THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

KMG - Q1 2016 KMG Chemicals Inc Earnings Call

EVENT DATE/TIME: DECEMBER 10, 2015 / 10:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Eric Glover *KMG Chemicals - IR Manager*

Christopher Fraser *KMG Chemicals - Chairman, CEO and President*

Malinda Passmore *KMG Chemicals - CFO*

CONFERENCE CALL PARTICIPANTS

Michael Harrison *Seaport Global Securities LLC - Analyst*

Rosemarie Morbelli *G. Research, LLC - Analyst*

Lewis Moser *Mafax Investors - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the KMG Q1 2016 Earnings Conference Call.

At this time, all participants are in a listen-only mode. Later we will conduct a question and answer session and instructions will be given at that.

(Operator Instructions) As a reminder, this call is being recorded.

I would now like to turn the conference over to Eric Glover, Investor Relations Manager. Please, go ahead.

Eric Glover - *KMG Chemicals - IR Manager*

Thank you, Sabrina. Good afternoon, and welcome to the KMG First Quarter Fiscal 2016 Financial Results Conference Call. I'm joined today by Chris Fraser, our Chairman and CEO; and Mindy Passmore, our CFO.

In a moment, we'll hear remarks from them followed by Q&A. During today's call, we will refer to financial measures not calculated according to generally accepted accounting principles. Please refer to today's earnings release available on our website for the reasons we are presenting non-GAAP financial information and for the appropriate table that reconcile these measures to our GAAP results.

Before we begin, I'd like to remind everyone that the information on this conference call include certain forward-looking statements that are based upon assumptions that in the future may prove not to have been accurate and are subject to significant risks and uncertainties, including statements regarding the future performance of the company.

I'll now hand it over to Chris Fraser, Chairman and CEO. Please go ahead, Chris.

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Thank you, Eric. Good afternoon, and thank you, everyone, for joining us today. Our Q1 earnings release was issued today after the market close. After my remarks, Mindy will review the financials, and then we'll take your questions.

Our fiscal year is off to a great start as we reported 30% growth in our first quarter adjusted EBITDA to a record of $11.4 million. This marked our seventh consecutive quarter of double-digit adjusted EBITDA growth on a year-over-year basis.

Adjusted earnings per share grew 75% year-over-year to a record $0.42, while GAAP EPS nearly quadrupled to $0.39. These positive results reflect our continued focus on execution and driving operational efficiencies consistent with our growth strategy. I'm pleased with the operational and financial progress we're achieving, and we'll continue to focus on maximizing margins and cash flow in each of our businesses to create long-term shareholder value.

Our performance in the first quarter was driven by solid volume growth and improved pricing in our Electronic Chemicals business, cost savings and operational efficiencies, resulting from the consolidation of our manufacturing operations; penta sales gross, with favorable manufacturing costs and the addition of the Industrial Lubricants business.

Our Electronic Chemicals segment continue to experience solid demand. Excluding the impact of foreign currency, Q1 sales in this segment increased 4% year-over-year led by volume growth in North America, where we again achieved record production levels. We also saw an increase in our volume in Asia. Volume was down in Europe compared to prior year period impacted by continued sluggish economic trends in the Eurozone. By enhancing our market positioning and diversifying our sales across a range of semiconductor end markets, we've have expanded our growth opportunity well beyond traditional PCs.

In the first quarter, we experienced particularly strong demand for our products used in the production of semiconductors for the data center, mobility in automotive markets. As data processors, sensors and logic chips continue to proliferate in a variety of electronic products and systems, our high-purity process chemicals will play a critical role in the semiconductor manufacturing process.

Our Other Chemicals segment, which includes our penta Industrial Lubricants businesses reported 90% sales growth from the fourth quarter of fiscal 2015. Demand for penta increased due to ongoing utility pole replacement programs by western utilities and favorable season trends in the wood treating industry. Reduced raw material cost also benefited our penta business in the first quarter.

Despite low oil and natural gas prices, sales on Industrial Lubricants business grew from the fourth quarter reflecting a seasonal uptick in maintenance and service spending for energy-related infrastructure. Our first quarter profitability increased significantly, with our gross profit margin climbing to 38.2% and consolidated EBITDA margins rising to 15%.

The improvement in margins reflect cost savings and operational efficiencies resulting from our global manufacturing restructuring and realignment programs as well as stronger sales volume in our Electronic Chemical business and improved pricing. Profitability also benefited from the absence of a lower-margin creosote sales.

Two years ago, we embarked on a restructuring of our manufacturing operations. And today, we have essentially completed this initiative and achieved the cost saving target we initially target.

Additionally, we've completed the transition of HF production from Bay Point plant, and we're currently realizing those cost savings benefits. Acquisitions represent a fundamental component of our growth strategy and we continually evaluate opportunities that would enhance growth within our existing markets as well as those in new markets.

In Electronic Chemicals market, we remain focused on expanding our presence and capabilities in Asia, where the majority of world's semiconductors are manufactured. We believe the ongoing consolidation with the semiconductor industry works to our advantage as KMG is a -- is the company best positioned in the world that can rely -- reliably supply high-purity wet process chemicals to this market on a global basis.

Turning now to our fiscal second quarter outlook. We anticipate experiencing typical seasonal trends as November through January's slower period of the year due to reduced global semiconductor production following the holiday build, reduced demand from wood treaters due to wetter weather and planned facility shutdowns, and a lower level of valve maintenance service activity during the winter months. As a result of this seasonality, we anticipate our second quarter sales and adjusted EBITDA will decline moderately from our strong Q1 results, but are expected to exceed last year's second quarter results.

Our fiscal 2016 year is off to a strong start. We will review and update our annual financial outlook at our customary time when we report our second quarter results.

I will now hand the call over to Mindy for the financial review.

Malinda Passmore - *KMG Chemicals - CFO*

Thank you, Chris, and good afternoon, everyone. In my remarks, I will discuss adjusted or non-GAAP numbers as we believe non-GAAP information can provide useful insight into the underlying operating performance of our business. The non-GAAP numbers I referenced are reconciled to the corresponding GAAP numbers in today's earnings release.

As I noted last quarter, our Wood Treating Chemicals business has been combined with the Industrial Lubricants business to form the Other Chemicals segment. These businesses were combined into one segment as separately, they were immaterial to our overall results.

First quarter consolidated net sales were $76.6 million compared to $90.8 million in the last year's first quarter. Sales declined on a year-over-year basis due to the divestiture of the creosote business in fiscal 2015 as well as the impact of foreign exchange. Gross profit margin in the first quarter was 38.2%, an increase of 780 basis points from last year's first quarter.

Gross profit margins improved due to higher sales volume in Electronic Chemicals, cost savings resulting from the restructuring and realignment of our Electronic Chemicals operations, a favorable product mix and the absence of low-margin creosote sales in the Other Chemicals segment.

First quarter distribution expense declined to $10.1 million or 13.2% of sales compared to $13 million or 14.3% of sales last year. Distribution expense decreased primarily due to lower cost in Asia and the absence of creosote sales in the first quarter of fiscal '16 and lower freight costs in North America.

First quarter SG&A expense was $11.2 million, up from $9.2 million in last year's first quarter, reflecting higher audit expenses, a $500,000 increase in stock-based compensation expense, higher depreciation and amortization expense for our new ERP system and related to the Industrial Lubricants business we acquired and expenses from the addition of the Industrial Lubricants business.

Excluding 490,000 in restructuring and realignment charges, consolidated adjusted EBITDA in the first quarter was $11.4 million, up 30% from $8.8 million in last year's first quarter. The improvement in adjusted EBITDA was due to increased sales volume and pricing in our Electronic Chemicals business, cost savings realized from our global manufacturing consolidation, increased sales volumes and lower raw material costs in our penta business and the contribution from our Industrial Lubricants business.

First quarter interest expense was $152,000 versus $803,000 in the same period last year. The decrease was due to reduced interest rates resulting from the refinancing of the term notes and our revolving credit facility as well as lower debt levels. Also, we incurred a prepayment fee in connection with the refinancing of our term notes in the prior year.

Our income tax rate was 35.8% in the first quarter as compared to 40.4% in the prior year. The decrease in the Q1 2016 tax rate compared to Q1 2015 was primarily due to the absence of discrete items. Excluding the impact of the net operating losses in Italy, our effective tax rate in the first quarter was 34.2%. We project a fiscal 2016 tax rate of approximately 35%. First quarter fiscal 2016 GAAP net earnings were $0.39 per diluted share versus $0.10 per share in last year's first quarter.

Adjusted diluted EPS for the first quarter of fiscal 2016 was $0.42, up from $0.24 in the first quarter of fiscal 2015. Adjusted EPS increased year-over-year primarily due to higher sales volume and improved margins in both Electronic Chemicals and Other Chemicals segments, the addition of the Industrial Lubricants business and lower interest expense.

Turning to our segment results. First quarter Electronic Chemicals sales were $66.1 million, essentially flat compared to last year's first quarter despite the impact on the strong U.S. dollar, which reduced first quarter 2016 Electronic Chemicals segment sales by $3 million.

Excluding the foreign exchange impact, Electronic Chemicals sales grew by 4% compared to the prior year first quarter. Q1 EBITDA in the Electronic Chemicals segment was $10.3 million, an improvement of 39% compared to $7.4 million in last year's first quarter. Foreign currency translation reduced EC segment EBITDA by approximately $300,000 in the first quarter of 2016 as compared to the prior year period.

EC EBITDA margins improved 440 basis points year-over-year, primarily due to higher volume and enhanced manufacturing efficiencies from our restructuring and realignment initiative. In our Other Chemicals segment, Q1 sales were $10.6 million compared to $24.4 million in the comparable quarter last year. The decline was due to the absence of creosote sales. This was partially offset by increased sales of penta and the addition of the Industrial Lubricants business. Penta sales increased sequentially on a year-over-year basis due to higher volume and favorable seasonal trend.

Industrial Lubricants sales improved from the fourth quarter of fiscal 2015 due to favorable seasonal trends as maintenance spending is typically stronger during the winter month. Other Chemicals Q1 EBITDA was $4 million, representing a segment margin of 37.9% compared to the prior year level of $2.7 million, representing a segment margin of 10.9%. The increase in EBITDA and the EBITDA margin was due to higher penta sales, lower raw materials cost and the addition of the Industrial Lubricants business. Additionally, the absence of lower-margin creosote sales benefited EBITDA margins in the current quarter.

During the first quarter of fiscal 2016, we used cash generated from operations to reduce our debt by $1.5 million. As of October 31, 2015, our debt balance was $51.5 million compared to $53 million at the end of fiscal 2015. Operating cash flow for Q1 2016 was $8 million down from $9.6 million in the first quarter of fiscal 2015.

Although net income increased from the first quarter of fiscal '15, we had positive cash flows from lower accounts receivable and inventory, operating cash flow declined, primarily to timing of payments to vendors, nonrecurring payments related to the Bay Point facility and inventory purchases to support growth.

Capital expenditures were $3.6 million for the first quarter of fiscal 2016, which was in line with our planned 2016 spending of approximately $15 million. The financial results discussed in this call and presented in our press release today will be included in our 10-Q. We have not yet completed the process of filing our 10-Q for the first quarter, and we will file for an extension. We will be able to complete our filing of the 10-Q in the five-day extension period.

Operator, now let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And our first question comes from the line of Rosemarie Morbelli of Gabelli & Company.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

Were there anything special in the quarter that made it so strong and that you did not anticipate?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. I wouldn't say there was anything that we -- that was unusual. It was just a combination of a lot of thing -- good things happening at the same time, all of which we're working towards. So the higher volume we talked -- talked about in the EC business, primarily in North America, we continue to see good progress there. And then, in the -- specifically, in our penta business, our sales were strong, maybe a little bit stronger than we had anticipated and the impact as well at the lower raw material cost added to improved profitability there.

So overall, I won't say there was anything that we -- anything unusual. It's the progress, as I said, the restructuring and realignment of our manufacturing businesses that we've been working on for last two years is kind of completed and run it's course. So we're at that annual run rate that we had talked about for sometime. So it all came together at good timing.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

And Chris, regarding the raw material cost, have you benefited at this stage from all of the lower cost from the previous oil prices around $50? Now we are in the 30s. Do you expect a new wave of benefit? Or do you have -- at this stage, do you have to give up the first wave to your customers before you start benefiting from the second wave if there is one?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. So we're -- so the lower oil prices benefit us in several ways, right? One is our transportation costs and freight costs of shipping our products, and we've been able to see that benefit specifically year-over-year, but even most recently. So we're seeing that benefit. We do buy a lot of raw materials that have inbound freight. So we do see the benefit there. On the penta side between phenol and solvents, we're as I said, getting the benefit of those as well. In some of our products in the EC, some of them, we do get some benefit as well on the raw materials there.

So all in all, we see a benefit across multiple fronts. And I'd say we're at a level right now that I would say we would see a continuing if oil price would go down lower than we've seen additional benefit. But as oil prices stay where they are today with $30 to $40 a barrel, we anticipate that the savings we've seen will continue and carryforward in the upcoming quarters.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

So that brings me to the gross margin, which at 38%, is really quite high, not that I am complaining, but last year fourth quarter you had the full quarter of Val-Tex. And so I would not argue, but I would summarize that it is -- we are comparing it on an apples-to-apples basis. So how did you go from 34.9% to 38.2% sequentially?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. So that's a great question. So part of it is the additional volume we saw in this quarter over last quarter in our EC business which the more volume we put through the plants through this consolidation that we've done, it improves our margins. As I said, we also got the benefit of lower raw material costs in the Wood Treating business-- would helped up -- pushed up our margins well. You've got somewhat of a mix. When you look across the whole company, our sales were higher in North America, which is higher margins in the EC business than it does in other regions of the world. Val-Tex, which also has favorable margins, had an uptick in sales. So partly, it's a mix issue, part of it's raw materials, part of it's volume and part of it is improved pricing.

We -- the full benefit also of the realignment around the hydrofluoric acid plant shutdown at Bay Point, we had to work through the inventories that we had on that product before we started realizing the full benefit. So in this quarter, we got the full benefit of it that was more than we had gotten in the fourth quarter that that added to our margin improvement. So again, a lot of things lined up to provide for a good quarter. And as we looked at the bridging from Q4 to Q1, it's the underlying reasons that I just outlined.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

And so if I may ask one last question, then I'll get back in queue. On the SG&A side, on the other hand, you had the exact opposite from 12.2% of revenues to about 14.6%. So what caused that other than your compensation, which I am assuming is in this quarter and was not in Q4 or maybe there was some in Q4? And what are we looking at for the balance of the year? I mean, is that $11 million a quarter more or less a new number, new normal?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. It's a good question. So Mindy, you want to handle that?

Malinda Passmore - *KMG Chemicals - CFO*

Sure. Yes, so during our first quarter, we did have higher -- of [2016], we did have significantly higher professional fees that we would not anticipate to reoccur going forward. And then there were just some discrete items in both quarters that went kind of both directions. So I would say that in terms of going forward and when you look at Q4, I think we were around 9.3%, and now we're 11.2% -- in Q1. We're not going to be as low as a 9.3%, but we're going to probably -- we're not -- we're not definitely not going to be as high as 11.2% either. So it'll be somewhere in that -- in between there.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

Are the professional fees related to the ERP? And can you share that amount?

Malinda Passmore - *KMG Chemicals - CFO*

It's really more related to our year-end audit. And yes, it's about $0.5 million.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

Okay. Thanks.

Operator

And our next question comes from the line of Mike Harrison of Seaport Global Securities. Your line is now open.

Michael Harrison - *Seaport Global Securities LLC - Analyst*

Was hoping that you could give a -- maybe a little bit more color on what's going on in Electronic Chemicals in terms of volume price mix. You mentioned that FX is a headwind and that volume was higher. But as we look at the year-on-year change, is pricing up and has mix improved as well?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. Yes and yes. So pricing is up and mix has been working in our favor as well. When we look at our overall EC sales globally, the wafer volumes year-over-year in the semiconductor industry is projected to be about a 4% increase from '14 to '15, and our sales basically track that as of right now when we look on a year-over-year basis. So we're in line with the global industry. However, if you look at the segment specifically for North

THOMSON REUTERS

America, the industry on wafer production is growing at about 2.5% year-over-year, so what we grew, we grew more than as you know, a bigger portion of our business is in North America than it is in Asia. So Asia grew more than the average and more than North America, but that's a smaller piece of our business.

So there's a couple things going on, on mix. Some is in product mixes, but more pertinent is the geographic mix. We have higher margins in North America and we grew more than the -- what I would say, the industry projections for growth were. So we had a geographical mix that benefited our overall margins. And as I've said, that volume, when we were -- got our manufacturing consolidation lined out, those volumes contribute pretty significantly to margin improvement as we push higher volumes through a more efficient [plans].

Michael Harrison - *Seaport Global Securities LLC - Analyst*

And can you talk a little bit about what you're seeing in -- among your key customers in North America just in terms of kind of where inventory levels are? You mentioned that we're heading into a seasonally weaker period. We kind of have seen the strength heading into the holiday build. Are you concerned that inventory levels are a little flat right now and that we may see some correction as we get into the first part of the calendar year?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. So I wouldn't say we'd see a correction. I think what we'll see is we're anticipating, in conversations with our customers, that the traditional pattern of the build that they had prior to the holiday season and then the slowdown in some of the inventory, I won't say corrections, but modifications that happened in our second quarter through the holiday. So I won't say we anticipate anything out of the normal seasonal trends.

And if you look at 2016 projections for the semiconductor industry, they're essentially flat year-over-year on '15. It's not going to grow to the levels that it did in '15 versus '14. So what we're anticipating is, essentially year-over-year, flat to slightly improving and that -- little bit different to each region, but overall, globally. So that's kind of what we're looking at and anticipating, Mike, as we look out for the next quarter and then as it follows on to the remaining two quarters of our fiscal '16.

Michael Harrison - *Seaport Global Securities LLC - Analyst*

And is there any good explanation for what's driving the softness in Europe in Electronic Chemicals other than just macro factors?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. There's some individual customer-by-customer situations that are playing out differently for each one. Some of the customers are doing okay. Some of the ones that are serving the automotive industry, seem to be doing well. Some of the -- other ones that are dealing more with memory or some of the other areas seem to be down a little bit softer than others. So it's a combination of things. It's not just one particular area. So it's kind of a customer-by-customer, but when we aggregate it all up, we are seeing continue to see softness versus last year.

We would like to think we've reached the bottom. And as we look out over last quarter versus this quarter, we see it stabilizing versus where it was a year ago. So we'd like to think we're at that bottom, but we'll see. And typically, Europe, for example, last year, had a pretty decent amount of drop-off in Q2 versus Q1 because of the holiday. So we're watching that carefully. As we said, we expect it to be down and we're anticipating it would be more consistent with kind of the multiyear trend versus maybe what we saw last year.

Michael Harrison - *Seaport Global Securities LLC - Analyst*

All right. And then, is there any update on your plans in Asia to increase the Electronic Chemicals position, either through greenfields or brownfields or through an acquisition?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. So we -- that's a key area for us, Mike, and that's something we're continue to focus on. I think we're making good progress. We've got several opportunities that we're pursing. Hopefully, some of them will come to fruition soon. And they're all around exactly what you said is expanding our manufacturing base and expanding our geographic reach in Asia. It's a key strategy for us, and I -- all I can really say at this point is I'm optimistic about the opportunities and some coming to fruition.

Michael Harrison - *Seaport Global Securities LLC - Analyst*

All right. And then, just a couple on the penta business. You've got a strong El Nino predicted this winter. Historically, that has set up a big hurricane season the following year. Do you have any customers that are building inventory at this point due to weather concerns? Or do you expect to see any inventory build? Or would that be atypical of the way your customers behave?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes, that would be atypical at this point. We have had relatively low hurricane seasons for a number of years. So we're anticipating some slowdown in the second quarter because of both weather and they'd take some downtime and maintenance of things. So we don't see anybody building inventory for it.

We had a strong quarter for the reasons I talked about. We saw a strong volume, but then our -- we had big costs as well, but -- so we are anticipating a slowdown in the second quarter. But at this point, Mike, we're not seeing anybody do anything exceptionally out of the norm to build inventory in anticipation of El Nino or any other weather aspects.

Michael Harrison - *Seaport Global Securities LLC - Analyst*

Okay. And you also mentioned in your press release some replacement programs that are going on with utility poles. I know there are some areas, particularly in the West, where the poles are kind of getting up there in average age. Do you anticipate that 2016 is going to be unusually strong in terms of those replacement programs or pretty typical and we just kind of saw a nice quarter here?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. So we think it's going to be a steady increase because there's not one year where they're going to do a massive replacement. It's a long-term maintenance replacement pole program over the next, let's say, 10 years. So we expect this 1% to 2% growth per year driven by the West, and we saw that play out here in this quarter. And we anticipate that uptick next year as well. Again, not major, but just a continued 1% to 2% growth per year as they go through the pole replacement in the West. And if there is any storm anomalies like you said, that will even drive the demand even stronger.

Operator

(Operator Instructions) We do have a follow-up question from Rosemarie Morbelli from Gabelli & Company.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

I was wondering, Chris, if you could talk about Val-Tex? The demand obviously seems to have been strong, but as we hear about big oil companies lowering their CapEx projections and the lower -- due to the lower price of oil, do you anticipate that this quarter was kind of an anomaly in terms of the growth rate? And what was the growth rate, by the way? Can you share that?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. So we don't think it was anomaly. It's a little bit of seasonality. This is a quarter that lot of maintenance gets done prior to the winter. So it's -- what we're learning about the business is that this is a typical strong quarter as a lot of maintenance gets done, just like we expect next quarter to be softer because of the slowdown in maintenance. So we're not seeing anything, Rosemarie, that would say that reduced capital spending is going to impact the valve maintenance that we see in the products that they sell.

I think there's two things really going on that I would comment about on Val-Tex is they are impacted by the low oil and gas prices. I said before, some of our businesses are positively impacted. Obviously, Val-Tex would be negatively impacted. And the impact there is less drilling. Lower oil prices, lower natural gas prices lead to less drilling and therefore less valve, less maintenance for drilling. But the majority of their business is -- business is for existing infrastructure and pipelines, and the maintenance on that is kind of -- is ongoing and needs to continue on -- to go on.

So I would say we've seen the impact of the lower oil and gas, pricing on Val-Tex and we anticipate that that level that we're at right now taking out the seasonality will continue. If oil prices go precipitously lower, then we could see a further impact on Val-Tex. And we really didn't share what the specific growth rate was on Val-Tex. It's just not the granularity that we're providing, Rosemarie.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

Okay, no, I appreciate the help. So when -- based on what you just said, that lower CapEx level could impact the growth rate a couple of years out as not as much drilling and therefore not as many valves are going to be used and therefore fewer than -- in the normal environment would be needed maintenance. Am I correct in assuming that?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. So if drilling stays down or drilling does not come back to levels it was or even increase, then yes, that would continue to impact Val-Tex. If drilling reduced from the level that it is now or rig counts were reduced from where they are now, then yes, that would further impact Val-Tex.

The one thing I would comment on about is there's a projection for increased pipelines in North America. And the more pipelines there are, the more valves there are, which is a positive impact for Val-Tex. So that's another driver for their -- the demand of their sealants and lubricants. So that's something -- although that infrastructure takes quite a bit of time to put in place, but long-term, it's -- there's a -- there'll be a growth rate of pipelines across North America.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

Okay. So you don't necessarily need a lot of drilling?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Well, it helps. The more drilling is the better for Val-Tex, no question. But we feel good about the base business for Val-Tex and feel good about their position in the marketplace, but feel good about the base demand for their products.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

And in this environment, do you find that there are M&A opportunities to add to Val-Tex at reasonable price?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes, that's the silver lining. Yes, we do think that because of the lower oil prices, it does provide a greater environment for lower pricing on acquisitions to bolt-on and to link up with Val-Tex. So yes, there's -- we think it's an opportunity. So along with Asia and other acquisitions, it's an area that we are keenly focused on. And again, we're hoping to bring some things to fruition, but we think it could yield us to be able to pay a lower purchase price than we would have had to a year or two ago.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

And if I may just quickly on the electronics side, you have talked about the database automotive being -- and mobile applications being the main reason for the strong demand. Are you seeing any change on the PC or the television side?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. So PCs are absolutely down. I mean, the projections that they'll be down '15 versus '14. It's somewhere between 7% and 9% year-over-year. So there's no doubt that it's impacting the chips that go into the PCs. Tablets are also down, so there's impact there. So the good news is our customers -- most of our customers have diversified products that they sell. So they were able to have strong sales in other areas. And so as I said, we see good volume particularly in those one areas. But even with the decline in PCs, we're still seeing an uptick in our overall volume. But most definitely, there is a decrease in PCs and tablets.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

Okay. And are you involved in television? Or they don't use that much and they are not growing anyway?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. It's not a lot of chips, but it's -- and it's not -- we don't see anything really out of the norm there relative to semiconductors.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

Okay. And my last question, if I may. Mindy, I believe, mentioned operating losses in Italy, can you give us a little more on that?

Malinda Passmore - *KMG Chemicals - CFO*

On the tax rate? Yes --

Rosemarie Morbelli - *G. Research, LLC - Analyst*

No, you talked about operating losses in Italy?

Malinda Passmore - *KMG Chemicals - CFO*

Yes, yes and that was with respect to -- I think it was in the context of the tax rate, but yes. So the restructuring, if you may recall, when we first started the restructuring program, we had quite a large charges for depreciation and for some of the beginning severance, et cetera, those were types of costs. And so what that did is essentially put Italy into a net operating loss position. And for tax purposes, we cannot recognize a tax benefit on that net operating loss until we can realize it. So until we have profits that offset it in Italy specifically. So not just in Europe, but in Italy specifically. And so that's what creates a higher effective tax rate overall.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

Okay. And when do you expect Italy to become profitable? Is it a 2016 event? Or does it take until 2017?

Malinda Passmore - *KMG Chemicals - CFO*

Well, for -- we would need to finish the restructuring program there. And at that point -- I don't have a -- want to give a projection for Italy specifically, but there's a possibility at that point, there would be some profitability.

Rosemarie Morbelli - *G. Research, LLC - Analyst*

Okay. Thank you very much and congratulations again.

Operator

And our final question comes from the line of [Lewis Moser] of [Mafax] Investors.

Lewis Moser - *Mafax Investors - Analyst*

I was wondering, I caught the call a little bit late, and I just heard something that you mentioned about the next quarter in terms of the comparison with the previous year. Could you just repeat that? I didn't quite -- I don't know if I understood.

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Sure. What we said was that we anticipate that the second quarter, due to the seasonality of several of our businesses, will be lower than this quarter, but above our earnings of last year's second quarter.

Lewis Moser - *Mafax Investors - Analyst*

Because last year, it looks like you earned $0.47, is that correct?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

I don't --

Malinda Passmore - *KMG Chemicals - CFO*

No.

Lewis Moser - *Mafax Investors - Analyst*

I'm just looking at the -- at Yahoo Finance and they show $0.47 a year ago, and almost $80 million in sales.

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes. So what we're talking about is operating income and operating results. So that's what we're referring to when we're saying we'll be on par -- it will be better than last year, but not at the same level that we achieved in the first quarter.

Lewis Moser - *Mafax Investors - Analyst*

Okay. Do you have any new products that you're working on that might make a difference in the coming years?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Well, in electronics space, we're continually working with our customers to reach higher levels of purity or blends that may be more favorable for their production. One of the things that we feel very good about is working with our customers to help them reach the standards of production that they're aspiring to in their new [fabs]. And so it isn't to say there are new products per se. But today, for example we're having conversations with customers on fabs in production that they anticipate having two years from now. And so we're working with them. So there aren't necessarily new products per se, but there may be new blends or higher purity levels of the products that we currently supply to meet their higher demands and standards.

Lewis Moser - *Mafax Investors - Analyst*

The company stock is considerably less than it was about a year ago, and I was wondering if you have any opinion as to where it's priced now versus what it really should be, if you look at this increase in earnings and so forth?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Yes, we really don't give out what projections we think the stock ought -- price ought to be. Let's just say that I'm -- I mean, the stock to me is undervalued and we feel confident about that, but really don't have any projections. I think the -- what I'd like to point to is that we continue to execute on our strategy. We continue to deliver good results. As I've said, we've had seven consecutive quarters of double-digit growth year-on-year. I feel good about our execution of our strategy, our execution of the specific plans that we've put out in place. Our margins continue to improve. And so I feel good about the execution of business and I'm confident over time that stock price will reflect the execution and strategy that we're putting in place.

Malinda Passmore - *KMG Chemicals - CFO*

Can I -- I want to just jump in about the $0.47 that you mentioned. That is our -- was our GAAP EPS last year. And that was a high number because we had the sale of the -- gain on the sale of the creosote business in that number. So what we're --

Lewis Moser - *Mafax Investors - Analyst*

Okay. What was the [net gap] on that?

Malinda Passmore - *KMG Chemicals - CFO*

Well, the adjusted diluted earnings per share was $0.30. So it's about a $0.17 difference. And so when we are referring to having a stronger second quarter this year, we're talking about on an adjusted basis.

Lewis Moser - *Mafax Investors - Analyst*

I see. Considering the fact that you feel it's undervalued, is there any possibility to buy back some stock?

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

So that's something we evaluate every quarter with our board. And we, at this point, do not have any specific plans on a stock buyback. But it is something that we consider and discuss at the board level every quarter, the pros and cons of that. So but no specific plans at this point.

Lewis Moser - *Mafax Investors - Analyst*

Okay. And the last question is, you have one or two analysts that cover the company. Is there any interest in expanding that, so that you get a little bit more visibility on Wall Street?

Eric Glover - *KMG Chemicals - IR Manager*

This is Eric. There is interest in that, absolutely. So we are frequently visiting different people, different analysts, going to different conferences and looking for additional coverage.

Lewis Moser - *Mafax Investors - Analyst*

Okay, great. Thanks very much.

Operator

And I'm showing no further questions at this time. I would now like to turn the conference back to Chris Fraser. Please go ahead.

Christopher Fraser - *KMG Chemicals - Chairman, CEO and President*

Thank you. We appreciate your participation today and your interest in KMG. And we look forward to speaking with you on our second quarter conference call in March. Thanks, again.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a great day.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.