over to Michael.

Michael D. Burger - *Electro Scientific Industries, Inc. - CEO, President & Director*

Thank you, Shelley. We are obviously very excited about where we are as a company. We really appreciate all of your interest and attention today and look forward to giving you an update next quarter. Thank you very much.

Operator

Thank you. Ladies and gentlemen, that concludes your conference call for today. You may now disconnect. Thank you for joining, and enjoy the rest of your day.
