CABOT MICROELECTRONICS CORPORATION
FOURTH QUARTER AND FULL FISCAL YEAR 2017
CONFERENCE CALL SCRIPT
OCTOBER 26, 2017

Good morning. With me today are David Li, President and CEO, who is participating in our call from our office in Shanghai, and Bill Johnson, Executive Vice President and CFO.

This morning we reported results for our fourth quarter and full fiscal 2017, 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, 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 record quarterly and annual results for revenue, diluted earnings per share and cash flow from operations for our fourth quarter and full fiscal 2017. This reflects sustained successful execution of our strategic initiatives, coupled with strong semiconductor industry demand. During the quarter, we achieved revenue of $136.8 million, approximately eleven percent higher than in the same quarter last year, and diluted earnings per share of $1.03, which represents an increase of 24 percent compared to last year. In addition, we continued our strong cash flow generation trend, with cash flow from operations of approximately $50 million. For full fiscal 2017, we achieved revenue of $507.2 million, approximately 18 percent higher than last year – well in excess of industry growth. We also achieved diluted earnings per share of $3.40, which represents an increase of approximately 40 percent compared to full fiscal 2016, and cash flow from operations of approximately $140 million.

We believe our record revenue and earnings performance in fiscal 2017, after also achieving record earnings in fiscal 2015 and 2016, is evidence of the strength of our focused business model, our continued technology leadership, and strong execution.

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

To provide some context for our fourth quarter results, let me first offer some perspectives on the global semiconductor industry environment. As reported by some of our customers and industry analysts, IC demand was strong during the September quarter, and our results reflect this. Reports suggest that overall semiconductor demand was driven by a continued robust memory market, generally due to the growing requirements for storage in a wide range of end-use applications, as well as a healthier logic market driven by mobile product launches. Due to this, some of our customers and industry analysts have reported expectations for continued firm demand during the December quarter. This is also consistent with what I am hearing from customers in Asia, and through October we have seen continued solid demand for our IC CMP consumables products. Later in the call, Bill will provide commentary on our revenue expectations for the December quarter.

Considering longer-term expectations for the semiconductor industry, we believe a number of factors will drive growth in semiconductor industry demand over time:

First, the ongoing transition from traditional planar or 2D NAND memory to advanced 3D NAND especially for mobile and server applications. General industry commentary as well as what we have observed from our customers suggests that the industry appears to still be in the early stages of transition, in terms of wafer starts, with around 30 percent of the NAND market having been converted to 3D memory. You may recall that the transition from 2D to 3D memory is significant for our business, since 3D NAND technology requires roughly twice the number of CMP steps, in particular tungsten and dielectrics. With 2D memory still representing nearly 70 percent of the NAND market, we expect the industry transition from 2D to 3D memory will continue over the next several years.

Second, reports also indicate healthy demand for legacy logic technologies driven by demand in automotive, sensors, and connected devices, along with strong demand in advanced logic driven by high-performance computing, artificial intelligence and new smart phone introductions.

And, third is semiconductor growth in China. China continues to be in the spotlight, with a number of fabs under construction, others announced, and additional domestic and international investment in both logic and memory capacity expected in the future.

We believe we are well-positioned to benefit from these long-term industry demand trends, based on our global resources, capabilities and infrastructure, which we believe uniquely position us to deliver innovative CMP solutions to our customers around the world, and across the foundry, logic and memory segments. Based on our positioning, technology leadership, and execution, we expect to continue to be able to grow our company faster than the industry.

Within that semiconductor industry context, now let me turn to company related matters. During fiscal 2017, we experienced robust demand for our tungsten and dielectrics slurries, and polishing pads solutions supported by the differentiated, value-added total customer experience we provide. This drove approximately 18 percent year-on-year revenue growth for the full fiscal year. Of particular significance, we achieved year-on-year revenue growth of approximately 26 percent in China and 25 percent in Korea for the full fiscal year. Our strong positions in these countries are notable, given expectations for long-term overall semiconductor growth in China, and continued memory growth in Korea.

Now let me provide an update on each key product area, beginning with tungsten slurries. During fiscal 2017, we experienced strong demand for our tungsten slurry products across a wide range of applications and technology nodes. As a result, we achieved record revenue in our tungsten product area in the fourth fiscal quarter, and for the full year. Robust demand for our unique, high-performing tungsten solutions, which embody broad and deep technology, covering a wide range of applications and technology nodes, drove year-over-year revenue growth of approximately 19 percent for the full fiscal year. This year we continued to support our strategic customers' transitions to 3D NAND and FinFET technologies using our tungsten slurries. For full fiscal 2017, approximately 28 percent of our tungsten revenue was driven by these advanced technologies; this is up significantly compared to 20 percent in fiscal 2016, and thirteen percent in fiscal 2015. We believe the strong growth trajectory we have demonstrated in our tungsten product area reflects the continued successful execution of our strategies of technology leadership and supply chain and operations excellence. Building on our robust intellectual property portfolio, we have introduced around 15 advanced tungsten solutions for 3D NAND and FinFET applications over the last three years, and our customers continue to be delighted by our quality and supply chain excellence. We believe this combination of innovation, execution, and experience has enabled the leadership we have earned in this area, and underscores our commitment to this important product area. From this strength, we expect continued profitable growth in our tungsten product area, as the industry continues to move to advanced applications, particularly in memory.

Moving on to our second key product area, during fiscal 2017 we continued to advance the broad transformation of our dielectrics slurries, in conjunction with the commercialization of our family of higher performing, lower cost and higher profitability products. Our success on this initiative over the last three fiscal years was a key contributor to the record quarterly revenue we achieved during the fourth fiscal quarter, and the approximately 21 percent year-over-year revenue growth for the full fiscal year. Throughout the year, we continued the qualification of our colloidal silica-based dielectrics solutions, winning new opportunities, displacing incumbents and replacing some of our own legacy solutions. In addition, we also saw strong demand for our high-performing ceria-based dielectrics slurries, which have provided our customers with higher throughput, improved defectivity and lower cost of ownership. As a result of our efforts, we are experiencing higher growth and profitability from these ceria and colloidal solutions.

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

Turning to CMP pads, our third key product area, during the fourth fiscal quarter we achieved record revenue for the eighth consecutive quarter. Our revenue for the full year was also a record, and grew by approximately 32 percent year-over-year, well in excess of industry growth. We believe we have doubled our participation in pads in the past two years. Our growth in this area is a result of continued broad customer adoption of our products across the foundry, logic and memory segments, as we leverage our global sales channel, technical resources and infrastructure to speed the qualification of our pad offerings. In addition, we are leveraging our supply chain capabilities, manufacturing expertise and quality systems to improve supply assurance, productivity and profitability in our pads product area. Finally, during the year we expanded our pad product offerings with the commercialization of a family of new configurations focused on improving both performance and profitability in this product area.

We continue to view CMP pads as the greatest organic growth opportunity for our company. Based on our full fiscal 2017 revenue of approximately $69 million and the momentum we have achieved in this product area over the past several years, and consistent with what we have previously discussed, we are confident that we will be able to grow our pad revenue to over $100 million in fiscal 2019, which would reflect compound annual growth of at least 20 percent.

The execution of our strategic initiatives this fiscal year also included progress on the commercialization of CMP slurry and pad consumable sets. Supporting this, we experienced customer pull for our combined products. As we have discussed in the past, we continue to see consumable sets as a growth driver, and we believe that given our broad product portfolio in CMP slurries along with our technology and capabilities in CMP pads, we are uniquely positioned to deliver best-in-class slurry and pad consumable sets.

During fiscal 2017, we earned a number of significant awards from our customers in recognition of our ability to successfully deliver innovative, high-quality, high-performing, and reliable CMP slurries and polishing pads. We were honored to have again earned: Intel's most prestigious award for suppliers, the Supplier Continuous Quality Improvement Award, for the fifth consecutive year; Texas Instruments' Supplier Excellence Award; the Outstanding Performance Supplier Award for the second consecutive year from Inotera, a subsidiary of Micron; and, SMIC's Best Supplier Award. We are proud of this recognition, and also of the awards we have received from other customers over the years. We believe these awards are an important part of our company's brand, and evidence of the unique value we provide to our customers through close collaboration.

To summarize, as we enter fiscal 2018, I am confident that we are well-positioned for continued profitable growth, in excess of the IC CMP consumables market, based on the significant momentum in our tungsten, dielectrics and polishing pads product areas. We believe that our effective execution in these areas, along with our global resources, capabilities and infrastructure, differentiate us among leading suppliers of specialty materials to the semiconductor industry, and position us well to continue delivering significant value to our shareholders.

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 fourth quarter of fiscal 2017 was a record $136.8 million, which represents an 11.5 percent increase from the same quarter last year. Total revenue for the full fiscal year was $507.2 million and a record level for our company, which represents a 17.8 percent increase from fiscal 2016. Our fourth quarter and full year revenue results reflect the continued successful execution of our strategic initiatives and continued strong global semiconductor industry demand that we have seen over the last six quarters.

Drilling down into revenue by product area:

Tungsten slurries contributed 43.6 percent of total quarterly revenue. We achieved record tungsten revenue for the quarter, with revenue up 18.0 percent compared to the same quarter in fiscal 2016, and also record revenue for the full year, up by 19.5 percent compared to fiscal 2016. We continue to see strong demand for our tungsten slurries for advanced applications, including 3D memory and FinFET; and, as Dave discussed earlier, we expect this key product area will drive future profitable growth for our company.

Dielectrics slurries, representing a second key product area, provided 24.0 percent of our revenue in the fourth fiscal quarter. We achieved record dielectrics revenue for the quarter, with sales up 21.2 percent from the same quarter in fiscal 2016. For the full year, dielectrics slurry revenue increased by

21.3 percent. Our dielectrics slurry growth was primarily driven by strong demand for our ceria- and colloidal silica-based solutions. We look forward to winning more business in this area with our higher performing, lower cost and higher profitability products.

Sales of polishing pads – our third key product area – represented 13.0 percent of our total revenue for the quarter, and increased 14.0 percent compared to the same quarter in fiscal 2016. Our pads product area achieved record revenue for the eighth consecutive quarter. We also achieved record pad revenue for the full year, with revenue up by 31.9 percent compared to the prior year.

Sales of slurries for polishing metals other than tungsten, including copper, aluminum and barrier, represented 11.9 percent of our total revenue, and decreased 6.2 percent from the same quarter in fiscal 2016. For the full year, revenue here decreased by 1.8 percent.

Finally, quarterly revenue from our Engineered Surface Finishes business, or ESF, which includes QED Technologies, represented 6.6 percent of our total quarterly sales. For the full year, ESF achieved record revenue, which was up 24.7 percent compared to the prior year. Revenue from our data storage products represented 0.9 percent of our quarterly revenue.

Gross profit for the quarter was 51.2 percent of revenue, which is 140 basis points higher than the 49.8 percent that we reported in the same quarter of fiscal 2016. This includes $1.2 million of amortization expense related to our NexPlanar acquisition. Excluding this, non-GAAP gross profit was 52.1 percent of revenue. Factors impacting gross profit this quarter compared to last year include benefits of lower raw material costs, higher sales volume and a higher valued product mix, partially offset by higher fixed manufacturing costs, including higher incentive compensation expense.

For the full fiscal year, gross profit was 50.1 percent of revenue, which is 130 basis points higher than the 48.8 percent we reported in the prior year, and slightly above our prior full fiscal year guidance for GAAP gross profit of 49 to 50 percent of revenue. Our fiscal 2017 gross profit includes $4.8 million of amortization expense related to NexPlanar. Excluding this, non-GAAP gross profit was 51.1 percent of revenue. For full fiscal 2018, we currently expect our GAAP gross profit margin to be between 50 and 52 percent of revenue. This includes an adverse effect of approximately 100 basis points related to the 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 $37.0 million, including $0.5 million of NexPlanar amortization expense. Operating expenses were $1.7 million higher than the $35.4 million reported in the same quarter of fiscal 2016, primarily due to higher incentive compensation expense, partially offset by a gain on the sale of surplus research and development equipment, and the absence of an impairment charge recorded in fiscal 2016 for a NexPlanar intangible asset related to a technology under development.

For the full fiscal year, total operating expenses were $142.1 million, which includes $1.9 million of NexPlanar amortization expense. Previously, we had expected our GAAP operating expenses for the full fiscal year to be between $140 million and $142 million. Operating expenses were $6.4 million higher than the $135.7 million reported in fiscal 2016, primarily due to higher incentive compensation expense. We currently expect our GAAP operating expenses for full fiscal 2018 to be between $142 million and $147 million. This includes approximately $2 million of NexPlanar amortization expense.

Operating income for the quarter represented 24.2 percent of revenue, which was 320 basis points higher than in the same quarter of fiscal 2016. Operating income for the full fiscal year of 22.1 percent of revenue was 480 basis points higher than in fiscal 2016. The significant year-over-year increases represent operating leverage driven by revenue growth combined with our ongoing attention to controlling costs, and progress toward achieving our multi-year financial objective of expanding profit margins, which we introduced during our fiscal 2017 investor event.

Our effective tax rate for the quarter was 19.0 percent, compared to 16.5 percent in the same quarter of fiscal 2016.

For the full fiscal year, our effective tax rate was 20.5 percent, which is slightly below our expected effective tax rate range for the full fiscal year of 21 to 22 percent, compared to 15.0 percent in fiscal 2016.

The year-over-year increases are primarily due to the absence of last year's retroactive reinstatement of the research and experimentation tax credit, and changes in the jurisdictional mix of our earnings. We currently expect our effective tax rate for full fiscal 2018 to be within the range of 24 to 27 percent; this is higher than the rate for full fiscal 2017 primarily due to the expiration of the tax holiday benefit in South Korea that we received based on our investment in new facilities there in fiscal 2011.

Our net income for the quarter was a record $26.5 million, which was 28.0 percent higher than the $20.7 million reported in the same quarter of fiscal 2016. The increase was primarily due to higher revenue and a higher gross profit margin, partially offset by a higher tax rate and higher operating expenses. Excluding amortization expense related to NexPlanar, net income this quarter was $27.6 million on a non-GAAP basis.

For the full fiscal year, our net income was a record $87.0 million, which was 45.3 percent higher than the $59.8 million reported in fiscal 2016. Excluding the referenced amortization expense, net income this fiscal year was $91.2 million on a non-GAAP basis.

Diluted earnings per share were a record $1.03 for the fourth fiscal quarter, which represents an increase of 24.1 percent compared to the 83 cents reported in the same quarter of fiscal 2016. Excluding the NexPlanar amortization expense, diluted earnings per share this quarter were $1.07 on a non-GAAP basis.

We also achieved record diluted earnings per share for the full year of $3.40, which is 39.9 percent higher than the $2.43 reported in fiscal 2016. Excluding the amortization expense, diluted earnings per share this fiscal year were $3.56 on a non-GAAP basis.

Turning now to cash and balance sheet related items, capital investments for the quarter were $5.3 million, bringing our full year capital spending to $21.2 million. This is near the low end of our prior guidance range of $21 million to $23 million for the full year. As previously discussed, our capital spending in fiscal 2017 included our facility expansion in South Korea, which we completed during the second fiscal quarter, and expansion of our polishing pads manufacturing capacity to support anticipated growth. For full fiscal 2018, we currently expect our capital spending to be within the range of $18 million to $22 million. Depreciation and amortization expense for the quarter was $6.4 million. In addition, we purchased $8.3 million of our stock during the quarter under our share repurchase program, and $12.0 million for the full fiscal year, which leaves approximately $122 million of authorization remaining as of September 30. We generated record cash flow from operations of $51.4 million in the fourth fiscal quarter and a record $141.4 million for the full year, representing an increase of $46.2 million compared to fiscal 2016. We ended the year with a cash balance of $397.9 million, and we have $143.9 million of debt outstanding.

Our strong cash generation model has enabled us to implement a balanced capital deployment strategy over the years, for which our priorities continue to be: funding organic investments to improve our global capabilities in our core CMP consumables business, dividends, acquisitions in closely-related areas, and share repurchases. Consistent with this, in fiscal 2017 we increased our quarterly cash dividend by eleven percent over the regular quarterly cash dividend paid since the initiation of this program in January, 2016. We believe this demonstrates both confidence in our ongoing cash generation capabilities and our continued commitment to delivering value to our shareholders.

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

During the fourth fiscal quarter, we saw a seven percent sequential increase in revenue from our IC CMP consumables products, compared to the third quarter of fiscal 2017. This is stronger than the expected two percent increase for the fourth quarter that we referenced during our conference call in July. Earlier, Dave talked about general industry expectations for continued firm demand during our first quarter of fiscal 2018. Consistent with that outlook, we expect demand for our IC CMP consumables products in the December quarter to be slightly higher than the record level of revenue we achieved in our fourth fiscal quarter, even though the December quarter is traditionally seasonally softer than the September quarter.

To summarize, from a financial standpoint, we have now delivered strong performance for six consecutive quarters, and record revenue, earnings and cash flow for our fourth quarter and full fiscal 2017. For fiscal 2018, our expectations are for continuing firm near-term demand, sustained solid gross margin performance, and ongoing prudent management of operating costs on continued cost discipline. Based on all of this, we believe we are well-positioned to deliver another year of successful performance in fiscal 2018.

Now I'll turn the call back to the operator, as we prepare to take your questions.

Those are all the questions we have this morning. Thank you for your time and your interest in Cabot Microelectronics; we look forward to talking with you again soon.