CABOT MICROELECTRONICS CORPORATION
FIRST QUARTER FISCAL 2019 CONFERENCE CALL SCRIPT
FEBRUARY 7, 2019

Good morning. With me today are David Li, President and CEO who is participating from Asia, and Scott Beamer, Vice President and CFO.

Last night we reported results for our first quarter of fiscal 2019, which ended December 31, 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, 2018, and our Form 10-Q for the quarter ended December 31, 2018, which will be available by February 11, 2019. 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 slide presentation.

Please save the date for our Investor Day event, which will be held on June 18th at Nasdaq MarketSite in New York City. Further details and formal invitations will be sent out in the coming weeks.

I will now turn the call over to Dave.

Thanks, Colleen.

Good morning, everyone, and thanks for joining us.

I am excited to announce strong results for our first quarter, especially since this is the first time we are reporting performance for our combined company following the acquisition of KMG, which closed in mid-November. As a reminder, our first quarter of this fiscal year 2019 includes approximately six weeks of KMG results and a full quarter of CMC results. We are also introducing a new reporting structure, which includes two segments: Electronic Materials and Performance Materials. Electronic Materials includes products and solutions for the semiconductor industry and is comprised of CMC's legacy CMP slurries and polishing pads businesses as well as the recently acquired KMG electronic chemicals business. Performance Materials consists of KMG's pipeline performance, wood treatment and CMC's legacy QED business.

Our first quarter revenue increased 58% compared to the same period last year. This is a new record level for the company, driven by the KMG acquisition and solid organic growth in our legacy CMC businesses.

Revenues in both of our new segments, Electronic Materials and Performance Materials, grew year-over-year on a pro forma basis. Total adjusted EBITDA for the company was $77 million, which excludes acquisition and integration-related expenses of $38 million. Our total adjusted EBITDA nearly doubled compared to the adjusted EBITDA reported in same quarter last year, primarily as a result of the KMG acquisition. We believe that our strong results this quarter are an early indicator of the earnings power of our new combined company.

Let me now turn to additional specifics on our results and some thoughts on industry outlook by segment:

Starting with the Electronic Materials segment, which continues to be the large majority of our business, this quarter we delivered record growth in both CMP slurries and pads, as well as strong growth in the KMG electronic chemicals business. Our IC CMP consumables revenue increased 3% sequentially, another record, and is in line with our previous guidance. We also achieved record revenue in tungsten slurries and pads, which demonstrates the continued successful execution of our product strategies as well as the strength of our technology and solutions in these important product areas.

Looking ahead, recent reports from customers and industry analysts suggest that the semiconductor industry should return to a more traditional seasonal pattern this year with predicted weaker demand in the first half particularly in the foundry segment, balanced by expectations for stronger growth in the second half of calendar 2019. Consistent with this, our revenues are expected to decline slightly sequentially in the second quarter vs this record quarter, as Scott will cover later in the call. Despite this potential for near term industry softness, we feel that we are well-positioned for continued success due to the strength of our consumables-based business, as well as our strong participation in the highest growth parts of the industry, particularly memory. Within memory we continue to see benefits from our customers converting from 2D to 3D NAND, which doubles the number of CMP steps and in turn significantly increases the need for advanced semiconductor solutions including tungsten slurries.

Longer term, we remain optimistic about industry growth potential with continued strong demand for both memory and logic devices driven by new applications such as the internet of things, autonomous driving, industrial automation, cloud and high-performance computing, virtual reality, and 5G. With all these emerging technologies, customers' demand for quality, innovation, and operations and supply chain excellence, are expected to become even more extreme, which we believe play to our unique strengths as a partner for our customers.

In the Performance Materials segment, we also recorded strong revenue. This segment is primarily comprised of our solutions for the oil pipeline industry, and we saw record revenue for those pipeline solutions driven by increased demand for our industry leading drag-reducing agents, or DRA's. As we have previously discussed, DRA's are essential to performance and safety of pipelines, and help reduce operating costs by significantly increasing throughput of oil and reducing energy requirements. With continued growth in oil production in the U.S., primarily in the Permian basin, we anticipate strong future growth for this exciting business.

We are now almost three months into our integration of KMG and I am pleased with our progress; we believe we are well on our way to meeting or exceeding our synergy target of $25 million on a run-rate basis within the first two years of the acquisition, as we identify best practices, talent, and technology around the company globally.

Looking ahead, we are excited about our continued growth potential. We believe that these strong first quarter results along with the progress we have made on integration, and the positive feedback we have heard from our customers gives us continued confidence and encouragement towards our goal of building the premier provider of critical materials.

With that, I will turn the call over to Scott to provide more details on our financial results.

Thanks, Dave, and hello everyone.

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

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

Revenue for the first quarter of fiscal 2019 was a record $222 million, which is $82 million, or 58%, higher than the same quarter last year. As Dave mentioned, we are excited about the performance of both our CMC legacy businesses and the recently acquired KMG businesses. Revenue from our CMC legacy businesses was up $20 million, or 14% compared to prior year, and revenue from our IC CMP consumables was up 3% sequentially, which was in line with our expectations. Specifically, in the CMP area, slurries and pads each delivered record revenues. Additionally, the KMG acquisition added $62 million to revenue in the quarter, for the approximately six weeks that we owned the business during the December quarter.

Our Net Income of $13 million in the quarter improved compared to a $3 million loss reported in the prior year. This quarter's net income was negatively impacted by acquisition and integration-related expenses and an inventory step-up charge on acquired inventory that was sold, while last year's net income was adversely impacted by the U.S. Tax Cut and Jobs Act. Excluding these, non-GAAP net income was $53 million, an increase of $22 million, or 70% over the same quarter last year. Our EPS was $0.48 per diluted share in the quarter. Non-GAAP EPS was $1.90 per diluted share.

Now please refer to slide 4, which provides some higher-level P&L comparisons.
I would remind everyone that first quarter results include a partial quarter, or about 6 weeks, of KMG results and naturally a full quarter of CMC results.

As mentioned, we reported record revenue in the quarter. Although most of the increase was driven by the KMG acquisition, we are proud that even if KMG results were excluded, we still would have reported our *seventh* consecutive quarter of record revenue.

Adjusted EBITDA was $77 million, or 34.7% of revenue, an increase from $43 million.

As mentioned earlier, we are now presenting our results in two reportable segments: Electronic Materials, which represents approximately 85% of our revenue, and Performance Materials. Please refer to slide 5 for the additional information about the businesses included within each segment.

Now let's drill down to revenue results by segment and business, which are shown on slide 6. We are presenting the results as both reported revenues and pro-forma revenues. The pro forma revenues represent CMC and KMG combined results as if we had owned KMG for the *full* first quarter of both fiscal years 2018 and 2019. We believe it is important to refer to these figures so you may understand how the performance of the businesses on a comparable basis.

On this basis, revenue in our Electronic Materials segment grew by $24 million, or 11%. Our CMP slurries revenue increased 10% year-over-year, with strong results in our tungsten and dielectrics products. CMP pads reported a 30% increase in revenues from last year due to continued customer adoption of our NexPlanar products. Our electronic chemicals business also grew by $6 million, or 8%, on a comparable basis versus prior year.

Similarly, revenue in Performance Materials increased $8 million, or 17%. The increase was driven by growth across each business area.

Slide 7 shows revenue and adjusted EBITDA by segment and as you can see, both segments have a strong profitability profile. We are not providing pro forma reconciliations of the prior year's adjusted EBITDA by segment due to timing differences.

Acquisition and integration-related expenses were significant this quarter at $38 million. Of the $38 million, about 1/3 of these impacted Cost of Goods Sold. Excluding these, adjusted EBITDA was $77 million, and adjusted EBITDA margin was 34.7% in the quarter, compared to $43 million and 31% for last year.

Now please refer to slide 8, which provides balance sheet and cash flow information.

We ended the quarter with $209 million cash balance and about $1.1 billion in debt outstanding.

As a reminder, we assumed approximately $1.1 billion of debt to finance our acquisition of KMG. This week, we entered into an agreement to swap approximately 70% of our debt from variable to fixed rates. We continue to expect our leverage to decline from currently close to 3 times EBITDA to close to 2 times EBITDA in two years.

We generated cash flow from operations of approximately $14 million. This is typically a seasonally low quarter for operating cash flow, due to typical payouts of compensation-related accruals, and this was further impacted by acquisition and integration-related expenses. Our capital expenditures were $8 million and accordingly, our free cash flow was $6 million in the quarter.

I will now provide some closing remarks on slide 9.

From a financial perspective, we achieved new milestones in terms of revenue and Non-GAAP net income this quarter. We had 6 weeks of KMG's results in our December quarter and the acquisition added $62 million to revenue in the quarter. We are also very pleased with the performance of our CMC legacy businesses which continued to deliver strong results.

Our primary areas of focus right now are the KMG integration and realizing the associated synergies, while continuing to deliver the world-class solutions and delivery that our customers have come to expect. Although, the first quarter P&L impact from synergies was minimal as expected, we continue to expect to deliver $25 million on a run rate basis within the first two years and have already executed on actions that would deliver $13 million in synergies annually.

Please move to slide 10 where we provide some expectations.

We are providing revenue guidance for the second quarter of fiscal 2019 based on currently projected sequential changes compared to our pro forma revenue for the first quarter of fiscal 2019, which is shown on slide 6 of this slide presentation: For the second quarter of fiscal 2019, we currently expect total revenue to be down low single digits on a percentage basis, with Electronic Materials revenue expected to be down low single digits, and Performance Materials revenue expected to be up low single digits, on a percentage basis. Consistent with industry outlook, we expect to see some level of recovery in the second half of the fiscal year.

Interest expense for our second quarter is expected to be between $13 and $14 million.
As we think about full year fiscal 2019, we expect Adjusted EBITDA to be between $325 and $355 million. Depreciation and amortization is expected to be between $35 and $45 million, which excludes approximately $60 million in acquisition-related amortization. We expect interest expense to be between $47 and $50 million this year.

At present, we expect our effective tax rate for the full fiscal year to be in the range of 23%-26%, which is higher than reported this quarter due to the favorable impact of stock-based compensation in our first quarter and expected changes in the geographic mix of our taxable income. For example, as we continue to grow our business in Korea, our tax rate will increase due to the higher corporate tax rate in that country.

Our current capital spending expectation for the full fiscal year is between $60 and $70 million as we make some strategic investments in the newly acquired KMG businesses.

As we think about our business for the remainder of the year, we continue to be very excited about the earnings power of our combined company. When we announced the KMG acquisition in August, we referenced pro-forma information that showed a path to achieving 31% EBITDA for the combined company, and we believe this continues to be a reasonable near-term expectation, with improvement anticipated longer term as we drive even stronger results for the combined company.

There are several reasons why Q1 performed better in this regard. First, we had only a partial quarter of the KMG businesses and we delivered record revenues in our slurry business. Additionally, the first fiscal quarter is historically the lowest cost base of any of our quarters since our salary and merit increases begin on January 1st.

At the highest level, Non-GAAP EPS grew from $1.19 to $1.90 per diluted share, driven by growth in both the underlying CMC legacy businesses and accretion from KMG. We discussed in August that we expected accretion from the KMG acquisition to be about $1 per share for the first year, excluding costs for acquisition and integration-related items, and in this partial quarter, we delivered about $0.15 per diluted share, which is in line toward achieving this target.

In summary, we are pleased with our strong financial performance in the first quarter and we believe we remain on track for effectively integrating KMG. We believe the results show the strength of our consumables-based business model and the attractiveness of the various industries in which we participate. For fiscal 2019, we remain confident in our ability to drive continued revenue growth as we provide innovative, high-quality solutions that solve our customers' most demanding challenges.

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.