Cabot Microelectronics Corporation
Fourth Quarter Fiscal Year 2013 Conference Call Script
October 29, 2013

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 fourth quarter and full fiscal year 2013, which ended September 30. 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, 2012. We assume no obligation to update any of this forward-looking information.

I will now turn the call over to Bill Noglows.

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

This morning we announced strong financial results for our fourth quarter and full fiscal year 2013. During the quarter, we achieved record revenue of $116.3 million dollars, a gross profit margin of 50.9 percent of revenue and diluted earnings per share of 70 cents, an increase of approximately 43 percent compared to the same quarter last year. For full fiscal 2013, we reported revenue of $433.1 million dollars, reflecting stronger demand for our products in the second half of the fiscal year after soft industry demand during the first half, gross profit margin of 49.0 percent, which is the highest annual level since fiscal 2010, and earnings per share of $2.16, approximately 23 percent higher than last year. Bill Johnson will provide more detail on our financial results later in the call.

Let me start this morning by recapping certain industry trends which we believe began to impact our CMP consumables business during fiscal 2012, continued through fiscal 2013 and may continue into fiscal 2014. As the industry continues to consolidate, fewer and larger semiconductor companies are accounting for a greater portion of the capital spending in the industry. We think that more capital spent by fewer companies has resulted in more rational capacity expansion, and this has reduced the cyclicality of the industry when compared to historic trends. At the same time, the semiconductor industry is now being driven more by consumer products such as smart phones and tablets, versus demand for personal computers and enterprise IT spending. Consumers are now driving industry demand trends, and this has introduced more seasonal shifts in demand around the "back to school" and "holiday" seasons. Finally, the industry's multiyear trend of declining PC demand being slightly more than offset by greater growth in mobile devices has resulted in relatively soft overall semiconductor industry growth. The overall effect of all of these trends has resulted in a slower growth rate for the semiconductor industry as a whole, which is less cyclical than in the past, with greater seasonal swings in demand. For calendar year 2013 *World Semiconductor Trade Statistics* estimates semiconductor industry revenue growth at approximately two percent, and predicts five percent growth in calendar year 2014. We have seen the impact of these trends in our CMP consumables business, which has generally tracked overall semiconductor industry growth in the past.

Turning now to company-related matters, during fiscal 2013, we continued to execute our strategies related to technology, customer collaboration and supply chain management. I would like to highlight some of our key accomplishments during the fiscal year.

Let me start by talking about a heightened focus in our company from a technology standpoint. Historically we have developed new CMP consumables products on a relatively broad basis, in pursuit of fulfilling our mission of being the CMP solutions provider to the overall industry. However, in light of slowing industry growth, and continued and increasing consolidation of our customer base, we are now focusing our research and development activity much more heavily on innovating game-changing technology for leading edge applications, for technology leading customers. In the recent past, we have spent approximately 14 percent of our revenue on Research and Development activities. We believe that by focusing on advanced technologies, with technology leading companies, we can drive greater innovation, and create more compelling new CMP solutions for our customers that will assure our continued success as technology continues to advance. The recent growth in revenues from our CMP solutions for polishing aluminum and advanced dielectrics are specific examples of our ability to innovate to meet our customers' challenging product performance requirements for leading edge applications.

Additionally, throughout the year, we continued to further develop our pad business. This year our first generation D100 and second generation D200 pad products were adopted for a number of applications, including advanced node technologies. However, we were disappointed that we were not able to grow our pad revenue in fiscal 2013 from the record revenue level of fiscal 2012 due to the slow pace of new business wins, continued competitive pricing pressure as well as customer efficiency gains in their use of our pad technology. In fiscal 2013 we sold more pads than during the previous fiscal year; however, due to competitive pricing pressure, our revenue did not increase. In addition, as we discussed last quarter, some of our pad customers appear to be extending the life of our D100 pads. While this increased efficiency had an adverse effect on our pad revenue, we believe it builds loyalty in these customers, and reinforces our value proposition of longer pad life, which can drive further adoption of our technology. We continue to view our pad business as an attractive growth opportunity, and look to reestablish revenue growth in fiscal 2014.

From a customer standpoint, we believe the supplier excellence awards we earned during the fiscal year exemplify our ongoing commitment to collaborating with our customers and consistently delivering innovative, high performing and high-quality products and services. During the second fiscal quarter, we were honored to have earned Intel's most prestigious award for suppliers, the Supplier Continuous Quality Improvement, or SCQI, award, and Texas Instruments' Supplier Excellence award. More recently, we were delighted to have received Microchip Technology's Outstanding Supplier Performance award. These awards recognize our product quality and reliability, and our service to our customers, and we are honored to be recognized as an elite supplier within our customers' broader supply chains.

Furthermore, our global business teams are focused on a range of formal and informal projects with our customers to address specific business opportunities with them for advanced technologies. Our pipeline of these opportunities remains healthy, and we continue to partner with our customers around the world on product evaluations and qualifications.

Finally, from an operations standpoint, we continued to improve our productivity this year, which had a significant positive impact on our strong gross margin performance in fiscal 2013. Our emphasis on, and expertise in, quality systems and supply chain management has become increasingly critical as our customers' requirements for product quality and consistency continue to increase, and product specifications for leading edge applications continue to tighten. Continuous improvement and variation reduction in all aspects of our supply chain are the pillars of our global operations strategy. We believe our capabilities in supply chain management and quality systems are unmatched in the CMP industry, and represent a competitive advantage for us as technology advances.

In addition, this year we made significant progress in qualifying products from our research, development and manufacturing facility located in South Korea, which we opened in August 2011. As planned, this facility has enhanced our capabilities in the region and has enabled better support for key customers. We were pleased with our ability to ramp production at this facility in the second half of the year, which contributed to our strong profitability.

Now let me provide a few comments on our outlook for the overall semiconductor industry for fiscal 2014. Certain industry analysts and some of our strategic customers are forecasting some softness in demand early in our fiscal year due to the slowing of high-end smartphone growth in favor of higher growth of mid- and lower-end smart phones. Further, PC demand remains sluggish -- industry reports suggest that 2013 may be the bottom for the PC market, with 2014 forecast showing low single-digit growth. If this is true, we would expect to see another fiscal year with softer demand conditions in the first half, and stronger demand in the second half, as we saw in fiscal years 2012 and 2013.

To conclude my remarks today, based on the sound execution of our long-term strategic initiatives and successful performance in fiscal 2013, we believe we are well positioned for continued success in fiscal 2014. Our ability to provide innovative, high performing and high-quality solutions for leading edge applications, in collaboration with our customers around the world, differentiates us from other CMP consumables suppliers. Looking ahead, we remain focused on continuing to be a technology enabler, and further strengthening our core CMP consumables business, while delivering value to our customers and our shareholders.

And with that, I'll turn the call over to Bill Johnson.

Thanks, Bill.

Revenue for our fourth quarter of fiscal 2013 was a record $116.3 million, which reflects continued strengthening in demand that we saw during the third fiscal quarter. Revenue was up by 5.1 percent from the same quarter last year and up 5.7 percent from the prior quarter.

Total revenue for the full fiscal year was $433.1 million, which represents a 1.3 percent increase from fiscal 2012. Full year revenue results reflect stronger demand for our products in the second half of the fiscal year after soft industry conditions in the first half, and include a $5.9 million adverse impact associated with foreign exchange rate changes.

Drilling down into revenue by business area:

Tungsten slurries contributed 34.2 percent of total quarterly revenue, with revenue down 2.2 percent from the same quarter a year ago and up 2.9 percent sequentially. For the full year, Tungsten slurry revenue decreased by 3.6 percent. As we have discussed in the past, our Tungsten slurry products are used heavily in the production of DRAM chips, and we believe that the decline in demand for PCs, with the associated reduction in DRAM demand, accounts for our lower Tungsten revenue compared to the same quarter last year and full fiscal 2012.

Dielectrics slurries provided 28.0 percent of our revenue this quarter, with sales up 3.0 percent from the same quarter a year ago and up 6.3 percent sequentially. For the full year, Dielectric slurry revenue increased by 3.2 percent. Within Dielectrics, revenue from our Advanced Dielectrics slurry business increased by approximately 18 percent for the full year and represents a record revenue level.

Sales of slurries for polishing metals other than Tungsten, including Copper, Aluminum and Barrier, represented 18.3 percent of our total revenue, and increased 23.7 percent from the same quarter last year, and were up 5.5 percent sequentially. For the full year, our product revenue from slurries for polishing these metals increased by 13.7 percent, driven by particularly strong growth in our Aluminum slurry business, revenue from which more than doubled compared to last year. We achieved record revenue levels for our Aluminum slurry products for both the quarter and full fiscal year.

Sales of polishing pads represented 7.5 percent of our total revenue for the quarter, and decreased 11.6 percent from the record revenue recorded in the same quarter last year and increased 2.7 percent sequentially. For the full year, polishing pad revenue was down by 2.2 percent compared to our record revenue last year.

Data Storage products represented 4.2 percent of our quarterly revenue. This revenue was up 3.1 percent from the same quarter last year and down 6.5 percent sequentially. For the full year, revenue for Data Storage slurries was essentially even with the prior year.

Finally, revenue from our Engineered Surface Finishes business, or ESF, generated 7.9 percent of our total quarterly sales. Our ESF revenue was up 38.0 percent from the same quarter last year, up 32.6 percent sequentially, and down 3.5 percent for the full year. The largest part of our ESF business is QED, and our QED business achieved record revenue for the quarter. Recall that most of our QED business is capital equipment related, so revenue can fluctuate significantly quarter to quarter. I would point out that our QED business enters fiscal 2014 with a very limited equipment order backlog.

Our gross profit was particularly strong this quarter, representing 50.9 percent of revenue, compared to 48.6 percent in the same quarter last year and 49.7 percent last quarter. Compared to the year ago quarter, gross profit percentage increased primarily due to lower fixed manufacturing costs and benefits associated with a weaker Japanese yen versus the U.S. dollar. The increase in gross profit percentage versus the previous quarter was primarily due to lower variable manufacturing costs, despite higher costs associated with the transition to a new raw material supply contract with an existing supplier that we discussed last quarter, and higher sales volume, partially offset by higher fixed manufacturing costs.

For the full fiscal year, gross profit represented 49.0 percent of revenue, which is above our full year guidance range of 46 to 48 percent of revenue. Gross profit margin increased from 47.7 percent of revenue in fiscal 2012 primarily due to the favorable impact of the weaker Japanese yen and lower fixed manufacturing costs. For full fiscal year 2014, we are increasing our full year guidance for gross profit margin to be between 48 and 50 percent of revenue; that is up by a full two percentage points versus our annual guidance for fiscal 2013.

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 $35.5 million were $2.2 million higher than the same quarter a year ago and $3.1 million higher than in the previous quarter. The year over year increase was primarily due to higher staffing related expenses, including incentive compensation costs related to our strong financial performance, partially offset by lower depreciation expense and clean room materials expense. The sequential increase was primarily due to higher staffing related costs, including incentive compensation costs.

For the full year, total operating expenses decreased 1.4 percent to $135.6 million, and were within our guidance range for full fiscal year 2013 of $132 million to $136 million. Looking forward, we are lowering our full fiscal year 2014 guidance for operating expenses to be within the range of $131 million to $135 million.

Diluted earnings per share were 70 cents this quarter, up from 49 cents in the same quarter last year and 65 cents reported in the previous quarter. Compared to the same quarter last year, earnings per share increased primarily due to the higher level of sales, higher gross profit margin and a lower effective tax rate, partially offset by higher operating expenses. The increase compared to the prior quarter was mainly due to the higher revenue and a higher gross profit margin, partially offset by higher operating expenses. Diluted earnings per share for the full year were $2.16, which is up by 23 percent, or 41 cents, from the $1.75 we achieved last year, primarily due to a higher gross profit margin, a lower effective tax rate, a favorable impact of the weaker Japanese yen reflected in other income, and a higher level of sales.

We expect our effective tax rate for full fiscal year 2014 to be roughly equivalent to our full fiscal 2013 rate, which was roughly 31 percent.

Turning now to cash and balance sheet related items, capital investments for the quarter were $4.4 million, bringing our full year capital spending to $14.6 million, which is below our prior guidance of approximately $18 million for the year. For full fiscal year 2014, we expect capital spending to be approximately $15 million. Depreciation and amortization expense for the quarter was $4.9 million. In addition, we purchased $10.0 million of our stock during the quarter. We ended the quarter with a cash balance of $226.0 million, which is $24.4 million higher than in the prior quarter and $47.6 million higher than last year, and we have $161.9 million of debt outstanding.

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

Historically, our fourth fiscal quarter is seasonally our strongest quarter of the year, frequently followed by some seasonal softening in demand in the first quarter of a new fiscal year, and we are seeing that softness now. Examining revenue patterns within the three months of our fourth fiscal quarter, we saw demand for our CMP consumables products in July increase by about 10 percent from the average of the three months in our June quarter. Then revenue decreased sequentially in August and September. As we observe orders for our CMP consumables products received to date in October that we expect to ship by the end of the month, we see October results trending approximately seven percent lower than what we saw in the month of September and around ten percent lower than the average rate over the September quarter. We think this is consistent with the forecasts of certain industry analysts and some of our customers, as we discussed earlier, which call for some softness in demand early in our fiscal year. However, 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.