

**Electro Scientific Industries,
Inc.**

Company▲

ESIO
Ticker▲Q1 2015 Earnings Call
Event Type▲Jul. 31, 2014
Date▲**— PARTICIPANTS****Corporate Participants**

Brian Smith – Director-Investor Relations, Electro Scientific Industries, Inc.

Edward C. Grady – President, Chief Executive Officer & Director, Electro Scientific Industries, Inc.

Paul Oldham – Chief Financial Officer, Vice President of Administration and Corporate Secretary, Electro Scientific Industries, Inc.

Other Participants

James A. Ricchiuti – Analyst, Needham & Co. LLC

Mark S. Miller – Analyst, Noble Financial Capital Markets

Tom R. Diffely – Analyst, D. A. Davidson & Co.

— MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the ESI Fiscal 2015 First Quarter Earnings Conference Call. My name is Shelley and I will be your operator for today. At this time, all participants are in listen-only mode and later we will conduct a question and answer session. [Operator Instructions] As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the conference over to your host for today, Mr. Brian Smith. Please proceed.

Brian Smith, Director-Investor Relations

Thank you, Shelley, and good afternoon, everyone. My name is Brian Smith, Director of Investor Relations for ESI. With me today are Edward C. Grady, our CEO; and Paul Oldham, our Chief Financial Officer. This call will cover our fiscal first quarter 2015 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 these forward-looking statements.

This call also contains time-sensitive information that we believe to be accurate as of today, July 31, 2014, and which could change in the future. This call is the property of ESI.

Now I will turn the call over to Ed.

Edward C. Grady, President, Chief Executive Officer & Director

Thank you, Brian. Good afternoon and welcome to our first quarter conference call. Overall, this was a constructive quarter for us. Several of our end markets improved after periods of slow demand, orders grew sequentially and we executed well against our financial expectations.

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More importantly, we completed several actions that began to lay the foundation for the revitalization and we continue to develop and validate plans and milestones that have put us on a path towards long-term growth. I'll discuss our actions and milestones in more detail in a few minutes. But first, I'd like to give you a brief overview of the business.

Bookings were up sequentially to \$47 million. The improvement was broad-based with flex via drilling, advanced microfabrication, semiconductor components, all showing sequential growth. We also drove seasonally strong bookings in our customer service and support business adding new service contracts and seeing strong activity on our on-demand support offerings.

The largest sequential increase came from our flex circuit via drilling systems. You may recall that we saw very weak demand in our March quarter, and we expected a rebound in this quarter Q1. The demand came even stronger than we had expected. In addition, we introduced two new versions of our Model 5335 via drilling system, which will extend our capabilities and better position us in this market as we go forward.

We also won a new design in our new advanced microfabrication business. This was smaller in magnitude than we had seen in the past, but it represents a new key technology application for us. While recently this business has not contributed as much revenue to ESI as in the past, it remains an area of tremendous growth potential.

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

Paul Oldham, Chief Financial Officer, Vice President of Administration and Corporate Secretary

Thank you, Ed, and good afternoon, everyone. The following information includes results from our first quarter of fiscal 2015, which ended on June 28. 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 and other items.

Bookings were \$47 million compared to \$32 million last quarter and \$58 million a year ago.

As Ed mentioned, the increase was across the board and reflected general market improvement. Orders in our Interconnect & Microfabrication business were up significantly from last quarter, particularly in our flex business as we saw OEMs begin to place demand on the supply chain largely in China and Taiwan. Korea continues to be relatively weak given the continued overcapacity in that market.

Advanced microfabrication orders improved sequentially on the design win Ed mentioned earlier and modest follow-on capacity orders. Orders in our Semiconductor business were also up slightly from Q4, with strong customer pull for circuit trim products driven by ongoing demand for sensor technology.

We also saw sequential improvement in our Component Test business, with strong demand for tooling and a few new capacity orders. We expect to see small capacity orders in this area, but meaningful improvement in demand will ultimately be driven by new technology as we expand into additional chip types.

Finally, our service and support business had a strong quarter for both contracts and time and material as customers begin to gear up their capacity. Our Service business has grown steadily over the last year, reflecting the strength of our installed base.

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Our book-to-bill ratio was 1.26. Shipments were \$37 million and backlog increased by \$9 million to \$37 million. Revenue for the quarter was \$35 million, down 6% from last quarter and 24% from last year. Revenue levels were consistent with the bookings we saw in the fourth quarter but came in at the high end of our guidance range.

GAAP gross margin was 38% and included about \$600,000 of purchase accounting and equity compensation and cost of sales. On a non-GAAP basis, gross margin was 40% compared to 46% last quarter and 44% last year. We expected to see lower gross margins this quarter on lower volume, competitive price pressures and some favorable items from last quarter that did not repeat. Also we invested in and shipped a couple of development systems at low margin, which should benefit us in the future. Looking forward to next quarter, we expect non-GAAP gross margin in the low 40% range.

GAAP operating expenses were \$22.2 million, including \$1.3 million of equity compensation and purchase accounting. Non-GAAP operating expenses in Q1 were \$21 million, down from \$22.3 million last quarter based on discretionary expense control and cost last quarter associated with the installation of our first glass and semiconductor tools, which did not repeat. We expect non-GAAP expenses next quarter to increase about \$1 million on higher volumes and timing of project and other expenses. We would expect expenses around this level for the next few quarters as we invest in our growth initiatives.

On a GAAP basis, operating loss was \$9 million. Non-GAAP operating loss was \$7.4 million compared to a loss of \$5 million in the prior quarter, reflecting the lower sales and gross profit. Income tax on a GAAP basis was a benefit of \$700,000 largely due to a favorable ruling in Taiwan related to our patent infringement proceeds in fiscal year 2013. On a non-GAAP basis, tax expense was \$250,000 reflecting foreign taxes. For fiscal year 2015, we expect to pay roughly \$1 million to \$1.5 million of tax based on foreign income.

On a GAAP basis, first quarter net loss was \$8.3 million or \$0.27 per share compared to a loss of \$0.92 per share last quarter, which included charges for restructuring and asset impairments. On a non-GAAP basis, net loss was \$7.4 million or \$0.24 per share compared to a loss of \$5 million or \$0.16 per share last quarter.

Turning now to our balance sheet, cash and investments were \$106 million at quarter end. We generated \$740,000 of operating cash during the quarter largely related to working capital improvements.

We paid \$2.4 million as a quarterly dividend and we spent \$1.5 million to repurchase about 208,000 shares at an average price of \$7.01 per share. For the quarter, inventories increased by \$1.5 million largely due to pending early Q2 shipments. Inventory turns were approximately 1.5 times. Accounts receivable decreased by \$5 million to \$33 million and DSO improved slightly to 86 days.

Capital expenditures were \$1.2 million and depreciation and amortization excluding purchase accounting was \$2 million. In summary, despite the challenging revenue quarter, we executed well, managing discretionary spending and delivering EPS at the high end of our expectations. In addition, we are encouraged by the sequential improvement in orders, which will drive sequentially higher sales next quarter.

However, we are still in the early phases of our plans to revitalize the company, and expect that it will still be several quarters before we see the impact of these actions in sustainable top line growth. Given the stronger orders and expected timing of customer deliveries, we expect Q2 revenues to be in the \$40 million range. Non-GAAP loss per share is expected to improve to between \$0.17 and \$0.22.

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Now, I will turn the call back to Ed for a further discussion of our plans as we look forward.

Edward C. Grady, President, Chief Executive Officer & Director

Thanks, Paul. I'm encouraged by our financial execution this quarter but the work to revitalize ESI is just beginning. We believe we've made solid progress in initiating the plans and actions, which will enable us to grow in the future.

Let me start by discussing some of the actions we have already taken. First, last quarter I mentioned that we needed to increase the marketing expertise within ESI. I'm pleased to report that during the quarter, we brought in several key marketing professionals including James Latham, our new Chief Marketing Officer. He is an experienced and well-rounded marketing leader with a demonstrated success in both product development and customer engagement. His role is to drive our market development efforts, ensure that we are both creating products with both broad market appeal and connecting with customers to demonstrate our competitive advantages.

Next, we hired Gerald Li to lead our China operation. We feel that China is the largest and fastest-growing region for laser systems use and manufacturing of microelectronics. To capture a larger share of this market, we must be more engaged with both contract manufacturers who serve large multinationals and fast-growing local companies who are increasingly innovating to bring consumer electronic products to market.

In addition, we need to deliver platforms and products utilizing our technology that meets the needs of these customers in China. Gerald has a wealth of experience doing just that for several large global companies and he has already increased our understanding and appreciation for the magnitude of this opportunity for ESI.

The corporate reorganization we initiated this spring is also bearing fruit. We reorganized our product groups around market demand characteristics instead of product family or technology. This focus is improving our understanding of the markets and increasing our speed and effectiveness to bring innovative products and applications to existing and new customers. Finally, we continue to strengthen our position in our existing markets with the introduction of new versions of our flex drilling system, which contributed to our bookings this quarter.

Now, let me discuss our plans going forward. Our plan centers on four key initiatives. The first key initiative is to move away from a focus on a few customers serving as technology drivers and reorient our focus onto large and growing markets. We've begun this initiative by making key marketing hires and we've already felt their impact. However, there's much we can do to connect with more customers to discover and meet their needs.

Our second key initiative is to shift from focusing on solving emerging next-generation problems to addressing existing adjacent markets where both market and technology risks are lower. Our third initiative is to penetrate new applications by designing for lower cost. Most of the growth in laser microfabrication has come in the mid and lower end applications. We can apply our technologies to win in these market segments through low-cost overall cost of ownership.

Our fourth initiative is to better utilize our internal laser capability to create both differentiation and a cost advantage in our systems. As we look to the near future, we have identified a set of key actions and milestones that will direct engage our progress towards becoming a market-driven growth technology company.

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Let me start with the milestones for the current quarter, our fiscal Q2. First, we expect to launch a new mid-range platform with modular design that can address a wide variety of consumer electronics and wearable applications.

Second, we plan to expand our customer reach by utilizing third-party sales channels and expect to sign our first [ph] rep (14:02) agreement in China. This will be our first step towards expanding our access to this large and growing market. We've invested in commercializing our internal laser technology with a goal of 50% utilization in our products in the next three years. We expect to qualify our first new laser for use in a major ESI platform this quarter.

Now let me discuss the milestones for the second half of our fiscal year beginning in October. We've been making good progress on updating our business plans in addressable markets and we expect to communicate those in early October, and we will do that at our analyst meeting. In addition, we will continue our investment in China with the intent to open a localized design center that will focus on developing products to meet the specific needs of both local OEM and contract manufacturers.

As a result of these investments, we would expect to receive our first order from a new OEM or contract manufacturer in China by the end of this fiscal year. We're investing and expanding our product offerings into large adjacent markets, and we expect to introduce the first of these products in the second half of this fiscal year as well.

Next, we are taking actions to drive demand and increase customer engagement. These include updating our customer demo centers in the major Asian markets and developing a small job shop for customers that will open up new applications and systems revenue opportunities. We expect both of these to be completed this fiscal year.

We expect to add our capability in three-dimensional micromachining, which will also open up new market applications for us. In the second half of the year, we expect to qualify our second internal laser for use in one of our key platforms.

Finally, we plan to introduce a new low-cost modular platform by early next fiscal year. This low-end platform will possess technology and flexibility that will allow it to address applications that ESI has not participated in before. Our management team continues working diligently on a detailed turnaround and long-term growth plan that centers on our initiatives in marketing, lower cost solutions, proprietary lasers and expanding into lower-risk markets and applications.

I mentioned earlier that we will share some of the details with you in early October. In fact, we'll be holding an Analyst Day event on October 1 in New York City. We'd love to see you there. The invitations will go out soon. And if you're interested or have questions, please contact Brian.

To summarize, we've made good progress in all of our strategic initiatives, and we now have the right people in place to drive each initiative to success. Success for ESI means we are expanding our application sets, serving more customers, addressing larger markets and growing our revenues and profits. All our energy is focused on this outcome.

On a personal note, to put this past quarter in context, we've been focused on the turnaround at ESI only for the past 90 days. While we're not satisfied with the current business level, we are making tremendous progress towards getting back on track and revitalizing the company. We're headed in the right direction. And certainly, we will hit some challenges as we move forward.

But the future for ESI is very bright. We are up to the challenge. This has been a real team effort and I'm excited to be a part of it. I want to publicly thank all of our employees for the engagement and commitment to see us through this journey.

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This concludes our prepared remarks. At this time, we'll be pleased to take your questions.
Operator?

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of Jim Ricchiuti with Needham & Co. Please proceed.

<Q – Jim Ricchiuti – Needham & Co. LLC>: Thanks. Good afternoon. I had a question on the improvement you saw in the flex market. I'm wondering if there was any change in the competitive dynamics in that market particularly you alluded to, I think in the last call, one competitor who I believe you've since initiated some legal action against. What's happening in that market from a competitive standpoint is it just the market improving or you're seeing some easing of the pressure?

<A – Ed Grady – Electro Scientific Industries, Inc.>: Jim, this is Ed Grady. I'd say we're seeing cross currents and dynamics. The first is there's no question that as the new introductions of the next generation cell phones, tablets and so on are coming to market, that there's an increased demand in the marketplace for the flex circuit. So while there has been an overcapacity in Korea that was driven by an over-buy last year, what we're seeing is a shift in some of the supply base whereas a few of the suppliers just don't have enough capacity. So the supply chain is moving around. This is, I guess, the first answer and we are able to fill that gap.

The second part of your question is competitive pressure, and, yes, as we mentioned last quarter, we've had some competitive pressure. As Paul mentioned, we've seen some pricing pressure from the marketplace. So I'd say that we are doing what we need to do to defend this market and I'd say that's pretty much where we are.

<Q – Jim Ricchiuti – Needham & Co. LLC>: Okay. Ed, just one final question, and I'll jump back in the queue. The new design win in the advanced microfabrication area, was that with an existing customer?

<A – Ed Grady – Electro Scientific Industries, Inc.>: Yes.

<Q – Jim Ricchiuti – Needham & Co. LLC>: And that's something that's already work is underway? Was that completed and shipped?

<A – Ed Grady – Electro Scientific Industries, Inc.>: It's underway right now.

<Q – Jim Ricchiuti – Needham & Co. LLC>: Got it. Okay. Thank you.

Operator: Your next question comes from the line of Mark Miller with Noble Financial Capital Markets. Please proceed.

<Q – Mark Miller – Noble Financial Capital Markets>: Good afternoon. Just want to go back and talk a little – talk about using internally developed lasers. Is this just for a specific product or could this branch to a number of your products?

<A – Ed Grady – Electro Scientific Industries, Inc.>: We expect to have our first design in a new platform this quarter, and we have multiple new laser technologies that we are evaluating from the internal laser group. And again, our goal is to have over 50% of our new products with our own lasers in them within the next [ph] three (21:40) years.

So, yeah, multiple applications, multiple laser capabilities all built around high rep rate fiber-based laser technology. This is not old technology. This is new advanced leading-edge laser technology, all of our internal stuff.

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<Q – Mark Miller – Noble Financial Capital Markets>: And I imagine that will have a very significant impact on margins. And can you care to kind of give a range?

<A – Ed Grady – Electro Scientific Industries, Inc.>: Yeah, I think there's two things. I think both of them I pointed out last quarter, but let me restate. So, yes, we can obviously build lasers at a lower cost than we can buy them and those lasers will have margin that will contribute to our overall margin. I think the second, maybe one of the most important parts of having our own laser in some of these advanced applications is lasers are getting very expensive.

And as we are the follow-on laser supplier, once the tool is deployed, we get not only the revenue and margin at the tool sale, but we also get the revenue and margin as the lasers are replaced over time. So I'd say the long-term contribution to the company significantly increases as we have tools with our lasers in them.

<Q – Mark Miller – Noble Financial Capital Markets>: Your win in China, I mean, was that predicated upon pricing, performance, relationships?

<A – Paul Oldham – Electro Scientific Industries, Inc.>: Well, we had a strong quarter in China really across many elements of the business. Our flex business was strong. We saw good microfabrication business in China. Our service business was strong there where we have a large installed base. So, it was really broad-based strength in China this quarter.

<Q – Mark Miller – Noble Financial Capital Markets>: And finally, and I'll jump back in the queue, your SG&A this quarter compared to other recent quarters with similar revenues seems higher. I'm just wondering, this is a trend we should model in or was that just due to this quarter? Just trying to understand what SG&A will be running as a percent of sales as we go forward.

<A – Paul Oldham – Electro Scientific Industries, Inc.>: I think SG&A will probably run in this range. We'd expect it to be a little higher next quarter primarily due to little higher volumes and also timing of some legal and other expenses. But fundamentally, the structure is staying flat. So there's going to be some cost related to volume and whatnot, but the relative structure should stay in this range.

<Q – Mark Miller – Noble Financial Capital Markets>: When you say higher next quarter, is it higher percentage-wise of sales or dollar-wise?

<A – Paul Oldham – Electro Scientific Industries, Inc.>: Higher, slightly higher in dollar amounts, lower as a percentage of sales.

<Q – Mark Miller – Noble Financial Capital Markets>: Thank you.

<A – Paul Oldham – Electro Scientific Industries, Inc.>: Yeah. I think the increase from a percentage of sales is really all to do with the lower revenues, overall expenses are roughly flat in SG&A from Q4.

<Q – Mark Miller – Noble Financial Capital Markets>: Thank you.

Operator: Your next question comes from the line of Tom Diffely with D.A. Davidson. Please proceed.

<Q – Tom Diffely – D. A. Davidson & Co.>: Hi. Good afternoon. So maybe just a follow-up on the last question, when you look at SG&A, you gave us a nice guidance for the next couple of quarters, but as you look into next year or the second half, at some of these investments, where do we see

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the impact of these investments? Is it coming out of the balance sheet or is it going to be evident on the SG&A or OpEx line?

<A – Paul Oldham – Electro Scientific Industries, Inc.>: Well, the way we think about it generally, Tom, is that our goal is to make these investments roughly within the cost envelope that we have today. So we're reprioritizing activity. We're doing arbitrage on head count and we're trying to make the investments we need to make in both product development and marketing within our current cost envelope.

Now that will move around a little bit quarter-to-quarter, and then there will be some variable costs related to volumes. But fundamentally, we would expect to see operating expenses roughly flat or up slightly as we grow the top line over time, which should have them come down as a percentage of sales.

<Q – Tom Diffely – D. A. Davidson & Co.>: Okay. All right. And then you talked about expansion using something like an Asian distributor to get little more aggressive in Asia in general. Do you feel like you have a product portfolio today that you can do quite a bit of expansion with? Or do you really need to get some of these new tools out before you get, really, the bang for your buck with the expansion through Asia?

<A – Ed Grady – Electro Scientific Industries, Inc.>: I'd say, the answer, Tom, is two, is both. There's clearly no question that we have some products particularly in the flex area that we can identify a new customer base within China. And it's a very interesting opportunity for us. So, I'd say that the existing products will be run through the channel. But it will be to customers that we just have not had access to in the past.

And the second part is there are certain customers, particularly some of the contract manufacturers and the OEMs of some of the microelectronic devices, who need products that have a lower purchase cost and lower cost of ownership. So those will actually have to wait for this new low-cost platform to get in place. So I'd say both are true, and we expect to see effect from both sides of that business as we go forward this year.

<Q – Tom Diffely – D. A. Davidson & Co.>: Okay. Okay. Thanks.

<A – Ed Grady – Electro Scientific Industries, Inc.>: I don't think we're finished, by the way, bringing on one rep. That's not the case.

<Q – Tom Diffely – D. A. Davidson & Co.>: All right. It sounds good. And also it sounds like laser is obviously a pretty big focus to source it internally. When you look at this potential over the next year or two, what's the toughest challenge, is it creating the system themselves, is it laser knowhow or maybe is it IP working on guys like [ph] IP Fotronics (27:52) out there that have long IP in this area?

<A – Ed Grady – Electro Scientific Industries, Inc.>: A lot of it has to do with just development of the technology. There are couple of cases where there's IP in place that we have to work around but fundamentally we've got some pretty advanced IP ourselves both in the picosecond and [ph] sensor second (28:12) area. So I'd say the biggest issue is just getting these products to be robust and deployable in units.

<Q – Tom Diffely – D. A. Davidson & Co.>: Okay. Would you actually buy subsystems and assemble them or would you actually from scratch kind of put these things together?

<A – Ed Grady – Electro Scientific Industries, Inc.>: The lasers themselves?

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<Q – Tom Diffely – D. A. Davidson & Co.>: Yeah.

<A – Ed Grady – Electro Scientific Industries, Inc.>: We're actually building lasers.

<Q – Tom Diffely – D. A. Davidson & Co.>: Okay. All right. And then I guess when you look at the cost structure, I mean, of the lasers themselves, is there a specific technology that is not available today that you could, in addition to the cost benefits but technology that you're going to be developing that is not available on the market today that will be unique with what you have or do you think it is strictly more of a cost issue?

<A – Ed Grady – Electro Scientific Industries, Inc.>: I think in some cases, it's a form fit and function capability that we can design to fit in our applications better. The close working relationship between the process engineers, which is the core strength of ESI of designing the process, we can actually work with the laser manufacturer, internal laser manufacturer to get the laser to do exactly what we wanted to do.

And while we work with some third parties, it's a much longer cycle time. It has been a longer cycle time in many cases. So I think the ability to customize and make these be unique to our process is the technical advantage.

<Q – Tom Diffely – D. A. Davidson & Co.>: Okay. And finally, Ed, when you look at your new focus on the broader base of customers, how do you not lose focus, I guess, on your biggest customers today or how do you keep their needs to [ph] make sure you don't lose (30:10) another customer?.

<A – Ed Grady – Electro Scientific Industries, Inc.>: I think it's an organizational issue. And the way we've designed the organization is we have some specific people that are very focused on making sure that we support our largest customers and not just in the microelectronics space but in the flex drilling space as quickly as well.

So, again, it's an organizational focus and we have a team in place and we're able to then leverage on the learning, the process learning we do across the full spectrum of capability in drilling and cutting, welding and marking. So I'd say that the biggest opportunity we have is to leverage the applications development work that we do in the apps labs where we define the processes and in some cases that's for a single large customer and in other cases it's for a broader base.

<Q – Tom Diffely – D. A. Davidson & Co.>: Okay. All right. Thank you.

Operator: Your next question is a follow-up question from Jim Ricchiuti with Needham & Company. Please proceed.

<Q – Jim Ricchiuti – Needham & Co. LLC>: Ed, as you move forward with the work on doing more internal sourcing of lasers, are there any plans for any additional areas where you might become more vertically integrated, and would you be able to do that if you are doing that internally or potentially look outside for some bolt-on type acquisitions?

<A – Ed Grady – Electro Scientific Industries, Inc.>: Jim, I'd say that most of our focus is on what we have today. We clearly do have some ideas on how we can partner with some other people in the space, and it appears that partnering is a more reasonable approach short-term. I would never take off the table the potential of doing some tuck-ins that might make sense, but it certainly is not our number one focus today.

<Q – Jim Ricchiuti – Needham & Co. LLC>: Got it. And just with respect to the booking strength that you saw last quarter, how would you characterize the market environment? Now it's still got a

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few months left in the quarter. But just in general, are you seeing this kind of broad-based strength thus far in the quarter? Wonder if you'd comment on that.

<A – Paul Oldham – Electro Scientific Industries, Inc.>: We don't tend to comment that much on the current quarter, Jim. But I would say that we've historically seen this window of time being the time when most consumer electronics manufacturers are sort of gearing up their supply chain, and so we're seeing that activity occur.

How long that carry-through will be, we'll have to wait and see. But this is the time when that's occurring. It's largely we see those orders in the first quarter, but they can bleed into the second quarter as well.

<A – Ed Grady – Electro Scientific Industries, Inc.>: Yeah. Jim, and the other thing I would add to that is that while we've been heavily focused on the microelectronics and consumer product side, clearly this effort that we have to leverage this cutting and drilling capability into other markets is beginning to have some very significant interest, which will create a less of the cyclical based on cyclical market demand based on just the consumer electronics space. So it's going to be very interesting to see how this plays out over the next couple of quarters.

<Q – Jim Ricchiuti – Needham & Co. LLC>: Okay, thanks very much.

<A – Paul Oldham – Electro Scientific Industries, Inc.>: You bet.

Operator: We have a follow-up question from Mark Miller with Noble Financial Capital Markets. Please proceed.

<Q – Mark Miller – Noble Financial Capital Markets>: The principal competitor in the cellphone area of one of your largest customers has had some challenges in the last quarter. And I'm just wondering do you anticipate that could show up in any improved business for you from this large customer?

<A – Ed Grady – Electro Scientific Industries, Inc.>: I think what we saw is that the difficulties at another large cellphone manufacturer were probably more evident in the supply chain in Korea where we saw the overcapacity the past couple of quarters. I think generally as the industry unit demand continues to grow across the board particularly in some of the newer entrees into the cellphone and tablet markets that were beginning – that that the growth in these market segments is coming back. And I think that's what we've seen in the first quarter.

Will that repeat in Q2 or beyond? Certainly the expectation is that if the demand across the board, not with a single customer but across the board continues to grow, that we should be seeing continued demand in this particular area. So I don't know if I've answered your question but I don't see a shift in the number of total consumer electronics, cell phone and tablet devices doing anything other than growing globally and whether it's one company or the other, the demand is still there.

<Q – Mark Miller – Noble Financial Capital Markets>: Thank you.

Operator: Your next question comes from [ph] Pete Enderwin (35:55). Please proceed.

<Q>: Yes. Thank you. Just one quick question and that is DSOs were 86, down from 93 in the fourth quarter, but that seems like a still high level. What's the dynamic that contributes to that and where do you see that going over the next several quarters?

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<A – Paul Oldham – Electro Scientific Industries, Inc.>: Yeah. That's a quite high level compared to what we've seen historically, but not so high as it relates to the rest of the industry. But the factors that have affected us is, one, we've had still a pretty heavy component of our shipments come late in the quarter that tends to leave more dollars and receivables. The second thing is we've been more aggressive on terms as one of the competitive weapons that we utilized in protecting our market share particularly in the flex business. Those are the two primary factors.

<Q>: And where you see it going from here?

<A – Paul Oldham – Electro Scientific Industries, Inc.>: I think that as we see quarters with more revenues, we'll see the DSO come down a bit because the shipments will moderate. I probably expect to see those in kind of a mid-70s would be our target in the long term.

<Q>: Okay. Thank you.

<A – Paul Oldham – Electro Scientific Industries, Inc.>: Yes.

Operator: We have no further questions at this time. And I would now like to turn the call back over to Ed Grady for the closing remarks.

Edward C. Grady, President, Chief Executive Officer & Director

Thank you, Shelley. I'd like to thank all of you on the call. Let me remind you again of our analyst event on October 1. You're welcome to call Paul, Brian or me if you have any further questions. And thank you all for attending our call today.

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

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