Cabot Microelectronics Corporation
First Quarter Fiscal Year 2015 Conference Call Script
January 29, 2015

Good morning. With me today are Bill Noglows, Chairman of our Board of Directors, David Li, President and CEO, and Bill Johnson, Executive Vice President and CFO.

This morning we reported results for our first quarter of fiscal year 2015, which ended December 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, 2014. 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.

On December 16, we announced that our Board of Directors had elected David Li, as President, CEO, and member of the Board, effective January 1, and that I am continuing to serve as Chairman in an Executive capacity. I am delighted with this exciting transition for our company, and to take this opportunity at our first quarter earnings conference call of fiscal 2015 to introduce David.

Over the last several years, we have shared in detail with you the tremendous value proposition we believe that we bring to our strategic customers, delivered through close collaboration as we develop leading-edge solutions for their increasingly demanding requirements. During this time, we have expanded our infrastructure to better serve our growing customer base in Asia. Today, over half of our fixed assets and our global staff are located in the region where we generate more than 80 percent of our revenue and have approximately 75 percent of our production activity. Through this approach, our company has generated very strong business and financial results. David's appointment as CEO reaffirms our commitment to this strategy. Let me provide a little background on David and the experience he brings to this role.

David has been a key contributor to the company's success in a wide-range of roles over 15 years with our company. For the last seven years he has served as Vice President of Asia Pacific. In this role, David has developed deep partnerships with our key customers, and has proven to be an outstanding leader. I am confident that as our CEO, David's track record, energy and vision for the continued growth and development of our company -- coupled with our history of strong operational and financial management and results -- will mean ongoing success for our company and greater value for our shareholders.

It has been an honor to lead Cabot Microelectronics as its CEO for the last eleven years, and I am confident that our long-term executive succession planning will continue to provide for a seamless transition of leadership. Continuing as Chairman, I look forward to working with David and the rest of the Board to advance our company's strategy.

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

Thank you, Bill, and good morning everyone.

I am honored and excited by the opportunity to serve as CEO of Cabot Microelectronics. First, I would like to thank and recognize Bill for his leadership of our company over the past 11 years. It is Bill's vision and leadership that has made us the very successful company that we are today. Further, I am delighted that Bill is continuing to serve as Chairman of our Board of Directors and look forward to continue working with him in this capacity

Now I would like to provide a high level summary of our quarterly financial results, offer some commentary on our views of the current condition of the semiconductor industry, and provide an overview of our business activities.

This morning we announced very strong financial results for our first quarter of fiscal 2015, which continues the strong positive momentum we experienced during our fourth fiscal quarter of 2014. During the quarter we achieved revenue of $111.9 million dollars, 11 percent higher than the same quarter last year. We recorded a gross profit margin of 50.9 percent of revenue, representing a 340 basis point improvement year-over-year, and record earnings per share of 80 cents, an increase of 78 percent compared to the prior year. We believe our results are evidence of the continued successful execution of our business strategies, including closely collaborating with our strategic customers, technology leadership, and operations and quality excellence. We are encouraged by this strong start to our fiscal year, about which Bill Johnson will provide more detail.

Let me now share a few thoughts on our views of the current state of the semiconductor industry. A few weeks ago we participated in SEMI's Industry Strategy Symposium, or ISS conference, in California. This is an annual event, which focuses on trends in the industry from economic, market, technology and manufacturing perspectives. The conference addressed the demands for the continued development and manufacture of advanced semiconductor devices, while stressing the importance of supply chain excellence to deliver increased value to all stakeholders. Equally important was the shared view of sustained future growth for the industry, driven by the continued demand for mobile devices and systems, stabilization of traditional PC markets, and the future potential of the Internet of Things, all of which are expected to drive greater innovation and demand for semiconductor devices. We share this view of the future of the industry, and based on our own analysis, our customers' expectations, and other external forecasts, we remain highly energized and optimistic about the long term future growth prospects for our company.

As we have discussed in the past, we have seen our customers increasingly emphasize development and production of advanced technologies like High-K Metal Gate, 3D NAND and FinFET, in response to the industry's continued scaling of semiconductor devices to smaller geometries. These advancements are driving the need for new and critically important CMP steps, which require more rigorously formulated and higher quality CMP solutions. As demonstrated by our early leadership in Aluminum slurries for High-K Metal Gate, we expect that these advancements will continue to play into our strengths as a CMP technology leader while we partner with our strategic customers to help enable new transistor and device architectures. We believe our focused approach to R&D and new product development, and our global footprint will continue to enable us to capitalize on new product introductions and win more business.

Moving on to near term semiconductor industry conditions, various industry reports suggest that overall IC inventories are generally on the lean side of normal levels, primarily driven by solid demand for mobile devices during the holiday season, and a firm forecast for electronic system shipments going forward. In response to this, IC manufacturers continue to actively manage inventory in the supply chain, with capacity utilization at leading edge technology nodes greater than 95 percent, and overall industry utilization at approximately 90 percent. Recent reports by a number of our customers call for typical seasonal softening during the March quarter. Conversely, the leading foundry is calling for near-term demand that appears to be stronger than normal seasonal demand. Recall that typically, we experience seasonal softening of demand in our second fiscal quarter, which is historically our seasonally weakest quarter of the year. Later in the call, Bill Johnson will provide some commentary on recent order patterns.

Now let me turn to our core IC CMP consumables business, which generated 10 percent revenue growth compared to the same quarter last year. During the quarter, we experienced solid growth in demand for our CMP solutions for both memory and logic applications year-over-year. Our Tungsten product area achieved record quarterly revenue for the third consecutive quarter and we attained double digit year-over-year revenue growth in this area, as well as for our Aluminum, Pads and Advanced Dielectrics slurries.

We believe this growth is a result of our continued focus on offering CMP solutions for advanced and legacy applications that are designed to deliver higher performance and significantly lower costs to our customers. In particular, we are currently introducing a new family of Dielectrics products, which we commercially launched in July of last year and first mentioned during our third quarter call of fiscal 2014. We believe these solutions will provide higher performance and greater value to our customers, compared both to competitors' products and some of our own existing products, while also improving our profitability. We have high expectations for the adoption of these new solutions, and we are encouraged by our customers' level of sampling and a number of their positive initial reactions to product performance.

In summary, our overall pipeline of new business opportunities in our CMP consumables business remains rich, with product evaluations underway with customers across a wide range of slurry and pad applications and technology nodes. Further, our global teams continue to partner closely with our technology leading customers to satisfy their ever increasing performance requirements.

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

Thanks, David, and good morning everyone.

Revenue for the first quarter of fiscal 2015 was $111.9 million, 11.4 percent higher than the same quarter last year. We generated 10.2 percent revenue growth from our CMP consumables products for semiconductor applications compared to the prior year. I would add that foreign exchange rate changes, primarily the weaker Japanese yen versus the U.S. dollar, reduced revenue by $1.2 million year-over-year.

Drilling down into revenue by product area:
Tungsten slurries contributed 40.3 percent of total quarterly revenue, and we achieved record revenue for the third consecutive quarter. Revenue was up 20.8 percent from the same quarter a year ago, reflecting strong demand from the foundry, memory and logic segments.

Dielectrics slurries provided 25.2 percent of our revenue this quarter, with overall sales down 5.9 percent from the same quarter a year ago. The revenue decrease reflects the loss of some low margin, legacy Inter Layer Dielectrics business that we mentioned during our call last quarter. However, within Dielectrics, revenue from our Advanced Dielectrics product area grew 18.1 percent compared to the same quarter last year; this represents the fourth consecutive quarter of year-over-year revenue growth in Advanced Dielectrics.

Sales of slurries for polishing metals other than Tungsten, including Copper, Aluminum and Barrier, represented 17.8 percent of our total revenue, and increased 11.8 percent from the same quarter last year. Within this area, revenue from our Aluminum slurry products grew 35.6 percent compared to the prior year.

Sales of polishing pads represented 7.8 percent of our total revenue for the quarter, and increased 18.2 percent compared to the same quarter last year; we have now grown our pad revenue year-over-year for four consecutive quarters.

Data Storage products represented 3.9 percent of our quarterly revenue. Our Data Storage revenue was down 12.4 percent from the same quarter last year on soft PC demand, and some business loss that we first mentioned during our third quarter call of fiscal 2014.

Finally, revenue from our Engineered Surface Finishes, or ESF area, which includes QED, generated 5.0 percent of our total quarterly sales. Our ESF revenue was up 86 percent from the same quarter last year. Volatility in our QED revenue is common, since it is primarily a capital equipment-oriented business.

Our gross profit this quarter represented 50.9 percent of revenue. This is up 340 basis points from 47.5 percent in the same quarter a year ago. Compared to the year ago quarter, gross profit percentage increased primarily due to product mix, higher sales volume and benefits associated with foreign exchange rate changes, partially offset by effects of lower manufacturing yields, higher raw material costs, and higher fixed manufacturing costs. Our full fiscal year 2015 guidance range of 48 to 50 percent of revenue remains unchanged

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 $34.4 million were $2.4 million higher than in the first quarter of fiscal 2014. The increase was primarily due to separation costs associated with the departure of three executive officers, which we announced in early January, and higher incentive compensation costs.

Recall that we typically experience an increase in operating expenses in the March quarter due to certain new calendar year factors such as merit salary increases, higher payroll taxes, and higher costs around our annual meeting in March. We continue to expect operating expenses for our full fiscal year 2015 to be between $132 million and $137 million.

Diluted earnings per share were a record 80 cents this quarter, which represents an increase of 78 percent compared to the 45 cents we reported in the first quarter of fiscal 2014. This reflects higher revenue and gross margin, partially offset by higher operating expenses, and also reflecting the benefit of a lower effective tax rate. Our effective tax rate for the first fiscal quarter was 12.3 percent, compared to 26.8 percent last year. We continue to benefit from lower income tax expense on foreign earnings, and this quarter we saw a specific benefit from the reinstatement of the U.S. research and development tax credit. We now expect our effective tax rate for full fiscal year 2015 to be within the range of 16 to 18 percent, which is lower than our previous estimate of 18 to 20 percent.

Turning now to cash and balance sheet related items, capital investments for the quarter were $2.5 million. For full fiscal year 2015, we continue to expect capital spending to be within the range of $10 million to $15 million. Depreciation and amortization expense for the quarter was $4.7 million. In addition, we purchased $15.0 million of our stock during the quarter under our share repurchase program, and as of the end of the quarter, there was approximately $110 million of authorization remaining. We generated cash flow from operations of $21.7 million, and we ended the quarter with a cash balance of $295.4 million and have $170.6 million of debt outstanding.

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

During the first fiscal quarter, we saw a four percent decrease in revenue for our CMP consumables products, compared to the fourth quarter of fiscal 2014. Typically we see further seasonal weakening of demand in our second fiscal quarter. As we observe orders for our CMP consumables products received this month, we see January results trending slightly below the average rate in our first fiscal quarter. However, with this years' Lunar New Year beginning on February 19th, our strong January orders to date may reflect some pre-buying before the holiday. Our expectation is for some softening of demand during our second fiscal quarter.

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 will now turn the call back to David for some closing remarks.

Thanks, Trisha.

Concluding my remarks today, I would like to reemphasize that we continue to focus on growth and development as the world’s leading supplier of CMP polishing slurries and a growing supplier of CMP pads. Looking ahead, we expect to continue to partner closely with our technology leading customers to innovate and commercialize leading-edge CMP solutions to meet their challenging product performance requirements. We are committed to continuing to provide value to our shareholders over a range of industry and macroeconomic environments through ongoing implementation of our core strategies of technology leadership, collaborating with customers, and operations and quality excellence.

We look forward to the next opportunity to speak with you. Thank you for your interest in Cabot Microelectronics.