Cabot Microelectronics Corporation
Second Quarter Fiscal Year 2017 Conference Call Script
April 27, 2017

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

This morning we reported results for our second quarter of fiscal 2017, which ended March 31, 2017. 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, 2016. 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 GAAP to non-GAAP financial measures.

I will now turn the call over to David.

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

This morning we announced strong results for our second quarter of fiscal 2017, reflecting continued robust semiconductor industry demand and successful execution of our strategic initiatives. In particular, we believe our results in the first half of this fiscal year reflect the continued momentum we have established in three key product areas – CMP tungsten slurries, dielectrics slurries, and CMP pads – and we believe these will be drivers for continued profitable growth for the company over the next several years.

During the quarter, we achieved revenue of $119.2 million dollars, approximately 20 percent higher than in the same quarter last year. Our gross profit margin was 50.4 percent of revenue, the highest level since fiscal 2015, and we achieved diluted earnings per share of 71 cents, which represents an increase of approximately 92 percent compared to last year. In addition, we continued our strong cash flow generation trend, with cash from operations of $32.8 million dollars.

Bill will provide more detail on our financial results later in the call.

To provide some context for our second quarter results, let me first offer some perspectives on the global semiconductor industry environment. General industry sentiment suggests a continued robust memory market, primarily driven by the demand for more storage in a wide range of end-use products as well as in data centers. As a result, reports indicate that memory device inventories are lean due to continued strong demand and tight production capacity. Conversely, certain industry participants that are more closely tied to smartphones have reported softer demand conditions due to mobile product seasonality. For the full year, industry analysts continue to hold a strong outlook for the semiconductor industry, driven by expectations for a continued strong memory market and semiconductor demand in China, and a pick-up in smartphone demand beyond the June quarter.

Now let me turn to company-related matters. During the quarter, we experienced strong demand for our tungsten and dielectrics slurries, as well as our pads solutions across a wide range of applications and technology nodes. This drove approximately 19 percent year-on-year revenue growth for the quarter from our IC CMP consumables products. Of particular significance, we achieved year-on-year revenue growth in China of approximately 25 percent for the quarter. Our strong business position there is notable, given expectations for long-term growth in China.

Now let me provide a brief update on each key product area.

First, within CMP slurries, during the quarter we experienced robust demand for our tungsten slurries driven by our continued support of our customers' production ramps of 3D NAND and FinFET technologies, as well as our leading supply positions in other applications. As a result, in the second fiscal quarter we achieved revenue growth in our tungsten slurry product area of approximately 18 percent compared to last year. We believe this growth demonstrates our continued leadership in tungsten slurries across the foundry, logic and memory segments. Our strategies in this product area are focused on continuing to innovate, enhance our supply chain capabilities and quality systems, and leverage our global technical support and infrastructure to better support our customers. Over the years, we have seen sustained revenue growth from our tungsten products, which underscores our execution in, and commitment to, this important product area.

Moving on to our second key product area, during the quarter we experienced healthy demand for our dielectrics slurries, with revenue up approximately 18 percent compared to the same quarter last year. The execution of our strategies in this product area have led to the ongoing successful transformation of our dielectrics slurries with the growing adoption of a family of higher performing, lower cost and higher profitability colloidal silica- and ceria-based products. For example, during the quarter we advanced customer adoption of our colloidal silica-based dielectrics slurries for advanced memory applications.

Across our tungsten and dielectrics product areas, we have a strong pipeline of active opportunities around the world covering foundry, logic, and memory customers, on both 300 and 200mm platforms, and we look forward to winning more business with these solutions to drive profitable growth.

You may recall that during our conference call last October, we discussed our plans to expand our existing facility and capabilities in South Korea to further support growing demand for our CMP solutions. I am pleased to report that, in line with our expectations, during our second fiscal quarter we opened the expanded facility. We believe this expansion enhances our global infrastructure, and our ability to provide local development and manufacturing capabilities to support our customers within the region, and we look forward to continuing to leverage this facility to support future growth.

Turning to CMP pads, our third key product area, this quarter we achieved record revenue for the sixth consecutive quarter, and year-over-year revenue growth of approximately 44 percent. This was largely driven by continued strong customer pull for our NexPlanar product line. We continue to leverage our global sales channel and technical resources to speed the qualification and adoption of our pad offerings. And as a result, during the quarter, we won additional business with three of our technology-leading customers for advanced logic and memory applications. We believe these wins demonstrate our ability to proliferate our supply positions across our customers' semiconductor fabs, and underscore our pads' value proposition. In addition, we added to our strong pipeline of new business opportunities, including CMP slurry and pad consumable sets, across a wide range of customers and applications. We believe that given our position as the leading supplier of CMP slurries with a broad slurry product portfolio, along with our position as the second largest CMP pad supplier, we are uniquely positioned to deliver best-in-class slurry and pad consumable sets. We look forward to advancing this initiative in the future.

In conjunction with our efforts to drive growth in our pads product area, and in particular to position our company for sustained growth in China, during the quarter we made progress on our collaboration with Konfoong Materials International, or KFMI. This collaboration in China emphasizes our commitment to provide semiconductor manufacturers with reliable, local manufacture of advanced CMP pad technology. We have received strong interest from our customers in China from early marketing efforts. Based on the progress of our combined teams, we believe we are on track to begin customer sampling during the June quarter, and would expect our first KFMI related revenue in fiscal 2018.

Through these efforts, and continuing with the strong growth performance we have achieved, we are confident in our ability to grow our pads revenue to between $80 and $90 million dollars in fiscal 2018, consistent with what we have previously discussed, and are optimistic that we will be able to grow it to over $100 million dollars in fiscal 2019.

During the quarter, we earned several awards from customers in recognition of our ability to successfully deliver innovative, high-quality, high-performing, and reliable CMP slurries and polishing pads. We were honored to have again earned Intel’s most prestigious award for suppliers, the Supplier Continuous Quality Improvement Award, for the fifth consecutive year, as well as Texas Instruments’ Supplier Excellence Award for our performance in 2016. We are proud of this recognition, and also of the awards we have received from other customers over the years. We believe these awards are an important part of our company’s brand, and evidence of the unique value we provide to our customers through technology, world-class operations, quality systems and infrastructure, and close collaboration.

The financial performance we reported this quarter represents the continuation of a long-term trend of sustained strong profitability and cash flow generation. This has enabled us to execute a balanced capital deployment strategy over the years, including organic investments, dividends, acquisitions and share repurchases. In further support of this, on March 7, we announced that our Board of Directors declared a quarterly cash dividend of 20 cents per share on the company's common stock, an increase of eleven percent over the regular quarterly cash dividend paid since the initiation of this program in January, 2016. We believe this demonstrates both confidence in our ongoing cash generation and our continued commitment to delivering value to our shareholders.

Looking ahead, we expect continued healthy semiconductor industry demand in the second half of our fiscal year, particularly in memory and in China. Given this industry outlook, and combined with our continued focus on and momentum in executing our strategic initiatives related to our three key product areas – growth in tungsten slurries, including the continued adoption of 3D NAND and FinFET technologies, the transformation of our dielectrics slurry product line, and growing CMP pad revenue, including slurry and pad consumable sets – we are confident that we are well-positioned to deliver continued profitable growth for our company.

With that, I will turn the call over to Bill for more detail on our financial results.

Thanks, Dave, and good morning everyone.

Revenue for the second quarter of fiscal 2017 was $119.2 million, which represents a 20.1 percent increase from the same quarter last year. The increase reflects continued strong global semiconductor industry demand that we began to see during the third quarter of fiscal 2016. Year to date, revenue of $242.4 million represents a 21.5 percent increase from last year.

Drilling down into revenue by product area:

Tungsten slurries contributed 43.5 percent of total quarterly revenue, with revenue up 18.1 percent compared to the same quarter last year. We continue to see strong demand for our tungsten slurries for advanced applications, including 3D memory and FinFET; and, as Dave mentioned earlier, this is a key product area that we expect will drive future profitable growth.

Dielectrics slurries, representing another key product area, provided 23.4 percent of our revenue this quarter, with sales up 17.6 percent from the same quarter a year ago. Our dielectrics growth was primarily driven by strong demand for our colloidal silica- and ceria-based solutions. We look forward to winning more business in this area with our higher performing, lower cost and higher profitability products.

Sales of our polishing pads – our third key product area – represented 14.4 percent of our total revenue for the quarter, and increased 43.5 percent compared to the same quarter last year. Our pads product area achieved record revenue for the sixth consecutive quarter.

Sales of slurries for polishing metals other than tungsten, including copper, aluminum and barrier, represented 12.3 percent of our total revenue, and increased 3.5 percent from the same quarter last year.

Finally, revenue from our Engineered Surface Finishes area and data storage products represented 5.1 percent and 1.4 percent, respectively, of our quarterly revenue.

Gross profit for the quarter was 50.4 percent of revenue, compared to 47.3 percent of revenue we reported in the same quarter a year ago. This includes $1.2 million of amortization expense related to the NexPlanar acquisition. Excluding this, non-GAAP gross profit was 51.4 percent of revenue. Factors impacting gross profit this quarter compared to last year include higher sales volume and a higher valued product mix, partially offset by higher fixed manufacturing costs, including higher incentive compensation expense.

Year to date, gross profit was 50.1 percent of revenue, compared to 48.6 percent last year. This includes $2.4 million of amortization expense related to NexPlanar. Excluding this, non-GAAP gross profit for the first half of the fiscal year was 51.1 percent of revenue. We currently expect our GAAP gross profit margin for the full fiscal year to be between 49 and 51 percent of revenue; this is higher than our prior full year guidance range of 48 to 50 percent of revenue. This includes an adverse impact of approximately 100 basis points related to NexPlanar amortization expense.

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 were $36.1 million, including $0.5 million of NexPlanar amortization expense. Operating expenses were $1.5 million higher than the $34.6 million reported in the same quarter a year ago. This reflects higher incentive compensation costs and higher professional fees, partially offset by lower clean room materials expense.

Year to date, total operating expenses were $69.5 million, which includes $0.9 million of amortization expense related to NexPlanar. We continue to expect GAAP operating expenses for the full fiscal year to be between $137 million and $142 million. This includes approximately $2 million of NexPlanar amortization expense.

Diluted earnings per share were 71 cents this quarter, or 76 cents on a non-GAAP basis excluding the NexPlanar amortization, which represents an increase of 91.9 percent compared to the 37 cents we reported in the second quarter of fiscal 2016. The increase in earnings this quarter was primarily driven by higher revenue and a higher gross profit margin. Year to date, diluted earnings per share were $1.60, or $1.68 on a non-GAAP basis, which is 92.8 percent higher than the 83 cents reported last year.

Our effective tax rate for the second fiscal quarter was 20.8 percent, and 20.5 percent year to date. We continue to expect our effective tax rate for the full fiscal year to be within the range of 19 to 22 percent.

Turning now to cash and balance sheet related items, capital investments for the quarter were $6.7 million, bringing our year to date capital spending to $11.7 million. This includes the facility expansion in South Korea that we completed during the second quarter. For the full fiscal year, we continue to expect capital spending to be within the range of $20 million to $25 million. Depreciation and amortization expense for the quarter was $6.5 million, and we generated cash flow from operations of $32.8 million. We ended the quarter with a cash balance of $343.7 million and $150.4 million of debt outstanding.

As Dave mentioned, we are pleased to have increased our quarterly cash dividend during the quarter, which would represent an annualized rate of 80 cents per share, or approximately $20 million in aggregate, and a payout ratio of approximately 33 percent of our fiscal 2016 net income, and 26 percent of free cash flow. Looking ahead, our current priorities for uses of cash are organic investments to fund growth within CMP consumables, dividends, including increasing our quarterly dividend as earnings grow, acquisitions in closely-related areas that leverage our core capabilities, and share repurchases. With these capital deployment priorities, and our continued focus on the profitable growth of our company, we believe we are well-positioned for continued delivery of significant value to our shareholders.

Now I would like to offer a few comments on recent revenue and order patterns.

During the second fiscal quarter, we saw a four percent decrease in revenue from our IC CMP consumables products, compared to the first quarter of fiscal 2017. This is slightly better than the approximately five percent reduction we had referenced during our first quarter conference call in January, and which we had confirmed during our Annual Meeting in March. Earlier, Dave talked about general industry expectations for continued strong demand, and in particular for memory devices. Consistent with that outlook, we expect demand for our IC CMP consumables products in the June quarter to be around three percent higher than in our second fiscal quarter.

To summarize, from a financial standpoint, we have now achieved strong performance over four consecutive quarters. As we think about the second half of fiscal 2017, we expect continued solid demand, and we are raising our full fiscal year gross profit margin guidance range to 49 to 51 percent of revenue. Based on our revenue growth and profitability through the first half of fiscal 2017, and expected continued momentum in tungsten and dielectrics slurries and polishing pads, we believe we are on track to deliver another year of strong performance.

Now I'll turn the call back to the operator, as we prepare to take your questions.

That is all the questions we have this morning. I am pleased to announce that on May 23 we will host a virtual investor and analyst event, or a CCMP experience at your convenience. On May 2, we will issue a press release with further details. We look forward to your participation. Thank you for your time and your interest in Cabot Microelectronics.