CABOT MICROELECTRONICS CORPORATION
THIRD QUARTER FISCAL 2018 CONFERENCE CALL SCRIPT
July 26, 2018

Good morning. With me today are David Li, President and CEO, and Scott Beamer, Vice President and CFO.

Last night we reported results for our third quarter of fiscal 2018, which ended June 30, 2018. Whether you're joining us online or over the phone, we encourage you to review the investor slide presentation that we've made available under the Quarterly Results section of the Investor Relations center on our website, cabotcmp.com.

A webcast of today's conference call and the script of this morning's prepared comments will also be available on our website shortly after this live conference call. You may request any of the information by calling our investor relations office at 630-499-2600.

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 Form 10-K for the fiscal year ended September 30, 2017. We assume no obligation to update any of this forward-looking information.

Also, our remarks this morning reference non-GAAP financial measures. Our earnings release and slide presentation include a reconciliation of GAAP to non-GAAP financial measures. Additionally, data is represented by rounded values throughout this discussion and in the supporting materials.

I will now turn the call over to Dave.

Thanks, Colleen.
Good morning, everyone, and thanks for joining us.

Last night we announced another very strong quarter with record revenue, net income, and earnings per share. This is the fifth consecutive quarter in which we have reported record revenue. We believe that this strong financial performance demonstrates continued execution of our strategic initiatives in addition to sustained favorable industry demand conditions.

Let me start by providing our view of global semiconductor industry demand as well as some highlights of our performance. Scott will provide additional details about our financial results later in the call.

During the June quarter, we saw demand for our products remain strong across our memory, logic and foundry customers. In particular, the memory segment continued to be very strong and the continued transition to 3D NAND and strong demand for DRAM drove sales to our customers. Industry research would suggest that 2D to 3D NAND wafer capacity is approximately 50% converted, with the remainder expected to be completed over the next several years, providing additional anticipated momentum to memory growth. Despite some reported industry delays in capital equipment spending, we expect customers to continue to maximize fab utilization to satisfy demand, which should bode well for continued CMP consumable growth. We also see continued capacity expansions in 3D NAND and DRAM, primarily in Korea and China, as demand remains robust and DRAM capacity continues to appear relatively tight.

On the logic and foundry side, we saw continued solid demand for our solutions particularly in the legacy technologies which support a broad range of applications including automotive, industrial automation, and the internet of things. In the advanced technologies area, consistent with recent customer and industry reports, we saw some softness in demand as the industry appears to be gearing up ahead of anticipated new consumer product launches expected later this year. We continue to work closely with our customers to help them transition to new technology nodes that likely will require the use of more advanced technologies and new materials and remain confident about the long-term growth prospects in this important customer segment.

Now let me turn more specifically to company-related matters. This quarter we recorded strong results in all three key product areas; tungsten slurries, dielectrics slurries, and CMP pads.

Geographically, revenues increased across regions, notably, revenue in Korea was up 57%, and China was up 24%, compared to the previous year.

Turning to performance by product area, we delivered record revenue in our tungsten slurries, which was approximately 18% higher than in the same quarter last year. This growth was driven by the continued ramp of solutions supporting our 3D NAND customers, as well as strong growth in logic and foundry applications. As mentioned earlier, we expect to continue to benefit from ongoing strong demand for memory as well as our customers' ongoing transition to 3D NAND over the next several years.

In addition, during this quarter we achieved record revenue from our dielectrics slurries. This was primarily driven by increased demand and the benefit of customer conversions to our ceria based solutions in advanced memory applications. These are higher margin products that provide lower total cost of ownership and better performance to our customers. We are excited about the growth we see in the adoption of our advanced dielectrics products, and believe we are well positioned to continue growing revenue while also improving margins in this product area.

Turning to CMP pads, revenue increased 19% year over year as continued strong growth and adoption of our NexPlanar product line offset some softness in legacy pad revenues associated with weaker foundry demand. Our focus on potential new opportunities and our global support of customer qualifications remain catalysts for growth in our pads business and we remain confident of achieving our goal to reach at least $100 million in annual revenue by the end of fiscal 2019.

Looking ahead, we are excited about our sustained strong performance. We feel confident about our ability to continue delivering against our long term financial goals of growth faster than the industry as well as margin expansion. Although recent reports suggest that industry growth may be beginning to moderate, particularly on the capital equipment side, we believe our business model, which is consumables focused and based on wafer starts, will allow us to continue to profitably grow. As a result, we currently expect fourth fiscal quarter revenue for our IC CMP consumables business to increase by low single digits compared to the third quarter.

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

Thanks, Dave, and good morning everyone.

My comments will generally follow the related slide presentation we posted on our website last night, along with our press release.

Let's start with an overview of our financial performance this quarter, which is provided on slide 3.

Revenue for the third quarter of fiscal 2018 was a record $150 million, which is $22 million, or 18% higher than the same quarter last year. The increase reflects continued strong global semiconductor industry demand and the focus on our three key product areas.

Sequentially, total revenue increased $7 million or 5%, with IC CMP consumables revenues up 5%, which is at the higher end of the expectations we shared on our previous conference call in April.

Our Net Income of $35 million was also a record, and represented an increase of $15 million, or 76% over the same quarter last year driven by higher revenues and increased gross margin. Non-GAAP Net Income was $36 million.

Now let's drill down into revenue, which is shown on slide 4.

As previously stated, we define tungsten slurries, dielectric slurries and polishing pads as three key product areas that are strategically important to us. During the quarter, these accounted for approximately 80% of total revenue, and I'll mention each in order:

Tungsten revenue was a record $64 million, an increase of 18% compared to the same quarter last year.

Dielectrics slurries also delivered record revenue of $37 million, up 21% from the same quarter a year ago.

Sales of polishing pads delivered revenue of $21 million, up 19% compared to the same quarter last year.

Sales of slurries for polishing metals other than tungsten, including copper, aluminum and barrier, represented $18 million, an increase of 13% from the same quarter last year.

Finally, revenue from our Engineered Surface Finishes products, which includes QED, Data Storage, and Electronic Substrates was $10 million, up approximately 13% from the same quarter last year.

Now please refer to slide 5, which provides some higher-level P&L comparisons.

Gross margin for the quarter was 53.6%, compared to 48.9% in the same quarter a year ago. Excluding $1.3 million of amortization expense related to the NexPlanar acquisition, gross margin was 54.5%. Higher sales volume and a higher valued product mix had a favorable impact on margins, and more than offset higher fixed manufacturing costs, including higher staffing related expenses.

Year to date, gross margin was 53.0%, compared to 49.7% last year. This includes an adverse impact of $3.9 million related to the NexPlanar amortization expense. Our gross margin improvement was primarily driven by higher volumes in tungsten and dielectrics product areas as well as progress toward our ongoing initiative to transition our dielectrics slurry portfolio to advanced, higher margin products.

Operating expenses, which include research, development and technical, as well as selling and marketing, and general and administrative costs, were $39 million this quarter, an increase of $3 million over the same quarter a year ago. This primarily reflects higher staffing related expenses and higher professional fees. As a percent of revenue, our operating expenses declined to 25.8%, compared to 27.8% in the third quarter of fiscal 2017.

Our operating margin was 27.9% in the quarter, an increase of 690 basis points from the same quarter last year. This increase was driven by higher gross margins and prudent control of operating expenses.

The tax rate for the quarter was 18%, which was below our previous expectation of 21-24%. This is due to a favorable impact of a change in a prior period tax position.

Diluted EPS was $1.34 this quarter, which was also a record and represents an increase of 74% over the prior year quarter. Diluted EPS on a non-GAAP basis was $1.37. This was primarily driven by higher revenue and higher gross margin.

Now please refer to slide 6, which provides balance sheet and cash flow information.

We generated cash flow from operations of $37 million. We ended the quarter with a cash and short-term investments balance of $311 million and no debt outstanding. During April, we repatriated $200 million to the US and paid off our remaining term loan of $138 million.

Capital spending for the quarter was $6.4 million, bringing our year to date total to $15 million.

Accordingly, our free cash flow was $30 million in the quarter.

As previously communicated, we have committed to returning at least 50% of our prior year's free cash flow to shareholders by way of dividends and share repurchases. Through June 30, we have returned $51 million, which represents 85% of our full year target to return at least $60 million.

We provide some closing remarks on slide 7.

From a financial perspective, we achieved very strong performance this quarter, including records for revenue, net income and EPS, and I would like to highlight the operating leverage we are seeing on revenue growth. In the third quarter, revenue increased $22 million from the prior year, while operating income increased $15 million, implying that approximately two thirds of our incremental revenue dropped directly to operating income. Year to date, our operating leverage is 59%.

Finally, in the appendix on slide 8, we provide a table showing updates to certain expectations.

As we think about the fourth quarter of fiscal 2018, we expect solid demand conditions for our products to continue. With that said, and as Dave mentioned, we currently expect fiscal fourth quarter revenue for our IC CMP consumables to show a low single digit increase compared to our strong third quarter results.

We are narrowing our full fiscal year gross margin guidance to between 52% and 53% and we expect to be at the high end of this range. This would be consistent with our year to date of 53%.

We also expect our operating expenses for the full fiscal year to be between $150 and $155 million.

We expect to manage our operating costs to provide strong operating leverage and net income growth.

We continue to expect our effective tax rate in the fourth quarter to be between the previously communicated range of 21%-24%. Our capital spending expectation for the full fiscal year remains between $18 and $22 million.

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