Cabot Microelectronics Corporation
Second Quarter Fiscal 2014 Conference Call Script
April 24, 2014

Good morning. With me today are Bill Noglows, Chairman and CEO, and Bill Johnson, Executive Vice President and CFO.

This morning we reported results for our second quarter of fiscal year 2014, which ended March 31. A copy of our earnings release is available in the investor relations section of our website, cabotcmp.com, or by calling our investor relations office at 630-499-2600. A webcast of today's conference call and the script of this morning's formal comments will also be available on our website.

Please remember that our discussions today may include "forward-looking statements" that involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from these forward-looking statements. These risk factors are discussed in our SEC filings, including our report filed on Form 10-K for the fiscal year ended September 30, 2013. We assume no obligation to update any of this forward-looking information.

Also, our prepared remarks this morning reference non-GAAP financial measures. Our earnings release includes a reconciliation of non-GAAP financial measures.

I will now turn the call over to Bill Noglows.

Thanks, Trisha. Good morning, everyone, and thanks for joining us.

This morning we announced solid financial results for our second fiscal quarter of 2014. We reported total company revenue of $99.5 million, a gross profit margin of 46.8 percent of revenue, which includes the adverse effect of a $2.1 million asset impairment charge, and earnings per share of 40 cents. Excluding this impairment, our non-GAAP gross profit margin was 48.9 percent of revenue, which is 70 basis points higher than in the same quarter last year, and non-GAAP earnings per share were 46 cents, which is an increase of 15 percent compared to the same quarter a year ago, on slightly lower revenue; on this basis, we have now expanded gross margins year-over-year for five consecutive quarters.

While we are pleased with these results, they reflect a continuation of the soft industry conditions that we referenced in January when we reported results for our first fiscal quarter. As you may recall from our prior communications, we have talked in the past about seasonal trends within our business, in tandem with evolving trends within the global semiconductor industry, including greater seasonal swings in demand. This now marks the third fiscal year in which our CMP consumables business has experienced soft industry demand conditions during the first half of the year. Consistent with the previous two fiscal years, we have seen a relatively slow start to the year and expect strengthening in demand in the second half. Bill Johnson will provide more detail on our financial results later in the call.

Let me start this morning with an overview of the global semiconductor industry environment. Various industry reports and comments made by some of our strategic customers suggest that currently most IC inventories are at relatively lean levels, and indicate a promising outlook for strengthening in demand in the industry during the June quarter. This is likely due to continued conservative management of IC device inventory in the supply chain. Certain industry analysts continue to expect further growth in demand for mobile electronic devices, and are forecasting double digit growth in demand for smartphones and tablets through 2017. However, overall semiconductor industry demand will likely continue to be muted by weak demand for PCs. For the first quarter of the calendar year, Gartner reported a lower decline of PC shipments compared with the past seven quarters, but still a decline, nonetheless. As a result of all this, it appears that

IC manufacturers are generally increasing fab utilization rates, and manufacturing capacity for IC devices at leading edge technology nodes is now at or near full utilization.

Throughout the history of the semiconductor industry, scaling semiconductor devices to smaller and smaller geometries has resulted in both increasing performance and lower costs of semiconductor devices. As the industry continues to shrink dimensions, these technology node transitions become more challenging and introduce new requirements for power and speed. Industry reports suggest new transistor and device architectures and innovations in fab materials will become more critical to overcoming technical and physical obstacles in the future. For example, advanced technologies like high K metal gate, FinFet and 3D NAND involve new CMP applications, increasing the role that highly engineered materials and highly formulated CMP solutions like ours are likely to play going forward.

We believe that the confluence of all of these trends means that our company, with its deep relationships with strategic customers, is well positioned to respond quickly and effectively to increasingly challenging customer demands and requirements by leveraging our industry leading technology, global infrastructure, robust supply chain and rich quality systems.

Now let me discuss company-related matters.

As a result of our intensive focus on supporting our customers, during the quarter we earned a number of awards from our customers for our performance in 2013. The criteria to win these awards are extremely rigorous. Accordingly, we are proud to have earned Intel's most prestigious award for suppliers, the Supplier Continuous Quality Improvement Award, for the second consecutive year. In particular, we are one of only eight of Intel's more than 15,000 suppliers who won this award, and we believe this repeated recognition exemplifies our commitment to being a long term strategic partner, successfully delivering the highest standards for quality, manufacturing efficiency and technology. In addition, we are honored to also have received awards from SMIC, HHGrace and Huali. We believe the recognition by these three customers is evidence of our success in supporting our customers in China, an important and growing region for the semiconductor industry. Our close collaborations with our customers in China resulted in approximately 23 percent revenue growth there when compared to the same quarter a year ago. We are delighted to be recognized as an elite supplier within our customers' broader supply chains and we look forward to continuing our efforts to consistently exceed their expectations.

Turning to our CMP polishing pads business, we are pleased that our Pads business achieved year-over-year revenue growth of approximately five percent during the quarter. Our pipeline of business opportunities for our D100 and D200 pad products is at an all-time high, and our global business teams continue to partner with existing and new customers. As a result of these collaborations, during the quarter we earned new D100 business at one strategic customer, by displacing the incumbent technology. Furthermore, we saw an increase in the level of product evaluation and qualification activity of our D200 soft pad technology by a number of our strategic customers for several applications where we believe our pad's low defectivity provides particular value. This momentum reinforces our continued belief that our Pads business represents a significant growth opportunity for our company.

Turning to our CMP slurry business, we continue to gain traction as we focus our research and development activity on innovating game-changing technology for leading edge applications with technology leading customers. This increased focus led to business wins during the quarter in advanced node Copper and Dielectrics applications at certain strategic customers. With the ongoing introduction of the new materials to be polished and evolving device architectures that I mentioned earlier, we believe we are well positioned to continue to be a key technology enabler, supporting our customers' activities to address both performance and cost of ownership requirements.

Let me now provide a few comments on our capital allocation strategy. Through our strong financial performance throughout our history, we have established a track record of delivering significant value to our shareholders. Over the last decade, we have repurchased roughly $270 million of our stock under several share repurchase programs, including repurchasing $20 million during our second fiscal quarter, and also distributed nearly $350 million to our shareholders as a special cash dividend as part of our capital management initiative in 2012. Through this capital allocation, we have distributed around $620 million in total to our shareholders. In further support of continuing to provide additional value to our shareholders, on April 22 our Board of Directors authorized an increase in our existing share repurchase program to $150 million, from the previously remaining approximately $62 million. Our key priorities for capital allocation continue to be funding organic growth opportunities within the company, share repurchases and acquisition opportunities in closely related areas.

In conclusion, as I mentioned in my introductory remarks, based on demand patterns within the industry and in our company over the previous two fiscal years, we generally expect softer demand conditions in the first half of the fiscal year followed by stronger demand in the second half. It appears that we are now seeing firming of demand early in our third fiscal quarter, which we believe represents the start of a stronger second half.

We are encouraged by the high level of engagement with our technology leading customers on a wide range of new business opportunities. Over the years we have made capital investments, particularly in the Asia Pacific region, to strengthen our ability to serve the global semiconductor industry, including three facilities located in the two largest CMP consumables markets in the world. We believe that our global infrastructure, and our technical, operational and commercial capabilities are unmatched by our competitors. We believe these capabilities enable us to collaborate in real time with our strategic customers to a degree that our competitors cannot, and we are confident that this positions us well for continued success.

And with that, I will turn the call over to Bill.

Thanks, Bill, and good morning everyone.

Revenue for the second quarter of fiscal 2014 was $99.5 million which represents a 0.9 percent decrease from the same quarter last year. We believe the decrease in revenue primarily reflects continued soft demand within the global semiconductor industry as Bill mentioned, as well as a $1.0 million adverse impact associated with foreign exchange rate changes, primarily the weaker Japanese yen versus the U.S. dollar. Compared to the same quarter last year, revenue from our CMP consumables business was down by 0.2 percent. Year to date, revenue of $200.0 million represents a decrease of 3.3 percent from the prior year and includes a $2.8 million adverse impact associated with foreign exchange rate changes, primarily the weaker yen.

Drilling down into revenue by business area, Tungsten slurries contributed 37.8 percent of total quarterly revenue, with revenue up 2.0 percent from the same quarter a year ago.

Dielectrics slurries provided 29.3 percent of our revenue this quarter, with sales down 2.1 percent compared to last year.

Sale of slurries for polishing metals other than Tungsten, including Copper, Aluminum and Barrier, represented 17.4 percent of our total revenue, and increased 1.6 percent from the same quarter last year.

Sales of our polishing pads represented 7.8 percent of our total revenue for the quarter and reflect an increase of 4.8 percent from the same quarter last year. As Bill mentioned, we were able to secure a new D100 pad business win during the quarter, as well as increase the level of qualification and evaluation activity for our D200 pad products.

Data Storage products represented 4.5 percent of our quarterly revenue, down 17.3 percent from the same quarter last year.

Finally, revenue from our Engineered Surface Finishes business, which includes QED, generated 3.2 percent of our total sales, and was down 18.7 percent from the same quarter last year. Volatility in our QED revenue is common, given it is primarily a capital equipment-oriented business.

Our gross profit this quarter represented 46.8 percent of revenue, and this includes a $2.1 million asset impairment charge related to certain manufacturing assets. Excluding this impairment charge, non-GAAP gross profit was 48.9 percent of revenue, which is 70 basis points higher than the 48.2 percent of revenue we reported in the same quarter a year ago. Other factors impacting gross profit this quarter include benefits associated with a weaker Japanese yen and lower incentive compensation costs, partially offset by higher variable manufacturing costs, including higher raw material costs.

Year to date, gross profit represented 47.1 percent of revenue. Excluding the impairment charge, year to date non-GAAP gross profit was 48.1 percent, which represents a 50 basis point improvement over the first six months of fiscal 2013. In light of first half results, including the impairment, we currently expect gross profit for the full fiscal year to be near the lower end of our guidance range of 48 to 50 percent of revenue.

Now I'll turn to operating expenses, which include research, development and technical, selling and marketing, and general and administrative costs. Operating expenses this quarter of $31.9 million were $2.5 million lower than in the second quarter of fiscal 2013. The decrease was primarily due to lower staffing related costs, including incentive compensation costs.

Year to date, total operating expenses were $63.9 million, which is 5.7 percent lower than during the same period last year. As a reflection of this, we are lowering our full fiscal year guidance range for operating expenses to be within a range of $127 million to $131 million; this is $4 million lower than our prior guidance range of $131 million to $135 million.

Diluted earnings per share were 40 cents this quarter. Excluding the referenced asset impairment, non-GAAP diluted earnings per share were 46 cents, which represents an increase of 15.0 percent compared to 40 cents reported in the second quarter of fiscal 2013. Year to date, diluted earnings per share were 86 cents, or 92 cents on a non-GAAP basis, excluding the impairment, compared to 81 cents last year. Last year's results included a 7 cent adverse impact of a foreign tax adjustment.

Our cumulative year to date effective income tax rate was 27.0 percent. We continue to benefit from increased pretax profits in certain jurisdictions which have lower tax rates than the U.S. We now expect our effective tax rate for full fiscal year 2014 to be within the range of 27 to 29 percent which is less than our previous estimate of roughly 30 percent.

Turning now to cash and balance sheet related items, capital investments for the quarter were $3.6 million, bringing our year to date capital spending to $7.3 million. For full fiscal year 2014, we continue to expect capital spending to be approximately $15 million. Depreciation and amortization expense for the quarter was $4.9 million. In addition we purchased $20.0 million of our stock during the quarter, compared to $10.0 million in the same quarter last year. As Bill mentioned earlier, our Board of Directors has authorized an increase in our existing share repurchase program to $150 million, from the previously remaining approximately $62 million. We ended the quarter with a cash balance of $239.1 million and have $157.5 million of debt outstanding.

I'll conclude my remarks with a few comments on recent sales and order patterns.

During the second fiscal quarter, which is traditionally the seasonally weakest quarter of our fiscal year, we saw a decrease in revenue for our CMP consumables products of approximately one percent compared to the prior quarter. As we observe orders for our CMP consumables products received to date in April that we expect to ship by the end of the month, we see April results trending approximately seven percent higher than the average rate in our second fiscal quarter. I would caution, as I always do, that several weeks of CMP related orders out of a quarter represent only a limited window on full quarter results.

Thank you for your time and your interest in Cabot Microelectronics.