Cabot Microelectronics Corporation
First Quarter Fiscal Year 2017 Conference Call Script
January 26, 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 first quarter of fiscal year 2017, which ended December 31, 2016. 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 first quarter of fiscal 2017, as we achieved record levels of revenue and profit for the second consecutive quarter. Our performance reflects strong semiconductor industry demand and the continued successful execution of our strategic initiatives, including continued momentum from last year in three key product areas – CMP slurries for polishing tungsten, dielectrics slurries, and CMP pads.

During the quarter, we realized record revenue of $123.3 million dollars, approximately 23 percent higher than in the same quarter last year. Our gross profit margin was 49.9 percent of revenue and we achieved record diluted earnings per share of 88 cents, which represents an increase of approximately 91 percent compared to last year. In addition, we continued our strong cash flow generation trend, with cash from operations of $25.1 million dollars.

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

To provide some context for our first quarter results, let me first offer some perspectives on the global semiconductor industry environment. As forecast by several of our customers and industry analysts, industry demand was solid during the December quarter and our results are consistent with this, as well as with the expectations we discussed during our fourth quarter conference call in October. You may recall that at the end of the September quarter, most IC inventories related to smartphone, wireless, network, automotive, and gaming markets were at lean levels. As a result of this, demand for our IC CMP consumable products remained healthy through the quarter, which historically has seen seasonally softer conditions.

Now, exiting the December quarter, industry reports and comments made recently by some of our strategic customers suggest that foundry and logic inventories may be slightly elevated due to some seasonality in mobile areas. Conversely, other reports suggest that memory inventories, particularly

3D NAND and DRAM, are lean due to robust end demand, including the continued proliferation of solid state drives, and tight production capacity. Industry analysts generally hold a strong outlook for the semiconductor industry for the full year, but based on these near-term views, industry expectations are for a minor inventory correction for some ICs during the March quarter, which is historically seasonally soft. Since our company supplies virtually all semiconductor manufacturers in the world, we believe we are well-positioned for success even with differing near-term demand conditions across the foundry, logic and memory segments. Later in the call Bill will provide commentary on our expectations for demand of our IC CMP consumable products during the March quarter.

Transitioning to a longer term view, two weeks ago, our company attended SEMI's Industry Strategy Symposium in California. This annual event early in the calendar year, represents a great opportunity to compare views with other industry participants. The theme of this year's conference was "growth – within a changing landscape and amidst new opportunities," with the overall industry sentiment expressed at the event decidedly bullish for 2017, and beyond. Discussion at the conference highlighted two particular areas. The first is how industry consolidation among device makers, equipment companies and materials suppliers, along with efforts to establish a more robust domestic semiconductor industry supply chain in China, is changing the competitive landscape. The second area focused on growth opportunities, highlighting demand for ICs driven by automotive, industrial automation and data center applications. Participants also predicted a stable demand outlook for consumer devices including smartphones, and additional future growth from the internet of things. In particular, the outlook for memory seems to be strong given the storage required to support the future needs for connected devices, and relatedly the transition from 2D to 3D NAND. We believe our focused business model, along with our broad product and technology portfolio, and extensive global infrastructure, position us well for continued growth within this expected environment – for example, in fiscal 2016 our revenue grew in the memory segment by approximately 18 percent, and in China our revenue grew by approximately 20 percent.

Now let me turn to company related matters. During the quarter, we experienced strong demand for our tungsten and dielectrics slurries and pads solutions across a wide range of applications and technology nodes. This drove approximately 24 percent year-on-year revenue growth for the quarter from our IC CMP consumable products. Of particular significance, we achieved year-on-year revenue growth in China of approximately 36 percent for the quarter. Our strong business position there is notable, given expectations for long-term growth in China.

Turning to CMP slurries, during the quarter we experienced robust demand driven by the growing adoption of 3D NAND and FinFET technologies, as well as our leading supply positions in other applications. As we have discussed in the past, 3D NAND and FinFET applications require additional CMP steps, in particular tungsten and dielectrics. As a result, we achieved record revenue in our tungsten product area in the first fiscal quarter, and year-over-year revenue growth of approximately 25 percent. Over the years, we have seen sustained revenue growth from our tungsten products, which underscores our continued leadership in, and commitment to, this important product area.

In addition, we achieved significant growth from our dielectrics slurries, with revenue up approximately 27 percent compared to the same quarter last year. This was primarily driven by demand for our ceria and colloidal-silica based dielectrics solutions for advanced applications. We believe these CMP solutions provide benefits of higher removal rate, improved defectivity and lower cost of ownership, and as a result, during the quarter we won new business for 3D NAND and DRAM memory applications with our ceria solutions.

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

I am pleased to report that during the quarter we were one of only four consumables suppliers, and the only CMP supplier, to receive an Outstanding Performance Supplier Award from Inotera, a wholly-owned subsidiary of Micron, which is now our third largest customer. For the second consecutive year, our company was recognized for demonstrating outstanding performance in quality, technical service, safety, cost and logistics. We are honored to have earned this prestigious award and believe this repeated recognition from Inotera, along with the many other awards we have won over the years from a number of other customers, are evidence of our long-term commitment to collaborating closely with our customers, and our ability to deliver a broad portfolio of best-in-class CMP solutions, to the highest standards for quality, performance and technology.

Turning to CMP pads, this quarter we achieved record revenue and year-over-year revenue growth of approximately 54 percent. This was driven by continued strong customer pull for our products, including slurry and pad consumable sets. During the quarter, we added to our rich pipeline of new business opportunities across a wide range of customers and applications, and we are working to expand our product offerings. We continue to leverage our global sales channel and technical resources to speed the qualification and adoption of our pad offerings, and we continue to experience significantly shorter qualification times than in our prior efforts. As a result, we are confident in our ability to grow our pads revenue from approximately $52 million dollars that we achieved in fiscal 2016 to between $80 and $90 million dollars in fiscal year 2018, which we have previously discussed.

In further support of our strategy to accelerate growth in our pads product area, and to position our company for sustained growth in China, in early November we announced a collaboration with Konfoong Materials International, or KFMI. KFMI is a privately-owned, China-based company specializing in the development and manufacture of ultra-high purity metal materials and sputtering targets for the global semiconductor and integrated circuit industries. The collaboration combines our NexPlanar pad technology with KFMI’s experience in materials manufacturing, including their ability to meet the strict quality standards required of the semiconductor industry. Also, this collaboration emphasizes our commitment to provide semiconductor manufacturers in China with reliable, local manufacture of the most advanced CMP pad technology. We are proud to partner with KFMI on this exciting initiative and look forward to updating you in the future on our progress.

Looking ahead, I am confident of continued momentum in each of our tungsten, dielectrics and pads product areas, including CMP slurry and pad consumable sets, which we believe provide the foundation for continued profitable growth for our company. We remain focused on delivering innovative, high-performing and high-quality CMP solutions, which leverage our global resources, quality systems and supply chain capabilities. We believe these attributes, combined with our focused business model, differentiate us among leading suppliers of specialty materials to the semiconductor industry, and position us well to deliver another year of strong performance.

And 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 first quarter of fiscal 2017 was a record $123.3 million, which represents a 22.8 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.

Drilling down into revenue by product area:

Tungsten slurries contributed 44.9 percent of total quarterly revenue. We achieved record revenue for the quarter, with revenue up 24.5 percent compared to the same quarter last year. Our tungsten growth was driven by strong demand from both memory and logic applications, including 3D memory and FinFET, which we are confident will continue to drive profitable growth for our company.

Dielectrics slurries provided 23.8 percent of our revenue this quarter, with sales up 27.2 percent from the same quarter a year ago. As Dave mentioned earlier, during the quarter, we saw continued strong demand for some of our new, high-performing ceria and colloidal-silica based dielectrics slurry products.

Sales of polishing pads represented 13.2 percent of our total revenue for the quarter, and increased 54.2 percent compared to the same quarter last year. Our pads product area achieved record revenue during the quarter.

Sales of slurries for polishing metals other than tungsten, including copper, aluminum and barrier, represented 12.8 percent of our total revenue, and decreased 3.5 percent from the same quarter last year.

Finally, revenue from our Engineered Surface Finishes area and data storage products represented 4.1 percent and 1.3 percent of our quarterly revenue, respectively.

Gross profit for the quarter was 49.9 percent of revenue, compared to 50.0 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 50.9 percent of revenue. Other factors impacting gross profit this quarter compared to last year include higher sales volume, a higher valued product mix and higher fixed manufacturing costs, including higher incentive compensation expense. Our full fiscal year GAAP gross profit guidance range of 48 to 50 percent of revenue remains unchanged. This includes approximately 100 basis points of 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 $33.4 million, including $0.5 million of NexPlanar amortization expense. Operating expenses were $2.4 million lower than the $35.8 million we reported in the same quarter a year ago, primarily due to the absence of costs related to both our NexPlanar acquisition and 2015 CEO transition, and lower clean room materials expense, partially offset by higher incentive compensation expense. 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. Recall that we typically experience an increase in expenses in the March quarter due to certain factors related to the new calendar year, such as merit salary increases and higher payroll taxes, and also costs related to our annual meeting in March.

Diluted earnings per share were a record 88 cents this quarter, or 92 cents on a non-GAAP basis excluding the NexPlanar amortization, which represents an increase of 91.3 percent compared to the 46 cents we reported in the first quarter of fiscal 2016. The increase in earnings this quarter was primarily driven by higher revenue and lower operating expenses, partially offset by a higher effective tax rate.

Our effective tax rate for the first fiscal quarter was 20.3 percent, compared to 15.5 percent in the same quarter last year. The increase is primarily related to changes in the jurisdictional mix of our earnings and the absence of last year's retroactive reinstatement of the research and experimentation tax credit. We now expect our effective tax rate for the full fiscal year to be within the range of 19 to 22 percent. Previously, we had estimated 17 to 20 percent for the full fiscal year.

Turning now to cash and balance sheet related items, capital investments for the quarter were $4.9 million. For the full fiscal year, we continue to expect capital spending to be within the range of $20 million to $25 million; as we have previously discussed, this includes our ongoing facility expansion in South Korea. Depreciation and amortization expense for the quarter was $6.7 million, and we generated cash flow from operations of $25.1 million. We ended the quarter with a cash balance net of debt outstanding of $151.0 million.

Our strong cash generation model has enabled us to implement a balanced capital deployment strategy, including organic investments, dividends, share repurchases and M&A. As of January 30, our next dividend payable date, we will have paid four quarterly cash dividends -- nearly $18 million -- to our shareholders since the initiation of our dividend program in January, 2016. This reflects a payout ratio of approximately 30 percent of our fiscal 2016 net income, and 23 percent of free cash flow. We believe we are well-positioned for continued delivery of significant value to our shareholders in this regard.

I'll conclude my remarks with a few comments on demand for our IC CMP consumable products.

During the first fiscal quarter, we saw a five percent increase in revenue from our IC CMP consumable products, compared to the fourth quarter of fiscal 2016. Earlier, Dave talked about general expectations of some industry participants for softer near-term semiconductor industry demand, consistent with traditional seasonal patterns. In addition, recall that the Lunar New Year, which begins on January 28, typically introduces some fluctuation in demand around this holiday period. Consistent with all of this, we expect demand for our IC CMP consumable products in the March quarter to be around five percent lower than in our first fiscal quarter.

To summarize, from a financial standpoint, we continued our strong performance from the second half of fiscal 2016 and achieved record revenue and profit again this first fiscal quarter. Looking ahead, our expectations are for seasonally softer demand conditions during our second fiscal quarter and the typical increase in expenses due to the new calendar year; however, at present we would expect some general seasonal strengthening of demand in the second half of our fiscal year. We believe we are well-positioned to deliver another year of strong performance in fiscal 2017.

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. Thank you for your time and your interest in Cabot Microelectronics.