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Corning Incorporated

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Samik Chatterjee: Hi. Good morning, everyone. Thank you. Welcome to day two. I'm Samik Chatterjee. I cover Hardware Companies at J.P. Morgan. For us kicking it off on day two here is Corning. I have the pleasure of hosting Edward Schlesinger, EVP and CFO of the company.

Thank you for taking the time to come to the conference. I'll get right into the questions, and we can take some audience questions as we go along. I did want to start with a few more long-term topics for you before we get into the more near-term, macro, etc., discussion.

Your long-term capital allocation decisions in terms of how you prioritize investments across the different segments of the different market access platforms is really where I want to start with.

How you're thinking about the exposure that you have across these market access platforms to consumer versus enterprise or business spending, and how you're think about long-term capital decisions about where to invest?

Edward Schlesinger: Thanks, and thanks for having us today. Appreciate it. I would start off by saying we apply a very disciplined approach to capital allocation. We have a 345 framework that we use to invest three core technologies for manufacturing platforms.

We look to invent new capabilities or combinations of those core technologies, manufacturing platforms across the markets we serve. We do that through investing in research and development. The majority of our research and development spending is focused on the nearer term in terms of revenue opportunities. Think of that as the next five-year window.

We do spend a decent amount beyond that as well. Then what we look to do is once we feel we have an opportunity to commercialize, we invest capital. We try to do that in a very disciplined way where we create a level of certainty in generating a return. We target a 20 percent return on that invested capital when it's fully up and running.

We look to derisk that in ways by getting incentives or customer funding or long-term supply

agreement. So that's the approach we take. We prioritize organic growth across the markets that we serve. If we're successful in doing that, we generate cash and then our goal is to return that cash to shareholders.

We think we have a lot of organic growth opportunities in the foreseeable future. So that's how we're thinking about deploying capital in the near term.

Samik: No, great. The reason I've started with that is you have diversified in markets that you address, but when I look at, overall, your exposure to consumer spending, you have limited diversification to overall consumer spending as a driver.

How are you thinking about the concentration of revenue drivers to consumer spending? Do you see more opportunities to diversify beyond the leverage that you have to consumer spending?

Edward: If I think about our consumer-focused markets first -- display, specialty materials in auto -- our goal is to outperform in those markets. We do that by adding content into those markets, and we tend to grow faster.

We look for new technology curves. A great example is in the automotive space where the need for glass is becoming more relevant in automobiles, so we have an opportunity to leverage up on that curve. We look for replacement cycles or new design cycles, so that's our focus in those particular areas.

We also have markets where we're chasing a secular trend like in optical communications, the need for broadband, or in solar, the need for green energy. We think we have a nice diversified group of end markets. Again, our goal is to outperform in the consumer-based end markets.

Samik: On that front, you mentioned this in terms of more of the Corning product in every end market. Maybe we can go to the different segments. You did touch on it briefly. When we look at the different end markets, maybe flesh that out a bit more. How do you think about more Corning as a strategy in each of those?

Edward: I'll start maybe with specialty materials. You can think of what we've done over the last decade is outperform a relatively flat smartphone market. We've doubled the size of our business in that market. I think it's a good example.

We invent new glass compositions. When we sell into the market, that allows us to value up in

terms of the content we're providing. We're selling that at a higher price point, so higher sales, higher value.

We also add content into the devices we serve in that space. Glass on the backs of phones was a huge growth driver. Camera lenses is a good example in more recent times, the cover glass that goes on a camera lens.

In our automotive business, we think of that as $100 per auto market, if you think about it as addressable market for us. Today, we're much smaller than that. We're in the $30 to maybe $40 per auto range.

We sell substrates and filters primarily in the ICE vehicle space as well as on hybrid EVs. We're looking to go from that $30 to $40 up to $100 by adding interior glass, which is a $30-plus opportunity. Then exterior glass, think of that as windows in the car, lighting, sensors, and other glass materials that will go into autonomous vehicles and things of that nature.

That's another $30-plus, in terms of content. That's a way to add more Corning into a market. Even in the markets where we're chasing a secular trend, we have opportunities to add more content in. If I think about optical communications, we have a product called Edge Distribution.

It's a solution that we sell into a data center that reduces the labor content to build out the data center, reduces the time to get the data center up and running. It also happens to have a lower carbon footprint. It allows us to sell more content in a growing Market as well.

Samik: Just to be clear then, in display, how do you think about the more Corning strategy?

Edward: In display, the biggest driver for us has been screen size. If you think about TV units have been relatively flat. In fact, they've actually been down the last few years, but relatively flat, 225 million or so TVs per year.

The market volume has actually grown because TVs are getting bigger. We have gen 10.5 factories, which service these large panel-making fabs that make large-sized TVs. It allows us to outperform in terms of the volume we get in a market that isn't growing that much.

Samik: Let's move through the segments starting with optical. When you think about long-term demand drivers here, how do you think about those long-term drivers? Do they remain intact, particularly if we go through a recession now in consumer spending and the average consumers

spend towards some of these services, like 5G broadband, were to moderate going forward?

How do you think about the long-term demand drivers remaining intact?

Edward: In this space, I would first say I'm cautious right now. The biggest indicator for us of what's happening in this space is our orders. Normally, we would see a seasonal increase in orders as we go from Q1 to Q2.

We're not really seeing that seasonal increase. That could be as big as ten to fifteen percent if you go back in time, and we're not seeing that. Without that inflection in orders, it's hard to call an uptick in volume. For sure, that could last for a period of time. On our Q1 earnings call, we talked about not expecting an uptick in sales in this business.

That said, I think the drivers that are going to drive growth over the longer term are still intact -- the need for broadband, the build-out of 5G, the build-out of cloud computing. I think those things are all intact. There's a lot of private commitment for that build-out, and there's also a lot of public funding for that build-out.

You have the BEAD program here in the United States, which is set to kick off in the near term, which will infuse a significant amount of capital into that industry. We feel very optimistic long term but very cautious in the near term.

Samik: On that frontal, though, maybe to look through what's happened in the last few years, how much of the demand slow-down you're seeing right now is a function of pull forward of demand over the last few years? We've seen that across many other hardware categories.

If you're looking at current trends, do you see this as under-shipping demand and your over-shipping demand for the last few years?

Edward: I think you have two dynamics going on right now. For sure there was over-shipping or inventory building up in the supply chain. That's definitely a factor. We're seeing that play out for sure in some of the customers or deployments where we participate.

I also think you're seeing a slowdown in deployment of capital by some of the large telcos and even in the data center space. Our view is that's a cash conservation approach by those customers in this macro environment. They're conserving cash.

Again, we talk to our customers all the time and so we're relatively close to what they're thinking about in the near term, and we haven't heard anybody talk about reducing their long-term goals in terms of whether it's homes passed or data center capacity.

We think those commitments still exist, and we think the short-term is cash conservation and some inventory digestion.

Samik: I'll move to a question on margins for the Optical segment. They were up year over year, despite lower volumes in 1Q. How sustainable are the margin improvements in the near term in the absence of volume improvement?

Maybe a follow-up to that, long-term margins in this business, particularly if you think about the right balance between selling fiber and connected products where it should belong to margins [inaudible] .

Edward: As we ended 2022, even towards the middle of 2022, we acknowledge that our profitability in total wasn't where we wanted it to be. Difficult supply chain environment, we absorbed a lot of inflation, and so we set out to take a number of actions to improve our margins.

We talked about that on our fourth quarter and on our first quarter call. Optical Communications is a business where we enacted all of those things. We increased our price, we improved the way we operate our factories.

We talk about that as improving our productivity metrics, think about it as running a much more efficient factory, and we just took cost out of our business. We still have more work to do in this space but in total, and in Optical in particular, in Q1, our margins went up.

Our sales were actually down and our margins went up, which is not what you would typically expect in that kind of an environment. I think that is sustainable for us. We definitely intend to continue to improve our margins.

In Optical, I think we probably need volume to get back to where it was to see a step up in margins, a meaningful step up in margins, from where we are. If you go back to maybe the back half of 2018 or the front half of 2019, those margins were probably about as good as we had in this business.

I think that's where we aspire to get to when we get our volume back and with the additional

actions that we're taking.

Samik: Just a clarification there, what's the pricing dynamic on that front? Is pricing contributing to it? As some of this demand comes off, what are you seeing on the pricing front?

Edward: We took pricing actions in Optical, so that has for sure contributed to it. So far so good. The place where we saw the tightest capacity was in fiber and cable. It's still reasonably imbalanced supply-demand, so it's reasonable to assume that the pricing holds.

I have not yet seen significant deflation in cost, so I think to the extent that happens, that will be something for us to watch. Now, that's positive, but the question is, will we be able to hold our pricing increases in that environment?

Samik: You do give us the split for the Optical business in terms of revenue by carrier and enterprise. If you look at 1Q, carrier was down year over year, enterprise was up. The question on that front was going to be, is overall enterprise still holding up a bit better or is there more risk to downside than in the coming quarters from the enterprise side?

Edward: I think in general for us, it's very customer-specific in terms of where we're seeing declines or where we're seeing the pacing of the projects. Enterprise was down sequentially from Q4 and capital spending at a lot of the large hyperscalars has definitely declined from the run rate where it was, but you're right. The more marked impact was in carrier.

Again, in the near term, we very much are focused on the order rates. I think we factored in generally speaking both of those sides of the business in terms of how we're pacing right now.

Samik: When you think about a rebound between the two segments, how do you think about that playing out? Do you see it playing out earlier in the enterprise, is there a shorter overall down cycle for them, or how do you think about it? Any signs as well of a rebound from either of them?

Edward: No signs of a rebound at this point in any...Again, very customer-specific. There are certainly customers that are continuing to spend and deploy, but no signs of a general rebound. I think it'll come as it comes as opposed to it's more on the enterprise side or more on the carrier side.

Samik: For some of the other companies I've hosted, generally, we've started with a question about the macro. Maybe this is the right point to ask you in terms of the capital spending

hesitation that you're seeing from your customers.

I know there are a lot of macro noise and other things playing out, particularly discussions about the debt ceiling. When you think about when those get resolved as you talk to customers, do customers, are waiting for some of these discussions to play out and then wait for a more calmer period before they start spending again?

Any insights from your discussions with customers as to what debt inflection or what the trigger might be for them to start spending again?

Edward: I would say I'm not sure that I have any insight on that in terms of how the debt ceiling issue plays out and whether customers are tying their spending to anything, in particular, other than just their cost. Their cost of borrowing or whatever it is, their cost of capital, and the consumer demand or the end demand in the markets that they're in.

We continued to pace our own capital and make sure that we're thoughtful in how we spend, and we'll continue to do that until we see demand pick back up. Different industries we're in. We're in different places, for sure, in display. We saw the bottoming out of display much earlier than we did in other industries.

We talked about this in the first quarter. We saw an inflection at the end of Q1 in terms of panel maker utilization coming back. We're starting to see spending there comeback and I expect that to continue into the second quarter. Generally, that's playing out. In most of the other places, it's still wait and see.

Samik: Last one on Optical. You have the new capacity or the additional capacity will bring you on in Arizona. Given the broader pullback you're seeing, how are you thinking about pacing it? Is there a more measured approach in bringing that capacity online?

Edward: Yeah, for sure. We talked about capital in total being slightly less than what we spent in 2022 for the year of '23. We'll continue to be very measured in how we spend capital. As I mentioned at the onset, our goal is to derisk our return, and so part of doing that is not bringing the capital on too early.

Samik: Let's switch to display. Panel maker utilization, you commented on what you've seen in March. I think the obvious question is going to be, how did it track in the month of April [inaudible] in 1Q? Are you still continuing to sort of see that improvement, and would your expectations be

that we see that improvement continues in 2, 3Q as well?

Edward: Yeah, the good news is things in Q2 are generally playing out as we expected. Utilization levels are up. We think panel makers were producing well below the demand for quite some time and inventory is normalized in that industry. We feel pretty good about the rate of deployment. We talked about our volume being up in Q2 as compared to Q1.

It's probably too early to call anything specific for Q3 or Q4, but given where we are now, we don't really see anything materially changing from what's happening in the second quarter.

Samik: The reason to ask about that is I think the sequential increase from 1Q to 2Q is pretty significant. Based on what you seeing, are you expecting a similar sequential increase or something more moderate like a panel maker, utilization continues to move up as you seeing in April? Do you continue to see a strong sequential Improvement into 3Q as well?

Edward: I think it's just probably too early for us to call that. I would not expect a decline, but I wouldn't call anything specific for Q3 at this point.

Samik: On this pricing, it did decline slightly on a sequential basis in the March quarter. That was after I think eight quarters of stable to rising prices. Why shouldn't we be thinking of this as the turning point on pricing?

Edward: Yeah, I think in display, we talked about a favorable pricing environment and definitionally, the way we think about it is, of course, we want prices to go up, but if prices are flat or slightly down. That fits into that framework. We're looking to ensure prices don't take these big declines like we saw years in the past.

A slight decline is reasonable especially given the fact that utilization was really low for such a long period of time. The drivers of why we're in that favorable environment or of the drivers of why we're in that favorable environment, our competitors being not profitable or losing money actually in the fourth quarter of 2022 and in general not being profitable as a good driver for helping to sustain pricing in that industry.

We feel pretty good about it going forward.

Samik: Let me open it up here to the audience and see if there are any questions anyone has. Let me then continue on display. One more question, and this is in the third party of the public

data that we track on display.

I don't know if you've seen this trend overall because on the display side you cater to more of the larger panels, but clearly through the last year or so there was a decline or moderation of the average increase in the panel sizes that was evident in third party data.

More recently, it has started to reflect again in terms of the increase year over year in panel sizes. How should I interpret that? Is that generally a tailwind for you going forward or because you really are more concerned on the larger sizes, didn't see the down moderation on the panel sizes impacting your business, you really won't be a beneficiary on the up cycle as well?

Edward: Yeah, I think we think of screen size as generally driving a few percentage points of growth for glass in the industry. It means we sell more glass into the industry even if the units are flat. We talked about that as being in maybe an inch and a half of screen size per year.

Last year, you're right. The overall growth rate was lower than that. I think an inch, inch and a half is probably the right number to think about for the next several years. It's certainly favorable for us in general. I don't know that we'll get any a significant increase. It really just depends on how that plays out relative to what happened in 2022.

Samik: Let me switch to specialty materials. You've been, as you outlined, outperforming the underlying market there. As you look forward, is there a lot more in terms of new use cases to look on when you particularly focus on the smartphone market in terms of driving content opportunity? Or is more of the increase going to come from wearables and other products that you go into?

Edward: Yeah, I think we still have some headroom in smartphones to continue to add new glass compositions and even new components into the devices. I don't know that the headroom is the same as what we saw, let's say, over the last decade. There's definitely some headroom.

New device categories, for sure, will continue to contribute growth. Wearables is a good example. I think longer term you have AR, which is certainly an opportunity in that space.

Samik: Maybe this is sort of going one level down, but in terms of innovation that you're working on in that area, what does that pipeline look like? Because a question that we often get from investors is you really don't have that much performance improvement on the smartphone glass to really go after anymore.

There's probably a bit more on the wearable side as you outlined, but in terms of your innovation pipeline, we've made these visits to your facilities. There's always new features, new characteristics that you're introducing. What does that innovation pipeline look like?

Edward: Yeah, we have not talked a lot publicly, so I don't have anything new to share with specifics on innovation. Bendable glass is something we've talked about. The adoption of that isn't necessarily significant in the near term, but I certainly think that glass composition is an opportunity.

We definitely have many things in the pipeline. We work very much with our customers directly, so we typically aren't sharing anything publicly until they're ready for us to do that.

Samik: OK. Can we talk about the opportunity around AR, VR? Have you sized it up, what that means on the glass side? Is that more of a bendable higher content opportunity than the normal glass you would do on a smartphone?

Edward: Yeah, I think the way to think about AR...This is my opinion. The way to think about it is there's probably no device today that's really at scale from a cost or design perspective. It means it's a ways out in time before it's something. I don't know how many units eventually get sold, but I think the content per unit could be significantly greater than a smartphone for Corning.

You don't necessarily need the same number of units to see a relatively large market size. If you believe AR is successful, I think it's certainly a TAM or an addressable market that could be significant for us.

Samik: The same question, but on the smartphone side and foldable phones, I think one of your primary customers is probably now the only customer that hasn't introduced a foldable phone. The question on that front is going to be when you think about content per smartphone, how much of an uplift could a foldable phone be?

What are you working in terms of innovation to make that glass more essential to a foldable phone? Maybe give us some sense of how long before a customer launches a product with you, something that's as radical as a foldable phone, how long before do you start engaging with them in developing that product?

Edward: The last part of the question, I mean, it could be years. The innovation cycle could be

long depending on the customer and depending on the nature of what they're trying to do. Certainly there could be a relatively long cycle. I don't have anything new to share in this space. I certainly won't talk about what any of our customers are intending to do.

Samik: Yeah, please go. Actually, just wait for the mic. Sorry.

Audience Member: You talked about the automotive marketplace and trying to go after content per vehicle. How do you make sure you're balancing the margin opportunities in the content per vehicle so you're not chasing after commodity spaces where there's revenue opportunities?

Edward: For us, if I think about auto glass, which is really where today we have a relatively small business, very large market-sized opportunity, we tend to participate where the glass challenge is hard. The margin opportunity is greater. You can think of on the interior form factor or size as opposed to a small display screen where you might have a much lower margin.

That's the place where we do better. Those are the business opportunities that we chase. On the exterior, I think it's still a little earlier to figure out what's going to happen there.

If you think about like LIDAR or autonomous or semi-autonomous driving, the materials that are going to be required to do a lot of that are going to be higher-end glass compositions where, again, it works well for a company like Corning as opposed to a generic composition of glass.

I think the margin opportunity is good in that space. How it all plays out, it's just early really to know. We've got a lot of orders in backlog. We've got over a billion dollars of orders that we've won in the auto glass space. Think of that as revenue over a few years of time, not an individual year. As new car models come out, you'll start to see that.

Most of that's on the interior, but we are certainly seeing many opportunities to bid on the exterior and in specialized glass opportunities as well.

Samik: Any other questions? Let me follow up on the automotive question here. There are concerns around the automotive market, but still for the early part of the year, it's held up pretty well. Even if I today look at third-party forecast for automotive, they're expecting modest growth for the year.

It seems like that should be then a segment that you're relatively more positive about, relative to some of the others for the year. How are you thinking about automotive? Help us balance that out

with what you're seeing on the diesel side.

Edward: On autos, it's going to be the fourth year in a row where less cars are built than the end market demand, assuming the end market demand hasn't structurally changed. We're not predicting any real significant growth in units in 2023. That's how we think about it. We continue to outperform.

Recent US emissions, EPA emissions regulations bode well. We think that will require new gas particulate filters on US cars, starting in the '26, '27 timeframe, which is a huge opportunity from a content perspective for us.

There's definitely room to grow even in the ICE vehicle space going forward for us. More cars being built would be good, but I don't have an opinion on when that really starts to tick up.

Samik: In the time we have left, let me go through a few questions on the financials or mostly cash flow. That's where I get a lot of questions from investors.

Free cash for generation for the last couple of years has been good on account of low capex investments. How should we think about capital spending intensity going forward? Are we at a point where you need to start investing again in terms of higher capex? How should we think about the go forward?

Edward: For '23 specifically, we intend to spend a little less capital than we did in 2022. We are trying to be very measured and thoughtful about when we add capital. Our goal is to de-risk the return that we try to get.

It's possible we go through a growth cycle and we need capital. I wouldn't preclude that from happening, but that's good news in the sense that means we have a level of certainty. We use many different tools. We've been using a lot of tools lately to minimize the outflow of capital like incentives, government incentives, or customer funding. That helps.

Take or pay contracts also give us, a level of certainty on that capital. I don't know that you can ever think of Corning as not being capital intense. It's capital intense to some extent to melt glass. Our goal is to try to make sure that we generate a return on that capital that's reasonable in a short period of time.

Samik: One of the questions I did receive from investors who will email even before coming to

the conference was clearly your display business is the one that's poised to do very well through this year. What does that mean for capital investment through the year?

Where is the display in terms of utilization of your own facilities? Do we need to sort of see a leg of capex just to keep up with the growth that you're probably expecting on the rebound?

Edward: For sure there's maintenance of business capital that we need to spend in display. We don't have any intentions about doing anything significant. We have capacity to be able to meet what we would see as increasing demand there.

Samik: Free cash flow conversion in relation to net income, that's largely, if I remember the numbers right, on average been around 60, 70 percent. Most companies we cover are higher than that. That's obviously a function of your capital intensity. As you look at this model longer term, do you see areas where you can tweak things to improve that conversion over time?

Edward: In the short term, the best thing we can do is improve our profitability. I talked about that a little bit earlier. Our profitability has been impacted by inflation and the global supply chain environment. Improving our profitability for sure improves cash.

Improving our inventory, that also improves our operating cash flow. If we can do those things, that should improve our conversion a little bit. Being more measured on the capital is definitely going to help. I don't know that we can convert at a much higher rate than that.

If we can continue to convert at least at that rate and grow, you should start to see us improve our free cash flow in total.

Samik: On that front, the ROIC hurdle rate that you have of 20 percent, is that now largely being followed across all segments? Do the certain segments, like display, get a pass because they've already been grandfathered in?

Edward: The way to think about it is new capital. If we're going to build a factory or add a significant addition on to a new factory, whatever business it's in, that's the target rate that we go after. Of course, we want it to be much higher than that, but that's the cutoff for us as we think about where we put our capital.

Samik: Last one, you've refrained from doing open market repurchases for a while now. We understand buyback that you need to do from Samsung, but how should we think about maybe

starting some open market repurchases? What could the timing for that look like?

Edward: In 2021, we bought back about four or five percent of the company through a transaction with Samsung. We paid for that over three years. In April of '23, we made the last payment on that buyback. The good news is we now, going forward, will have some firepower because we don't have to make any more of those payments. That was a half a billion dollars we spent in April of '23.

The good news is, going forward, we have the opportunity to do that. As I mentioned at the onset, our capital allocation approach is to prioritize organic investment and then to find ways to return cash to shareholders. We pay a nice dividend, then we intend to use buybacks as a tool as we go forward.

Samik: I'll wrap it up there. We're close to the end of time. Thank you. Thanks for coming to the conference. Thank you, everyone.

Edward: Thank you.

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