Cabot Microelectronics Corporation
Fourth Quarter and Full Fiscal Year 2014 Conference Call Script
October 23, 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 fourth quarter and full fiscal year 2014, 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, 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 these 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 financial results for our fourth quarter and full fiscal year 2014. During the quarter, we achieved record revenue of $116.3 million dollars, including record revenue in our Tungsten, Pads and Aluminum product areas, a gross profit margin of 49.1 percent of revenue and diluted earnings per share of 65 cents. For full fiscal 2014, we reported revenue of $424.7 million dollars, reflecting record revenue in our Pads, Aluminum and Advanced Dielectrics product areas, but soft demand in QED Technologies and our Data Storage product line. We recorded a gross profit margin of 47.8 percent of revenue for the full fiscal year, which includes the adverse impact of the $2.1 million dollar asset impairment charge we recorded during the second fiscal quarter, and earnings per share of $2.04. Excluding this impairment, non-GAAP gross profit margin was 48.3 percent and non-GAAP earnings per share was $2.10 for the year. Bill Johnson will provide more detail on our financial results later in the call.

Let me start this morning by recapping certain global semiconductor industry trends that we believe affected our CMP consumables business during fiscal 2014.

First, as you may recall we have talked in the past about seasonal trends within our business, in tandem with evolving trends within the global semiconductor industry. During our fiscal year, we saw the continued trend of fewer and larger semiconductor companies accounting for a greater portion of capital spending in the industry, and this has continued to reduce the cyclicality of the industry when compared to historical trends. At the same time, the increasing importance of consumer demand versus enterprise based demand for electronic systems has introduced more seasonal shifts in demand around the "back to school" and "holiday" seasons. This now marks the third consecutive fiscal year in which our CMP consumables business has experienced soft industry demand conditions during the first half of the year, followed by stronger demand during the second half.

A second trend that impacted the industry during our fiscal year was the continued scaling of semiconductor devices to smaller and smaller geometries. As the industry continues to shrink dimensions, leading edge technology node transitions have become significantly more challenging. To respond to these challenges, the industry has placed a heightened focus on new transistor and device architectures, which in turn is driving greater innovation in fab materials. For example, we have seen increasing emphasis on development and production of advanced technologies like high k metal gate, 3D NAND and FinFET, requiring more highly engineered materials and highly formulated CMP solutions. As such, we are seeing that many of our new products are becoming more critical to overcoming our customers' technical and physical obstacles, and we remain confident about the role our CMP solutions are likely to play in enabling these leading edge technologies going forward. In response to this technology trend, we continue to focus on advanced technologies, driving greater innovation, and creating more compelling new CMP solutions for our customers, which we expect will assure our continued success.

Now let me provide some general comments on current conditions we are seeing within the industry. Industry reports suggest that overall IC inventories are generally in line with forecasted IC sales, primarily driven by the continuation of positive trends in mobile connectivity and anticipated solid demand for electronics during the holiday season. While consumer reports indicate that the growth rate for high-end smartphones remains strong, demand for tablets appears to be slowing a bit due to the transition in demand to larger screen smartphones. Additionally, although the contraction of PC demand continues to slow due to some growth in the enterprise sector, consumer demand for PCs continues to be muted. In response to these trends, IC manufacturers continue to actively manage IC inventory in the supply chain, with capacity at leading edge technology nodes at or near full utilization, and around 90 percent utilization for legacy nodes.

Let me turn now to company related matters, beginning with CMP slurries. We are pleased that our Tungsten and Aluminum product areas achieved record revenue in the quarter, with revenue growth of approximately 13 percent and 16 percent, respectively, compared to the same quarter last year. Additionally, we reported record annual revenue in Aluminum and Advanced Dielectrics, with our Aluminum revenue growing by 23 percent compared to fiscal 2013. During the fiscal year, we won new business for tungsten, dielectrics, copper and TSV applications, including both legacy and advanced node technologies. We believe our more focused approach to R&D and new product development, which we have discussed in the past, contributed to this year's new product introductions and business wins.

In fiscal 2014, we spent approximately $59 million dollars on Research and Development, or approximately 14 percent of our revenue. We believe this investment in technologies is far in excess of any of our competitors, and underscores our strong commitment to innovation within the CMP consumables space.

Turning to our CMP polishing pads, we were delighted that we were able to reestablish revenue growth in fiscal 2014. Our Pads product line achieved record quarterly and full fiscal year revenue. The fourth quarter was our third consecutive quarter of achieving year-over-year revenue growth. Notably, we grew quarterly revenue by 14 percent compared to the same quarter last year, and annual revenue by approximately three percent. We believe this growth is primarily due to the ramp of business wins we highlighted several quarters ago. During the fiscal year, customers continued to actively sample our pad products for a range of new business opportunities. As a result of this collaboration, our pad products were adopted for a number of applications, including advanced node technologies. Our pipeline of new business evaluations underway with customers remains at an all-time high, and our global business teams continue to partner with existing and new customers. We remain confident that our attractive pad value proposition of longer pad life and lower defectivity will enable us to continue the momentum we established during fiscal 2014 as we head into fiscal 2015.

Fiscal 2014 was a prolific year for us in terms of customer recognition of our excellent quality systems and supply chain management capabilities. During the year, we were awarded seven supplier excellence awards for our outstanding support, contributions and performance. Most recently, during our fourth fiscal quarter, we received Samsung's Best in Value Award, one of only two suppliers to receive the award, and the only materials supplier. Earlier in the year we received Intel's most prestigious award for suppliers, the Supplier Continuous Quality Improvement, or SCQI, award for the second consecutive year. These awards recognize our product quality and reliability, and our service to our customers, and we are honored to be regarded as an elite supplier within our customers' broader supply chains. We look forward to continuing to build upon our strong relationships with our technology-leading customers to consistently deliver innovative, high-quality, high-performing and reliable CMP products and solutions.

Now let me provide a few comments on our near term outlook for the overall semiconductor industry. Sentiment regarding near term demand seems somewhat mixed. Certain industry analysts and some of our strategic customers are forecasting solid demand early in our fiscal year, while others are suggesting softer demand conditions. Further, macroeconomic concerns also provide an overlay of uncertainty over the next year. Based on seasonal demand patterns we have seen in the past three fiscal years, with softer demand in the first half followed by stronger demand in the second half, as we enter fiscal 2015 we expect some seasonal softening of demand in our first fiscal quarter, and we are experiencing some of that softening now.

Concluding my remarks today, technology node progression and new chip architectures continue to introduce new CMP challenges, which we believe represent growth opportunities for our CMP consumables business. We remain focused on supporting our customers by closely collaborating with technology leaders, and we intend to continue to develop game-changing technology, while leveraging our extensive global infrastructure and our distinctive experience and expertise in quality systems and supply chain management. Furthermore, we are confident in our ability to execute our strategies and continue to provide value to our shareholders over a range of industry and macroeconomic environments.

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

Thanks, Bill, and good morning everyone.

Revenue for our fourth quarter of fiscal 2014 was a record $116.3 million, which reflects continued strengthening in demand that we saw beginning in the third fiscal quarter. We generated 3.9 percent revenue growth from our CMP consumables products for semiconductor applications over the same quarter last year.

Total revenue for the full fiscal year was $424.7 million. 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; however, lower revenue from QED Technologies, which is primarily capital equipment-oriented, and our Data Storage product line, which is tied to the PC industry, primarily drove an overall 2.0 percent year-over-year revenue decrease. Foreign exchange rate changes also reduced revenue by $2.4 million, primarily due to the weaker Japanese yen versus the U.S. dollar.

Drilling down into revenue by product area:

Tungsten slurries contributed 38.7 percent of total quarterly revenue, and we achieved record revenue for the second consecutive quarter. Revenue was up 13.3 percent from the same quarter a year ago, reflecting strong demand from the memory and foundry segments. For the full year, Tungsten slurry revenue increased by 4.0 percent.

Dielectrics slurries provided 25.2 percent of our revenue this quarter, with sales down 9.7 percent from the same quarter a year ago. For the full year, Dielectric slurry revenue decreased by 4.1 percent. The revenue decrease reflects the loss of some low margin, legacy ILD business that we mentioned during our call last quarter. However, within Dielectrics, revenue from our Advanced Dielectrics product area achieved year-over-year growth for the third consecutive quarter, and record revenue for the full year.

Sales of slurries for polishing metals other than Tungsten, including Copper, Aluminum and Barrier, represented 18.8 percent of our total revenue, and increased 2.8 percent from the same quarter last year. For the full year, revenue increased by 0.3 percent. Within this area, we achieved record revenue from our Aluminum slurry products for both the quarter and full fiscal year, with double digit revenue growth on both bases.

Sales of polishing pads represented 8.5 percent of our total revenue for the quarter, and increased 14.0 percent compared to the same quarter last year; we have now grown our pad revenue year over year for three consecutive quarters. Revenue was up by 2.5 percent for the full year. We achieved record revenue levels for our pads products for both the quarter and full year.

Data Storage products represented 3.6 percent of our quarterly revenue. Our Data Storage revenue was down 15.6 percent from the same quarter last year and down 13.7 percent for the full year on continued contraction of PC demand, and some business loss, as we mentioned last quarter.

Finally, revenue from our Engineered Surface Finishes area, which includes QED, generated 5.2 percent of our total quarterly sales. Our ESF revenue was down 34.1 percent from the same quarter last year and down 32.7 percent for the full year. Volatility in our QED revenue is common, given it is primarily a capital equipment-oriented business.

Our gross profit this quarter represented 49.1 percent of revenue, compared to 50.9 percent in the same quarter last year. Our gross profit percentage decreased primarily due to higher variable manufacturing costs, including higher raw material costs, partially offset by a higher valued product mix.

For the full fiscal year, gross profit represented 47.8 percent of revenue, which includes the adverse effect of the $2.1 million asset impairment charge related to certain manufacturing assets that we recorded during the second fiscal quarter. Excluding the impairment charge, non-GAAP gross profit was 48.3 percent of revenue. Our full fiscal year 2014 guidance range was 48 to 50 percent of revenue. Gross profit margin decreased from 49.0 percent of revenue in fiscal 2013, primarily due to higher variable manufacturing costs, including higher raw material costs, and the asset impairment, partially offset by benefits associated with foreign exchange rate changes. For full fiscal year 2015, we expect our gross profit margin to be between 48 and 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 $34.1 million were 3.8 percent lower than in the fourth quarter of fiscal 2013. The decrease was primarily due to lower staffing related expenses, including incentive compensation costs, partially offset by higher professional fees.

For the full year, total operating expenses were $131.3 million, which is $4.4 million lower than last year. The decrease was driven by lower staffing related costs, including incentive compensation costs, partially offset by higher professional fees. Our guidance range for full fiscal year 2014 was $127 million to $131 million. Looking forward, we expect our operating expenses for full fiscal year 2015 to be within the range of $132 million and $137 million. The expected increase is primarily due to anticipated higher staffing related costs; the midpoint of this range represents a 2.4 percent increase versus fiscal 2014.

Diluted earnings per share were 65 cents this quarter, up from 64 cents in the same quarter last year. Earnings per share increased primarily due to a lower effective tax rate and lower operating expenses, partially offset by a lower gross profit margin. Diluted earnings per share for the full year were $2.04, or $2.10 on a non-GAAP basis, excluding the asset impairment, compared to $2.19 last year. You should note that as we previously disclosed, prior year earnings per share were revised to reflect some non-material adjustments compared to our original disclosure. We discussed this in our Form 10-Q for the June quarter, and you will see a more complete discussion in our fiscal year 2014 Form 10-K that we expect to file mid-November.

We expect our effective tax rate for full fiscal year 2015 to be between 18 and 20 percent, which is lower than 26.0 percent in fiscal 2014.

Turning now to cash and balance sheet related items, capital investments for the quarter were $2.3 million, bringing our full year capital spending to $12.6 million, below our guidance of approximately $15 million for the year. For full fiscal year 2015, we expect capital spending to be within the range of $10 million to $15 million. Depreciation and amortization expense for the quarter was $5.0 million. In addition, we purchased $6.4 million of our stock during the quarter, and $53.0 million for the full year. As of the end of the quarter, there was approximately $125 million of authorization remaining in our share repurchase program. We ended the quarter with a cash balance of $284.2 million, which is $18.6 million higher than last quarter and $58.1 million higher than last year, and we have $172.8 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 some softness now. Examining revenue patterns within the three months of our fourth fiscal quarter, we saw demand for our CMP consumables products increase by about five percent from the average of the three months in our June quarter. 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 four percent lower than the average rate over the September quarter. 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.