CABOT MICROELECTRONICS CORPORATION
FIRST QUARTER FISCAL 2019 CONFERENCE CALL SCRIPT
May 9, 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 second quarter of fiscal 2019, which ended March 31, 2019. 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. We assume no obligation to update any of this forward-looking information.

Also, our remarks this morning reference certain non-GAAP financial measures, including adjusted pro forma results. Our earnings release and slide presentation include a reconciliation of each non-GAAP financial measure to the nearest comparable GAAP financial measure. We also provided supplemental pro forma information in this quarterly release, which compares current results as if Cabot Microelectronics owned KMG during the comparable period last year. Additionally, data reflects rounded values throughout this discussion and in the slide presentation.

As a reminder, we will be holding our Investor Day on June 18th at Nasdaq MarketSite in New York City. Please RSVP to the email invitation by May 18th or contact me directly if you have not received an invitation and you are interested in attending.

I will now turn the call over to Dave.

Thanks, Colleen.

Good morning, everyone, and thanks for joining us.

Last night we announced results for our second quarter of fiscal 2019, which includes a full quarter of CMC and KMG results. Record revenue of $265 million was up 86% compared to the same period last year, primarily benefiting from the KMG acquisition. Pro forma revenue was up 2% year-over-year, driven by growth in CMP pads, electronic chemicals and pipeline performance products. Revenue on a proforma basis was down 6.5% sequentially, which is at the low end of the updated guidance that we provided during our annual meeting in March.

Revenue in both of our segments, Electronic Materials and Performance Materials, grew year-over-year on a pro forma basis. Total adjusted EBITDA for the company was $86 million, or 32% of sales and $11 million higher compared with the pro forma EBITDA in the prior year, driven primarily by higher gross profit and lower selling and general expenses, which reflects the strength and resilience of our business model, our ability to deliver on synergies related to the KMG acquisition, as well as a continued focus on cost discipline particularly during this softer semiconductor demand environment.

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

Starting with our Electronic Materials segment, revenue was up 1% year-over-year on a pro forma basis. After delivering record results for seven consecutive quarters, our CMP slurries revenue declined this quarter due almost entirely to softer market conditions, particularly in memory but also in foundry. As previously discussed, our CMP slurries play a critical role in enabling DRAM and NAND production and this quarter our business was adversely impacted as our customers reduced utilization rates to address higher chip inventories and falling memory prices. Most industry analysts expect this softness in semiconductor demand to recover in the second half of this calendar year and we remain excited about the long-term future growth of the semiconductor industry to support and enable future technologies.

In CMP pads, we delivered another quarter of solid results. We are proud of our ongoing achievements in this business, growing from slightly above $30 million in revenue in fiscal 2015 to nearly $100 million in revenue on a run-rate basis in the first quarter of fiscal 2019. One item that we wanted to mention is that, similar to CMP slurries, our pads business is very connected with wafer starts so the overall market softness we are experiencing may impact our ability to meet our articulated goal of $100 million in revenue for full fiscal year 2019. We remain confident that CMP pads will be a significant growth driver for our company and are optimistic about the long-term growth prospects of this product area.

In electronic chemicals, we saw stable demand this quarter and we believe there is opportunity for future growth driven by the continued expected strength in advanced logic. Our high purity process chemicals have a high participation in logic applications so as our customers continue the transition to advanced nodes with increased device complexity, the demand for these products is expected to increase significantly.

Looking ahead, recent reports from customers and industry analysts suggest there is still some level of uncertainty in overall semiconductor industry demand given the weakness in certain end markets, but most believe there will be some level of recovery in the second half of calendar 2019. Consistent with that outlook, we saw results for our Electronic Materials segment stabilize in April and expect results to be approximately flat next quarter with continued strengthening expected in the second half of the calendar year.

Longer-term, we remain excited about the future demand for global semiconductor materials. We believe we will continue to benefit from increased device complexity and growing computing power and storage requirements, which translate to additional demand for consumable materials. Our high-quality products, innovative solutions, best-in-class service, and global R&D infrastructure position us as the premier materials supplier to the semiconductor industry.

Turning to Performance Materials, we saw an 8% increase in revenue year-over-year on a pro forma basis. The growth in this segment continues to be driven by strong results in our pipeline performance business, which delivered double-digit year-over-year growth. Our drag-reducing agents, or DRA's, enable pipeline operators to optimize the efficiency and throughput of oil transport, which support the growing needs of the industry. With continued growth expected in U.S. oil production, primarily in the Permian basin as well expansion internationally, we continue to experience extremely strong demand for our DRA solutions and anticipate a strong future for this business.

We are now nearly six months post the close of our KMG acquisition, and we are pleased with the integration progress to date. Customer feedback continues to be positive, and we believe we are well positioned to meet or exceed our synergy target of $25 million on a run-rate basis within the first two years of the acquisition. We are also happy with the performance of the acquired businesses to date, which we believe offer many future growth opportunities as well as significantly expands our total addressable market. We generated cash flow from operations of approximately $54 million through the second quarter and have already prepaid $100 million of debt borrowed to finance the KMG acquisition.

Looking ahead, we hope to see many of you at our investor day in New York on June 18 where we will share our vision and future strategies for the company.

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.

We are presenting the results as both reported and adjusted on a pro forma basis. Pro forma results are presented following SEC guidelines and are shown as if we owned KMG from the beginning of fiscal 2018. This not only allows us to meet our reporting obligations but also enables us to provide our financial results on a basis that shows meaningful comparisons. We will of course give greater prominence to reported GAAP results but will often refer to adjusted pro forma figures to communicate our performance and the drivers of the underlying businesses.

Our team has worked diligently to provide information that allows us to analyze our financial results on a comparable basis so we can have meaningful discussions. While there are many supplementary financial tables included in our second quarter press release, I would like to point investors and analysts to slide number 12 in the earnings presentation which summarizes the more relevant pieces building up to our adjusted pro forma numbers.

When viewing slide 12, please let me direct your attention to last column which contains the total adjusted pro forma figures that I will typically reference throughout my prepared comments. Slide 13 performs the same process for the comparable period, which was our second quarter of fiscal 2018.

To arrive at the adjusted pro forma results, we have excluded the same types of items as we have in the past, for example, amortization expenses and certain non-recurring acquisition and integration-related charges. Supplementary data tables are provided in the exhibits of the press release and the slide presentation.

Now, let’s start with an overview of our financial performance this quarter, which is provided on slide 3.

Revenue for the second quarter of fiscal 2019 came in at $265 million, which is $122 million, or 86%, higher than the same quarter last year. Pro forma revenue, which assumes that we owned KMG in the prior year, increased $6 million or 2%. We are pleased with positive growth vs. the prior year despite softer industry conditions.

Results in both segments improved on year-over-year basis with growth in CMP pads, electronic chemicals and pipeline performance products more than offsetting lower revenue in CMP slurries.

Our net income was $27 million, and diluted EPS was $0.92 in the quarter. Adjusted pro forma net income was $46 million, which was $5 million, or 13%, higher compared with the adjusted pro forma net income in the second quarter last year. Adjusted pro forma EPS was $1.55, which was $0.17, or 12%, higher than last year.

Just stepping back for a moment, we grew pro forma revenue by $6 million despite softer industry conditions, while growing adjusted pro forma net income by $5 million. Adjusted EBITDA was 32% of revenue, showing what we believe to be the significant earnings and cash flow power of the company.

Now please refer to slide 4, which provides some higher-level P&L comparisons for both reported and adjusted pro forma results.

Our reported gross margin was 43.3% this quarter but was 46.3% on an adjusted pro-forma basis. As shown on slide 12, we are adding back $8 million to gross profit as we remove the effects of inventory write-up and amortization on acquired production-related assets. This compares to 44.4% last year, an increase of 190 basis points, primarily due to continued mix improvement in tungsten and dielectrics slurries as well as positive growth in performance materials.

Also, on slide 12, we are deducting $16 million from operating expense, of which $13 million is amortization on acquired intangibles and $3 million is for integration and acquisition-related expenses incurred during this quarter. The result is adjusted pro-forma net income of about $46 million which is referenced throughout our materials.

Our adjusted pro forma EBITDA was $86 million, or 32% of revenue, which was $11 million higher than the comparable metric in the prior year. This was driven primarily by higher gross profit and lower selling and general expenses.

Now let’s discuss revenue results by segment and business, which are shown on slide 5.

As you know, we are presenting our results in two reportable segments: Electronic Materials, which contributed approximately 80% of our quarterly revenue, and Performance Materials, which contributed the remaining 20%.

Pro forma revenue in our Electronic Materials segment grew by $2 million, or 1%, despite a challenging industry environment. Our CMP slurries revenue declined 4% year-over-year, due to softer results across all products, primarily in dielectrics and non-tungsten metal slurries. Additionally, tungsten revenue was down slightly from last year's quarter as weakness in memory and foundry was partially offset by strength in advanced logic.

CMP pads reported a 14% increase in revenues from last year due to continued customer adoption of our NexPlanar product line. As Dave mentioned earlier on the call, we are proud of our growth in this business, which delivered outstanding performance in the last several years, growing at a 20% compound annual growth rate since 2015.

Our electronic chemicals business grew by $4 million, or 5%, on a comparable basis versus the prior year. We benefited from strong demand for our products from advanced logic customers as they continue to transition to advanced technology nodes.

Moving to Performance Materials, revenue increased $4 million, or 8%, over the prior year. This increase was driven primarily by growth in pipeline performance products.

Slide 6 shows revenue and adjusted EBITDA by segment. Electronic Materials delivered $75 million of EBITDA and an EBITDA margin of 35% in the quarter. Performance Materials EBITDA was $23 million, and EBITDA margin was 43%.

Now please refer to slide 7, which provides some balance sheet and cash flow highlights.

We ended the quarter with $192 million cash on hand. We prepaid $45 million in debt this quarter and made another prepayment of $55 million in April, which reduces our debt to $943 million at the end of April. We made these prepayments according to our capital deployment plan.

Overall, we are very pleased with our ability to generate significant cash as a newly combined company. We continue to expect our leverage to decrease from around 3 times EBITDA at the time of the acquisition to our target of 2 times EBITDA in two years following the acquisition.

We generated cash flow from operations of $54 million year-to-date. Our capital expenditures were $19 million year to date, and as a result, our free cash flow was $35 million year to date.

I will now provide some closing remarks on slide 8.

From a financial perspective, we achieved new revenue milestones, primarily due to the KMG acquisition, but also from a 2% improvement in pro forma revenue. CMP pads and electronic chemicals grew, which offset the declines in CMP slurries that were driven by weakness at memory and foundry customers. Adjusted pro forma gross margin, net income and EBITDA all showed strong growth benefiting from higher profitability and synergies, as well as continued overall control of operating expenses.

Specifically, we delivered $3.5 million of synergies to OPEX in our second quarter P&L and have now implemented actions that should contribute to $20 million in synergies on a run-rate basis. This puts us on target to achieve $25 million in run-rate synergies by the end of the second year following the KMG acquisition.

On slide 9 we provide some forward-looking expectations.

We are providing revenue guidance for the third quarter of fiscal 2019 compared to our second quarter on a sequential basis.

For the third quarter of fiscal 2019, we currently expect total revenue to be approximately flat to up slightly on a percentage basis. Electronic Materials revenue is expected to be approximately flat, and Performance Materials revenue is expected to be up mid-single digits, on a percentage basis. Consistent with the industry outlook that Dave provided, as well as our performance to date, we are tightening our full year EBITDA range by lowering the upper end to $345 million from the prior $355 million.

We have prepaid $100 million of debt, and now expect our full-year interest expense to be between $45 and $47 million, with approximately $13 million expected in the third quarter.

Depreciation and amortization is still expected to be between $35 and $45 million, which excludes approximately $60 million in acquisition-related amortization.

Our current capital spending expectation for the full fiscal year is now between $45 and $55 million, and we continue to expect our effective tax rate for the full fiscal year to be in the range of 23% to 26%.

As we think about our business for the remainder of the year, we continue to be delighted with the earnings power of our combined company, and our ability to deliver earnings and cash flow accretion from the KMG acquisition.

Consistent with our expectation announced at the time of the KMG acquisition, we still expect to deliver EPS accretion of about $1 per share for the first year following the acquisition, excluding costs for acquisition and integration-related items, and have delivered about $0.50 per diluted share in the first two quarters.

In summary, despite industry headwinds, we are pleased with our financial performance in the first half of our fiscal year. We believe our results show the continued strength of our consumables-based business model even during the current softer demand environment. For fiscal 2019, we remain confident in our ability to drive continued revenue growth on a pro forma basis 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.