Cabot Microelectronics Corporation
Third Quarter Fiscal 2014 Conference Call Script
July 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 third quarter of fiscal year 2014, which ended June 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.

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 third fiscal quarter of 2014, including total company revenue of $108.4 million dollars, a gross profit margin of 47.7 percent of revenue, and earnings per share of 53 cents, all of which are higher than the previous quarter's results. Our gross margin this quarter was lower than we expected, due to certain higher costs we experienced during the quarter. Bill Johnson will provide more detail on our financial results later in the call.

Revenue from our CMP consumables products increased by approximately nine percent sequentially, reflecting the seasonal strengthening of the demand environment that we have seen in recent years. Notably, we also achieved record revenue in our Tungsten and Advanced Dielectrics slurry businesses this quarter, and nearly forty percent year-over-year revenue growth in China.

Let me start this morning by providing some general comments on conditions we are seeing within the semiconductor industry. Industry reports suggest that most IC inventories are on the lean side of normal levels. This is likely due to the continued conservative management of IC device inventory in the supply chain, coupled with capacity constraints and limitations in availability of advanced node technologies. Memory customers have commented that supply for memory ICs, especially DRAM, will likely fall short of demand through the end of this calendar year and into 2015.

Industry sources are forecasting demand growth for tablets and smartphones of 20 to 30 percent during the calendar year, with smartphone growth in China, in particular, at the very high end of this range. Growth of these mobile internet devices seems to be slowing at the high end of the market, but it is still quite robust overall.

Furthermore, it appears we are now seeing a slowdown in the rate of decline of PC sales in 2014, after eight consecutive quarters of contraction. Gartner reports that after declining over nine percent in 2013, the global PC market is on pace to contract only three percent in 2014. In addition, some significant PC manufacturers have recently made public statements indicating that enterprise demand continues to improve, thus potentially enabling some growth in 2014; Gartner's growth forecast for enterprise IT spend is around two percent.

In response to these trends, it appears that fab utilization rates at our customers are generally increasing, with capacity at leading edge technology nodes at or near full utilization. Certain industry analysts' consensus for digital IC unit growth during the third calendar quarter is between four and five percent. Other reports and comments from customers generally indicate a firm outlook for demand in the September quarter. With the continuation of positive trends in mobile connectivity, and some recovery within the PC market, this would imply sustained semiconductor demand, and accompanying demand for our CMP consumables products.

This industry outlook was further supported during our company's participation at Semicon West earlier this month in San Francisco. The overall tone at the conference was generally optimistic for the longer term, driven by a number of technology inflection points, such as 3D NAND, FinFet and multi-patterning. These emerging applications have introduced technical challenges; however, we believe they represent business growth opportunities for a company like ours. These new device architectures have driven the need for new innovations in fab materials and should drive increased demand for CMP consumables. Despite a somewhat cautious near term outlook, as 3D NAND and FinFet have seen a relatively slow ramp primarily due to technical challenges, we remain confident about the important role highly engineered materials and highly formulated CMP solutions like ours, are likely to play going forward.

Turning now to company related matters, we are pleased that our CMP polishing Pads business achieved year-over-year revenue growth of approximately four percent during the quarter. This represents the second consecutive quarter of year-over-year revenue growth. Customers continue to actively sample our D100 and D200 pad products for new business opportunities and we believe our expanding, high-quality pipeline of evaluations underway with our customers underscores our attractive pad value proposition of longer pad life and lower defectivity. Roughly 20 percent of our pipeline of Pads business opportunities is specific to evaluations and qualifications of our D200 platform, including several technology leading customers, where we believe our tunable platform can provide particular value. Our global business teams continue to partner with existing and new customers, and as a result of these collaborations we won new D100 and D200 business for shallow trench isolation and advanced node applications during the quarter.

Furthermore, our product development teams are actively working to expand our product portfolio to address market needs and our customers' evolving performance and cost of ownership requirements. We continue to believe our Pads business represents a significant growth opportunity for our company.

Turning to our IC CMP slurry business, our Tungsten and Advanced Dielectrics businesses achieved record revenue in the quarter and year-over-year revenue growth for the second consecutive quarter. We are also pleased with the continued growth we are experiencing with our slurry products for polishing aluminum, as we assist our customers with their ramp of advanced technology nodes. Year-to-date revenue from our Aluminum business is up approximately 25 percent year-over-year. Additionally, during the quarter we won new business for tungsten and copper applications, including legacy and advanced node technologies. As we have discussed in the past, we are focusing our research and development activity much more heavily on innovating game-changing technology for leading edge applications with technology leading customers. Our CMP solutions for polishing tungsten, advanced dielectrics and aluminum are specific examples of our ability to innovate to meet our customers' challenging product performance requirements.

Concluding my remarks this morning, we continue to navigate this challenging growth environment while helping to enable our customers' transition to more advanced node technologies. Technology node transitions are becoming more challenging with the ongoing introduction of new materials to be polished and evolving device architectures. As a key technology enabler, we believe our broad and deep technical capabilities, as well as our global supply chain management and advanced quality systems, differentiate us from our competitors, and position us well to continue to successfully partner with our customers to consistently deliver high-performing and high-quality products and services.

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

Thanks, Bill, and good morning everyone.

Revenue for the third quarter of fiscal 2014 was $108.4 million. We generated 2.5 percent revenue growth from our CMP consumables products for semiconductor applications over the prior year; however, lower revenue from our QED Technologies business, which is capital-equipment oriented, primarily drove the overall 1.5 percent year-over-year decline in total revenue. As Bill mentioned, revenue from our CMP consumables products increased by approximately nine percent sequentially, which is higher than the seven percent increase we had been seeing for the first several weeks of April that we mentioned when we reported results for our second fiscal quarter. Year to date, revenue of $308.3 million represents a decrease of 2.7 percent from the prior year, reflecting lower revenue from QED Technologies, and also including a $2.7 million adverse impact associated with foreign exchange rate changes, primarily the weaker Japanese yen versus the U.S. dollar.

Drilling down into revenue by business area,

Tungsten slurries contributed 38.9 percent of total quarterly revenue, with revenue up 9.1 percent from the same quarter a year ago. Our Tungsten business achieved record revenue during the quarter, reflecting strong demand from the memory and foundry segments, and year-over-year revenue growth for the second consecutive quarter.

Dielectrics slurries provided 27.4 percent of our revenue this quarter, with sales down 3.0 percent compared to last year. Within Dielectrics, revenue from our Advanced Dielectrics business represents a record level this quarter, and a second consecutive quarter of year-over-year revenue growth.

Sales of slurries for polishing metals other than Tungsten, including Copper, Aluminum and Barrier, represented 18.1 percent of our total revenue, and decreased 2.3 percent from the same quarter last year. Revenue from our Aluminum business reflects an increase of 3.5 percent from the same quarter last year.

Sales of our polishing pads represented 8.1 percent of our total revenue for the quarter and reflect an increase of 3.7 percent from the same quarter last year. Revenue from our Pads business increased year-over-year for the second consecutive quarter.

Data Storage products represented 3.9 percent of our quarterly revenue, down 19.8 percent from the same quarter last year.

Finally, revenue from our Engineered Surface Finishes business, which includes QED, generated 3.6 percent of our total sales, and was down 44 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 47.7 percent of revenue. This is down from 49.7 percent in the same quarter a year ago, and was lower than we expected. Compared to the year ago quarter, gross profit percentage decreased primarily due to higher variable manufacturing costs, including higher raw material costs, and higher logistics costs. In particular, during the quarter we experienced lower slurry manufacturing yields. In addition, this quarter we sold some inventory that was produced last quarter in a lower production environment, and so it carried higher unit costs; we have seen this transitory cost impact in the past.

Year to date, gross profit represented 47.3 percent of revenue, which includes a 70 basis point adverse impact of the asset impairment charge we recorded during the second fiscal quarter, related to certain manufacturing assets. We expect gross profit for the full fiscal year to be around 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 $33.2 million were 2.6 percent higher than in the third quarter of fiscal 2013. The increase was primarily due to higher travel costs, and professional fees associated with amending our existing credit agreement, which we completed this quarter.

Year to date, total operating expenses were $97.2 million, which is 3.0 percent lower than during the same period last year. We continue to expect operating expenses for the full fiscal year to be between $127 million and $131 million.

Diluted earnings per share were 53 cents this quarter, compared to 65 cents reported in the third quarter of fiscal 2013, which included a 5 cent benefit associated with our permanent reinvestment election in Japan. Year to date, diluted earnings per share were $1.39, which includes a 6 cent adverse effect of the asset impairment charge, compared to $1.46 last year.

Our year to date effective income tax rate was 25.9 percent. We continue to benefit from increased pretax profits in certain foreign jurisdictions. We now expect our effective tax rate for full fiscal year 2014 to be within the range of 26 to 28 percent, which is lower than our previous estimate of 27 to 29 percent.

Turning now to cash and balance sheet related items, capital investments for the quarter were $2.9 million, bringing our year to date capital spending to $10.2 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 $5.0 million. In addition, we purchased $18.6 million of our stock during the quarter under our share repurchase program, compared to $10.0 million in the same quarter last year. As of the end of the quarter, there was approximately $131 million of authorization remaining in our share repurchase program.

In late June we amended our existing credit agreement. The amendment improves certain pricing and covenant terms, brings the total term loan commitment back to its original amount and extends the maturity date to 2019. We ended the quarter with a cash balance of $265.5 million and have $175.0 million of debt outstanding.

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

During the third fiscal quarter, we saw an increase in revenue for our CMP consumables products of approximately nine percent compared to the prior quarter. As we observe orders for our CMP consumables products received to date in July that we expect to ship by the end of the month, we see July results trending roughly in line with the average rate in our third fiscal 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.

That is all the questions we have this morning. Thank you for your time and your interest in Cabot Microelectronics.