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UCTT.OQ - Ham-Let (Israel-Canada) Ltd, Ultra Clean Holdings, Inc. -
M&A Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the UCT acquisition of Ham-Let conference call. As a reminder, this call is being recorded. (Operator Instructions)

I would now like to turn the conference over to Rhonda Bennetto, Investor Relations. Please go ahead.

Rhonda M. Bennetto - *Ultra Clean Holdings, Inc. - VP of IR*

Thank you, Sarah, and good morning, everyone. We issued a press release yesterday afternoon announcing an agreement to acquire Ham-Let. A copy of that release is available on our website at uct.com.

With me today are Jim Scholhamer, Chief Executive Officer; and Sheri Savage, Chief Financial Officer.

Today's call contains forward-looking statements that are subject to risks and uncertainties. For more information, please refer to the Risk Factors section in our SEC filings or yesterday's press release. All forward-looking statements are based on estimates, projections and assumptions as of today, and we assume no obligation to update them after this call. Financial metrics discussed on today's call are being presented on a non-GAAP basis. A reconciliation of GAAP to non-GAAP can be found in today's press release on our website.

And with that, I'd like to turn the call over to Jim. Jim?

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

Thank you, Rhonda, and good morning, everyone. Yesterday, we announced our intent to acquire Ham-Let, a global leader in the development, manufacturing and distribution of ultra-high purity and industrial flow control systems, valves, fittings and connectors, largely used for the manufacturing of today's most complex semiconductor devices. We are very excited about this transaction as it brings us significantly closer to our aspirational goal of becoming a \$2 billion company.

With the addition of Ham-Let, a public company listed on the Tel Aviv exchange, UCT strengthens its leading position as the partner of choice with a significantly broader, higher-value portfolio of market-leading product solutions.

The timing is ideal as semiconductor device complexity continues to drive increased demand, creating significant business opportunities. In addition, we are gaining access to a new set of customers in the semiconductor fab infrastructure and sub-fab market, which represents an excellent platform for growth.

The larger, more diversified UCT will become further entrenched in the critical semiconductor manufacturing processes to help our customers navigate their technology road maps. We have spoken with our largest customers, and they are very supportive of this acquisition. They recognize the value in UCT expanding our vertical capabilities by consolidating the very fragmented supply chain, and they welcome UCT bringing strength and scale into the flow component space.

Ham-Let's high-value, high-margin components are used primarily within our current gas panel product line as well as gas distributions throughout the semiconductor tools. In addition, gas distribution is a significant element of the sub-fab infrastructure within chip-making facilities, providing an additional platform for growth.

UCT will be able to provide more vertically integrated gas and chemical delivery systems and is well recognized as a leading supplier of high-quality gas panel and distribution systems in the industry. We will also capitalize on opportunities to leverage the broader technical capabilities for our customers and the ability to utilize Ham-Let's products on our customers' most challenging applications.

Ham-Let's semiconductor business currently holds about a 5% share of a \$2 billion market. The critical subsystem market alone is on track to exceed 19% growth for 2020, with vacuum-related subsystems growing at a higher rate as the use of low-pressure processes are becoming a larger part of the overall WFE. And demand is expected to continue into 2021.

By leveraging UCT's solid customer relationships and global operational footprint, we see a sizable opportunity to grow our market share. With Ham-Let's complete line of high-quality products, we expect to grow revenue at a faster rate than either company could achieve individually.

Ham-Let also generates about 40% of their revenue from non-semi business, including the flow of high-purity gases and liquids used in pharmaceuticals, food processing, chemical, oil and gas, petrochemical and power generation. Ham-Let utilizes distributors to support many of these industries.

Now I would like to turn the call over to Sheri for a brief financial review of the acquisition. Sheri?

Sheri L. Savage - Ultra Clean Holdings, Inc. - Senior VP of Finance & CFO

Thanks, Jim. In addition to adding approximately \$200 million in annualized revenue, we expect to create revenue synergies through cross-selling opportunities. We have also identified numerous ways to achieve cost synergies. These include the elimination of duplicate public company costs, redundant facilities, operational efficiencies and other general administrative areas. We anticipate cost savings in the range of \$20 million to be realized incrementally over the next 3 years.

As noted in the press release, Ham-Let's gross margin profile is very attractive and well above our current consolidated UCT margin model, and we believe we can improve it further. By executing on cost synergies, we expect Ham-Let's operating margins to improve notably and land well within our product model of 8% to 10% in 2021. This acquisition is being structured as an all-cash deal valued at \$348 million or 14.5x adjusted EBITDA, representing a modest premium due to the high IP component of Ham-Let's product lines. UCT has secured a committed debt financing through Barclays to fund the acquisition and repay Ham-Let's debt.

At the same time, we are reviewing our overall capital structure to ensure we maintain a strong balance sheet and financial flexibility.

And with that, I'll turn the call back over to Jim. Jim?

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

Thanks, Sheri. To summarize, this acquisition expands our semiconductor addressable market by over \$2 billion; strengthens our leading competitive position in the gas panel market; brings scale to Ham-Let's higher gross margin, high-value product offering; broadens our engagement with our current customer base; and adds a new set of customers.

UCT has a long history of successfully acquiring and integrating quality companies. We are excited to work together with Ham-Let and believe there is a strong cultural fit between the organizations. We believe that this acquisition significantly increases the value that we can deliver to our customers and positions us well to continue to outperform and outgrow the markets we serve, creating an even greater shareholder value.

With that, I would now like to open up the call for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from Patrick Ho with Stifel.

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

Congrats on the deal. Jim, maybe first off, in terms of some of the potential revenue synergies -- and I'm not looking for any quantifiable aspects of it. But you mentioned that there are some cross-selling opportunities. One area that I looked at on the sub-fab side of things, those are chipmakers where you recently expanded your customer base to include that on the parts cleaning side of things. Are those the cross-selling opportunities you see there?

And maybe as the second question related to the sub-fab, that's an area that, obviously, a lot of investors don't focus on. They focus on the clean room. But is there a recurring revenue aspect to this fab that this acquisition brings you into?

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

Yes. Thanks, Patrick. Great questions. Absolutely. On the first part, on the sub-fab, we do have a small presence at this point with the QuantumClean acquisition, cleaning of several of the parts and components in that space. And that's an area when we get into the next step of integration and continued search for synergies we expect to see a lot of opportunity to expand in that area.

Ham-Let already has several large customers that they're servicing now, but we definitely believe there's significantly more opportunity to penetrate in that space. And it is definitely a significant part of the capital spend. And as I was thinking about this, it actually, oftentimes, is a little bit out of phase with the WFE, the normal equipment capital spend, too. So it might have some additional impact there. It's more of a constant spending as the infrastructure is built.

I'm not sure about recurring revenue, but definitely, those parts tend to wear out more than you would see in a lot of WFE equipment. A lot of the cross-selling opportunities are in the WFE equipment themselves. There are -- I think we're seeing right now in this environment as we're starting to push up against and looks like potentially exceed peak WFE levels of the last cycle. And you throw the COVID and a lot of the constraints on the whole supply chain, we're seeing our customers more open to alternative solutions, especially in the component space as well where, in the past, changing out a supplier, it used to take quite a bit of time for you to copy exact requirements. We're seeing those things move more quickly.

So Ham-Let is currently a supplier to us. We -- as a first step, we look to -- we would look to use Ham-Let's products as exclusively as possible in our own offerings. But we also see a lot of opportunities with the OEMs and the strength of our sales channel with the OEMs and their requirements there as well.

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

Great. That's helpful. And maybe as my follow-up question for Sheri, on the \$20 million in cost synergies, that's obviously an attractive number but one also you spread out over 3 years. Aside from the general, I guess, administrative stuff that the duplicate costs there that are taken out, where would you say are some of the most incremental cost synergies or cost savings you can get? Is it more in the manufacturing, the ability to flex there, things of that nature? Where are the incremental parts of that cost synergy target that you set?

Sheri L. Savage - *Ultra Clean Holdings, Inc. - Senior VP of Finance & CFO*

Yes. I would definitely assume that a lot of the synergies are coming out of the cost of goods sold area, especially within operational efficiency. So I -- there may be some with OpEx, but I think the majority of it will definitely be a benefit to gross margin, which will allow a better fall-through surrounding their op margin.

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

Great. Congrats again.

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

Thank you, Patrick.

Operator

Our next question will come from Tom Diffely with D.A. Davidson.

Thomas Robert Diffely - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

This looks like a very nice acquisition. First question, I guess, on the cost synergy side, is it more the case that you'll use your existing OEM customers to move the flow control systems? Or is there an opportunity to take your gas panel into the sub-fab or gas panel into the other industries as well?

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

Yes. I think primarily, the first area of opportunity is within the gas distribution around the tool, which is often what the OEMs are providing, and in the gas panel itself, that we're -- one of our largest product lines in our company, that's obviously the primary aspect. I -- and then there are several large sub-fab companies that are providing the gas distribution systems within the sub-fab. And currently, the selling is supporting those customers who are building those. I think getting into that space and competing is something that we would really not be looking at initially down the road.

You never close out those opportunities, but I don't think that's really an area where we would look at in the near term.

Thomas Robert Diffely - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Okay. And then, Sheri, when you look at the cost synergies, is it going to be a bit of a barbell, where you get a big chunk of it upfront as soon as you close the deal and then take a few years to get to the second big piece of it?

Sheri L. Savage - *Ultra Clean Holdings, Inc. - Senior VP of Finance & CFO*

I think it's going to incrementally build as we move through this coming year. So we'll have some synergies this year that are very easy, obviously, to get through some of the operational efficiencies and looking at redundant facilities will take a tad bit longer. So I would assume that some of that synergy will come a little bit later. So I would say it would build over the course of the 3 years.

Thomas Robert Diffely - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Okay. Great. And then finally, on the manufacturing capabilities. Are there any unique capabilities that come with the flow control manufacturing that you could also use on your side of the business?

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

Yes, we'll definitely be looking at all those options. Some of the new engineering programs we're working on with some of our newer customers that we're looking to expand our share, they have some very unique requirements around high pressure and other areas that Ham-Let brings a lot of expertise in.

I think that that's a -- I think the ability for Ham-Let to really support our current gas panel products with the cost and delivery and the QCD part of the equation, I think the big push there is supporting our current product line and really selling it to the OEMs for all the other applications around the tool for gas distribution where we currently play a smaller role.

Thomas Robert Diffely - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Okay. Great. And congratulations on the acquisition.

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

Thank you, Tom.

Sheri L. Savage - *Ultra Clean Holdings, Inc. - Senior VP of Finance & CFO*

Thank you.

Operator

Our next question comes from Christian Schwab with Craig-Hallum Capital Group.

Christian David Schwab - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst & Partner*

Congratulations on the acquisition. I have just a few quick questions. Number one, what is the anticipated cost of debt and what the terms are, if you could share with that. Does Ham-Let have any historical 10% customers? Who's their primary competitor? And lastly, how did you find the acquisition? Was the deal shopped? Was there other competitive offers? Or did you go and find them and put the deal together? That's it.

Sheri L. Savage - *Ultra Clean Holdings, Inc. - Senior VP of Finance & CFO*

Okay. I can start with the debt. So we have a debt commitment at this point. We have not gone out for debt yet. So obviously, the anticipation would be that we would get a similar rate as we currently have with our current Term B loan. But we will be going out for debt at the beginning of -- or during Q1 time frame.

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

Yes. I think as far as the deal, the deal -- we've been looking at Ham-Let now actually for several years. So it was actually a CEO-to-CEO discussion that has occurred and kind of reheated up as we looked at the -- really the timing right now is really ideal, as I mentioned in my script. The customers are more open than ever to these types of solutions.

So we -- in the summer, we kind of rekindled the discussions that we've had in the deal. The deal was not shopped. It was just the 2 of us working together over the last several quarters to put it together.

Christian, I'm sorry, I didn't catch the second question in the middle.

Christian David Schwab - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst & Partner*

Just any historical 10% customers? And who is their primary competitor that they run into?

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

Yes. The customer base, I'm not sure about the percentages off the top of my head. And there are several larger customers in the sub-fab area that they -- like Edwards, that they support. And the largest competitors in the -- especially in the WFE space, is Swagelok is the largest competitor. And then there's a pretty -- then there's a -- if you look at the pie, that's the majority, the largest share of the pie, and then it is broken between Parker and another smaller company called Compair, Ham-Let. And those are the primary in the now, say, the non-Japanese space of the WFE market.

Christian David Schwab - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst & Partner*

Great. No other questions. Congrats on the deal.

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

Thank you, Christian.

Operator

Our next question comes from Krish Sankar with Cowen.

Kinney Chin - *Cowen and Company, LLC, Research Division - Research Associate*

This is Steve calling on behalf of Krish. Just a few quick ones. Just in terms of the customer base for Ham-Let, just wondering, is UCT currently a meaningful customer at all for Ham-Let?

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

I'd say not significantly a material customer. There's been a lot of momentum over the last year. We've actually been working with Ham-Let to change -- to adopt more and more of their components in our gas panel. So we've been working kind of as partners with the OEMs to get those changes through. So it's a relatively small share of the components that we use in the gas panel. But we've been building up momentum through the year in a kind of partner-like relationship, especially, as I've mentioned, there's been a lot of stress on the supply chain overall during COVID. And you've seen the OEMs really open up to expanding the position of other alternatives.

Kinney Chin - *Cowen and Company, LLC, Research Division - Research Associate*

Got it. And then just also related from a, I guess, a milestone standpoint, I guess, is there an estimate on when the Board does -- this [type of business can finally] be approved by both Boards? And also are there any regulatory-type approvals that are needed as well?

Sheri L. Savage - *Ultra Clean Holdings, Inc. - Senior VP of Finance & CFO*

Yes. We will go through some regulatory approvals over the course of the next couple of months. Obviously, the Boards have approved this transaction. It's more just associated with some of the regulatory filings that we need to do in certain countries to close the deal. So that's -- that will happen immediately, and we'll work to close that.

Kinney Chin - *Cowen and Company, LLC, Research Division - Research Associate*

Okay. Great. And I guess, Sheri, just the last one for you. If you can remind us just from a capital structure standpoint, once the deal is closed, what will your leverage ratio look like? And can you just remind us what your long-term target is for that?

Sheri L. Savage - *Ultra Clean Holdings, Inc. - Senior VP of Finance & CFO*

Yes. If we used all debt to fund this, which we're obviously in the middle of looking at, considering other finance alternatives just to ensure a balanced approach. But if we use all debt, we would be at a 2.9 gross leverage ratio or 2.1 net. So again, we're looking to see how we can balance that. But the factors associated with that is really the market conditions at the time as well as just timing of our core results and our Q1 outlook. So we're just -- we're balancing all of those.

Kinney Chin - *Cowen and Company, LLC, Research Division - Research Associate*

Understood. Okay. Congrats on the deal.

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

Thank you, Steven.

Sheri L. Savage - *Ultra Clean Holdings, Inc. - Senior VP of Finance & CFO*

Thanks so much.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Jim Scholhamer for any closing remarks.

James P. Scholhamer - *Ultra Clean Holdings, Inc. - CEO & Director*

Yes. Thank you all for attending today. And I wish you all happy and safe holidays and, of course, good health. And we really look forward to talking to you next year further about this and as well as on the -- UCT's other activities in 2021. Thank you.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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