Corning, Incorporated

November 28, 2023
10:15 AM EST

Josh Spector: All right, everyone. We're going to get started here. Thanks everyone for joining us in person and online for UBS' Global Technology Conference. My name is Josh Spector, and I cover North American Chemicals and Packaging for UBS, as well as a few other niche areas. Today, we're hosting Corning for a fireside. Corning has been a leader in material science around glass and ceramic technologies and has consistently evolved exposure to stay at the leading edge of those technologies.

Today, I'm joined by Ann Nicholson, Corning's VP of Investor Relations, with a relatively long history between corporate development, strategy and various other roles at Corning. I'm going to turn it over to Ann to give a brief overview of Corning and some comments therein. Afterwards, we'll go to Q&A. For those of you that have the app, you can ask questions on that, and I'll try to work that in as we go through this fireside session. With that, thanks Ann, and go ahead.

Ann Nicholson: [Audio difficulty] I'll be making forward-looking statements, and actual results may differ materially [audio difficulty]

Josh Spector: Do we need to check the mic real quick? Yep.

Ann Nicholson: Is that better? Do you hear me now? Yeah, there we go. Okay, great. As Josh said, I'll provide a brief overview of our long-term value creation model, update you on our continued progress on the priorities that we've outlined to get through the short term and keep our model on track.

Our long-term strategy is built on a complementary set of capabilities in 3 core technologies, glass science, ceramic science and optical physics, as well [audio difficulty] engineering platforms that turn these capabilities into products that move the world forward, and we're leaders in each. By capturing synergies among them, we create breakthrough products and processes, improve the return on our innovation investment, and reduce our capital intensity. Our capabilities are vital for progress [audio difficulty].

This is what we call our more [audio difficulty] sensitivity to economic cycles of our end markets sometimes. Overall, our value creation profitable franchise like [audio difficulty] while helping make the world a little bit better.

Our products for example clean the air we breathe, contribute to decarbonizing the electric grid, connect people to information services and each other, provide the window through which we access information and entertainment, and help facilitate the discovery and delivery of life-saving medicines.

Of course, in order to keep the long-term model on track, we must effectively adjust short-term challenges as they arise. When we entered this year, we recognized that demand was below historical trends in markets that constitute the vast majority of our sales. And therefore, that our profitability and cash flow would not be where we needed them to be. We've been executing plans to improve profitability and cash flow during this current period of lower volume. While we're not certain when our markets will return, we are confident that they will. And when they do, as a result of our execution, we expect improving leverage on that volume.

Our third quarter results, which we announced last month, demonstrate the continued progress on the programs that we've put in place to improve profitability and cash flow and that includes increasing price, improving productivity, and lowering inventory. These initiatives led to another quarter of improved gross margin and cash flow despite volume coming in at the lower end of our expectations, mostly in optical communications and display.

In the third quarter, we drove an 80 basis point sequential gross margin expansion to 37% on consistent sales, driven primarily by pricing actions in Display. And to see our progress more clearly, if you compare to the third quarter of this year to the fourth quarter of last year when we launched our comprehensive plan, third quarter '23 sales were down almost $200 million, yet we've expanded gross margin by 340 basis points.

In terms of cash generation, third quarter free cash flow of $466 million grew sequentially by $156 million. Year-over-year, free cash flow grew by 83% despite lower sales. Our gross margin improvements, our ability to run with lower inventory levels, and our lower capital spending are the key behind these results.

Looking ahead, we'll continue our programs focusing on price, productivity, and cost so that we improve profitability and cash flow despite our muted sales outlook in the short term, and build a springboard for profitability as our volume reverts to trend. In parallel, we'll continue to increase our value capture with our More Corning approach. And as we move forward, we're pursuing objectives across the company that we expect will drive durable growth and shareholder value.

Let's take a quick look across our market access platforms and a few recent examples of More Corning. Beginning with Optical Communications, we're a leader in optical fiber, cable, fiber-to-the-home, and data center solutions, which position us to benefit from secular trends in broadband, cloud computing and advanced AI. Our objective is to outpace growth of the optical market, and we're leveraging an array of More Corning drivers to achieve that, including innovative, low-cost, faster to deploy, and greener solutions, as well as high-density solutions to interconnect GPUs.

In Display, we're a market leader in glass substrates with a global manufacturing footprint, cost advantages, distinctive capabilities, and leadership in Gen 10.5. Our business benefits from the ubiquity of electronic displays and the demand for life-like presentations. And we're driving More Corning opportunities through the ongoing growth in the size of displays. In line with our objectives, in the third quarter we restored our profitability back to pre-pandemic levels, and we expect to maintain that level going forward.

In Mobile Consumer Electronics, we're a market leader in cover materials and semiconductor lithography components, benefiting from secular trends in digital life, EUV lithography and localization of semiconductor production capacity. More Corning growth drivers in this business include innovations related to device scratching, impact resistant optics and surfaces, new categories such as bendables and AR, and capabilities in advanced optics for semiconductor manufacturing, particularly EUV lithography.

In line with our objective to increase sales and profit per device, we recently collaborated with Apple to deliver a durable glass with infused color, a first for any smartphone, and you're seeing the beautiful images right here behind me. These devices also feature a ceramic shield which we collaborated on with Apple to deliver a cover material with unparalleled smartphone performance.

Turning to Automotive, we're seeing growing adoption of our technical glass for displays, windows and sensors. At the same time, we're continuing to build on our long-standing leadership in emissions control products. Our objective is to deliver on a $100 per car opportunity as we capture trends in advanced driving experiences enabled by connectivity, autonomy, and electrification, as well as emission control requirements for low emission vehicles such as hybrids. And we have multiple More Corning drivers to support that. For example, you may have seen that we announced an expanded collaboration with long-time customer AUO to accelerate the production of their industry-leading large-format curved automotive display modules using our patented ColdForm technology.

And then finally, in Life Sciences, we have a strong base in research and are well positioned to address the demand for individualized, effective, and safe biologic medicines. To achieve our objective of growing faster than the market and delivering an asset-light model for pharmaceutical packaging, our More Corning drivers are focused on innovation in bioproduction, 3D cell culture, and greener and more efficient packaging. Recent progress here includes our announcement of Corning Viridian Vials. This new technology can improve filling line efficiency by up to 50% while reducing bio-manufacturing carbon-dioxide equivalent emissions by up to 30%.

In sum, across our markets, we are the technology leader as well as the low-cost producer and we're positioned to benefit from significant secular trends. We also plan to expand into new profit pools over time, such as the rapidly growing opportunity from the reshoring of US solar capacity. Looking ahead, we have the capacity and the capability to deliver $3 billion plus in additional sales with minimal cash, additional cash investment. This revenue will have strong incrementals as it returns and it represents a significant opportunity. We plan to capture it by maintaining existing capabilities and capacity throughout this current down cycle, all while we continue to improve our near-term profitability and cash flow.

We're on the right track. We're enhancing profits, improving cash generation, and delivering products that capture More Corning content opportunities, all while maintaining market positions and our ability to capture upside as it materializes. With that, I'll turn it over to Josh.

Josh Spector: Yeah. Thanks, Ann. I appreciate the overview. I guess before I get into Q&A, again, if you have few questions, you can put them in the app. And just as a research analyst, I need to disclose the nature of my own and that of UBS with any companies which I express a view on the call today. If you want to see those disclosures, www.ubs.com/disclosures, or you can ask me after this.

With what you went over, I think still a lot of questions around display and a lot of the moving parts. You guys are doing a pretty big price initiative which you're rolling out. You're still dealing with pretty muted demand. Your customers are going through their own reconciliation of demand and pricing. Can you walk through some of the moving pieces and kind of give us a feel of where we are today in terms of pricing, demand improvement, any physical recovery, etc.?

Ann Nicholson: Yeah, sure. In terms of pricing, first you can think about it as glass for us. We put forth a price increase across our customer base to really return our profitability to where it needed to be. We have been successful with that. Our customers are on average, receiving a double-digit price increase, mostly in the third quarter, with a little bit more expected in the fourth quarter. That has been going well, and you can see the results in the third quarter with Displays' NPAT margin returning back to the mid -- to 25%, which is where we want it to be.

Then if I move to our customers in a little bit downstream, we have -- our panel prices have started to drop a little bit. Panel makers are therefore pulling back on utilization. We're seeing a little bit of a tug-of-war with the panel makers and their customers, the set makers, because the set makers are looking for lower pricing and they're holding off buying hoping that prices will fall.

We think as that plays itself out, there's some optimism because we think that the supply chain inventory is going to exit the year in a healthy position. That means that next year, what we see happen at retail will flow back to glass a little bit more directly because we won't have inventory in between. And we expect the panel maker utilization will pick up at some point in the first half.

Josh Spector: Okay. And then can you talk about how competitors have responded more broadly? Typically, it's been low single-digit pricing. You're doing double digits. Have you seen capacity come out or any following of pricing? And how does that dynamic play out?

Ann Nicholson: Yeah. We don't have information from our customers. We don't talk to our customers, so we don't know specifically what's going on with our customers. If you think about the drivers of pricing that we have talked about over time really being, as you mentioned, supply/demand, but there's also profitability. We took actions on our profitability. We are -- we have cost advantages. Our competitors are not as profitable. They have low operating margins.

Even earlier this year, I think a couple went negative, a couple of quarters of negative. The rational person would say that they would follow suit to improve their profitability as well, but we don’t have that much data on it. On supply and demand, they have made some public comments and we've made public comments as well about managing supply to demand. They've made a couple of comments around tanks staying offline. We have some flexibility as you know. With our tanks, we supply Display Glass, Gorilla Glass and now Automotive Glass. We've got some flexibility and fungibility in how we manage those assets so that we can just do that, keep supply balanced to demand.

Josh Spector: Okay. And maybe broadening out a bit, in the last earnings call and then today, you note a lot of your end demand is running below trend. You're producing well below that. Can you talk through the different parts of the portfolio, where demand is today, or at least your sales into the channel versus where you think end demand is?

Ann Nicholson: Yeah. I think across the board, we are seeing demand below trend lines. We gave the example of Optical Communications. Our fiber shipments in the back half of this year we think are about 30% below the trend line. Similarly, car production is down, TV unit sales are still below trend, and smartphones are down off of the $1.4 billion. It's hard for us to know when those are going to bounce back. I mean, there's a lot of dynamics around consumer behavior. We think that fundamentally that they will. We don't see anything that says that these things are not going to revert back to trend. Common wisdom says that across our business it is probably the back half of next year, and that makes sense to us at this point.

Josh Spector: And I guess the optical gap is pretty large on what you call out. But when you think about the other businesses, are you thinking about growth off of this reset level in 2023? Or are you thinking about a snap back to trend? What's more realistic in your view?

Ann Nicholson: Yeah. I mean, I think we could see either scenario happening. Optical is a little bit independent. It's not a consumer market. It's a capital spend. I think in the Optical space, the $3 billion that we can grow back into without much capital spend, a good chunk of it is Optical. And the other businesses, I think it will just kind of depend on consumer behavior. And your guess is as good as ours. We're not economists on are we in a recession? Are we coming out? Are we going in further? Are interest rates going up, down, or staying the same? I mean those things will probably have some kind of effect on the consumer-facing markets.

And then I think if you think about Display, right now in the fourth quarter, we said our volume could be down as much as mid-teens. If the panel maker utilization is down that far, then they're back to underproducing, and so at some point, the set makers have to buy, utilization goes up, and our volume goes up. That one might be a little bit independent. And I think most people right now in 2024 are not predicting a lot of growth in TV units. Maybe some consumer, some recovery in IT.

Josh Spector: Okay, understood. When you talk about the $3 billion of basically sales potential, how do you think about what that means in terms of the drop-through to margins or margin potential on that relative to where you are today?

Ann Nicholson: Yeah. We have been working diligently through the year. I gave a lot of numbers on how we've been making our gross margin percent grow despite our sales going down. I think to appreciate that, if you think about it, most of our businesses are high fixed costs. And so, we've been able to actually, as the water is going down in terms of volume, actually chip away on the fixed costs. And then on OpEx as well. As that $3 billion starts to come back, we feel like we're going to have leverage, that we'll be able to expand gross margin, that we'll be able to control OpEx, and expand operating margin as well. We haven't given anything more specifically than that, but that's what we mean. I think Wendell mentioned it on our earnings call is like it's a really nice springboard because we're starting from a position, really a position of strength.

Josh Spector: And I guess how does that relate to CapEx and growth spend from here? Are there areas where you need to continue to spend because they're still growing? Or do you see the next maybe 2 to 3 years is maybe a lower level of CapEx and improved free cash flow?

Ann Nicholson: Yeah. For sure, we're entering 2024 -- our run rate is a little bit above maintenance CapEx. Our maintenance CapEx is about $1 billion. It's kind of depending on our tank repair schedules, but you can just say it's about $1 billion. And we expect to see a lower run rate. I think it's a reasonable assumption, a reasonable modeling assumption, say for 2024, maybe even 2025. As we get through next year, we can provide some updates. But yeah, definitely capital-lite as we grow back into Optical, Environmental, Gorilla Glass, even some growth in automotive.

And I think also a good thing to remember over this time period is that we're continuing to work on process improvements, getting more glass out per minute. And that frees up capacity for growth. As Automotive Glass continues to grow, they can use existing Display assets. They can be even a little bit asset-lite, at least on the melting of the glass, because we have those fungible assets.

Josh Spector: I guess moving to Optical and what's going on there, 2 questions I guess. One, is there any updated near-term view on what customer demand has looked like? And then 2, given some of the tailwinds you guys have been talking about in Optical. I think on the earnings call you talked about a 7% CAGR. Do you think that growth looks different over the next 3 to 5 years because of some of the other very secular trends in the space?

Ann Nicholson: Yeah. In the short term, no change. Our order rates are still low. We believe that the folks are still working through inventory. We're working on like trying to get through some more specifics and hope to have more information when we come to January. But for example, our customers are saying they're still committed to their multiyear plans. As we think about the short term, we're trying to figure out as much as anybody how much inventory is out there, how long it's going to take to work through.

But the good news is we think that the trends are still intact. And if you think about the next 3 to 5 years and the example of the fiber trend line that we gave in the earnings call, like what is driving that trend? What has been driving that trend over the last several decades? And to me, I think about it as just consumption of more bits per second and that you and I are using more bits per second. We're storing more bits. We're accessing it. We're using more data-intensive applications. And that just continues to happen. And there's more people that have the Internet for example. So that, I think we believe that that trend continues going forward. That's part A.

And part B, when you're making your pipe bigger so that you can get more bits per second through, copper reaches a limitation. Optical is being used now in more and more applications. We talk about it being closer to the edge of the network because the economics around copper don't work when you're getting into the gigabits per second over shorter and shorter distances. We're talking about -- that's how we got fiber-to-the-home. We're actually looking at projects and working on programs with fiber-to-the-chip. There's some exciting applications there.

And then I think probably the last category that's right now is in datacenters. In large language learning models, you've got a second network with GPUs. All hyperscale data centers today have CPU connections, there's Optical involved in that. This is an additional second layer. And the optical connections with GPUs could be 2x to 5x the amount of passive optical required to make those kinds of datacenters work.

Josh Spector: That makes sense. And I guess I want to kind of continue on the whole More Corning theme and a few other areas. I guess first, to talk about auto, where you talked about more content in the car, some of your ColdForm technology enabling new applications. Can you just talk about what the opportunity is there, specifically what it's doing, maybe what sets Corning apart in terms of being able to enable that?

Ann Nicholson: Yeah, for sure. It's actually very exciting. I'm a car person, so I'll try to keep it short. Consumers today are -- in addition to how fast does my car go, what's the power, what does the exterior look like, they're looking for their car to be like what they can get on their smartphone in terms of connectivity, access to information. It's really like beginning to have the inside of your car provides you the services that your smartphone does today. There's pull for being able to have that connectivity in your car.

We provide, as you said, a product that we call our ColdForm technology, which is used for the interior of displays. It has a really nice value prop. It is better quality, so it gives you better optics in the car. It's actually lower cost than the incumbent product that you can buy today. And it's a greener solution. You're using less carbon dioxide to make an interior display using ColdForm versus a hot form technology.

And then I mentioned it before, but it's worth saying again, it's also exciting because with the advances we have in Display, we can use existing assets. We have capabilities and understanding with how to make displays from the Display business as well as how to make products that are scratch resistant, that have good durability in the car like the cover materials on a smartphone.

Josh Spector: And I guess that transitions well into smartphones. I guess the simple question is really, what's next? It's been a content opportunity for you. What's the next evolution that gets more content for you guys in smartphones?

Ann Nicholson: Yeah. We'll continue working on durability, right? There's still work to go. Phones are not unbreakable. Don't try to break yours on purpose, but we've come a long way with the durability and the scratch resistance of the cover materials. And then there's new things that we're getting into on phones. For example, camera lens covers on the back of your phone. That's early days for us. We've got a business there, but there's a lot of more phones that we can capture to utilize our product. Things like bendable devices, augmented reality, virtual reality, there's applications for technical glass there as well.

Josh Spector: And then looking at the other parts of the portfolio to kind of wrap some of these things together, Life Sciences, Solar, everything else that you're doing, what are some of the bigger scale opportunities that you see there that could be meaningful for Corning 4 or 5 years from now?

Ann Nicholson: Yeah, Life Sciences, we've got a good foothold in research. And the products that we make and research are actually useful in cell and gene therapy in the production realm. There's products that we make, and as the industry is moving towards instead of a chemical to treat the problem that you have that you're using cells or actually gene-based therapies, that moves our products into production. There's still continued growth opportunity there. The Valor franchise, that we call it, if you think about the value prop that Valor has, it is great in terms of it's a best-in-class, in terms of safety, in terms of efficiency. And what we're doing is continuing to find ways to apply that value prop in the industry. It's got some potential there as well.

And then you mentioned Solar. Solar is a great application for us. Hemlock today manufactures polysilicon for the solar market. We've got additional capacity that we can bring online. And we think a nice opportunity set with onshoring of solar manufacturing in the U.S.

Josh Spector: For anybody in the room, a few more minutes. If you have any questions, put them in. But I'll ask the last one that I have is just as you focus more broadly on your core capabilities, I guess what are we not talking about? What inflections or S curves are out there that's going to be the next thing that you see Corning investing and becoming a meaningful part of the portfolio?

Ann Nicholson: Yeah. I think we've talked about them, but I'll run through the list that I had and that Jeff and I were just talking about yesterday. We mentioned Auto, we mentioned ColdForm technology, so that's for the interior. That business has got a good foothold, and it's really about how much share of that market do we get, do we continue to grow into. But exteriors has become -- glass for the exteriors of cars has really become more interesting to the OEMs in terms of some of the functionality that we can provide in a more technical glass versus the soda lime glass that you have on the car. So that's a good one. Data centers that we talked about, so advanced AI and our ability to really get more content per datacenter if you want to think about it that way is pretty exciting in the near term. And then finally, Solar. Being able to grow with that industry.

Josh Spector: Okay. No, I appreciate that, and I think we're about up on time. I think we'll leave it there. Thanks, Ann, for joining us today. Thanks, everyone, for joining us in the room and online. If you have any questions, I'm sure Ann and the Corning IR team will be around to answer questions later today.

Ann Nicholson: Thanks, Josh.

Josh Spector: Thanks, everyone.