

Corning Incorporated

Corning Incorporated presentation delivered at the 52nd Annual J.P. Morgan Global Technology, Media and Communications Conference on Tuesday, May 21, 2024 at 8:50 AM

Samik Chatterjee: Good morning, everyone. I'm Samik Chatterjee, and I cover hardware and networking companies at JP Morgan. I have the pleasure of hosting the Corning management team today for the fireside chat. I have with me Wendell Weeks, who's the chairman and CEO of the company.

Before I get started, I just want to remind everyone that Corning will be discussing forward-looking information and actual results may differ as part of...May differ. I guess that's what I've been given, [laughs] so I'll leave it there.

Wendell, just to kick it off, I saw the press release this morning. It just looks like things are getting better and better. In context of that, maybe just help us understand what is getting better, and then how do you think about share buybacks, the timing of that, what should we expect in context of that improvement?

Wendell Weeks: Will do. To begin with, because I think you're right, things are looking up. Winter is over. To just ground us for a second, I want to just take a moment and review how we create ongoing value in the long term, and just why we're so energized right now about some of the tremendous growth and shareholder value creation opportunities that are right in front of us.

For us, it all starts with our focused and cohesive portfolio. We have three core technologies, glass science, ceramic science, and optical physics, along with four proprietary manufacturing and engineering platforms. We're world leaders in each of these, even in the eyes of our competitors.

Today we focus our efforts on five market access platforms. This is what we call our 3-4-5 approach. Now, the way this works is that our probability of success increases as we apply more of our world-class capabilities. Our cost of innovation declines as we reapply our talent and we repurpose our existing assets.

Perhaps most importantly, by combining the capabilities in our portfolio, we create higher and

more sustainable competitive barriers. Most importantly of all, we delight our customers.

When we talk about focusing our portfolio, what that means is that we direct 80 percent of our resources on opportunities that use our existing capabilities from at least two of those three categories within our portfolio.

Now, few competitors can match our capabilities in any one of these areas. When we combine them, that's how we create these big market-leading positions and margins that are much higher than anybody else in our industries.

Let me just give you an example of this in action that's pretty topical, which is, let's just take one of our manufacturing and engineering platforms, Fusion.

When you all think about Fusion, I know when you do, Samik, you probably think of our display business, where our latest Gen 10.5 technology produces glass larger than two king-size beds put together, over 100 square feet, and as thin as a business card, and upon which our customers build six 75-inch TVs at a time. That's what's leading to how low-cost that LCD technology is.

We also use those same Fusion assets to serve almost all of our other market access platforms. The most famous of these, of course, it is our Gorilla Glass business, which we built on the assets that we originally capitalized for display. Today, now we've built a world-leading two-billion-dollar mobile consumer electronics platform.

We're taking the same approach in automotive. We've introduced our automotive customers to our glass expertise. We now have a triple-digit, fast-growing automotive glass business using these same Fusion assets. Now, as we speak, it's one of the things that makes this topical, we're applying our Fusion platform to our optical communication segment.

The rise of generative AI is driving the potential for our Fusion technology to bring flat, pristine, highly stable glass, initially as a substrate for GPUs, and in the near future, that substrate to become embedded with optical waveguides for co-packaged optics.

Just with this one example, I think you can see how our portfolio works. In just one of our core manufacturing platforms, together with three of our core technologies, we're able to serve four out of our five market-access platforms.

That's the power of 3-4-5, and it's a great example of how the capabilities in this portfolio lead to long-term growth and continued increasing effectiveness of innovation and reducing cost of innovation.

Now, turning more to the medium term, which is what has us pretty energized right now. As we shared the last couple of quarters, even though our market leadership position has only strengthened the last several years, demand in our markets has been temporarily depressed due to supply chain corrections and macroeconomic factors.

As a result, our sales are also well below our trend lines. The good news is that we believe quarter one is the bottom and we now see our sales and markets improving. Over the last couple of quarters, I've also outlined a framework for you, which we refer to internally. We have a much more detailed plan which we call Springboard.

This framework has three primary components. First, we believe that the first quarter, 2024, will be the lowest quarter of the year, will improve from the quarter one levels. We have clear evidence of improving market conditions.

Second, we expect to grow by more than three billion in annualized sales in the next three years. The outlook in each of our markets remains positive, and our market positions are very strong. Our innovative products and deep customer relationships are positioning us well to capture this growth.

Third, and perhaps, I think most importantly, as we capture this growth, we expect to deliver very powerful incrementals. The reason is really simple. We already have the required production capacity and the technical capabilities in place to service that growth. The cost and the capital are already in our financials. This is just a tremendous opportunity, we believe, for our shareholders.

Now, it's important to note that the Springboard opportunity is well above three billion dollars. We communicated the revenue opportunity conservatively to provide you with a more high-confidence plan. Now, to develop that, we had to think very deeply in probabilistic terms about various outcomes for our markets and our businesses.

Let me give you an example that I know is on your mind, Samik, which is the yen and its related impact on price in our display business. With respect to the yen, as we have shared many times, we're heads through the end of 2024 to support our core rate of 107. Currently, the yen spot rate is significantly weaker than 107.

We've also told you that going forward, we would maintain appropriate profitability in our display business through some combination of hedging and industrial solutions like price adjustment. I just thought I'd share with you in a little more detail what our approach will be to that mechanism in 2025.

We already have hedges in place for 2025. They're not at the 107 rate, but they are much better than the current spot rate. Now, as a reminder, our customers buy glass from us in yen, and they sell panels in US dollars, so they're benefiting from the current weak yen rate.

To maintain the level of profitability we have in display, we plan to use a currency-based price adjustment in combination with our hedges to ensure that we continue to deliver appropriate returns in this business.

Because, Samik, I know you will have a question for your models, for your modeling purposes, the way we think about appropriate profitability in our display business is, if you just look at the average and PAT return on sales in our segment reporting over the last four or five years, that average return is the return that we would expect to have in this business in 2025.

Now, that's just one example of the approaches that we're using to ensure that our Springboard plan delivers greater than a three-billion-dollar revenue opportunity with significant incremental profit and cash flow.

Finally, many investors have asked us, when Springboard is successful, what will you do with the additional cash that we generate from these strong incrementals?

As you know, our capital allocation priorities are to invest for organic growth. We invent, make, and sell product sets. We're an organic grower. That we return any excess cash that we have above those organic growth needs to our shareholders.

Now, because we already have the capital and capabilities in place to support our medium-term expected increase in sales, we also expect to generate a significant amount of excess cash in that term. Therefore, with the success of the Springboard framework, we'd expect to be able to accelerate the return of cash to our shareholders.

In fact, because of growing confidence in Springboard as each month goes by, we have begun to buy back our shares in the second quarter.

Right before we turn to Q&A, a few quick points. First quarter sales, we see encouraging signs of us returning to spring. As our markets improve, we're going to increase by more than three billion with powerful incrementals. Our second quarter guidance reflects this.

We've already established a higher profitability and cash flow base, and we've got a strong framework in place to drive even stronger returns on our existing innovation and capacity investments. We're going to make a lot of progress rapidly, and we'll continue to share that with you.

Samik: Great news on the buyback.

Wendell: Thank you.

Samik: Things are looking better. Maybe just going a bit deeper into the AI-related demand, just help us understand how you're thinking about the opportunity in total, as well as the timing in which it comes through.

Wendell: Generative AI has the potential to impact many of our market access platforms.

It will impact both the generation of the models and use of the models in our infrastructure-based business, optical communications, as well as causing refresh cycles on the user interface, as well as developing of entirely new user interfaces using this technology that we are already engaged on with a number of leaders in the space.

Let's concentrate on the one that's going to hit the fastest. Everybody talks about power in generative AI, and it is true. It uses a lot more power. If you look at the world through glass eyes like us, [laughs] what you see is that you use a lot more fiber optics for any given amount of power to do generative AI, 5 to 10 times as much.

The example that I've used with you, Samik, is if I equalize on power and just take a current CPU server rack that's a front end of the network today, that will use -- let's do about 10 kilowatts -- that will use, you have about 32 fibers that connect to the top of that rack, 16 two-fiber connectors.

Now, let's go to the back-end network in a GPU rack. First of all, let's just equalize on a 10 kilowatt. That'll cover about two H100 servers. H100 server will tend to different architectures, but

will tend to run with eight GPUs per server and an InfiniBand switch with 400G ports that uses 16 fibers.

Each of those H100 servers uses 128 fibers. If there's two of them in a rack to equalize on that power, that's 256 fibers. It's an eight-times increase in the amount of glass per rack.

Now, from an innovator's perspective, there's two things. First of all, of course, we love the volume. That's awesome. From an innovator's standpoint, and this is just the earliest gens, you see having to fit way more in the same space.

This is what's led us to invent a brand-new-to-the-world fiber that's smaller, brand-new-to-the-world cables, which are much smaller, brand-new-to-the-world connectors, which are dramatically smaller, like order of magnitude right.

New systems and new passive systems to be able to connect all these things and make installation speed way faster and reduce the probability of a outage on that fiber optic pipe.

From a plumber's perspective, [laughs] the near-term opportunity will be, as those innovations take place, especially in the large GPU clusters, you'll see that start to run through our numbers, and you should start seeing it in the back half as those big clusters start to get put in. Was that more than you wanted to know?

Samik: No, I wanted to actually ask you to elaborate on the other piece, which is the edge, which you referenced. We all have our forecast of when AI is going to be driving a replacement cycle, but definitely want to hear what you're hearing from your customers in, when do we see a replacement cycle on smartphone or any other edge devices you're thinking of?

Wendell: Like you, Samik, depending on who you speak with, which of my customers you speak with, you will get a different idea on what the primary interface will be for generative AI. You will get a compelling case from each of them on why their device set will have an innovation cycle and therefore become the primary.

I don't think I'm smart enough yet to know which one of them is right, but I do think they're all right in a way in which that you are going to have to upgrade your hardware to make use of this new tool in an effective way.

Whether or not it's going to be more silicon-heavy, like notebooks, or whether it'll be more like

phones, or whether it will be entirely new devices is up for debate.

Probably the most interesting space is the very new UI space. What will be the phone of the future with this. I know that's super interesting. There's a lot of really smart people working on it and we're enjoying working on it with them, but that is probably the most speculative of all.

Samik: Help me tie that with your specialty materials platform. I know you've talked about not having a major launch this year, but indicating it's more next year, how do you tie that with how your customers are thinking about when the replacement cycle can act straight?

Wendell: Right now, I'd say that the first efforts are to incorporate gen AI's capabilities into more existing format structures. Take mobile consumer electronics, the phones are down 20 percent since we first did the more Corning strategy. Our revenue is up 40. I think the first way they look at this is a reason to get phones moving again and to differentiate.

Our big next step up into how do we get more Corning on top of that base growth, that relies more on new materials that we're introducing in new form factors. It's just the way those adoption cycles work. Our next big material, to me, looks more like it'll hit next year than this.

Samik: I want to go back and follow up on your comments about using currency-based price adjustments with your display customers.

Wendell: I don't know what the question is, but that's the right topic. [laughs]

Samik: This comes from the step on the heels of taking a 20 percent price increase last year, same time, I guess. Just talk to us more in terms of, how do you think about pricing power that you have to take a price increase following the 20 percent, and how would you expect your competitors to respond in that sort of dynamic?

Wendell: Our confidence has grown because we just did a double-digit price increase. Though the industry was slow to follow, they did. For us, the discussion is pretty straightforward with our customers. That they're benefiting from this yen, and we should be able to share that in a more appropriate fashion.

No customer and consumer of electronics welcomes a price increase. Our relative position, because of our leadership in the technology, our ability to serve all types, all across the globe, and that none of our competitors are financially doing that well means that it's not like we're being

greedy.

That's the way we look at it. We're confident that we'll be able to do it again since we've done it. The first time, we were more nervous than we are the second time.

Samik: Going to the three billion Springboard opportunity, you're more than three billion that you talked about. You did provide a lot of details into the segments itself, clearly optical display, all are part of it, but help us to the extent that you can, quantify things.

When we think about, even when we start with the high confidence three billion that you talked about, what are the big buckets there? How to think about how much of that comes from display and optical versus the other segments.

Wendell: Because the pie is much bigger than the three, it's hard to do what share because we start out with a bigger number than we probabilistically adjust. What I can do for you is, which ones do we expect soonest. We have growth across all five of the platforms.

The ones that we'll see this year, right away, you'll see display and opto, will be the earliest ones coming in. We're beginning to see that evidence, which is what you saw reflected in our Q2 guide.

As we work our way through quarter two and we gather more data, more information, more orders in our order books, then we should be able to speak a little more confidently as we go forward. Those will be ones that will trigger in in the nearest term.

Automotive, both glass and environmental, that is going to move also starting late in this time period. See, I've already shared the next move there is more a Corning move because we haven't built more growth cycle in for the refresh cycle because we don't feel confident enough yet that we know when that is going to be.

In our life science segment, it's been about that whole pivot from COVID and everything that that did, and returning our product line availability to those other areas that are non-COVID related.

As those get available to supply and the markets clean out of the inventory, we'll see that start to come back too. A lot of these things start to come in this year, but the big ones for this year that you'll see right away are display and opto.

Samik: Let's talk about autos just briefly. You've talked about $100 per car opportunity there. How is the lower EV demand that we're seeing in the market impacting your own thinking on the timeline to get $200 per car in terms of content?

Anything you're seeing from automakers in terms of even them exploring change in platforms from EVs to maybe hybrids or other platforms?

Wendell: Let's start at the end and then we'll back up. At the end, there's no question that our automotive customers are thinking deeply about what their relative mix will be of ICE, whether it's a hybrid form or not, to EV. There's just no question.

In general, you can think about our play in auto as being, we have our established environmental business, which does pollution abatement for all ICE vehicles. That opportunity has been great. Cars are down, I don't know, probably about 15 percent since late in the last decade through to now. Our revenue is up about 60 percent in auto.

The huge bulk of that is driven by adoption of our new gas particulate filter technology, first in Europe, then in China. The exciting news is that the EPA just issued their guidance that starting in the 2027 model year, the US vehicles will now need GPF technology. That adds a few hundred million dollars of opportunity to that business alone.

Our automotive glass business is already in the triple-digit, hundreds of millions of dollars. It's growing really fast. We originally envisioned that as a good hedge bet in EVs. We're indexed a little heavier in EVs for that, but we're also on ICE vehicles.

We have ICE vehicles and EV vehicles today with $100 of content on them. Regretfully, it's just not all of them. [laughs] We're starting to see that fundamental technology work.

I think the biggest wild card for us in auto is our play in exterior, going to work or not. It's a cheap shot on goal for us because we use all of our Fusion assets. What the theory is is that autonomy will require camera-based systems from inside the cabin, which will require new material sets on the windshield because it becomes like a lens.

We have a particular customer who's hard over that they're right technically. We support that customer. Are they or not? It's just too early to tell. Autonomy is a complicated question and which way it'll solve is complicated. If that works too, then automotive can become our most important segment.

Samik: Let me open it up and see if anyone in the audience. Please go ahead.

Audience Member: Hi, I have a question. When you look at the NVL 72 from NVIDIA, it has something like a mile and a half, two miles of copper in the back. When do you foresee that going to fiber optics, given the fact that that's 70 percent less power in fiber optics? I know it's a lot more, but at some point, you can't run copper that long without it deteriorating.

Wendell: I'm smiling because you think like me. I love that.

[laughter]

[crosstalk]

Wendell: Talking about the miles of copper, man, that's a keeper. I love that one.

[crosstalk]

Wendell: No, you're exactly right.

Audience Member: [inaudible] .

Audience Member: You've nailed it in one. The way to think about it from just a raw...The techno-economic standpoint, what you're realizing is it's actually a pretty well-understood frontier, which is it's a weird metric. It's 100 gigabit per meter second.

If you have bandwidth requirements that are above 100 gigabit per second for a meter, that's all that means. Then it's less expensive to do it with photons than it is with electrons. Below, it's less expensive to do with electrons.

If you think about networking, what you see is the amount of distance that the copper is going is shrinking as the bandwidth goes up. In these next generations, you're looking at a gap of millimeters before people want to go into optics. That's when I was talking about our Fusion technology coming to the substrate form because...

Think of a switch ASIC or anything. At certain speeds, you're just going to want to go to light right away on that flat platform. This is what they mean by optical backplanes and everything like that.

There's all sorts of tricks that people have done to keep the copper in. They move the switch to the middle of the rack rather than the top of the rack because that reduces the distance.

You are right on just a fundamental physics thing that drives long-term secular trend in opto. It won't be for a cycle or two because that's hard problems to solve to get light on and off of those things and will change, but it's a big opportunity for us in semiconductor packaging and co-package optics.

It's something we're working on. It's really a great question. I'm keeping the mile and a half of copper. Let's run that one down. That's a keeper. [laughs]

Samik: Wendell, before we wrap up, I wanted to ask you a question on the margin front. As I was preparing for this discussion, it was interesting, I was looking through the model, and you used to do 41 percent gross margin when revenues were 7 to 11 billion.

Now, we're, for lack of a better word, struggling to get to 40 when you are at a 14 billion run rate. What changed and how do we get back to that?

Wendell: The way to think about our margins now is when inflation came, it changed the profitability ratios while for the same amount of volume, we could deliver the same amount of profit. Inflation hit us.

When it did and we began to work to share that more appropriately with our customers, we put those more dollars in price, which increases the size of the denominator. If what we're doing is you're sharing one-for-one, it's going into cost. Then we're offsetting that with going into the revenue. It depresses our margin percent even with the same dollars.

What we used to think of as 40, given how much we've increased our price and what's happened with inflation, we think about today as 38. That's the same number.

Now, what makes your question incredibly topical is because of the incrementals, we can't experience because the cost that's currently in our cost of goods sold and our OpEx is able to support higher revenues.

When those incrementals start to work, then you ought to be able to start seeing adjusted for the inflation pricing thing, us turning in real record gross margins once that's adjusted. That is what

we're aiming at. We see the same thing you do, and it's just, first one is just arithmetic. Second one is the incrementals are there.

Samik: Please, go.

Audience Member: I love your thinking about how to have disciplines in the operation. I think you called it the 3-4-5. At the same point, sometimes you can start to build a culture where people get very, it's like having a needle deep in the groove on the record at some point.

Because almost every segment you're in is trying to be disrupted right now by somebody else, how do you make sure you're not finding yourself in that place where the 3-4-5 is leading you to a place where we're so deeply entrenched in just seeing the things we see and not seeing the things that are to the left and right of us or five miles down the road that we can't even see right now?

Wendell: I think that's an excellent question. What we try to do is that 20 percent that we keep outside of that core discipline in the way we run our core research group is meant to go and look at those wilder spaces and what other people are doing. In the end, talent rules to be able to see that stuff. I think we do better in some areas than others, but that's the way we think about it.

Audience Member: Thank you.

Samik: Great. Wendell, thank you for attending the conference.

Wendell: Pleasure.

Samik: Thank you for the detailed presentation as well and the thoughts. Thank you to the audience as well.

Wendell: All right, guys. Thanks so much.

[applause]