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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the KMG Q2 2016 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to introduce your host for today's conference, Mr. Eric Glover, Investor Relations Manager. You may begin.

Eric Glover - *KMG Chemicals, Inc. - Investor Relations Manager*

Thank you. Good afternoon, and welcome to the KMG Second Quarter Fiscal 2016 Financial Results Conference Call.

With me today are Chris Fraser, our Chairman and CEO; and Mindy Passmore, our CFO. In a moment, we'll hear remarks from them, followed by a 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 tables 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.

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Thank you, Eric. Good afternoon, and thank you, everyone, for joining us today. Our second quarter earnings release was issued today after the market close, and our 10-Q will be filed tomorrow. After my comments, Mindy will review the financials, and then we'll take your questions.

I'm pleased to report that KMG had a solid second quarter, generating adjusted EBITDA of $11 million and adjusted EPS of $0.40. Each was a second quarter record high despite higher corporate overhead expenses that Mindy will discuss in more detail. Adjusted EBITDA increased 22% compared to last year's second quarter, marking the eighth consecutive quarter that adjusted EBITDA grew at a double-digit rate on a year-over-year basis. And adjusted EPS grew 33% year-over-year.

Additionally, our year-to-date cash flow more than doubled compared to the prior year, which is consistent with our focus on execution, driving operational efficiencies and maximizing margins and cash flow. Subsequently, we paid down $4.5 million in debt during the second quarter. And our balance sheet remained strong, providing the financial flexibility to pursue strategic acquisitions in the future.

Our performance in the second quarter relative to last year was driven by increased Electronic Chemicals product volume in North America and Asia, continued cost improvements resulting from the consolidation of our manufacturing operations, lower distribution expenses and a favorable mix of regional and product sales. Penta sales also grew with favorable raw material costs and the addition of the industrial lubricants business.

As expected, our business experienced typical seasonal trends in the second quarter, but our profitability and adjusted EBITDA exceeded our expectations. Although the overall macro environment remains challenging as the economic uncertainty in Europe and China weighs on global GDP growth, semiconductor manufacturers continue to develop the next generation of semiconductor devices that are smaller, faster, more integrated and consume less power.

Because of their complexity, these new devices are typically manufactured in the industry's most advanced fabs, which have maintained relative high utilization levels. High leading-edge fab utilization benefits our Electronic Chemicals business, as we focus on supplying the highest-purity chemicals for our customers' most advanced manufacturing processes. In addition, we are uniquely positioned as the only supplier with the ability to meet our customers' exacting purity requirements globally given our presence in North America, Europe and Asia.

Our second quarter Electronic Chemicals product volume increased from last year's second quarter, benefiting from relative strength in certain end markets such as data storage for cloud computing, automotive and the Internet of Things. More specifically, our business in North America continued to perform well, with product volume increasing year-over-year driven by demand for our high-purity products. In Asia, our product volume increased also from last year's second quarter, fueled by strong demand from the data storage market. However, overall, Electronic Chemicals revenue in Asia declined from last year's second quarter as we scaled back our less-profitable services business to focus on driving product volume growth. Electronic Chemicals product volume was down in Europe, impacted by the weak Eurozone economy.

Our Other Chemicals segment, which includes our penta and industrial lubricants businesses, reported a solid quarter despite typical softer seasonal trends. Penta sales increased from last year's second quarter due in part to ongoing utility pole replacement programs by Western utilities. Lower raw material costs also benefited our penta business in the second quarter.

Sales in our industrial lubricants business were down from the first quarter due to typical seasonality as valve maintenance service activity is lowered during the winter months. Although the downturn in the oil and gas industry remains a headwind for our industrial lubricants business, periodic maintenance must be performed on pipelines and other energy infrastructure to ensure optimal valve operation and to meet industry standards -- safety standards.

Overall, we achieved substantial improvements on our profitability, with gross margins reaching nearly 40% in the second quarter and our adjusted EBITDA margin climbing to 15.6% versus 11.3% in last year's second quarter. Cost savings and operational efficiencies arising from the restructuring and realignment of our global manufacturing operations were key drivers behind the expansion in gross margin.

We've improved our manufacturing cost structure by transitioning production from Milan to alternate sites in Europe; as well as transitioning HF production from Bay Point, our Bay Point plant, to our flagship plant in Pueblo, Colorado. In addition, we experienced a favorable mix of regional and product sales in our Electronic Chemicals business. North America, which is our highest-margin region, accounted for proportionately more of our EC segment sales compared to the first year ago quarter. North American EC business also benefited from stronger demand for our highest-purity products, which carry higher profit margins.

In Other Chemicals segments, profitability benefited from the absence of the lower-margin creosote sales business that we divested a year ago. And we continue to experience favorable raw material costs relative to last year's second quarter. The contribution from the industrial lubricants business also enhanced margins compared to the prior year quarter.

As Mindy will discuss in further detail, distribution expenses declined significantly from last year and was unusually low in the second quarter. Looking forward, we anticipate distribution expense will increase on a sequential basis given anticipated changes in shipment volume, customer and product mix within the electronic chemical business, increased diesel fuel cost and availability of preferred carriers.

Our corporate expenses increased by $2.3 million compared to the second quarter of last year. The increase was due to higher stock-based compensation costs, corporate relocation costs and additional audit expenses.

Although I'm pleased with our overall financial performance in the second quarter, I was dissatisfied with the amount of the incremental costs related to SOX compliance in our fiscal 2015 year-end audit. We are committed to effective internal controls and optimizing overall corporate overhead expenses and anticipate that SOX compliance and audit fees will decrease in the second half of the year.

Looking forward, acquisitions remain a fundamental component of our growth strategy, and we continue to evaluate acquisition opportunities that would enhance our growth within our existing markets as well as those in new markets. In the Electronic Chemicals market, we remain focused on expanding our presence and capabilities in Asia, where the majority of the world's semiconductor manufacturers -- semiconductors are manufactured. We also continue to identify opportunities that would complement our industrial lubricants business and provide new paths for growth.

Turning to our outlook. We forecast 2016 consolidated net sales will be approximately $300 million, unchanged from our prior guidance. In the Electronic Chemicals segment, we project fiscal 2016 sales to be flat to up slightly compared to the prior year, excluding an estimated foreign currency impact of approximately $7 million. In the Other Chemicals segment, we forecast fiscal 2016 sales will decrease compared to fiscal 2015 due to the divestiture of the creosote business, partially offset by the contribution from the industrial lubricants business.

As we look at the second half of fiscal '16, we anticipate raw material costs will increase relative to the first half of the year but remain favorable compared to last year's second half. In addition, we expect distribution expenses to increase in the third and fourth quarter, in part due to a more normalized shipping pattern with customer and product mix as well as higher diesel fuel costs.

Despite these headwinds, we are raising our fiscal 2016 adjusted EBITDA guidance to $43 million to $45 million from $40 million to $42 million previously, representing a 19% year-over-year growth at the midpoint of that range. Our increased EBITDA guidance reflects the strong EBITDA level achieved in the first half as well as our expectation for continued EBITDA growth on a year-over-year basis in both our Electronic Chemicals and Other Chemicals segments in the second half.

Our forecast includes a $400,000 increase in stock-based compensation in the second half of fiscal 2016 compared to the first half, with projected stock-based compensation expense totaling $5 million in fiscal 2016 versus approximately $3 million reported in fiscal '15.

Overall, I'm pleased with our continued progress. Our restructuring and realignment program has significantly improved our manufacturing efficiency and fundamentally improved our margin structure, helping us to drive strong growth in EBITDA and cash flow. We've enhanced our market position within our Electronic Chemicals segment, increasing our participation in key end markets like automotive, mobile and Internet of Things, while continuing to focus on supplying the highest-purity products for the production of the industry's most complex semiconductors. We believe that consolidation in the semiconductor industry plays to our strength, as we're uniquely positioned to reliably supply our global customers with the products they need anywhere in the world.

With last year's acquisition of Val-Tex, we've established a solid position in the industrial lubricants business, providing a third platform for growth. This business has contributed to our sales and earnings. And we're optimistic about the long-term outlook, as we see exciting opportunities for overseas expansion and the potential for value-creating acquisitions.

Now I'll turn the call over to Mindy for details of our financial performance in the second quarter.

Mindy Passmore - *KMG Chemicals, Inc. - 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 reference are reconciled to the corresponding GAAP numbers in today's earnings release.

Second quarter consolidated net sales were $70.9 million compared to $79.8 million in the last year's second quarter. Sales declined on a year-over-year basis primarily due to the divestiture of the creosote business in fiscal 2015 and a $2.1 million impact from foreign exchange, partially offset by the addition of the industrial lubricants business.

Gross profit margin in the second quarter was 39.8% compared to 35.8% in last year's second quarter. Gross profit margins improved due to cost savings resulting from the restructuring and realignment of our Electronic Chemicals operation, a favorable product mix, a higher proportion of Electronic Chemicals sales in North America, lower raw materials costs, the addition of the industrial lubricants business and the absence of low-margin creosote sales in the Other Chemicals segment.

Second quarter distribution expense decreased to $8.8 million compared to $13 million last year. Distribution expense decreased due to a favorable customer and product mix, reduced costs in Asia from lower service revenue, the absence of creosote sales and lower average diesel fuel cost and higher availability of preferred carriers.

SG&A expense increased by $3 million from last year's second quarter. Of this amount, $700,000 was attributable to the relocation of our corporate headquarters to Fort Worth from Houston, and $700,000 was due to increased stock-based compensation expense. In addition, we incurred $500,000 in incremental expenses related to SOX compliance and audit fees. Also, we incurred higher expenses for depreciation and amortization expense for our new ERP system and related to the industrial lubricants business we acquired and SG&A expenses from the addition of the industrial lubricants business.

Going forward, we anticipate SG&A expense in the second half of fiscal 2016 will decline compared to the first half of fiscal 2016 due to lower corporate relocation cost and lower incremental SOX compliance and audit fees. We anticipate that stock-based compensation expense will increase in the second half of fiscal 2016, partially offsetting these items.

Consolidated adjusted EBITDA, which excludes corporate relocation expenses and restructuring charges, was $11 million in the second quarter, up 22% from $9 million in last year's second quarter. The improvement in adjusted EBITDA reflected a favorable product and regional sales mix in the Electronic Chemicals business, lower distribution cost, cost savings realized from our global manufacturing consolidation, increased sales volume at lower raw material cost in our penta business and the contribution from our industrial lubricants business.

Second quarter interest expense was $252,000 versus $184,000 in the same period last year due to a higher debt level following the acquisition of the industrial lubricants business in May of 2015 and an increase in LIBOR following the Federal Reserve's recent rate increase.

Our interest rate in the second quarter was 1.4%. As a reminder, the interest rate on our revolving credit facility is based on a varying rate of the 30-day LIBOR, plus a margin based on our funded debt-to-EBITDA.

Our income tax rate was 34.1% in the second quarter, as compared to 35.7% in the prior year period. The decrease in the Q2 2016 tax rate compared to the Q2 2015 rate was primarily due to discrete items in the prior year. We project a fiscal 2016 tax rate of approximately 35%.

Second quarter fiscal 2016 GAAP net earnings were $0.33 per diluted share versus $0.47 per diluted share in last year's second quarter. Earnings in last year's second quarter benefited from a $0.31 per share gain from the sale of the creosote business. Adjusted diluted EPS for the second quarter of fiscal 2016 was $0.40, up 33% from the second quarter of fiscal 2015.

Turning to our segment results. Second quarter Electronic Chemicals sales were $62.5 million, including a foreign currency impact of $2.1 million, down from $66.6 million in the same period last year. Excluding the foreign currency impact, Electronic Chemicals sales declined by 3% compared to the prior year second quarter due to softness in Europe and lower services-related revenue in Asia, partially offset by increased product sales in North America and Asia.

Second quarter EBITDA in the Electronic Chemicals segment was $11.5 million, an improvement of 32% compared to $8.7 million in last year's second quarter. Foreign currency translation reduced EC segment EBITDA by approximately $300,000 in the second quarter of 2016, as compared to the prior year period. EC EBITDA margins improved 530 basis points year-over-year primarily due to enhanced manufacturing efficiencies from our restructuring and realignment initiatives, a favorable mix of regional and product sales volume and lower distribution costs.

In our Other Chemicals segment, Q2 sales were $8.3 million compared to $13.1 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.

Other Chemicals Q2 EBITDA was $3.1 million, representing a segment margin of 36.7% compared to the prior year level of $1.6 million, representing a segment margin of 12.6%. The increase in EBITDA and EBITDA margin was due to higher penta sales, lower raw materials costs 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 second quarter of fiscal 2016, we used cash generation -- generated from operations to reduce debt by $4.5 million. As of January 31, 2016, our debt balance was $47 million compared to $53 million at the end of fiscal 2015. Operating cash flow increased primarily due to net income and improvements to working capital. Operating cash flow in the first half of fiscal '16 was $14.1 million, more than double the $6.5 million generated in the first half of fiscal 2015.

Capital expenditures were $2.4 million for the second quarter of fiscal 2016 and $6 million for the year-to-date. We continue to expect 2016 full year capital expenditures of approximately $15 million, which includes expenses related to our ERP system implementation and asset investments to support increased shipment volume in our Electronic Chemicals business.

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 with Gabelli & Company. Your line is now open.

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

So you preempted my first question, which was going to be were you surprised by the results. And obviously, you said yes, and I was wondering if you could give us a little more in terms of the surprise. And how much do you think was in the second quarter versus the second half of the year?

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes, so I wouldn't say surprised. I think I said that we were -- it exceeded our expectations. I'm never surprised by good results, I guess I would say, but a good question, Rosemarie. So typical slowdown in EC from what the -- our first quarter, second quarter on normal terms is usually 4% or so in revenue. And as Mindy said, we were down about 3%. And so we were pleasantly surprised by the volume that we saw.

We were also encouraged by the margins that we've seen. We continue to see the benefit of our consolidation that we talk about. So our margins were better than we anticipated. In addition, on the penta side, our sales volume was stronger. Usually in this quarter, with the wet season, there isn't as much treating going on, but yet our volume held up better than we had anticipated.

And then on top of that, we did mention there were some -- there are several items that occurred that helped our overall profitability, as Mindy mentioned, some of which were our distribution of sales in which regions. In addition, we had distribution expenses that were normal -- were lower than normal, and that was due to whether it's certain customer shipments or various products. It was a product mix as well as a customer mix. So all those things factored together to have us have a better quarter than we had anticipated.

And as we guided for the second half, we expect our distribution expenses to be normalized, more typical. And then some of the additional expenses that Mindy talked about and then just an overall projection to how we see the industry performing in our second half gave us the guidance that we put forth.

Mindy Passmore - *KMG Chemicals, Inc. - CFO*

So raw materials --

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

I'm sorry. Go ahead.

Mindy Passmore - *KMG Chemicals, Inc. - CFO*

I was going to say also, raw materials, we've been very fortunate to have raw material costs low. We've talked about that in prior calls. And we keep saying we're anticipating that -- for them to go up. And we do anticipate -- well, we think they'll still be favorable to the prior year, but we think they'll go up in the second half.

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

So when we look at the distribution expense. It was $10 million in the first quarter, was $13 million last year. What is a normalized level going forward?

Mindy Passmore - *KMG Chemicals, Inc. - CFO*

Well, I would say that it depends on a lot of factors that, as we mentioned, it's got -- we've got the fuel costs. We've got the primary carrier acceptance rate and the mix, but I would say looking back at Q1 of this fiscal year might be something that I would suggest.

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

Okay. And just following up on the raw material cost. I mean oil is not going anywhere, or at least it doesn't appear to be doing so in a consistent fashion. So why do you expect your raw material cost to increase in the second half?

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes, so some of our raw materials are tied to oil. Some are not. And then there's also some dynamics within specific marketplaces. So for example, chlorine is a key raw material for us on pentachlorophenol. There has been an announced fairly large increase that is going into effect. We'll see if whether or not it actually holds or not, but at least the producers are -- have announced one.

And then on some of the other products that are organics based, we've seen some tightening, if you will, on the supply/demand, whether it's curtailing production, so therefore some of the producers are looking to increase pricing. So we've factored some of that in and anticipate some of that in the second half. We -- as Mindy said, we've experienced real favorable pricing here, better than we had anticipated for the first half of the year. And we're expecting some modification of that in the second half.

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

Following up, if I may, on penta. It was stronger than you thought. I mean, penta, my understanding, is benefiting from the fact that on the West Coast the utilities are replacing old poles, yet El Nino dumped water on the West Coast. So why was it stronger? I am not getting it. Because the weather didn't seem to help, unless they were replacing them in Nevada or something.

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes, well, weather does have an impact on two things. One is the ability to harvest the trees for the wood. So the amount of harvesting affects how many poles are being treated and what kind of inventory they're building, but in addition, you're right. It does affect how many poles are being replaced at any one time because of weather conditions, but -- so it was a slower second quarter than the first, as we said, but the volume was stronger than it was a year ago. And it was over the course of our second quarter, going back in November and December, we had fairly strong sales.

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

So now you're expecting this particular trend to continue in the second half on the penta side?

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes, we -- I would say, yes, that we continue to expect the replacement pole strategy, maintenance to continue, but it does move from quarter to quarter. And we expect it to pick up in the third quarter over the second quarter because of seasonality, but we do expect year-over-year that the penta sales, penta volume will continue to be higher than it was last year.

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

Thank you. I will get back in queue.

Operator

(Operator Instructions) And our next question comes from the line of Mike Harrison with Seaport Global. Your line is now open.

Mike Harrison - *Seaport Global Securities LLC - Analyst*

Hi, good evening. Was wondering, Chris, if you could tell us what the price and volume numbers were within the 3% decline in Electronic Chemicals.

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes, we don't break out volume relative to price when we talk about our overall revenue, but let's say we did continue to see some price improvement, as we've said, ongoing that positioning ourselves with the right customers and the right markets is part of our strategy. We also benefited from a product mix as well, but we don't specifically, Mike, break out the volume impact relative to overall revenue.

Mike Harrison - *Seaport Global Securities LLC - Analyst*

Okay. So if I assume, though, that volume was definitely negative year-on-year, can you just maybe help us understand how much of that was related to the exit of some of the service-oriented business in Asia and whether you were seeing any of your customers doing any destocking during the quarter?

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes, good question, Mike. So yes, you touched on a good point. I discussed the service industry in Asia -- the service business in Asia that we've been moving away from. That was a decent portion of our business in Asia that we had for a number of years. And we -- because of the profitability, we've been deemphasizing that part of the business.

So it affects our overall revenue, but it was a lower-margin business, so we're getting the benefit of higher margins but lower revenue. I would say, though, however, our product volume just from a volume standpoint was up in Asia. It was up in North America and down in Europe, so even though our revenue line was down in Asia, our product volume was up.

And to comment about destocking, we've not experienced that as of yet and don't have any indications that we're going to experience that. As of right now, we're not seeing any destocking. And we didn't see it in the second quarter. What we saw in the second quarter was a typical slowdown at the fabs and the foundries, as they built in the prior quarter getting into the holidays and then they slowed down production and operations in our second quarter.

Mike Harrison - *Seaport Global Securities LLC - Analyst*

Okay. And then in terms of the comments you had on mix and seeing good demand in some of the highest-purity chemicals that are needed for some of the most complex semiconductor applications, what's the outlook on those highest-margin products? Is that something you're pretty confident in as you look out over the next two to three quarters?

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes. And that's part of our strategy is to continue to position ourselves on those product areas. And so on two fronts, both being global, which allows us to have those products in multiple locations around the world and service the global customers; and at the same time, supplying product to the most sophisticated, most complex fab and semiconductor production and which require the highest-purity products. The higher the purity products, the more requirements it puts on us and the more value we create for the customers, so it's usually an area that we have higher margins in. So it's a real focus area for us, so we're going to continue to strategically position ourselves to be able to service that and provide those -- the highest-purity products we can.

Mike Harrison - *Seaport Global Securities LLC - Analyst*

And then turning to the penta side, kind of a similar question about the inventory, although in this case I'm curious if you're seeing any inventory build going on at your customers. In other words, then, could we have maybe seen Q2 strengths mean that we're pulling some sales forward from Q3 and Q4, which are typically seasonally stronger?

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes, we might have seen some of that, Mike. It's hard to tell. So it's really, like I said, hard to tell, but there might be a little bit of that going on. But the projections we get from our customers and specifically around the pole replacement, it's a -- from quarter to quarter, it's difficult to pin it down exactly, but the overall trend is good. And that pole replacement, we see continuing for another 10 years or so.

There are some projections out there that use double-digit growth on replacement numbers. So it's something we're watching, but there may have been some of that in the second quarter and we'll see as Q3 unfolds. But again, our Q2 volume was lower than in Q1, which had the seasonality, but it was stronger than Q2 last year.

Mike Harrison - *Seaport Global Securities LLC - Analyst*

Right. And then in terms of your comments around raw material expectations and expecting those to be higher in the second half versus the first half, have you guys announced any pricing actions on penta in order to offset some of the raw material increases?

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

No, we have not announced any price increases on penta.

Mike Harrison - *Seaport Global Securities LLC - Analyst*

Okay. On the industrial lubricants front, I was wondering if you could just give us an update on how you're seeing the M&A pipeline, particularly with some of the energy market weakness probably hurting some of those potential targets and making them look more attractive. And are you focusing narrowly around valve maintenance, which I think is a submarket within industrial lubricants? Or are you looking more broadly as you consider potential acquisition targets?

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes, so we are looking more broadly. We see, the valve lubricant and sealant business that we're in now, there's obvious consolidation opportunities within that space, but there are also tangential businesses that we see that have similar take to market, complementary products that would allow us to expand into that space in a broader way. So we're looking at that as well.

As far as opportunities go, yes, I would say the lower oil prices is providing us with more opportunities. It's always a question, Mike, and a challenge to get the buyer and seller to the same level of expectations. And so you still have some people holding on to maybe the past of what the businesses were, and so like until they get calibrated to the new reality, sometimes it takes some time. But having said that, we're seeing good opportunities, good discussions; and optimistic that that's going to bear fruit here over the coming year.

Mike Harrison - *Seaport Global Securities LLC - Analyst*

All right, Chris. And then the last one I have for you is just around the stock-based compensation. You'd talked about it being roughly at $5 million total, which is $2 million higher than last year. We've seen you guys take EBITDA from $29 million, $30 million in fiscal '13 up to your guidance here, is $43 million to $45 million for '16. How has the stock-based comp changed over that time period? And does it go even higher from here?

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes, it's a good question, Mike. So over two years ago, our stock-based compensation was approximately $1.5 million. So when we had an EBITDA around $30 million, we had a stock-based comp of about $1.5 million. Last year, when our EBITDA was approximately $37 million, we had a $3 million stock-based compensation expense. This year, with our guidance at $43 million to $45 million, we have $5 million of stock-based compensation, so you're right. If we were to net those out, it would even -- our performance. And improvement year-over-year would be even larger than what it appears.

So where we are today and the reason for that, I think it bears explanation. In prior time, because of the performance that the company was not progressing at the levels that the long-term incentive targets were set to, obviously there was no stock-based compensation paying out. As we've moved now to we're getting some progress, performance is going well, so with that comes the expense of stock-based compensation.

So we've not really changed our long-term incentive plan. What has actually changed is the performance and therefore the expense that goes with that. So this year, at $5 million, it's got -- our long-term incentive has three-year tranches. So we have a full load of three tranches in this year's expenses, and it's -- this is about the normalized level. Now it will move up and down, more down if our performance does not meet. And our expense will go down, obviously, but from a target standpoint, the $5 million level is about a normalized rate that we could assume, which -- so we're looking forward to not having that move from one year to the next so that we can compare EBITDA without the variation in stock-based compensation. As you said, $2 million is pretty significant from one year to the next.

Mike Harrison - *Seaport Global Securities LLC - Analyst*

Got it. Thank you very much.

Operator

(Operator Instructions) And our next question comes from the line of Rosemarie Morbelli with Gabelli & Company. Your line is now open.

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

Thank you. I was wondering, Chris, if you are making progress finding some manufacturing capabilities in Asia.

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes. So we've talked openly about a really keen part of our strategy is to expand our base in Asia. It's where the majority of semiconductors are consumed and produced and so having a larger base there. So we're disproportionate relative to the overall industry. So it's a key part of our strategy, to make acquisitions there.

We continue to work on several fronts. One is acquiring existing businesses in that space. And we continue to have conversations and discussions along those lines, but in addition, that we have also looked at brownfield opportunities, which would be to acquire assets that may be in related businesses that have similar assets that could be utilized for our technology and our production. So we're making good progress there as well.

So what we're trying to do is play several opportunities out and pursuing all of them that present themselves. So I am pleased with the progress we're making. And I'm confident that, over the next year, we'll be able to be successful in expanding our presence in Asia.

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

And still staying in Asia and the service-related operations. Are you getting out of it 100%? And how much is left of that particular side?

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes, so we really haven't broken out our product-versus-service aspects of our business. And it was a fairly large portion. And in fact, you'll remember we used to talk a lot about our distribution expenses and why -- people were asking why are they such a large percent of revenue in the past. We spoke to the fact, in Asia, a lot of those expenses went towards this service business and therefore had high distribution expenses.

So you'll see our distribution come -- expenses come down because of that as we move away from some of this business, but we still have services -- a service business in Asia. We have not completely exited. We are systematically addressing the business, the business that we're able to maintain sufficient margins, we're continuing on. And on ones that are not meeting margin expectations, then we're moving in a different direction. So it's an ongoing effort. We've not completely gone to where we expect to be, but it's a gradual process that you'll see affecting our year-over-year results on quarter. For example, this Q2 was -- you saw it pretty -- have an impact.

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

Yes. So that brings me to are you sharing with us to give us, on EC, the impact from FX on top line? Can you share more or less how much this exiting of that business is contributing to the decline?

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

No, we're not going to get into that specific, but -- so we'll just say that it has impacted our distribution expense. It has impacted our revenue. As I said, our product volume is up in Asia. Our product volume is up in North America, so I'm happy to say we're getting some price improvement. We've also gotten some volume improvement both in Asia and in North America. So you can kind of triangulate a little bit if you desire, but I'm happy with the progress on the volume from a product standpoint as well as price.

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

Okay. And at least the increase in volume, do you see, I am assuming it is because the fabs are producing more chips, any incline as to whether or not there are going to be new fabs being built? Are you hearing anything from your customers? Or are they -- can they supply some market growth without adding anything?

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

Yes, so there are -- I mean the investment and amount of capital being invested in the semiconductor fabs and foundries is remaining at a very high level. We're not seeing a drop off in that, which is encouraging to us though. So we're seeing the company still invest in it. The consolidation is only facilitating further investment. The fabs that are being built are the higher-technology fabs with a huge investment. That just facilitates them wanting to even have more capabilities to produce the higher-end chips.

So there's -- there are fabs being announced in Asia. Where Micron has a fab that they've announced that they're going to put in, Micron and Intel are working together in China. So what we're pleased about -- to see is that the investments continue, and the future looks good.

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

Okay. Thank you very much.

Operator

And I'm showing of further questions at this time. I would now like to turn the call back over to Mr. Chris Fraser for closing remarks.

Eric Glover - *KMG Chemicals, Inc. - Investor Relations Manager*

Okay.

Chris Fraser - *KMG Chemicals, Inc. - Chairman and CEO*

We appreciate your attention today and participation and your interest in KMG. And we look forward to speaking with you on our Third Quarter Conference Call. Thank you.

Operator

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