

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended May 2, 2021

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR
For the transition period from ___ to ___

Commission file number 0-15451



PHOTRONICS, INC.

(Exact name of registrant as specified in its charter)

Connecticut

(State or other jurisdiction of incorporation or organization)

06-0854886

(IRS Employer Identification No.)

15 Secor Road, Brookfield, Connecticut

(Address of principal executive offices)

06804

(Zip Code)

Registrant's telephone number, including area code

(203) 775-9000

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|---------------------------------|-------------------|---|
| COMMON | PLAB | NASDAQ Global Select Market |
| PREFERRED STOCK PURCHASE RIGHTS | N/A | N/A |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer
Smaller Reporting Company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock: \$0.01 par value – 61,979,000 shares outstanding as of May 21, 2021.

PHOTRONICS, INC.
QUARTERLY REPORT ON FORM 10-Q
MAY 2, 2021

TABLE OF CONTENTS

| | |
|---|----|
| Glossary of Terms and Acronyms | 3 |
| Forward-Looking Statements | 4 |
| PART I. FINANCIAL INFORMATION | |
| Item 1. Condensed Consolidated Financial Statements (unaudited) | 5 |
| Condensed Consolidated Balance Sheets | 5 |
| Condensed Consolidated Statements of Income | 6 |
| Condensed Consolidated Statements of Comprehensive Income | 7 |
| Condensed Consolidated Statements of Equity | 8 |
| Condensed Consolidated Statements of Cash Flows | 10 |
| Notes to Condensed Consolidated Financial Statements | 11 |
| Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations | 26 |
| Item 3. Quantitative and Qualitative Disclosures about Market Risk | 32 |
| Item 4. Controls and Procedures | 33 |
| PART II. OTHER INFORMATION | |
| Item 1. Legal Proceedings | 34 |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds | 34 |
| Item 6. Exhibits | 35 |

Glossary of Terms and Acronyms

Definitions of certain terms and acronyms that appear in this report are provided below.

| | |
|------------------------------|--|
| AMOLED | Active-matrix organic light-emitting diode. A technology used in mobile devices. |
| ASC | Accounting Standards Codification |
| ASU | Accounting Standards Update |
| DNP | Dai Nippon Printing Co., Ltd. |
| Exchange Act | The Securities Exchange Act of 1934 (as amended) |
| FASB | Financial Accounting Standards Board |
| Form 10-K | Annual Report on Form 10-K |
| Form 10-Q | Quarterly Report on Form 10-Q |
| FPDs | Flat-panel displays, or “displays” |
| High-end (photomasks) | For IC, photomasks that are 28nm or smaller; for FPD, AMOLED, G10.5+, and LTPS photomasks. |
| ICs | Integrated circuits, or semiconductors |
| LIBOR | London Inter-Bank Offered Rate |
| LTPS | Low-Temperature Poly Silicon, a polycrystalline silicon synthesized at relatively low temperatures; polycrystalline silicon in thin-film transistors (TFTs) are used in liquid-crystal displays (LCD) flat panels and to drive organic light-emitting diode (OLED) displays. |
| MLA | Master Lease Agreement |
| PDMCX | Xiamen American Japan Photonics Mask Co., Ltd., a joint venture of Photonics and DNP. |
| RMB | Chinese renminbi |
| ROU (assets) | Right-of-use asset |
| SEC | Securities and Exchange Commission |
| Securities Act | The Securities Act of 1933 (as amended) |

Forward-Looking Statements

This Form 10-Q contains forward-looking statements, as defined by the SEC. The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for forward-looking statements made by us, or on our behalf. Forward-looking statements are statements other than statements of historical fact, including, without limitation, those statements that include such words as “anticipates”, “believes”, “estimates”, “expects”, “intends”, “plans”, “predicts”, and similar expressions, and, without limitation, may address our future plans, objectives, goals, strategies, events, or performance, as well as underlying assumptions and other statements that are other than statements of historical facts. On occasion, in other documents filed with the SEC, press releases, conferences, or by other means, we may discuss, publish, disseminate, or otherwise make available, forward-looking statements, including statements contained within Item 2 – “Management’s Discussion & Analysis of Financial Condition and Results of Operations” of this Form 10-Q.

Forward-looking statements involve risks and uncertainties, which could cause actual results or outcomes to differ materially from those expressed. Our expectations, beliefs and projections are expressed in good faith and are believed by us to have a reasonable basis, including, without limitation, management’s examination of historical operating trends, information contained in our records, and information we’ve obtained from other parties. However, we can offer no assurance that our expectations, beliefs, or projections will be realized, accomplished or achieved.

Forward-looking statements within this Form 10-Q speak only as of the date of its filing, and we undertake no obligation to update any such statements to reflect changes in events or circumstances that may subsequently occur. Users of this Report are cautioned that various factors may cause actual results to differ materially from those contained in any forward-looking statements found within this Form 10-Q and that they should not place undue reliance on any forward-looking statement. In addition, all forward-looking statements, whether written or oral and whether made by us or on our behalf, are expressly qualified by the risk factors provided in Item 1A “Risk Factors” of our Form 10-K, as well as any additional risk factors we may provide in our Quarterly Reports on Form 10-Q.

PART I. FINANCIAL INFORMATION**Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

PHOTRONICS, INC.
Condensed Consolidated Balance Sheets
(in thousands, except per share amounts)
(unaudited)

| | <u>May 2,</u> <u>2021</u> | <u>October 31,</u> <u>2020</u> |
|---|------------------------------|-----------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 255,965 | \$ 278,665 |
| Accounts receivable, net of allowance for credit losses of \$1,356 in 2021 and \$1,324 in 2020 | 143,923 | 134,470 |
| Inventories | 56,384 | 57,269 |
| Other current assets | 39,336 | 29,735 |
| | <u>495,608</u> | <u>500,139</u> |
| Total current assets | 495,608 | 500,139 |
| Property, plant and equipment, net | 717,426 | 631,475 |
| Intangible assets, net | 1,356 | 3,437 |
| Deferred income taxes | 22,591 | 22,070 |
| Other assets | 29,008 | 31,061 |
| Total assets | <u>\$ 1,265,989</u> | <u>\$ 1,188,182</u> |
| LIABILITIES AND EQUITY | | |
| Current liabilities: | | |
| Short-term debt | \$ - | \$ 4,708 |
| Current portion of long-term debt | 25,658 | 8,970 |
| Accounts payable | 83,292 | 75,378 |
| Accrued liabilities | 50,337 | 53,883 |
| | <u>159,287</u> | <u>142,939</u> |
| Total current liabilities | 159,287 | 142,939 |
| Long-term debt | 88,444 | 54,980 |
| Other liabilities | 27,441 | 27,997 |
| | <u>275,172</u> | <u>225,916</u> |
| Total liabilities | 275,172 | 225,916 |
| Commitments and contingencies | | |
| Equity: | | |
| Preferred stock, \$0.01 par value, 2,000 shares authorized, none issued and outstanding | - | - |
| Common stock, \$0.01 par value, 150,000 shares authorized, 63,606 shares issued and 61,587 outstanding at May 2, 2021, and 63,138 shares issued and outstanding at October 31, 2020 | 636 | 631 |
| Additional paid-in capital | 511,215 | 507,336 |
| Retained earnings | 297,599 | 279,037 |
| Treasury stock, 2,019 shares at May 2, 2021 | (23,250) | - |
| Accumulated other comprehensive income | 35,192 | 17,958 |
| | <u>821,392</u> | <u>804,962</u> |
| Total Photronics, Inc. shareholders' equity | 821,392 | 804,962 |
| Noncontrolling interests | 169,425 | 157,304 |
| | <u>990,817</u> | <u>962,266</u> |
| Total equity | 990,817 | 962,266 |
| Total liabilities and equity | <u>\$ 1,265,989</u> | <u>\$ 1,188,182</u> |

See accompanying notes to condensed consolidated financial statements.

PHOTRONICS, INC.
Condensed Consolidated Statements of Income
(in thousands, except per share amounts)
(unaudited)

| | <u>Three Months Ended</u> | | <u>Six Months Ended</u> | |
|--|---------------------------|------------------------|-------------------------|------------------------|
| | <u>May 2, 2021</u> | <u>May 3, 2020</u> | <u>May 2, 2021</u> | <u>May 3, 2020</u> |
| Revenue | \$ 159,763 | \$ 142,774 | \$ 311,830 | \$ 302,510 |
| Cost of goods sold | <u>120,514</u> | <u>112,341</u> | <u>242,052</u> | <u>237,475</u> |
| Gross profit | 39,249 | 30,433 | 69,778 | 65,035 |
| Operating expenses: | | | | |
| Selling, general and administrative | 14,067 | 13,267 | 28,120 | 27,486 |
| Research and development | <u>4,375</u> | <u>4,462</u> | <u>9,085</u> | <u>8,541</u> |
| Total operating expenses | <u>18,442</u> | <u>17,729</u> | <u>37,205</u> | <u>36,027</u> |
| Operating income | 20,807 | 12,704 | 32,573 | 29,008 |
| Other income (expense): | | | | |
| Foreign currency transactions impact, net | (2,055) | (1,433) | (674) | 3,304 |
| Interest expense, net | 1,246 | 775 | 423 | (1,023) |
| Interest income and other income (expense), net | <u>37</u> | <u>(293)</u> | <u>159</u> | <u>464</u> |
| Income before income tax provision | 20,035 | 11,753 | 32,481 | 31,753 |
| Income tax provision | <u>3,714</u> | <u>3,781</u> | <u>6,651</u> | <u>12,853</u> |
| Net income | 16,321 | 7,972 | 25,830 | 18,900 |
| Net income attributable to noncontrolling interests | <u>5,795</u> | <u>1,688</u> | <u>7,268</u> | <u>2,316</u> |
| Net income attributable to Photronics, Inc. shareholders | <u>\$ 10,526</u> | <u>\$ 6,284</u> | <u>\$ 18,562</u> | <u>\$ 16,584</u> |
| Earnings per share: | | | | |
| Basic | <u>\$ 0.17</u> | <u>\$ 0.10</u> | <u>\$ 0.30</u> | <u>\$ 0.25</u> |
| Diluted | <u>\$ 0.17</u> | <u>\$ 0.10</u> | <u>\$ 0.30</u> | <u>\$ 0.25</u> |
| Weighted-average number of common shares outstanding: | | | | |
| Basic | <u>62,054</u> | <u>64,937</u> | <u>62,265</u> | <u>65,246</u> |
| Diluted | <u>62,568</u> | <u>65,417</u> | <u>62,786</u> | <u>65,933</u> |

See accompanying notes to condensed consolidated financial statements.

PHOTRONICS, INC.
Condensed Consolidated Statements of Comprehensive Income
(in thousands)
(unaudited)

| | <u>Three Months Ended</u> | | <u>Six Months Ended</u> | |
|---|---------------------------|------------------------|-------------------------|------------------------|
| | <u>May 2, 2021</u> | <u>May 3, 2020</u> | <u>May 2, 2021</u> | <u>May 3, 2020</u> |
| Net income | \$ 16,321 | \$ 7,972 | \$ 25,830 | \$ 18,900 |
| Other comprehensive income (loss), net of tax of \$0: | | | | |
| Foreign currency translation adjustments | 3,778 | (2,405) | 22,066 | (3,970) |
| Other | <u>21</u> | <u>1</u> | <u>21</u> | <u>19</u> |
| Net other comprehensive income (loss) | <u>3,799</u> | <u>(2,404)</u> | <u>22,087</u> | <u>(3,951)</u> |
| Comprehensive income | 20,120 | 5,568 | 47,917 | 14,949 |
| Less: comprehensive income attributable to noncontrolling interests | <u>6,431</u> | <u>2,742</u> | <u>12,121</u> | <u>4,560</u> |
| Comprehensive income attributable to Photronics, Inc. shareholders | <u>\$ 13,689</u> | <u>\$ 2,826</u> | <u>\$ 35,796</u> | <u>\$ 10,389</u> |

See accompanying notes to condensed consolidated financial statements.

PHOTRONICS, INC.
Condensed Consolidated Statements of Equity
(in thousands)
(unaudited)

Three Months Ended May 2, 2021

| Photronics, Inc. Shareholders | | | | | | | | | |
|--------------------------------------|---------------------|---------------|---|------------------------------|---------------------------|---|---|--|-------------------------|
| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income | Non- controlling Interests | | Total Equity |
| | Shares | Amount | | | | | | | |
| Balance at January 31, 2021 | 63,506 | \$ 635 | \$ 508,974 | \$ 287,073 | \$ (13,209) | \$ 32,029 | \$ 162,994 | | \$ 978,496 |
| Net income | - | - | - | 10,526 | - | - | 5,795 | | 16,321 |
| Other comprehensive income | - | - | - | - | - | 3,163 | 636 | | 3,799 |
| Shares issued under equity plans | 100 | 1 | 819 | - | - | - | - | | 820 |
| Share-based compensation expense | - | - | 1,422 | - | - | - | - | | 1,422 |
| Purchase of treasury stock | - | - | - | - | (10,041) | - | - | | (10,041) |
| Balance at May 2, 2021 | <u>63,606</u> | <u>\$ 636</u> | <u>\$ 511,215</u> | <u>\$ 297,599</u> | <u>\$ (23,250)</u> | <u>\$ 35,192</u> | <u>\$ 169,425</u> | | <u>\$ 990,817</u> |

Three Months Ended May 3, 2020

| Photronics, Inc. Shareholders | | | | | | | | | |
|---|---------------------|---------------|---|------------------------------|---------------------------|---|---|--|-------------------------|
| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Loss | Non- controlling Interests | | Total Equity |
| | Shares | Amount | | | | | | | |
| Balance at February 2, 2020 | 66,144 | \$ 661 | \$ 528,535 | \$ 264,222 | \$ (11,000) | \$ (11,742) | \$ 142,125 | | \$ 912,801 |
| Net income | - | - | - | 6,284 | - | - | 1,688 | | 7,972 |
| Other comprehensive (loss) income | - | - | - | - | - | (3,458) | 1,054 | | (2,404) |
| Shares issued under equity plans | 71 | 1 | 362 | - | - | - | - | | 363 |
| Share-based compensation expense | - | - | 1,220 | - | - | - | - | | 1,220 |
| Purchase of treasury stock | - | - | - | - | (5,894) | - | - | | (5,894) |
| Contribution from noncontrolling interest | - | - | - | - | - | - | 7,600 | | 7,600 |
| Balance at May 3, 2020 | <u>66,215</u> | <u>\$ 662</u> | <u>\$ 530,117</u> | <u>\$ 270,506</u> | <u>\$ (16,894)</u> | <u>\$ (15,200)</u> | <u>\$ 152,467</u> | | <u>\$ 921,658</u> |

See accompanying notes to condensed consolidated financial statements.

PHOTRONICS, INC.
Condensed Consolidated Statements of Equity
(in thousands)
(unaudited)

Six Months Ended May 2, 2021

| Photronics, Inc. Shareholders | | | | | | | | |
|--------------------------------------|---------------------|---------------|---|------------------------------|---------------------------|---|---|-------------------------|
| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income | Non- controlling Interests | Total Equity |
| | Shares | Amount | | | | | | |
| Balance at October 31, 2020 | 63,138 | \$ 631 | \$ 507,336 | \$ 279,037 | \$ - | \$ 17,958 | \$ 157,304 | \$ 962,266 |
| Net income | - | - | - | 18,562 | - | - | 7,268 | 25,830 |
| Other comprehensive income | - | - | - | - | - | 17,234 | 4,853 | 22,087 |
| Shares issued under equity plans | 468 | 5 | 1,156 | - | - | - | - | 1,161 |
| Share-based compensation expense | - | - | 2,723 | - | - | - | - | 2,723 |
| Purchase of treasury stock | - | - | - | - | (23,250) | - | - | (23,250) |
| Balance at May 2, 2021 | <u>63,606</u> | <u>\$ 636</u> | <u>\$ 511,215</u> | <u>\$ 297,599</u> | <u>\$ (23,250)</u> | <u>\$ 35,192</u> | <u>\$ 169,425</u> | <u>\$ 990,817</u> |

Six Months Ended May 3, 2020

| Photronics, Inc. Shareholders | | | | | | | | |
|---|---------------------|---------------|---|------------------------------|---------------------------|---|---|-------------------------|
| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Loss | Non- controlling Interests | Total Equity |
| | Shares | Amount | | | | | | |
| Balance at October 31, 2019 | 65,595 | \$ 656 | \$ 524,319 | \$ 253,922 | \$ - | \$ (9,005) | \$ 141,200 | \$ 911,092 |
| Net income | - | - | - | 16,584 | - | - | 2,316 | 18,900 |
| Other comprehensive (loss) income | - | - | - | - | - | (6,195) | 2,244 | (3,951) |
| Shares issued under equity plans | 620 | 6 | 2,967 | - | - | - | - | 2,973 |
| Share-based compensation expense | - | - | 2,576 | - | - | - | - | 2,576 |
| Purchase of treasury stock | - | - | - | - | (16,894) | - | - | (16,894) |
| Contribution from noncontrolling interest | - | - | - | - | - | - | 7,600 | 7,600 |
| Repurchase of common stock of subsidiary | - | - | 255 | - | - | - | (893) | (638) |
| Balance at May 3, 2020 | <u>66,215</u> | <u>\$ 662</u> | <u>\$ 530,117</u> | <u>\$ 270,506</u> | <u>\$ (16,894)</u> | <u>\$ (15,200)</u> | <u>\$ 152,467</u> | <u>\$ 921,658</u> |

See accompanying notes to condensed consolidated financial statements.

PHOTRONICS, INC.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

| | Six Months Ended | |
|---|-------------------------|------------------------|
| | May 2, 2021 | May 3, 2020 |
| Cash flows from operating activities: | | |
| Net income | \$ 25,830 | \$ 18,900 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 47,121 | 47,896 |
| Share-based compensation | 2,723 | 2,576 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (5,655) | (13) |
| Inventories | 2,266 | (8,989) |
| Other current assets | (8,591) | (6,887) |
| Accounts payable, accrued liabilities, and other | (5,475) | 7,840 |
| Net cash provided by operating activities | 58,219 | 61,323 |
| Cash flows from investing activities: | | |
| Purchases of property, plant and equipment | (73,516) | (30,127) |
| Government incentives | 5,775 | 5,260 |
| Other | (157) | (139) |
| Net cash used in investing activities | (67,898) | (25,006) |
| Cash flows from financing activities: | | |
| Proceeds from debt | 12,439 | 1,140 |
| Purchase of treasury stock | (23,250) | (16,894) |
| Repayments of debt | (8,636) | (389) |
| Proceeds from share-based arrangements | 1,180 | 3,423 |
| Contribution from noncontrolling interest | - | 7,600 |
| Net settlements of restricted stock awards | (371) | (251) |
| Net cash used in financing activities | (18,638) | (5,371) |
| Effect of exchange rate changes on cash, cash equivalents, and restricted cash | 5,686 | 475 |
| Net (decrease) increase in cash, cash equivalents, and restricted cash | (22,631) | 31,421 |
| Cash, cash equivalents, and restricted cash at beginning of period | 281,602 | 209,291 |
| Cash, cash equivalents, and restricted cash at end of period | \$ 258,971 | \$ 240,712 |
| Supplemental disclosures of non-cash information: | | |
| Accrual for property, plant and equipment purchased during the period | \$ 20,533 | \$ 2,891 |

See accompanying notes to condensed consolidated financial statements.

PHOTRONICS, INC.
Notes to Condensed Consolidated Financial Statements
(unaudited)
(in thousands, except share amounts and per share data)

NOTE 1 - BASIS OF FINANCIAL STATEMENT PRESENTATION

Photronics, Inc. (“Photronics”, “the Company”, “we”, “our”, or “us”) is one of the world's leading manufacturers of photomasks, which are high-precision photographic quartz or glass plates containing microscopic images of electronic circuits. Photomasks are a key element in the manufacture of ICs and FPDs, and are used as masters to transfer circuit patterns onto semiconductor wafers and FPD substrates during the fabrication of integrated circuits, a variety of FPDs and, to a lesser extent, other types of electrical and optical components. We currently have eleven manufacturing facilities, which are located in Taiwan (3), Korea, the United States (3), Europe (2), and two recently constructed facilities in China. Our FPD facility in Hefei, China, commenced production in the second quarter of fiscal 2019, and our IC facility in Xiamen, China, commenced production in the third quarter of fiscal 2019.

The accompanying unaudited condensed consolidated financial statements (“the financial statements”) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information, and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for annual financial statements. In the opinion of management, adjustments, all of which are of a normal recurring nature, considered necessary for a fair presentation have been included. The financial statements include the accounts of Photronics, its wholly owned subsidiaries, and the majority-owned subsidiaries which it controls. All intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect amounts reported in them. Estimates are based on historical experience and on various assumptions that are believed to be reasonable under the circumstances. Our estimates are based on the facts and circumstances available at the time they are made. Subsequent actual results may differ from such estimates. We review these estimates periodically and reflect any effects of revisions in the period in which they are determined.

Reclassified prior period amounts have been made to conform to the current period presentation, including the separation of *Foreign currency transaction impact, net*, from *Interest income and other income, net*, on the condensed consolidated statements of income, and the segregation of share-based compensation activity into the two categories of *Shares issued under equity plans* and *Share-based compensation* in the condensed consolidated statements of equity; in previous reports, we segregated this activity into three categories.

Our business is typically impacted during the first, and sometimes the second, quarters of our fiscal year by the North American, European, and Asian holiday periods, as some customers reduce their development and buying activities during those periods. Operating results for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ending October 31, 2021. For further information, refer to the consolidated financial statements, and notes thereto, included in our Form 10-K for the year ended October 31, 2020.

NOTE 2 - CASH, CASH EQUIVALENTS AND RESTRICTED CASH

Cash and cash equivalents include cash and highly liquid investments with an original maturity of three months or less, readily convertible to known amounts of cash, and so near to their maturity that they present insignificant risk of changes in value because of changes in interest rates. The carrying values of cash equivalents approximate their fair values, due to the short-term maturities of these instruments.

Restricted cash is included in *Other assets* on our May 2, 2021 and October 31, 2020, consolidated balance sheets, respectively. The restrictions on these amounts are primarily related to land lease agreements and customs requirements.

The following table presents cash and cash equivalents as reported in our condensed consolidated balance sheets, as well as the sum of cash, cash equivalents and restricted cash, as reported in our condensed consolidated statements of cash flows:

| | May 2, 2021 | October 31, 2020 |
|---------------------------|------------------------|---------------------------------|
| Cash and cash equivalents | \$ 255,965 | \$ 278,665 |
| Restricted Cash | 3,006 | 2,937 |
| | <u>\$ 258,971</u> | <u>\$ 281,602</u> |

NOTE 3 - INVENTORIES

Inventories are stated at the lower of cost, determined under the first-in, first-out (“FIFO”) method, or net realizable value. Presented below are the components of inventory at the balance sheet dates:

| | May 2, 2021 | October 31, 2020 |
|-----------------|------------------------|-----------------------------|
| Raw materials | \$ 54,793 | \$ 56,389 |
| Work in process | 1,370 | 767 |
| Finished goods | 221 | 113 |
| | <u>\$ 56,384</u> | <u>\$ 57,269</u> |

NOTE 4 - PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consists of the following:

| | May 2, 2021 | October 31, 2020 |
|---|------------------------|-----------------------------|
| Land | \$ 12,678 | \$ 12,422 |
| Buildings and improvements | 182,885 | 179,162 |
| Machinery and equipment | 1,940,092 | 1,812,791 |
| Leasehold improvements | 21,711 | 21,157 |
| Furniture, fixtures and office equipment | 16,293 | 15,665 |
| Construction in progress | 80,239 | 70,915 |
| | 2,253,898 | 2,112,112 |
| Accumulated depreciation and amortization | <u>(1,536,472)</u> | <u>(1,480,637)</u> |
| | <u>\$ 717,426</u> | <u>\$ 631,475</u> |

ROU assets resulting from finance leases are included in the table above as follows:

| | May 2, 2021 | October 31, 2020 |
|--------------------------|------------------------|-----------------------------|
| Machinery and equipment | \$ 42,760 | \$ - |
| Accumulated amortization | (512) | - |
| | <u>\$ 42,248</u> | <u>\$ -</u> |

Depreciation and amortization expense for property, plant and equipment (including amortization expense for ROU assets) was \$22.3 million and \$44.9 million for the three and six-month periods ended May 2, 2021, respectively, and \$22.1 million and \$45.6 million for the three and six-month periods ended May 3, 2020, respectively.

NOTE 5 - PDMCX JOINT VENTURE

In January 2018, Photronics, Inc. through its wholly owned Singapore subsidiary (hereinafter, within this Note “we”, “Photronics”, “us”, or “our”), and DNP, through its wholly owned subsidiary “DNP Asia Pacific PTE, Ltd.” entered into a joint venture under which DNP obtained a 49.99% interest in our IC business in Xiamen, China. The joint venture, which we refer to as “PDMCX”, was established to develop and manufacture photomasks for leading-edge and advanced-generation semiconductors. We entered into this joint venture to enable us to compete more effectively for the merchant photomask business in China, and to benefit from the additional resources and investment that DNP provides to enable us to offer advanced-process technology to our customers. No gain or loss was recorded upon the formation of this joint venture.

The total investment per the PDMCX operating agreement (the “Agreement”) is \$160 million. As of May 2, 2021, Photronics and DNP had each contributed cash of approximately \$65 million, and PDMCX had obtained local financing of approximately \$50 million; thus both parties have fulfilled their initial investment commitments under the Agreement. As discussed in Note 6, liens were granted to the local financing entity on assets with a total carrying value of \$93.3 million, as collateral for the loans.

Under the Agreement, DNP is afforded, under certain circumstances, the right to put its interest in PDMCX to Photronics. These circumstances include disputes regarding the strategic direction of PDMCX that may arise after the initial two-year term of the Agreement and cannot be resolved between the two parties. As of the date of issuance of these financial statements, DNP had not indicated its intention to exercise this right. In addition, both Photronics and DNP have the option to purchase, or put, their interest from, or to, the other party, should their ownership interest fall below twenty percent for a period of more than six consecutive months. Under all such circumstances, the sales of ownership interests would be at the exiting party’s ownership percentage of the joint venture’s net book value, with closing to take place within three business days of obtaining required approvals and clearance.

We recorded net income from the operations of PDMCX of \$2.3 million, and \$2.2 million during the three and six-month periods ended May 2, 2021, respectively, and losses of \$0.4 million and \$4.1 million during the three and six-month periods ended May 3, 2020, respectively. General creditors of PDMCX do not have recourse to the assets of Photronics (other than the net assets of PDMCX), and our maximum exposure to loss from PDMCX at May 2, 2021, was \$59.1 million.

As required by the guidance in Topic 810 - “Consolidation” of the ASC, we evaluated our involvement in PDMCX for the purpose of determining whether we should consolidate its results in our financial statements. The initial step of our evaluation was to determine whether PDMCX was a variable interest entity (“VIE”). Due to its lack of sufficient equity at risk to finance its activities without additional subordinated financial support, we determined that it was a VIE. Having made this determination, we then assessed whether we were the primary beneficiary of the VIE, and concluded that we were the primary beneficiary during the current and prior year reporting periods; thus, as required, the PDMCX financial results have been consolidated with Photronics. Our conclusion was based on the facts that we held a controlling financial interest in PDMCX (which resulted from our having the power to direct the activities that most significantly impacted its economic performance) and had the obligation to absorb losses and the right to receive benefits that could potentially be significant to PDMCX. Our conclusions that we had the power to direct the activities that most significantly affected the economic performance of PDMCX during the current and prior year reporting periods were based on our right to appoint the majority of its board of directors, which has, among others, the powers to manage the business (through its rights to appoint and evaluate PDMCX’s management), incur indebtedness, enter into agreements and commitments, and acquire and dispose of PDMCX’s assets. In addition, as a result of the 50.01% variable interest we held during the current and prior-year periods, we had the obligation to absorb losses, and the right to receive benefits, that could potentially be significant to PDMCX.

The carrying amounts of PDMCX assets and liabilities included in our condensed consolidated balance sheets are presented in the following table, together with our exposure to loss related to these assets and liabilities.

| Classification | May 2, 2021 | | October 31, 2020 | |
|--------------------------|--------------------|------------------------|---------------------|------------------------|
| | Carrying Amount | Photronics Interest | Carrying Amount | Photronics Interest |
| Current assets | \$ 51,855 | \$ 25,933 | \$ 56,095 | \$ 28,053 |
| Non-current assets | 137,963 | 68,995 | 141,097 | 70,562 |
| Total assets | 189,818 | 94,928 | 197,192 | 98,615 |
| Current liabilities | 27,132 | 13,568 | 31,922 | 15,964 |
| Non-current liabilities | 44,578 | 22,293 | 55,676 | 27,844 |
| Total liabilities | 71,710 | 35,861 | 87,598 | 43,808 |
| Net assets | \$ 118,108 | \$ 59,067 | \$ 109,594 | \$ 54,807 |

NOTE 6 - DEBT

Short-term debt was \$0.0 million, and \$4.7 million as of May 2, 2021 and October 31, 2020, respectively, with the 2020 amount representing an advance payment, under an MLA, to fund equipment purchased or leased in the U.S., and short duration borrowings in Xiamen, China, to fund operations. See below for further information. The weighted-average interest rate on our short-term debt as of October 31, 2020 was 2.02%.

The tables below provide information on our long-term debt.

| <u>As of May 2, 2021</u> | <u>Xiamen Project Loans</u> | <u>Xiamen Working Capital Loans</u> | <u>Hefei Equipment Loan</u> | <u>Finance Leases</u> | <u>Total</u> |
|-------------------------------------|---------------------------------------|---|-------------------------------------|---------------------------|------------------|
| Principal due: | | | | | |
| Next 12 months | \$ 6,955 | \$ 8,854 | \$ 2,318 | \$ 7,531 | \$ 25,658 |
| Months 13 – 24 | \$ 10,047 | \$ 989 | \$ 4,637 | \$ 6,463 | \$ 22,136 |
| Months 25 – 36 | 10,046 | 3,462 | 4,637 | 6,559 | 24,704 |
| Months 37 – 48 | 10,046 | - | 1,005 | 21,279 | 32,330 |
| Months 49 – 60 | 9,274 | - | - | - | 9,274 |
| Thereafter | - | - | - | - | - |
| Long-term debt | <u>\$ 39,413</u> | <u>\$ 4,451</u> | <u>\$ 10,279</u> | <u>\$ 34,301</u> | <u>\$ 88,444</u> |
| Interest rate at balance sheet date | 4.65% | 4.53% - 4.61% | 4.20% | Various ⁽³⁾ | |
| Basis spread on interest rates | 0.00 | 67.75 - 76.00 | (45.00) | N/A | |
| Interest rate reset | Quarterly | Monthly/Annually | Annually | N/A | |
| Maturity date | December 2025 | July 2023 | September 2026 | Various ⁽³⁾ | |
| Periodic payment amount | Increases as loans mature | Increases as loans mature | Varies ⁽¹⁾ | Various ⁽³⁾ | |
| Periodic payment frequency | Semiannual, on individual loans | Semiannual, on individual loans | Semiannual ⁽²⁾ | Monthly | |
| Loan collateral (carrying amount) | \$ 93,345 | N/A | \$ 88,150 | \$ 42,248 ⁽⁴⁾ | |

⁽¹⁾ First five loan repayments will each be for 7.5 percent of the approved 200 million RMB loan principal; last five installments will each be for 12.5 percent of the approved loan principal.

⁽²⁾ Semiannual repayments commence in March 2022.

⁽³⁾ See Note 8 for interest rates on lease liabilities, maturity dates and periodic payment amounts.

⁽⁴⁾ Represents the carrying amount at the balance sheet date of the related right-of-use assets, in which the lessors have secured interests.

| <u>As of October 31, 2020</u> | <u>Xiamen Project Loans</u> | <u>Xiamen Working Capital Loans</u> | <u>Total</u> |
|-------------------------------------|-------------------------------------|---|------------------|
| Principal due: | | | |
| Next 12 months | \$ 6,705 | \$ 2,265 | \$ 8,970 |
| Months 13 – 24 | \$ 7,334 | \$ 7,808 | \$ 15,142 |
| Months 25 – 36 | 9,592 | 3,814 | 13,406 |
| Months 37 – 48 | 9,789 | - | 9,789 |
| Months 49 – 60 | 9,432 | - | 9,432 |
| Thereafter | 7,211 | - | 7,211 |
| Long-term debt | <u>\$ 43,358</u> | <u>\$ 11,622</u> | <u>\$ 54,980</u> |
| Interest rate at balance sheet date | 4.90% | 4.53% - 4.61% | |
| Basis spread on interest rates | 25.00 | 40.00 - 76.00 | |
| Loan collateral (carrying amount) | \$ 94,459 | N/A | |

Xiamen Project Loans

In November 2018, PDMCX was approved for credit of 345 million RMB (approximately \$53.3 million, at the balance sheet date), subject to certain limitations related to PDMCX registered capital at the time of the initial approval, pursuant to which PDMCX has entered into separate loan agreements (the “Project Loans”) for intermittent borrowings. The Project Loans, which are denominated in RMB, were used to finance certain capital expenditures for our Xiamen, China, facility. PDMCX granted liens on its land use right, building, and certain equipment as collateral for the Project Loans. As of May 2, 2021, PDMCX had outstanding borrowings of 300.0 million RMB (\$46.4 million) against this approval. The interest rates on the Project Loans are variable, and based on the RMB Loan Prime Rate of the National Interbank Funding Center. Interest incurred on the loans is eligible for reimbursement through incentives provided by the Xiamen Torch Hi-Tech Industrial Development Zone, which provide for such reimbursements up to a prescribed limit. The Xiamen Project Loans have covenants and provisions, certain of which relate to the assets pledged as security for the loan, all of which we were in compliance with at May 2, 2021.

Xiamen Working Capital Loans

In November 2018, PDMCX was approved for revolving, unsecured credit of the equivalent of \$25.0 million, pursuant to which PDMCX may enter into separate loan agreements with varying terms to maturity. Under this credit agreement (the “Working Capital Loans”), PDMCX can borrow up to 140.0 million RMB to pay value-added taxes (“VAT”), and up to 60.0 million RMB to fund operations; combined total borrowings are limited to the equivalent of \$25.0 million. As of May 2, 2021, PDMCX had 86.1 million RMB (\$13.3 million) outstanding against the approval to pay VAT and no outstanding borrowings against the approval to fund operations. The interest rates on the approval to pay VAT are variable, based on the RMB Loan Prime Rate of the National Interbank Funding Center. Interest incurred on the VAT loans are eligible for reimbursement through incentives provided by the Xiamen Torch Hi-Tech Industrial Development Zone, which provide for such reimbursements up to a prescribed limit.

Hefei Equipment Loan

In October 2020, our Hefei, China, facility was approved to borrow 200 million RMB (approximately \$30.9 million, at the balance sheet date) from the China Construction Bank Corporation. Loan proceeds have been, and will be, used to fund the purchases of two lithography tools at the Hefei facility. As of May 2, 2021, we had 81.5 million RMB (\$12.6 million) outstanding against this approval. The interest rate on the loan is variable and based on the RMB Loan Prime Rate of the National Interbank Funding Center. The borrowings are secured by the Hefei facility, its related land use right, and certain manufacturing equipment. The Hefei Equipment Loan has covenants and provisions, certain of which relate to the assets pledged as security for the loan, including covenants for the ratio of total liabilities to total assets and the ratio of current assets to current liabilities, all of which we were in compliance with at May 2, 2021.

Finance Leases

In February 2021, we entered into a five-year \$7.2 million finance lease for a high-end inspection tool and, in December 2020, under an MLA which we entered into effective July 2019, we entered into a \$35.5 million lease for a high-end lithography tool. Upon entering into the latter lease, our prior \$3.5 million short-term obligation to the lessor became a portion of the lease liability. See Note 8 for additional information on these leases.

Corporate Credit Agreement

In September 2018, we entered into a five-year amended and restated credit agreement (the “Credit Agreement”), which has a \$50 million borrowing limit, with an expansion capacity to \$100 million. The Credit Agreement is secured by substantially all of our assets located in the United States and common stock we own in certain foreign subsidiaries. The Credit Agreement includes covenants around minimum interest coverage ratio, total leverage ratio, and minimum unrestricted cash balance (all of which we were in compliance with at May 2, 2021), and limits the amount of cash dividends, distributions, and redemptions we can pay on our common stock to an aggregate annual amount of \$50 million. We had no outstanding borrowings against the Credit Agreement at May 2, 2021. The interest rate on the Credit Agreement (1.11% at May 2, 2021) is based on our total leverage ratio at LIBOR plus a spread, as defined in the Credit Agreement.

NOTE 7 - REVENUE

We recognize revenue when, or as, control of a good or service transfers to a customer, in an amount that reflects the consideration to which we expect to be entitled in exchange for transferring those goods or services. We account for an arrangement as a revenue contract when each party has approved and is committed to perform under the contract, the rights of the contracting parties regarding the goods or services to be transferred and the payment terms are identifiable, the arrangement has commercial substance, and collection of consideration is probable. Substantially all of our revenue comes from the sales of photomasks. We typically contract with our customers to sell sets of photomasks, which are comprised of multiple layers, the predominance of which we invoice as they ship to customers. As the photomasks are manufactured to customer specifications, they have no alternative use to us and, as our contracts generally provide us with the right to payment for work completed to date, we recognize revenue as we perform, or “over time”, on most of our contracts. We measure our performance to date using an input method, which is based on our estimated costs to complete the various manufacturing phases of a photomask. At the end of a reporting period, there will be a number of uncompleted revenue contracts on which we have performed; for any such contracts under which we are entitled to be compensated for our costs incurred plus a reasonable profit, we recognize revenue and a corresponding contract asset for such performance. We account for shipping and handling activities that we perform after a customer obtains control of a good as being activities to fulfill our promise to transfer the good to the customer, rather than as promised services, or performance obligations, under the contract. We report our revenue net of any sales or similar taxes we collect on behalf of government entities.

As stated above, photomasks are manufactured to customer specifications in accordance with their proprietary designs; thus, they are individually unique. Due to their uniqueness and other factors, their transaction prices are individually established through negotiations with customers; consequently, our photomasks do not have standard or “list” prices. The transaction prices of the vast majority of our revenue contracts include only fixed amounts of consideration. In certain instances, such as when we offer a customer an early payment discount, an estimate of variable consideration would be included in the transaction price, but only to the extent that a significant reversal of revenue would not occur when the uncertainty related to the variability was resolved.

Contract Assets, Contract Liabilities, and Accounts Receivable

We recognize a contract asset when our performance under a contract precedes our receipt of consideration from a customer, or before payment is due, and our receipt of consideration is conditional upon factors other than the passage of time. Contract assets reflect our transfer of control of photomasks that are in process or completed but not yet shipped to customers. A receivable is recognized when we have an unconditional right to payment for our performance, which generally occurs when we ship the photomasks. Our contract assets primarily consist of a significant amount of our in-process production orders and fully manufactured photomasks which have not yet shipped, for which we have an enforceable right to collect consideration (including a reasonable profit) in the event the in-process orders are cancelled by customers. On an individual contract basis, we net contract assets with contract liabilities (deferred revenue) for financial reporting purposes. Contract assets of \$7.6 million are included in Other current assets, and contract liabilities of \$8.6 million and \$5.3 million are included in Accrued liabilities and Other liabilities, respectively, in our May 2, 2021 condensed consolidated balance sheet. Our October 31, 2020 condensed consolidated balance sheet includes contract assets of \$6.3 million, included in Other current assets, and contract liabilities of \$8.0 million and \$5.2 million are included in Accrued liabilities and *Other liabilities*, respectively. We did not impair any contract assets during the three or six-month periods ended May 2, 2021 or May 3, 2020. We recognized \$1.3 million and \$3.8 million of revenue from the settlement of contract liabilities that existed at the beginning of the three and six-month periods ended May 2, 2021, and recognized \$0.9 million and \$1.8 million of revenue in the respective prior year periods, that related to the settlement of contract liabilities that existed at the beginning of those periods.

We generally record our accounts receivable at their billed amounts. All outstanding past due customer invoices are reviewed for collectibility during, and at the end of, every reporting period. To the extent we believe a loss on the collection of a customer invoice is probable, we record the loss and credit the allowance for credit losses. In the event that an amount is determined to be uncollectible, we charge the allowance for credit losses and derecognize the related receivable. We did not incur any credit losses on our accounts receivable during the six-month period ended May 2, 2021, and credit losses on our accounts receivable were immaterial during the three and six-month periods ended May 3, 2020.

Our invoice terms generally range from net thirty to ninety days, depending on both the geographic market in which the transaction occurs and our payment agreements with specific customers. In the event that our evaluation of a customer’s business prospects and financial condition indicate that the customer presents a collectibility risk, we modify terms of sale, which may require payment in advance of performance. At the time of adoption, we elected the practical expedient allowed under ASC Topic 606 “Revenue from Contracts with Customers” (“Topic 606”) that permits us not to adjust a contract’s promised amount of consideration to reflect a financing component when the period between when we transfer control of goods or services to customers and when we are paid is one year or less.

In instances when we are paid in advance of our performance, we record a contract liability and, as allowed under the practical expedient in Topic 606, recognize interest expense only if the period between when we receive payment from the customer and the date when we expect to be entitled to the payment is greater than one year. Historically, advance payments we’ve received from customers have generally not preceded the completion of our performance obligations by more than one year.

Disaggregation of Revenue

The following tables present our revenue for the three and six-month periods ended May 2, 2021 and May 3, 2020, disaggregated by product type, geographic origin, and timing of recognition.

| | <u>Three Months Ended</u> | | <u>Six Months Ended</u> | |
|--------------------------------|---------------------------|------------------------|-------------------------|------------------------|
| | <u>May 2, 2021</u> | <u>May 3, 2020</u> | <u>May 2, 2021</u> | <u>May 3, 2020</u> |
| Revenue by Product Type | | | | |
| IC | | | | |
| High-end | \$ 41,259 | \$ 38,267 | \$ 78,039 | \$ 79,308 |
| Mainstream | 70,732 | 58,579 | 138,908 | 124,516 |
| Total IC | <u>\$ 111,991</u> | <u>\$ 96,846</u> | <u>\$ 216,947</u> | <u>\$ 203,824</u> |

| | | | | |
|------------|-------------------|-------------------|-------------------|-------------------|
| FPD | | | | |
| High-end | \$ 39,401 | \$ 31,809 | \$ 74,046 | \$ 71,579 |
| Mainstream | 8,371 | 14,119 | 20,837 | 27,107 |
| Total FPD | <u>\$ 47,772</u> | <u>\$ 45,928</u> | <u>\$ 94,883</u> | <u>\$ 98,686</u> |
| | <u>\$ 159,763</u> | <u>\$ 142,774</u> | <u>\$ 311,830</u> | <u>\$ 302,510</u> |

| | <u>Three Months Ended</u> | | <u>Six Months Ended</u> | |
|-------------------------------------|---------------------------|------------------------|-------------------------|------------------------|
| | <u>May 2, 2021</u> | <u>May 3, 2020</u> | <u>May 2, 2021</u> | <u>May 3, 2020</u> |
| Revenue by Geographic Origin | | | | |
| Taiwan | \$ 59,002 | \$ 55,513 | \$ 115,592 | \$ 121,626 |
| Korea | 40,239 | 36,261 | 79,022 | 76,997 |
| United States | 27,150 | 24,857 | 53,754 | 49,925 |
| China | 23,730 | 17,486 | 44,727 | 37,386 |
| Europe | 9,256 | 8,331 | 17,832 | 15,874 |
| Other | 386 | 326 | 903 | 702 |
| | <u>\$ 159,763</u> | <u>\$ 142,774</u> | <u>\$ 311,830</u> | <u>\$ 302,510</u> |

| | <u>Three Months Ended</u> | | <u>Six Months Ended</u> | |
|---|---------------------------|------------------------|-------------------------|------------------------|
| | <u>May 2, 2021</u> | <u>May 3, 2020</u> | <u>May 2, 2021</u> | <u>May 3, 2020</u> |
| Revenue by Timing of Recognition | | | | |
| Over time | \$ 144,697 | \$ 126,071 | \$ 285,982 | \$ 263,905 |
| At a point in time | 15,066 | 16,703 | 25,848 | 38,605 |
| | <u>\$ 159,763</u> | <u>\$ 142,774</u> | <u>\$ 311,830</u> | <u>\$ 302,510</u> |

Contract Costs

We pay commissions to third-party sales agents for certain sales that they obtain for us. However, the bases of the commissions are the transaction prices of the sales, which are completed in less than one year; thus, no relationship is established with a customer that will result in future business. Therefore, we do not recognize any portion of these sales commissions as costs of obtaining a contract, nor do we currently foresee other circumstances under which we would recognize such assets.

Remaining Performance Obligations

As we are typically required to fulfill customer orders within a short time period, our backlog of orders is generally not in excess of one to two weeks for IC photomasks and two to three weeks for FPD photomasks. As allowed under Topic 606, we have elected not to disclose our remaining performance obligations, which represent the costs associated with the completion of the manufacturing process of in-process photomasks related to contracts that have an original duration of one year or less.

Product Warranties

Our photomasks are sold under warranties that generally range from one to twenty-four months. We warrant that our photomasks conform to customer specifications, and will typically repair, replace, or issue a refund for any photomasks that fail to do so. The warranties do not represent separate performance obligations in our revenue contracts. Historically, customer claims under warranties have been immaterial.

NOTE 8 - LEASES

Our involvement in lease arrangements has typically been as a lessee. We determine if an agreement is or contains a lease on the date of the lease agreement or commitment, if earlier. Our evaluation considers whether the arrangement includes an identified asset and whether it affords us the right to control the asset. Our having the right to control the identified asset is determined by whether we are entitled to substantially all of its economic benefits and can direct its use.

We recognize leases on our consolidated balance sheet when a lessor makes an asset underlying a lease having a term in excess of twelve months available for our use. As allowed under ASC Topic 842 – “Leases” (“Topic 842”), we have elected to not apply the recognition requirements to leases that, at their commencement dates, have lease terms of twelve months or less and do not include options to purchase their underlying assets that we are reasonably certain to exercise. The present value of lease payments over the term of the lease provides the basis for the initial measurement of right-of-use assets and their related lease liabilities. Finance lease liabilities are determined using the rates implicit in the leases and operating lease liabilities are determined using our incremental borrowing rate, for collateralized loans, at the commencement date. Variable lease payments, other than those that are dependent on an index or on a rate, are not included in the measurement of ROU assets and their related lease liabilities. Lease terms will include extension periods if the lease agreement includes an option to extend the lease that we are reasonably certain to exercise. As allowed under Topic 842 we have elected, for all classes of assets, the practical expedient to not separate lease components of a contract from nonlease components of a contract.

In February 2021, we entered into a five-year \$7.2 million finance lease for a high-end inspection tool. Monthly payments on the lease, which commenced in February 2021, are \$0.1 million per month. Upon the payment of the fiftieth monthly payment and prior to payment of the fifty-first monthly payment, we may exercise an early buyout option to purchase the tool at 33.684638% of its original cost. If we do not exercise the early buyout option, then at the end of the five-year lease term, the lease shall continue to renew on a month-to-month basis at the same rental; at our option, after the original term or any renewal periods, we may return the tool, elect to extend the lease, or purchase the tool at its fair market value. Since we are reasonably certain that we will exercise the early buyout option, our lease liability reflects such exercise and we have classified the lease as a finance lease. The interest rate implicit in the lease is 1.08%.

In December 2020, we entered into a five-year \$35.5 million finance lease for a high-end lithography tool. Monthly payments on the lease, which commenced in January 2021, increased from \$0.04 million after the first three months to \$0.6 million for the following nine months, followed by forty-eight monthly payments of \$0.5 million. As of the due date of the forty-eighth monthly payment, we may exercise an early buyout option to purchase the tool at 39.84% of the initial lease liability. If we do not exercise the early buyout option, then at the end of the five-year lease term, at our option, we may return the tool, elect to extend the lease term for a period and a lease payment to be agreed with lessor at the time, or purchase the tool for its then-fair market value as determined by the lessor. Since we are reasonably certain that we will exercise the early buyout option, our lease liability reflects such exercise and we have classified the lease as a finance lease. The interest rate implicit in the lease is 1.58%. The lease agreement incorporates the covenants included in our Corporate Credit Agreement, which are detailed in Note 6, and includes a cross-default provision for any agreement or instrument with an outstanding, committed balance greater than \$5.0 million in which we are the indebted party.

The following table provides information on operating and finance leases included in our consolidated balance sheets.

| Classification | May 2, 2021 | October 31, 2020 |
|---|------------------------|-----------------------------|
| ROU Assets – Operating Leases | | |
| Other assets | \$ 6,967 | \$ 7,706 |
| ROU Assets – Finance Leases | | |
| Property, plant and equipment, net | \$ 42,248 | \$ - |
| Lease Liabilities – Operating Leases | | |
| Accrued liabilities | \$ 2,281 | \$ 2,175 |
| Other liabilities | 4,326 | 5,008 |
| | <u>\$ 6,607</u> | <u>\$ 7,183</u> |
| Lease Liabilities – Finance Leases | | |
| Current portion of long-term debt | \$ 7,531 | \$ - |
| Long-term debt | 34,301 | - |
| | <u>\$ 41,832</u> | <u>\$ -</u> |

The following table presents future lease payments under noncancelable operating and finance leases as of May 2, 2021. Imputed interest represents the difference between undiscounted cash flows and discounted cash flows.

| | Operating Leases | Finance Leases |
|-------------------------------|-------------------------|-----------------------|
| Remainder of fiscal year 2021 | \$ 1,194 | \$ 4,348 |
| 2022 | 2,342 | 7,231 |
| 2023 | 1,357 | 6,938 |
| 2024 | 803 | 6,938 |
| 2025 | 647 | 18,012 |
| Thereafter | 559 | - |
| Total lease payments | 6,902 | 43,467 |
| Imputed interest | 295 | 1,635 |
| Lease liabilities | <u>\$ 6,607</u> | <u>\$ 41,832</u> |

The following table presents lease costs for the three and six-month periods ended May 2, 2021 and May 3, 2020.

| | Three Months Ended | | Six Months Ended | |
|-------------------------------|---------------------------|------------------------|-------------------------|------------------------|
| | May 2, 2021 | May 3, 2020 | May 2, 2021 | May 3, 2020 |
| Operating lease costs | \$ 724 | \$ 633 | \$ 1,389 | \$ 1,797 |
| Short-term lease costs | \$ 39 | \$ 102 | \$ 86 | \$ 212 |
| Variable lease costs | \$ 157 | \$ 129 | \$ 301 | \$ 129 |
| Interest on lease liabilities | \$ 166 | \$ - | \$ 201 | \$ - |
| Amortization of ROU assets | \$ 455 | \$ - | \$ 455 | \$ - |

Presented below is statistical information related to our operating and finance leases. The information presented is as of the balance sheet dates.

| Classification | May 2, 2021 | | October 31, 2020 | |
|-----------------------|---|---|---|---|
| | Weighted-average remaining lease term (in years) | Weighted-average discount rate | Weighted-average remaining lease term (in years) | Weighted-average discount rate |
| Operating leases | 3.7 | 2.37% | 4.1 | 2.37% |
| Finance leases | 3.7 | 1.50% | - | - |

Supplemental cash flows information:

| | Three Months Ended | | Six Months Ended | |
|---|---------------------------|------------------------|-------------------------|------------------------|
| | May 2, 2021 | May 3, 2020 | May 2, 2021 | May 3, 2020 |
| Operating cash flows used for operating leases | \$ 627 | \$ 502 | \$ 1,229 | \$ 2,387 |
| Operating cash flows used for finance leases | \$ 166 | \$ - | \$ 201 | \$ - |
| Financing cash flows used for finance leases | \$ 864 | \$ - | \$ 864 | \$ - |
| ROU assets obtained in exchange for operating lease obligations | \$ 99 | \$ 58 | \$ 367 | \$ 340 |
| ROU assets obtained in exchange for finance lease obligations | \$ 7,200 | \$ - | \$ 42,672 | \$ - |

NOTE 9 - SHARE-BASED COMPENSATION

In March 2016, shareholders approved a new equity incentive compensation plan (the "Plan"), under which incentive stock options, non-qualified stock options, stock grants, stock-based awards, restricted stock, restricted stock units, stock appreciation rights, performance units, performance stock, and other stock or cash awards may be granted. Shares to be issued under the Plan may be authorized and unissued shares, issued shares that have been reacquired by us (in the open market or in private transactions) and are being held in the treasury, or a combination thereof. The maximum number of shares of common stock approved that may be issued under the Plan is four million shares. Awards may be granted to officers, employees, directors, consultants, advisors, and independent contractors of Photronics or its subsidiaries. In the event of a change in control (as defined in the Plan), the vesting of awards may be accelerated. The Plan, aspects of which are more fully described below, prohibits further awards from being issued under prior plans. Total share-based compensation costs for the three and six-month periods ended May 2, 2021, were \$1.4 million and \$2.7 million, respectively, and \$1.2 million and \$2.6 million for the three and six-month periods ended May 3, 2020, respectively. No share-based compensation cost was capitalized as part of an asset during the periods presented, and related income tax benefits were \$0.1 million in the three and six-month periods ended May 2, 2021, and immaterial in the prior year periods.

Restricted Stock

We periodically grant restricted stock awards, the restrictions on which typically lapse over a service period of one to four years. The fair value of the awards is determined on the date of grant, based on the closing price of our common stock. There were 15,000 restricted stock awards granted during the three-month period ended May 2, 2021, with a weighted-average grant-date fair value of \$12.65 per share, and there were 556,200 restricted stock awards granted during the six-month period ended May 2, 2021, with a weighted-average grant-date fair value of \$11.17 per share. There were 5,000 restricted stock awards granted during the three-month period ended May 3, 2020, with a grant-date fair value of \$9.90 per share, and there were 527,000 restricted stock awards granted during the six-month period ended May 3, 2020, with a grant-date fair value of \$15.21 per share. As of May 2, 2021, the total compensation cost not yet recognized related to unvested restricted stock awards was approximately \$9.8 million. That cost is expected to be recognized over a weighted-average amortization period of 2.9 years. As of May 2, 2021, there were 1,022,327 shares of restricted stock outstanding.

Stock Options

Option awards generally vest in one to four years, and have a ten-year contractual term. All incentive and non-qualified stock option grants must have an exercise price no less than the market value of the underlying common stock on the date of grant. The grant-date fair values of options are based on closing prices of our common stock on the dates of grant and are calculated using the Black-Scholes option pricing model. Expected volatility is based on the historical volatility of our common stock. We use historical option exercise behavior and employee termination data to estimate expected term, which represents the period of time that options are expected to remain outstanding. The risk-free rate of return for the estimated term of the option is based on the U.S. Treasury yield curve in effect at the date of grant.

There were no share options granted during the six-month periods ended May 2, 2021 or May 3, 2020. The Company received cash from option exercises of \$0.3 million and \$1.0 million for the three and six-month periods ended May 2, 2021, respectively, and \$0.4 million and \$3.2 million for the three and six-month periods ended May 3, 2020, respectively. As of May 2, 2021, the total unrecognized compensation cost related to unvested option awards was approximately \$0.2 million. That cost is expected to be recognized over a weighted-average amortization period of 1.4 years.

Information on outstanding and exercisable option awards as of May 2, 2021, is presented below.

| Options | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (in years) | Aggregate Intrinsic Value |
|----------------------------|-----------|--|--|---------------------------------|
| Outstanding at May 2, 2021 | 1,479,264 | \$ 9.39 | 4.3 years | \$ 4,894 |
| Exercisable at May 2, 2021 | 1,369,187 | \$ 9.40 | 4.1 years | \$ 4,511 |

NOTE 10 - INCOME TAXES

We calculate our provision for income taxes at the end of each interim reporting period on the basis of an estimated annual effective tax rate adjusted for tax items that are discrete to each period.

The effective tax rate of 18.5% in the three-month period end May 2, 2021, differs from the U.S. statutory rate of 21% primarily due to changes in forecasted jurisdictional earnings.

The effective tax rate of 20.5% differs from the U.S. statutory rate of 21.0% in the six-month period ended May 2, 2021, primarily due to changes in forecasted jurisdictional earnings, the benefits of investment credits in certain foreign jurisdictions, which were partially offset by the non-recognition of taxes or benefits that, in certain jurisdictions, have been offset by valuation allowances.

The effective tax rate of 32.2% exceeds the U.S. statutory rate of 21.0% in the three-month period ended May 3, 2020, primarily due to the non-recognition of the tax benefit of losses that, in certain jurisdictions, have been offset by valuation allowances, which were partially offset by the benefit of tax holidays and investment credits in certain foreign jurisdictions.

The effective tax rate of 40.5% exceeds the U.S. statutory rate of 21.0% in the six-month period ended May 3, 2020, primarily due to the non-recognition of the tax benefit of losses that, in certain jurisdictions, have been offset by valuation allowances, and the establishment of a valuation allowance for a loss carryforward in a non-U.S. jurisdiction, which were partially offset by the benefits of tax holidays and investment credits in certain foreign jurisdictions.

Valuation allowances, in jurisdictions with historic losses, eliminate the current tax benefit of losses in these jurisdictions where, based on the weight of information available to us, we determined that it is more likely than not that the tax benefits will not be realized. In the six-month period ended May 3, 2020, as a result of the reassessment of the aforementioned available information, we established a valuation allowance of \$2.1 million against a non-U.S. based loss-carryforward deferred tax asset that is not more likely than not to be realized.

Unrecognized tax benefits related to uncertain tax positions were \$2.8 million and \$2.7 million at May 2, 2021 and October 31, 2020, respectively, of which \$2.0 million, if recognized, would favorably impact the Company's effective tax rate. Accrued interest and penalties related to unrecognized tax benefits was \$0.1 million at May 2, 2021 and October 31, 2020. Although the timing of the expirations of statutes of limitations may be uncertain, as they can be dependent upon the settlement of tax audits, the Company believes the amount of uncertain tax positions (including interest and penalties, and net of tax benefits) that may be resolved over the next twelve months is immaterial. Resolution of these uncertain tax positions may result from either or both the lapses of statutes of limitations and tax settlements. The Company is no longer subject to tax authority examinations in the U.S. and major foreign or state jurisdictions for years prior to fiscal year 2015.

We were granted a five-year tax holiday in Taiwan that expired on December 31, 2019. This tax holiday reduced foreign taxes by \$0.1 million in the six-month period ended May 3, 2020; per share impact was immaterial.

NOTE 11 - EARNINGS PER SHARE

The calculation of basic and diluted earnings per share is presented below.

| | Three Months Ended | | Six Months Ended | |
|--|---------------------------|------------------------|-------------------------|------------------------|
| | May 2, 2021 | May 3, 2020 | May 2, 2021 | May 3, 2020 |
| Net income attributable to Photronics, Inc. shareholders | \$ 10,526 | \$ 6,284 | \$ 18,562 | \$ 16,584 |
| Effect of dilutive securities | - | - | - | - |
| Earnings used for diluted earnings per share | <u>\$ 10,526</u> | <u>\$ 6,284</u> | <u>\$ 18,562</u> | <u>\$ 16,584</u> |
| Weighted-average common shares computations: | | | | |
| Weighted-average common shares used for basic earnings per share | 62,054 | 64,937 | 62,265 | 65,246 |
| Effect of dilutive securities: | | | | |
| Share-based payment awards | <u>514</u> | <u>480</u> | <u>521</u> | <u>687</u> |
| Potentially dilutive common shares | <u>514</u> | <u>480</u> | <u>521</u> | <u>687</u> |
| Weighted-average common shares used for diluted earnings per share | <u>62,568</u> | <u>65,417</u> | <u>62,786</u> | <u>65,933</u> |
| Basic earnings per share | \$ 0.17 | \$ 0.10 | \$ 0.30 | \$ 0.25 |
| Diluted earnings per share | \$ 0.17 | \$ 0.10 | \$ 0.30 | \$ 0.25 |

The table below illustrates the outstanding weighted-average share-based payment awards that were excluded from the calculation of diluted earnings per share because their exercise prices exceeded the average market value of the common shares for the period or, under application of the treasury stock method, they were otherwise determined to be antidilutive.

| | Three Months Ended | | Six Months Ended | |
|--|---------------------------|------------------------|-------------------------|------------------------|
| | May 2, 2021 | May 3, 2020 | May 2, 2021 | May 3, 2020 |
| Share-based payment awards | <u>293</u> | <u>1,009</u> | <u>559</u> | <u>591</u> |
| Total potentially dilutive shares excluded | <u>293</u> | <u>1,009</u> | <u>559</u> | <u>591</u> |

Subsequent to May 2, 2021, our outstanding common stock was reduced by a net 0.7 million shares, primarily as a result of share repurchases. Please refer to Note 14 for information on our share repurchase programs.

NOTE 12 - CHANGES IN ACCUMULATED OTHER COMPREHENSIVE INCOME BY COMPONENT

The following tables set forth the changes in our accumulated other comprehensive income by component (net of tax of \$0) for the three and six-month periods ended May 2, 2021 and May 3, 2020.

| | Three Months Ended May 2, 2021 | | |
|---|---------------------------------------|-----------------|------------------|
| | Foreign Currency | | |
| | Translation Adjustments | Other | Total |
| Balance at January 31, 2021 | \$ 32,900 | \$ (871) | \$ 32,029 |
| Other comprehensive income | 3,778 | 21 | 3,799 |
| Less: other comprehensive income attributable to noncontrolling interests | 626 | 10 | 636 |
| Balance at May 2, 2021 | <u>\$ 36,052</u> | <u>\$ (860)</u> | <u>\$ 35,192</u> |

| | Three Months Ended May 3, 2020 | | |
|---|---------------------------------------|-----------------|--------------------|
| | Foreign Currency | | |
| | Translation Adjustments | Other | Total |
| Balance at February 2, 2020 | \$ (11,076) | \$ (666) | \$ (11,742) |
| Other comprehensive (loss) income | (2,405) | 1 | (2,404) |
| Less: other comprehensive income attributable to noncontrolling interests | 1,054 | - | 1,054 |
| Balance at May 3, 2020 | <u>\$ (14,535)</u> | <u>\$ (665)</u> | <u>\$ (15,200)</u> |

| | Six Months Ended May 2, 2021 | | |
|---|-------------------------------------|-----------------|------------------|
| | Foreign Currency | | |
| | Translation Adjustments | Other | Total |
| Balance at October 31, 2020 | \$ 18,828 | \$ (870) | \$ 17,958 |
| Other comprehensive income | 22,066 | 21 | 22,087 |
| Less: other comprehensive income attributable to noncontrolling interests | 4,842 | 11 | 4,853 |
| Balance at May 2, 2021 | <u>\$ 36,052</u> | <u>\$ (860)</u> | <u>\$ 35,192</u> |

| | Six Months Ended May 3, 2020 | | |
|---|-------------------------------------|-----------------|--------------------|
| | Foreign Currency | | |
| | Translation Adjustments | Other | Total |
| Balance at October 31, 2019 | \$ (8,331) | \$ (674) | \$ (9,005) |
| Other comprehensive (loss) income | (3,970) | 19 | (3,951) |
| Less: other comprehensive income attributable to noncontrolling interests | 2,234 | 10 | 2,244 |
| Balance at May 3, 2020 | <u>\$ (14,535)</u> | <u>\$ (665)</u> | <u>\$ (15,200)</u> |

NOTE 13 - FAIR VALUE MEASUREMENTS

The accounting framework for determining fair value includes a hierarchy for ranking the quality and reliability of the information used to measure fair value, which enables the reader of the financial statements to assess the inputs used to develop those measurements. The fair value hierarchy consists of three tiers as follows: Level 1, defined as quoted market prices (unadjusted) in active markets for identical securities; Level 2, defined as inputs other than Level 1 that are observable, either directly or indirectly; and Level 3, defined as unobservable inputs that are not corroborated by market data.

The fair values of our cash and cash equivalents (Level 1 measurements), accounts receivable, accounts payable, and certain other current assets and current liabilities (Level 2 measurements) approximate their carrying values due to their short-term maturities. The fair values of our variable rate debt instruments are a Level 2 measurement and approximate their carrying values due to the variable nature of the underlying interest rates. We did not have any assets or liabilities measured at fair value, on a recurring or a nonrecurring basis, at May 2, 2021 or October 31, 2020.

NOTE 14 - SHARE REPURCHASE PROGRAMS

In September 2020, the Company's board of directors authorized the repurchase of up to \$100 million of its common stock, pursuant to a repurchase plan under Rule 10b5-1 of the Securities Act. The company commenced repurchasing shares under this authorization on September 16, 2020. All of the 1.7 million shares repurchased under this authorization prior to November 1, 2020, were retired in fiscal 2020; the table below presents information on this repurchase program.

| | Three Months Ended May 2, 2021 | Six Months Ended May 2, 2021 | From Inception Date of September 16, 2020 |
|------------------------------|---|---|--|
| Number of shares repurchased | 797 | 2,019 | 3,750 |
| Cost of shares repurchased | \$ 10,041 | \$ 23,250 | \$ 40,750 |
| Average price paid per share | \$ 12.59 | \$ 11.51 | \$ 10.87 |

In August 2019, the Company's board of directors authorized the repurchase of up to \$100 million of its common stock, pursuant to a repurchase plan under Rule 10b5-1 of the Securities Act. This repurchase program was terminated in March of 2020. All of the shares repurchased under this program have been retired. The table below presents information on this repurchase program.

| | Three Months Ended May 3, 2020 | Six Months Ended May 3, 2020 | From Inception Date of September 25, 2019 |
|------------------------------|---|---|--|
| Number of shares repurchased | 549 | 1,464 | 2,460 |
| Cost of shares repurchased | \$ 5,894 | \$ 16,894 | \$ 27,894 |
| Average price paid per share | \$ 10.75 | \$ 11.54 | \$ 11.34 |

NOTE 15 - COMMITMENTS AND CONTINGENCIES

As of May 2, 2021, the Company had commitments outstanding for capital expenditures of approximately \$31.9 million, primarily for purchases of high-end equipment.

The Company's wholly owned subsidiary in South Korea has been involved in litigation regarding a 2016 informational tax filing for its non-South Korean bank accounts that was not timely made under a then recently issued presidential decree. A fine (based solely on the amount in such accounts) in the amount of \$2.2 million was assessed against our subsidiary. Our subsidiary appealed the fine on the grounds that it was not required to make the tax filing, and such appeal was pursued up to the Supreme Court in South Korea. Under South Korean law, the tax authorities were entitled to pursue the matter in both civil and criminal courts simultaneously, with the proviso that any criminal fine imposed would act to dismiss any civil fine. The prosecutor recommended a fine of \$0.03 million. The civil matter has subsequently been dismissed. Photonics was notified on March 12, 2020, that the Supreme Court rendered a decision against our subsidiary on the issue of whether our subsidiary was required to make the tax filing and remanded the case to the appellate court for determination of the fine. Prior to the Supreme Court decision, our assessment was that the possibility of a fine was deemed remote, based on advice of local counsel and the subsequent judgments in the lower courts having been in our favor. Our estimate of the possible range of loss is \$0.03 million to \$2.2 million with the most likely amount being \$0.03 million. Accordingly, during the three-month period ended May 3, 2020, we accrued a contingent loss of \$0.03 million. It is reasonably possible that the estimated loss will change in the near term. Our maximum exposure to loss in excess of amounts accrued is \$2.17 million. The imposition of the fine will not have a material impact on our financial position or financial performance.

We are subject to various other claims that arise in the ordinary course of business. We believe that our potential liability under such claims, individually or in the aggregate, will not have a material effect on the consolidated financial statements.

NOTE 16 - RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Standards Updates Adopted

In June 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses", the main objective of which is to provide more useful information about expected credit losses on financial instruments and other commitments of an entity to extend credit. In support of this objective, the ASU replaced the incurred loss impairment methodology, found in previous guidance, with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This ASU requires a cumulative-effect adjustment as of the beginning of the first reporting period in which the guidance is adopted. ASU 2016-13 was effective for Photonics in its first quarter of fiscal year 2021. We adopted ASU 2016-13 on November 1, 2020; the effect of the adoption was immaterial.

Accounting Standards Updates to Be Adopted

In March 2020, the FASB issued ASU 2020-04, "Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting", which provides optional expedients and exceptions to applying the guidance on contract modifications, hedge accounting, and other transactions, to simplify the accounting for transitioning from LIBOR, and other interbank offered rates expected to be discontinued, to alternative reference rates. The guidance in this Update was effective upon its issuance; if elected, it is to be applied prospectively through December 31, 2022. We are currently evaluating the effect the potential adoption of this ASU will have on our consolidated financial statements.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Management's discussion and analysis ("MD&A") of the Company's financial condition, results of operations and outlook should be read in conjunction with its condensed consolidated financial statements and related notes. Various segments of this MD&A contain forward-looking statements, all of which are presented based on current expectations, which may be adversely affected by uncertainties and risk factors (presented throughout this filing and in the Company's Form 10-K for fiscal 2020), that may cause actual results to materially differ from these expectations.

We sell substantially all of our photomasks to semiconductor designers and manufacturers, and manufacturers of FPDs. Photomask technology is also being applied to the fabrication of other higher-performance electronic products such as photonics, microelectronic mechanical systems and certain nanotechnology applications. Our selling cycle is tightly interwoven with the development and release of new semiconductor and display designs and applications, particularly as they relate to the semiconductor industry's migration to more advanced product innovation, design methodologies, and fabrication processes. The demand for photomasks primarily depends on design activity rather than sales volumes from products manufactured using photomask technologies. Consequently, an increase in semiconductor or display sales does not necessarily result in a corresponding increase in photomask sales. However, the reduced use of customized ICs, reductions in design complexity, other changes in the technology or methods of manufacturing or designing semiconductors, or a slowdown in the introduction of new semiconductor or display designs could reduce demand for photomasks – even if the demand for semiconductors and displays increases. Advances in semiconductor, display, and photomask design and production methods that shift the burden of achieving device performance away from lithography could also reduce the demand for photomasks. Historically, the microelectronic industry has been volatile, experiencing periodic downturns and slowdowns in design activity. These downturns have been characterized by, among other things, diminished product demand, excess production capacity, and accelerated erosion of selling prices, with a concomitant effect on revenue and profitability.

We are typically required to fulfill customer orders within a short period of time after receipt of an order, sometimes within twenty-four hours. This results in a minimal level of backlog orders, typically one to two weeks of backlog for IC photomasks and two to three weeks of backlog for FPD photomasks.

The global semiconductor and FPD industries are driven by end markets which have been closely tied to consumer-driven applications of high-performance devices, including, but not limited to, mobile display devices, mobile communications, and computing solutions. While we cannot predict the timing of the industry's transition to volume production of next-generation technology nodes, or the timing of up and down-cycles with precise accuracy, we believe that such transitions and cycles will continue into the future, beneficially and adversely affecting our business, financial condition, and operating results as they occur. We believe our ability to remain successful in these environments is dependent upon the achievement of our goals of being a service and technology leader and efficient solutions supplier, which we believe should enable us to continually reinvest in our global infrastructure.

Recent Developments

In the second quarter of fiscal 2021, we entered into a five-year \$7.2 million finance lease for a high-end inspection tool. Monthly payments on the lease, which commenced in February 2021, are \$0.1 million per month. Upon the payment of the fiftieth monthly payment and prior to payment of the fifty-first monthly payment, we may exercise an early buyout option to purchase the tool at 33.684638% of its original cost. If we do not exercise the early buyout option, then at the end of the five-year lease term, the lease shall continue to renew on a month-to-month basis at the same rental terms; at our option, after the original term or any renewal periods, we may return the tool, elect to extend the lease, or purchase the tool at its fair market value. Since we are reasonably certain that we will exercise the early buyout option, our lease liability reflects such exercise and we have classified the lease as a finance lease. The interest rate implicit in the lease is 1.08%.

In the first quarter of fiscal 2021, we entered into a five-year \$35.5 million finance lease for a high-end lithography tool. Monthly payments on the lease, which commenced in January 2021, increased from \$0.04 million after the first three months to \$0.6 million for the following nine months, followed by forty-eight monthly payments of \$0.5 million. As of the due date of the forty-eighth monthly payment, we may exercise an early buyout option to purchase the tool at 39.84% of the initial lease liability. If we do not exercise the early buyout option, then at the end of the five-year lease term, at our option, we may return the tool, elect to extend the lease term for a period and a lease payment to be agreed with lessor at the time, or purchase the tool for its then-fair market value as determined by the lessor. Since we are reasonably certain that we will exercise the early buyout option, our lease liability reflects such exercise and we have classified the lease as a finance lease. The interest rate implicit in the lease is 1.58%. The lease agreement incorporates the covenants included in our Corporate Credit Agreement, which are detailed in Note 6, and includes a cross-default provision for any agreement or instrument with an outstanding, committed balance greater than \$5.0 million in which we are the indebted party.

For further information, refer to Item 7 in our Form [10-K for the year ended October 31, 2020](#).

Results of Operations**Three and Six Months Ended May 2, 2021**

The following table presents selected operating information expressed as a percentage of revenue. The columns may not foot due to rounding.

| | Three Months Ended | | | Six Months Ended | |
|--|---------------------------|-----------------------------|------------------------|-------------------------|------------------------|
| | May 2, 2021 | January 31, 2021 | May 3, 2020 | May 2, 2021 | May 3, 2020 |
| Revenue | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of goods sold | 75.4 | 79.9 | 78.7 | 77.6 | 78.5 |
| Gross profit | 24.6 | 20.1 | 21.3 | 22.4 | 21.5 |
| Selling, general and administrative expenses | 8.8 | 9.2 | 9.3 | 9.0 | 9.2 |
| Research and development expenses | 2.7 | 3.1 | 3.1 | 2.9 | 2.7 |
| Operating income | 13.0 | 7.7 | 8.9 | 10.4 | 9.6 |
| Other income (expense), net | (0.5) | 0.4 | (0.7) | - | 0.9 |
| Income before income tax provision | 12.5 | 8.2 | 8.2 | 10.4 | 10.5 |
| Income tax provision | 2.3 | 1.9 | 2.6 | 2.1 | 4.3 |
| Net income | 10.2 | 6.3 | 5.6 | 8.3 | 6.2 |
| Net income attributable to noncontrolling interests | 3.6 | 1.0 | 1.2 | 2.3 | 0.7 |
| Net income attributable to Photronics, Inc. shareholders | 6.6% | 5.3% | 4.4% | 6.0% | 5.5% |

Note: All tabular comparisons included in the following discussion, unless otherwise indicated, are for the three months ended May 2, 2021 (Q2 FY21), January 31, 2021 (Q1 FY21) and May 3, 2020 (Q2 FY20), and for the six months ended May 2, 2021 (YTD FY21) and May 3, 2020 (YTD FY20), in millions of dollars. The columns may not foot due to rounding.

Revenue

Our quarterly revenues can be affected by the seasonal purchasing practices of our customers. As a result, demand for our products is typically reduced during the first, and sometimes the second, quarters of our fiscal year, by the North American, European, and Asian holiday periods, as some of our customers reduce their development and, consequently, their buying activities during those periods.

The following tables present changes in disaggregated revenue in Q2 FY21 and YTD FY21 from revenue in prior reporting periods.

Quarterly Changes in Revenue by Product Type

| | Q2 FY21 from Q1 FY21 | | | Q2 FY21 from Q2 FY20 | | YTD FY21 from YTD FY20 | | |
|---------------|----------------------|---------------------|----------------|----------------------|----------------|------------------------|---------------------|----------------|
| | Revenue in Q2 FY21 | Increase (Decrease) | Percent Change | Increase (Decrease) | Percent Change | Revenue in YTD FY21 | Increase (Decrease) | Percent Change |
| IC | | | | | | | | |
| High-end * | \$ 41.3 | \$ 4.5 | 12.2% | \$ 3.0 | 7.8% | \$ 78.0 | \$ (1.3) | (1.6)% |
| Mainstream | 70.7 | 2.6 | 3.8% | 12.2 | 20.7% | 138.9 | 14.4 | 11.6% |
| Total IC | \$ 112.0 | \$ 7.0 | 6.7% | \$ 15.1 | 15.6% | \$ 216.9 | \$ 13.1 | 6.4% |
| FPD | | | | | | | | |
| High-end * | \$ 39.4 | \$ 4.8 | 13.7% | \$ 7.6 | 23.9% | \$ 74.0 | \$ 2.5 | 3.4% |
| Mainstream | 8.4 | (4.1) | (32.9)% | (5.7) | (40.7)% | 20.8 | (6.3) | (23.1)% |
| Total FPD | \$ 47.8 | \$ 0.7 | 1.4% | \$ 1.8 | 4.0% | \$ 94.9 | \$ (3.8) | (3.9)% |
| Total Revenue | \$ 159.8 | \$ 7.7 | 5.1% | \$ 17.0 | 11.9% | \$ 311.8 | \$ 9.3 | 3.1% |

* High-end photomasks typically have higher average selling prices (ASPs) than mainstream products.

Quarterly Changes in Revenue by Geographic Origin

| | Q2 FY21 from Q1 FY21 | | | Q2 FY21 from Q2 FY20 | | YTD FY21 from YTD FY20 | | |
|---------------|----------------------|---------------------|----------------|----------------------|----------------|------------------------|---------------------|----------------|
| | Revenue in Q2 FY21 | Increase (Decrease) | Percent Change | Increase (Decrease) | Percent Change | Revenue in YTD FY21 | Increase (Decrease) | Percent Change |
| Taiwan | \$ 59.0 | \$ 2.4 | 4.3% | \$ 3.5 | 6.3% | \$ 115.6 | \$ (6.0) | (5.0)% |
| Korea | 40.2 | 1.5 | 3.8% | 4.0 | 11.0% | 79.0 | 2.0 | 2.6% |
| United States | 27.1 | 0.5 | 2.1% | 2.3 | 9.2% | 53.8 | 3.8 | 7.7% |
| China | 23.7 | 2.7 | 13.0% | 6.2 | 35.7% | 44.7 | 7.3 | 19.6% |
| Europe | 9.3 | 0.7 | 7.9% | 0.9 | 11.1% | 17.8 | 2.0 | 12.3% |
| Other | 0.4 | (0.1) | (25.5)% | 0.1 | 18.3% | 0.9 | 0.2 | 28.8% |
| Total Revenue | \$ 159.8 | \$ 7.7 | 5.1% | \$ 17.0 | 11.9% | \$ 311.8 | \$ 9.3 | 3.1% |

Revenue increased 5.1% in Q2 FY21, compared with Q1 FY21, primarily driven by increased demand for high-end FPD, including AMOLED and LTPS, and IC logic photomasks, and higher pricing for some mainstream IC nodes. These growth factors were somewhat moderated by lower revenue from mainstream FPD photomasks as we focused production on high-end FPD products.

Revenue increased 11.9% in Q2 FY21, compared with Q2 FY20, primarily driven by the same factors discussed above, as growth in IC and high-end FPD, was partially offset by declines in mainstream FPD photomasks.

Revenue increased 3.1% in YTD FY21, compared with YTD FY20, primarily driven by mainstream IC, due to higher demand and improved pricing, and high-end FPD, as a result of higher demand for mobile displays. These increases were partially offset by lower high-end IC and mainstream FPD.

Gross Margin

| | <u>Q2 FY21</u> | <u>Q1 FY21</u> | <u>Percent Change</u> | <u>Q2 FY20</u> | <u>Percent Change</u> | <u>YTD FY21</u> | <u>YTD FY20</u> | <u>Percent Change</u> |
|--------------|----------------|----------------|-----------------------|----------------|-----------------------|-----------------|-----------------|-----------------------|
| Gross profit | \$ 39.2 | \$ 30.5 | 28.6% | \$ 30.4 | 29.0% | \$ 69.8 | \$ 65.0 | 7.3% |
| Gross margin | 24.6% | 20.1% | | 21.3% | | 22.4% | 21.5% | |

Gross margin increased by 4.5 percentage points in Q2 FY21, from Q1 FY21, as a result of the increase in revenue from the prior quarter. Material costs were essentially unchanged from the prior quarter despite the increase in revenue, as a result, material costs, as a percentage of revenue, decreased 150 basis points. Labor remained flat, but as a percentage of revenue, fell 70 basis points. Equipment and other overhead costs decreased 1.7%, or 230 basis points as a percentage of revenue, with reduced outsourced manufacturing costs most significantly contributing to the decline.

Gross margin increased by 3.3 percentage points in Q2 FY21, from Q2 FY20, primarily due to the 11.9% increase in revenue from the prior year quarter. Material costs increased 10.0% from the prior year quarter, with the largest increase occurring at our China-based IC facility, where the increase was in line with that facility's increased revenue. Globally, material costs, as a percentage of revenue, decreased 50 basis points. Labor costs increased 17.6% from the prior year quarter, but only represented a 60 basis point increase, as a percent of revenue, while equipment and other overhead costs rose moderately at 1.9%, but fell 330 basis points as a percentage of revenue. Increased equipment service contract costs were the most significant contributor to the rise in equipment and other overhead costs.

Gross margin increased by 0.9 percentage points in YTD FY21, from YTD FY20, primarily as a result of the 3.1% increase in revenue from the prior year period. Material costs increased 3.1% from the prior year period, but were unchanged as a percentage of revenue. Labor costs increased 11.5% from the prior year, but only 90 basis points when compared to revenue. Equipment and other overhead costs decreased 2.0%, or 180 basis points as a percentage of revenue, with reduced outsourced manufacturing costs most significantly contributing to the decline.

As we operate in a high fixed cost environment, increases or decreases in our revenues and capacity utilization will generally positively or negatively impact our gross margin.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$14.1 million in Q2 FY21, or unchanged from Q1 FY21 and increased \$0.8 million from Q2 FY20. The increase is primarily the result of increased compensation costs. Selling, general and administrative expenses were \$28.1 million in YTD FY21, as compared with \$27.5 million in YTD FY20. The increase is primarily the result of increased compensation expenses, which were partially offset by decreased travel expenses.

Research and Development Expenses

Research and development expenses, which primarily consist of development efforts related to high-end process technologies for high-end IC and FPD applications, were \$4.4 million in Q2 FY21, compared with \$4.7 million in Q1 FY21 and \$4.5 million in Q2 FY20. Decreased development activities at our Asia-based sites, which were partially offset by increased activities in the U.S., led to the overall decrease from the prior quarter and the prior year quarter. Year over year, research and development expenses increased \$0.5 million, due to an increase in development activities in the U.S. exceeding a decline in such activities in Asia.

Other Income (Expense)

| | <u>Q2 FY21</u> | <u>Q1 FY21</u> | <u>Q2 FY20</u> | <u>YTD FY21</u> | <u>YTD FY20</u> |
|---|-----------------|----------------|-----------------|-----------------|-----------------|
| Foreign currency transactions impact, net | \$ (2.1) | \$ 1.4 | \$ (1.4) | \$ (0.7) | \$ 3.3 |
| Interest expense, net | 1.2 | (0.8) | 0.8 | 0.4 | (1.0) |
| Interest income and other income (expense), net | <u>-</u> | <u>0.1</u> | <u>(0.3)</u> | <u>0.2</u> | <u>0.5</u> |
| Other income (expense), net | <u>\$ (0.8)</u> | <u>\$ 0.7</u> | <u>\$ (1.0)</u> | <u>\$ (0.1)</u> | <u>\$ 2.8</u> |

Other income and expense, net decreased \$1.5 million in Q2 FY21 from Q1 FY21, primarily as a result of less favorable foreign currency exchange movements in China against the U.S. dollar, which were somewhat mitigated by reduced losses against the U.S. dollar in Korea. The \$3.5 million unfavorable foreign currency exchange movement was partially offset by a \$2.0 million favorable change in interest expense that resulted from interest subsidies received in China, which we recognize at the time of their receipt.

Other income and expense, net changed favorably from a loss of \$1.0 million in Q2 FY20 to a loss \$0.8 million in Q2 FY21. The \$0.7 million negative impact of foreign currency transactions was primarily due to unfavorable movements against the U.S. dollar in Korea and against the Japanese yen in Taiwan, which were partially offset by favorable movements against the U.S. dollar and the Japanese yen in China. The \$0.7 million unfavorable change from foreign currency transactions was partially offset by a \$0.4 million favorable change in interest expense that resulted from interest subsidies received in China, which we recognize at the time of their receipt.

Other income and expense, net changed unfavorably from a net other income of \$2.8 million in YTD FY20 to a net other expense of \$0.1 million in YTD FY21. The \$4.0 million negative impact of foreign currency transactions was primarily caused by unfavorable movements against the U.S. dollar in Korea and unfavorable movements against the U. S. dollar and the Japanese yen in Taiwan, which were partially offset by favorable movements against the U.S. dollar in China. The overall unfavorable impact of foreign currency transactions was partially offset by a \$1.4 million favorable change in interest expense that resulted from interest subsidies received in China, which we recognize at the time of their receipt.

Income Tax Provision

| | <u>Q2 FY21</u> | <u>Q1 FY21</u> | <u>Q2 FY20</u> | <u>YTD FY21</u> | <u>YTD FY20</u> |
|---------------------------|----------------|----------------|----------------|-----------------|-----------------|
| Income tax provision | \$ 3.7 | \$ 2.9 | \$ 3.8 | \$ 6.7 | \$ 12.9 |
| Effective income tax rate | 18.5% | 23.6% | 32.2% | 20.5% | 40.5% |

The effective income tax rate is sensitive to the jurisdictional mix of earnings, due, in part, to the non-recognition of tax benefits on losses in jurisdictions with valuation allowances.

The effective income tax rate decrease in Q2 FY21, compared with Q1 FY21, is primarily due to changes in the period to period forecasted mix of jurisdictional earnings.

The effective income tax rate decrease in Q2 FY21, compared with Q2 FY20, is primarily due to an increase in credits in a non-U.S. jurisdiction in Q1 FY21, and the establishment of a valuation allowance for a non-U.S.-based loss carryforward in Q2 FY20.

The effective income tax rate decreased in YTD FY21, compared with YTD FY20, primarily due to the establishment of a valuation allowance for a loss carryforward in a non-U.S. jurisdiction in YTD-FY20, as well as changes in the jurisdictional mix of earnings.

Liquidity and Capital Resources

Cash and cash equivalents totaled \$256.0 million and \$278.7 million as of May 2, 2021 and October 31, 2020 respectively. As of most recent balance sheet date, total cash and cash equivalents included \$182.7 million held by foreign subsidiaries. Our primary sources of liquidity are cash on hand, cash generated from operations and borrowing capacity available from financial institutions. Our corporate credit agreement has a \$50 million borrowing limit, with an expansion capacity to \$100 million. Although we have not accessed funds under our corporate credit facilities since 2011, it continues to afford us financial flexibility. In addition, in China we have approximately \$30.0 million of borrowing capacity for local operations on our various lines of credit. See Item 1. Condensed Consolidated Financial Statements - Notes to Condensed Consolidated Financial statements - Note 6 for additional information.

We continually evaluate alternatives for efficiently funding our capital expenditures and ongoing operations. These reviews may result in our engagement in a variety of financing transactions, in the transfer of cash among subsidiaries, and/or the repatriation of cash to the U.S. The transfer of funds among subsidiaries could be subject to foreign withholding taxes and, in certain jurisdictions, repatriation of these funds to the U.S. may subject them to U.S. state income taxes and/or local country withholding taxes. We believe that our liquidity, including available financing, is sufficient to meet our requirements through the next 12 months and thereafter for the foreseeable future. We continually seek organic and inorganic growth opportunities and stand ready to invest at the appropriate time utilizing our existing liquidity and available borrowing capacity. To support our growth strategy, we continue to invest in manufacturing equipment to expand capacity and enhance capability. We estimate capital expenditures for the full year 2021 to be approximately \$120 million, focused on high end and mainstream point tools to enhance operating capacity and efficiency. As of May 2, 2021, we had outstanding capital commitments of approximately \$32 million and recognized liabilities related to capital equipment purchases of approximately \$23 million. Although payment timing could vary, primarily as a result of the timing of tool installation and testing, we currently estimate that we will fund \$45 million of our total \$55 million committed and recognized obligations for capital expenditures over the next twelve months.

In September 2020, the Company's board of directors authorized the repurchase of up to \$100 million of its common stock, pursuant to a repurchase plan under Rule 10b5-1 of the Securities Act. This authorization does not obligate the Company to repurchase any dollar amount or number of shares of common stock. As of May 2, 2021, our current share repurchase program had approximately \$59.3 million available under its authorization. Depending on market conditions, we may utilize some or all of the remaining approved amount to reacquire additional shares.

Cash Flows

| | Six months ended | |
|---|---------------------------|---------------------------|
| | <u>May 2, 2021</u> | <u>May 3, 2020</u> |
| Net cash provided by operating activities | \$ 58,219 | \$ 61,323 |
| Net cash used in investing activities | \$ (67,898) | \$ (25,006) |
| Net cash used in financing activities | \$ (18,638) | \$ (5,371) |

Operating Activities: Cash provided by operating activities reflects net income adjusted for certain non-cash items, including depreciation and amortization, share-based compensation, and the effects of changes in operating assets and liabilities. The decrease in cash provided by operating activities for the six months ended May 2, 2021 compared to the six months ended May 3, 2020 was primarily due to changes in working capital experienced in Asia, the effects of which were partially offset by an increase in net income.

Investing Activities: Cash flows used for investing activities consists primarily of purchases of property, plant and equipment. For the six months ended May 2, 2021, purchases of property, plant and equipment were \$73.5 million compared to \$30.1 million for the six months ended May 3, 2020 as we increased our tool purchases in the current year primarily in response to market demands in Asia.

Financing Activities: Cash flows used in financing activities consist primarily of share repurchases, proceeds / repayments of debt, and contributions from noncontrolling interests. The increase in cash used in financing activities during the six months ended May 3, 2021 compared to the same period ended May 3, 2020, was primarily driven by \$11.3 million increased proceeds from debt, offset by \$8.2 million increase in debt repayments, \$7.6 million decrease in contributions from noncontrolling interests, and \$6.4 million increased purchases of treasury stock.

In January 2018, Photronics, through its wholly owned Singapore subsidiary, and DNP, through its wholly owned subsidiary "DNP Asia Pacific PTE, Ltd." entered into a joint venture under which DNP obtained a 49.99% interest in our IC business in Xiamen, China. The joint venture, which we refer to as PDMCX, was established to develop and manufacture photomasks for leading edge and advanced generation semiconductors. Under the joint venture's operating agreement, DNP is afforded, under certain circumstances, the right to put its interest in PDMCX to Photronics. These circumstances include disputes regarding the strategic direction of PDMCX that may arise after the initial two-year term of the operating agreement that cannot be resolved between the two parties. As of the date of issuance of this report, DNP had not indicated its intention to exercise this right. In addition, both Photronics and DNP have the option to purchase, or put, their interest from, or to, the other party, should their ownership interest fall below 20% for a period of more than six consecutive months. Under all such circumstances, the sales of ownership interests would be at the exiting party's ownership percentage of the joint venture's net book value, with closing to take place within three business days of obtaining required approvals and clearance. Should DNP exercise an option to put their, or purchase our, interest in PDMCX we may, depending on the relationship of the fair and book value of PDMCX's net assets, incur a loss. As of May 2, 2021, Photronics and DNP each had net investments in PDMCX of \$59.1 million.

Business Outlook

Our demand outlook for both IC and FPD is positive, with growing confidence, as we enter the second half of the year. It appears the trends we have been monitoring over the last few quarters are continuing, and our expectations are solidifying for sequential growth to continue throughout the rest of the year; thus, we are expanding capacity to align with these trends and expand our share of the growing market. As such, while we, as always, caution that our outlook, due to our short backlog (which typically does not exceed two weeks) is limited, we reaffirm our Q4 FY20 expectation for revenue to increase, as a percentage of FY20 revenue, in the high single digits. In addition, we expect margins to continue to improve as revenue growth generally enables contribution margin expansion and we continue to keep costs under control. Additionally, our investment strategy of timing capital expenditures with a robust business environment and customer commitments should minimize negative margin implications from new tools coming online. As a result, we continue to anticipate that operating profit will grow at a rate similar to the 23% increase we experienced in FY20.

Effect of Recent Accounting Pronouncements

See “Item 1. Condensed Consolidated Financial Statements– Notes to Condensed Consolidated Financial Statements – Note 16 – Recent Accounting Pronouncements” for recent accounting pronouncements that may impact our financial reporting.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Exchange Rate Risk

We conduct business in several major international currencies throughout our worldwide operations, and our financial performance may be affected by fluctuations in the exchange rates of these currencies. Changes in exchange rates can positively or negatively affect our reported revenue, operating income, assets, liabilities, and equity. The functional currencies of our Asian subsidiaries are the South Korean won, the New Taiwan dollar, the RMB, and the Singapore dollar. The functional currencies of our European subsidiaries are the British pound and the euro. In addition, we engage in transactions in, and have exposures to, the Japanese yen.

We attempt to minimize our risk of foreign currency transaction losses by producing products in the same country in which the products are sold (thereby generating revenues and incurring expenses in the same currency), and by managing our working capital. However, in some instances, we sell products in a currency other than the functional currency of the country where it was produced, or purchase products in a currency that differs from the functional currency of the purchasing entity. In addition, to the extent practicable, we attempt to reduce our exposure to foreign currency exchange fluctuations by converting cash and cash equivalents into the functional currency of the subsidiary which holds the cash. We may also enter into derivative contracts to mitigate our exposure to foreign currency fluctuations when we have a significant purchase obligation, or a significant receivable denominated in a currency that differs from the functional currency of the transacting subsidiary. We do not enter into derivatives for speculative purposes. There can be no assurance that this approach will protect us from the need to recognize significant foreign currency transaction gains and losses, especially in the event of a significant adverse movement in the value of any foreign currency in which we conduct business against any of our functional currencies, including the U.S. dollar.

Our primary net foreign currency exposures as of May 2, 2021, included the South Korean won, the Japanese yen, the New Taiwan dollar, the Chinese renminbi, the Singapore dollar, the British pound sterling, and the euro. As of that date, a 10% adverse movement in the value of currencies different than the functional currencies of our subsidiaries would have resulted in a net unrealized pre-tax loss of \$34.5 million, which represents an increase of \$2.0 million and \$2.6 million from our exposures at January 31, 2021 and October 31, 2020, respectively. Our most significant exposures at May 2, 2021, related to the Chinese renminbi and the South Korean won to the U.S. dollar, which were, respectively, \$13.2 million and \$11.9 million at that date. We do not believe that a 10% change in the exchange rates of non-US dollar currencies, other than the aforementioned currencies and the Japanese Yen, would have had a material effect on our May 2, 2021, condensed consolidated financial statements.

Interest Rate Risk

A 10% adverse movement in the interest rates on our variable rate borrowings would not have had a material effect on our May 2, 2021 condensed consolidated financial statements.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of May 2, 2021. We have established and currently maintain disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act, designed to provide reasonable assurance that information required to be disclosed in our reports filed under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated, and communicated to management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on an evaluation of our disclosure controls and procedures as of May 2, 2021, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were not effective due to a material weakness in our internal control over financial reporting as discussed below.

Based on our prior assessment as of October 31, 2020, management concluded that our internal control over financial reporting was not effective due to a material weakness relating to the accuracy and completeness of information used in monitoring compliance with covenants stipulated by the Company's debt agreements. This material weakness has not been remediated as of May 2, 2021.

Notwithstanding this material weakness, our management, including our chief executive officer and chief financial officer, has concluded that our financial statements included in this Form 10-Q present fairly, in all material respects, our financial position, results of operations, and cash flows for the periods presented in accordance with accounting principles generally accepted in the United States of America.

Remediation of Material Weakness

Our management is committed to maintaining a strong internal control environment and implementing measures designed to help ensure that the material weakness is remediated as soon as possible. Management is in the process of designing and implementing a remediation plan to address the material weaknesses referred to above.

Changes in Internal Control over Financial Reporting

Except for changes made in connection with our implementation of the remediation efforts mentioned above, there have been no other changes in our internal control over financial reporting during the fiscal quarter ended May 2, 2021, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION**Item 1. LEGAL PROCEEDINGS**

Please refer to Note 15 within Item 1 of this report for information on legal proceedings involving the Company.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**Issuer Purchases of Equity Securities**

In September 2020, the Company's board of directors authorized the repurchase of up to \$100 million of its common stock, pursuant to a repurchase plan under Rule 10b5-1 of the Securities Act. The share repurchase program commenced on September 14, 2020, and all 1.7 million shares repurchased under this program during fiscal 2020, were retired in October 2020. The following table presents information on our common stock repurchase activity for the second fiscal quarter of 2021.

| Period | Total Number of Shares Purchased (in millions) | Average Price Paid Per share | Total Number of Shares Purchased as Part of Publicly Announced Program (in millions) | Dollar Value of Shares That May Yet Be Purchased (in millions) |
|---------------------------------------|---|-------------------------------------|---|---|
| February 1, 2021 – February 28, 2021* | - | \$ 11.01 | - | \$ 69.3 |
| March 1, 2021 – March 28, 2021 | 0.4 | \$ 12.11 | 0.4 | \$ 65.0 |
| March 29, 2021 – May 2, 2021 | 0.4 | \$ 12.98 | 0.4 | \$ 59.3 |
| Total | 0.8 | \$ 12.59 | 0.8 | |

* Less than 0.1 million shares were repurchased during this period.

In August 2019, the Company's board of directors authorized the repurchase of up to \$100 million of its common stock, pursuant to a repurchase plan under Rule 10b5-1 of the Securities Act. This repurchase program was terminated on March 20, 2020. All shares repurchased under this program were retired in the year of their repurchase. The following table presents information on our common stock repurchase activity for the second fiscal quarter of 2020.

| Period | Total Number of Shares Purchased (in millions) | Average Price Paid Per share | Total Number of Shares Purchased as Part of Publicly Announced Program (in millions) | Dollar Value of Shares That May Yet Be Purchased (in millions) |
|----------------------------------|---|-------------------------------------|---|---|
| February 3, 2020 – March 1, 2020 | 0.1 | \$ 12.37 | 0.1 | \$ 77.0 |
| March 2, 2020 – March 29, 2020 | 0.5 | \$ 10.48 | 0.5 | \$ 0.0 |
| Total | 0.6 | \$ 10.75 | 0.6 | |

Item 6. EXHIBITS

| <u>Exhibit Number</u> | <u>Description</u> | <u>Incorporated by Reference</u> | | | | <u>Filed or Furnished Herewith</u> |
|-----------------------|--|----------------------------------|--------------------|----------------|--------------------|------------------------------------|
| | | <u>Form</u> | <u>File Number</u> | <u>Exhibit</u> | <u>Filing Date</u> | |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | | | | | X |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | | | | | X |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | | | | | X |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | | | | | X |
| 101.INS | XBRL Instance Document | | | | | X |
| 101.SCH | XBRL Taxonomy Extension Schema Document | | | | | X |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | | | | | X |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | | | | | X |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | | | | | X |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | | | | | X |

SIGNATURES

Pursuant to the requirements of the Exchange Act, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Photronics, Inc.
(Registrant)

By: /s/ JOHN P. JORDAN
JOHN P. JORDAN
Executive Vice President,
Chief Financial Officer
(Principal Financial Officer)

By: /s/ ERIC RIVERA
ERIC RIVERA
Vice President,
Corporate Controller
(Principal Accounting Officer)

Date: June 9, 2021

Date: June 9, 2021

EXHIBIT 31.1

I, Peter S. Kirlin, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Photonics, Inc.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ PETER S. KIRLIN

Peter S. Kirlin
Chief Executive Officer
June 9, 2021

EXHIBIT 31.2

I, John P. Jordan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Photonics, Inc.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ JOHN P. JORDAN

John P. Jordan
Chief Financial Officer
June 9, 2021

EXHIBIT 32.1**Section 1350 Certification of the Chief Executive Officer**

I, Peter S. Kirlin, Chief Executive Officer of Photonics, Inc. (the "Company"), certify, to my knowledge, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

- (1) The Quarterly Report on Form 10-Q of the Company for the quarter ended May 2, 2021 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

The foregoing certification is being furnished pursuant to 18 U.S.C. § 1350 and will not be deemed "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

/s/ PETER S. KIRLIN

Peter S. Kirlin
Chief Executive Officer
June 9, 2021

EXHIBIT 32.2

Section 1350 Certification of the Chief Financial Officer

I, John P. Jordan, Chief Financial Officer of Photonics, Inc. (the "Company"), certify, to my knowledge, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

- (1) The Quarterly Report on Form 10-Q of the Company for the quarter ended May 2, 2021 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

The foregoing certification is being furnished pursuant to 18 U.S.C. § 1350 and will not be deemed "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

/s/ JOHN P. JORDAN

John P. Jordan
Chief Financial Officer
June 9, 2021
