CABOT MICROELECTRONICS CORPORATION
FOURTH QUARTER FISCAL 2019 CONFERENCE CALL SCRIPT
November 18, 2019

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

Last night we reported results for our fourth quarter and full fiscal year 2019, which ended September 30, 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 June 30, 2019. 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 Chemicals during the comparable period last year. Additionally, data reflects rounded values throughout this discussion and in the accompanying slide presentation.

I will now turn the call over to Dave.

Thanks, Colleen.

Last night we announced results for our fourth quarter and full year fiscal 2019. We set another record for quarterly revenue, achieving $279 million, which is 78% higher compared to the same period last year, and up 2% sequentially. Fourth quarter revenue exceeded our previously provided guidance, driven by stabilization in semiconductor demand and continued strong growth in pipeline performance. For the full year, our revenue increased by 76% primarily due to the acquisition of KMG, which closed approximately one year ago. This acquisition was the largest in our company's history and has significantly broadened our portfolio of solutions and industry participation, nearly doubled our size, and has provided us with greater geographic balance. This is the fourth consecutive year that we have delivered sequential annual growth, which we believe demonstrates the strength and resiliency of our business model as well as our continued strong operational execution.

On a segment level, fourth quarter revenue in Electronic Materials was down 4% year over year as lower sales in CMP slurries was partially offset by growth in CMP pads and electronic chemicals. Sequentially, however, Electronic Materials revenue was up 3%, which was above our guidance of "approximately flat". This was a result of continued stabilization in the operating environment and a sequential improvement in demand for our CMP slurries from logic, foundry and memory customers during the quarter. Revenue in Performance Materials increased 15% year over year to a new record level, and was up 2% sequentially, also better than previous guidance, primarily driven by continued strong demand for our drag reducing agents from our pipeline customers.

Total adjusted pro forma EBITDA was $85 million, or 30.6% of sales in the quarter. For the full year, we reported EBITDA of $333 million, which was at the higher end of our guidance range.

Overall, we are proud of the results we delivered in fiscal 2019. Our pro forma revenue increased 3%, and adjusted pro forma EBITDA was $345 million, up $34 million year over year. We believe this demonstrates the strength of our portfolio, which continues to benefit from the acquired KMG businesses. Also contributing to our record revenue was our CMP pads business, which grew 14% to $95 million despite challenging industry conditions. We remain focused on delivering value to our customers through robust product solutions and superior attention to quality, which we believe continues to position us as the premier supplier of critical materials across the industries we serve.
Now let me turn to some thoughts on industry outlook:

Starting with Electronic Materials, stabilization in demand from memory customers has continued. It appears that the decline in both DRAM and NAND chip prices seen in the semiconductor industry over the past few quarters has moderated, and our customers' chip inventories are normalizing. Advanced logic and foundry demand appears to remain strong as customers continue to transition to smaller nodes to support new consumer devices. Overall, while the industry seems to have stabilized and we are seeing some encouraging signals from our customers, the timing of a strong overall recovery remains uncertain, particularly from the memory segment.

As we think about long-term demand for Electronic Materials, we continue to be excited about the additional logic and memory requirements needed to support emerging applications such as internet of things, autonomous driving, virtual reality, and high-performance computing. We are also seeing increased investments in 5G networks, which we believe will be a catalyst for many of these future applications. Additionally, we expect continued growth in demand for our products as customers move to 7nm and

5nm in logic, and 100 plus layers in 3D NAND, which require additional manufacturing steps. We believe all of these advanced technologies and applications will require greater intensity for new and advanced materials, which should position us well for growth above the industry.

We also remain confident about the long-term growth potential in our Performance Materials segment, primarily driven by our pipeline performance business, with higher demand for our drag reducing agents, which enable pipeline customers to optimize the efficiency and throughput of oil transport globally. We are already seeing significant demand from international customers, which we believe will supplement our strong positions in the U.S.

With these factors in mind, we now expect our revenue in the first quarter of Fiscal 2020 to be approximately flat, which reflects anticipated continued stabilization in electronic materials and continued strong demand in performance materials. Longer term, we continue to expect to grow our business faster than the industries in which we participate, as well as build upon our best in class profitability.

As we discussed at our Investor Day, fiscal 2020 will be a year of investment to support the future growth of our company. Our planned spending is focused on high-growth, high-margin businesses such as pipeline performance, which continues to deliver strong results. With this strategy in mind, we have made a decision to cease future investment in our wood treatment business, including the previously planned construction of a new production plant to replace our operations in Tuscaloosa, Alabama and Matamoros, Mexico. Although the wood treatment business has been solid and profitable, it remains a very small part of our company from a revenue perspective and we do not believe it fits with our core strategies. We currently expect to operate this business until around the end of calendar 2021 and are working closely with our customers on the transition.

Finally, I would like to sincerely thank our teams around the world for their hard work, dedication and execution. Without your efforts, we would not have been able to deliver the strong differentiated results that we did this year. We remain excited about our future and look forward to delivering another year of strong financial performance as well as returning significant value to our stakeholders as we continue our journey towards profitably growing our 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 as adjusted on a pro forma basis. Pro forma results are presented following SEC guidelines and are shown as if we had owned KMG from the beginning of fiscal 2018. We of course always give greater prominence to reported GAAP results but will refer to adjusted pro forma figures in order to provide meaningful comparisons. You can find the summary of adjustments in the press release.

Revenue for the fourth quarter of fiscal 2019 was $279 million, which is a record for our company, and $122 million, or 78%, higher than reported revenue in the same quarter
last year. Pro forma revenue was essentially flat year over year as growth in CMP pads, electronic chemicals and DRAs was offset by lower CMP slurries and QED revenue.

Our reported net loss was $20 million, or $0.70 per share in the quarter. Adjusted pro forma net income was $50 million, which was slightly lower compared with the adjusted pro forma net income in the fourth quarter last year. This quarter's adjustments include amortization on acquired production-related assets from the KMG acquisition, charges related to additional cleanup activities at the Tuscaloosa wood treatment facility which was impacted by a warehouse fire we reported last quarter, as well as impairment and restructuring charges related to our wood treatment business. Adjusted pro forma EPS was $1.68 per diluted share, which was $0.05 lower than last year.

Adjusted pro forma EBITDA was $85 million, or 30.6% of revenue, which is 50 basis points lower than last year.

Revenue for the full fiscal year was $1 billion $38 million, which is also a record for our company, and was $448 million, or 76%, higher than reported revenue in the prior year. The increase was primarily driven by the KMG acquisition, which we closed in November of last year. Pro forma revenue was $1.1 billion which was $36 million, or 3% higher than last year. The increase was due to growth in CMP pads, electronic chemicals and DRAs, which more than offset lower CMP slurries revenue.

Full year adjusted pro forma net income was $198 million, which was 9% higher compared with the adjusted pro forma net income in the prior year. Adjusted pro forma EPS was $6.72 per diluted share, which is $0.57 higher than last year.

Full year adjusted EBITDA was $333 million, at the higher end of the guidance we previously provided. Adjusted pro forma EBITDA, which assumes we owned KMG for the full fiscal year, was $345 million, or 31.4% of revenue.

Now please refer to slide 5, which provides some higher-level quarterly P&L comparisons for both reported and adjusted pro forma results.

Our reported gross margin was 40.6% this quarter, compared to 53.8% reported in the same quarter last year. As a reminder, this year's metric is negatively impacted by a re-class of some costs, which moved from operating expenses into cost of goods sold following our KMG acquisition, charges related to additional cleanup activities related to the Tuscaloosa fire, and acquisition-related amortization.

On an adjusted pro forma basis, gross margin was 44.2%, which was down compared to 45.7% in the same quarter last year. Gross margin was negatively impacted by lower CMP slurries volume, increased expenses associated with our wood treatment business and a less favorable product mix in the electronic chemicals business this quarter.

Excluding acquisition-related amortization and impairment charges, our adjusted pro forma operating expenses declined approximately $2 million year over year. Synergies reduced OPEX by approximately $5 million but were partially offset by higher professional fees and typical inflationary items.

Our adjusted pro forma net income of $50 million declined $1 million, or 2% compared to last year.

Our adjusted pro forma EBITDA was $85 million, or 30.6% of revenue, and $1 million lower than the comparable metric in the prior year, as lower gross margin was only partially offset by reduced operating expenses.

Now let's discuss revenue results by segment and business, which are shown on slide 6.

Electronic Materials, which contributed 78% of our quarterly revenue, reported an $8 million, or approximately 4%, decline in pro forma revenue year over year. CMP slurries revenue declined approximately 8% year over year, primarily driven by weakness in demand from memory customers.

CMP pads reported around a 2% increase in revenue from last year due to continued customer adoption of our NexPlanar product line, which was partially offset by softer industry demand.

Electronic chemicals revenue grew approximately 1% on a pro forma basis versus the same period last year, driven by our customers' continued transition to advanced technology nodes.

Moving to Performance Materials, pro forma revenue increased approximately $8 million, or 15%, over the prior year to a record level in the quarter. The increase was driven primarily by growing demand for DRAs both domestically and internationally, but was partially offset by difficult comparisons in our QED business.

Slide 7 shows revenue and adjusted EBITDA by segment. Electronic Materials delivered around $74 million of EBITDA, which was 34% of segment revenue, while Performance Materials EBITDA was approximately $28 million, which was 46% of segment revenue.

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

We had $188 million cash on hand and $942 million of total debt at the end of the quarter. Year-to-date we prepaid $100 million of debt and remain on track to reach our goal of 2 times net debt to EBITDA by the end of fiscal 2020.

On a year to date basis, we generated cash flow from operations of $177 million and our capital expenditures were $58 million. As a result, our free cash flow was $119 million, despite additional cash costs related to KMG acquisition.

We are very pleased with our strong cash flow generation this year, some of which we have used to fund investments back into the business and for KMG acquisition-related costs. We continue to prioritize organic investment on high-growth opportunities in both Performance Materials and Electronic Materials. Our additional capital deployment priorities remain: paying ongoing and increasing dividends over time, de-leveraging, executing M&A, and repurchasing our shares.

As Dave mentioned, we have made a decision to focus our capital investments on high-growth opportunities closer to our core, and we will cease further investment in our wood treatment business, which accounts for approximately 3% of our company's revenue. This is a slower-growth business that we view as non-core to the company. While we are exploring options for this business, including a potential sale, we will not invest in the construction of a new U.S. manufacturing facility or in the relocation of our production facilities in Tuscaloosa, Alabama and Matamoros, Mexico. As a reminder, due to Mexico's participation in the Stockholm Convention, penta no longer can be manufactured in Mexico after calendar 2021. After a careful review of our long-term strategy and capital allocation plans, we concluded that we will focus on opportunities that have higher potential for future growth and shareholder value creation, that are aligned with our core competencies and that likely would generate higher returns over time. This business decision has caused an asset impairment of $67 million, or $50 million after tax, which is a non-cash charge that impacted reported results. We have shown this item separately on the face of the P&L and it represents approximately 70% of the original value of the business. It is preliminary and subject to final analysis and control procedures.

On slide 10 we provide some forward-looking expectations.

For the first quarter of fiscal 2020, we currently expect total company revenue to be approximately flat compared to our fourth fiscal quarter. While the semiconductor industry continues to stabilize as Dave mentioned, there is continued uncertainty about the timing of the recovery in industry demand. Therefore, we expect revenue in our Electronic Materials segment to be approximately flat sequentially in the fiscal first quarter. Performance Materials revenue should be approximately flat to up low single digits sequentially as a result of continued growth in DRAs, partially offset by expected softer performance in QED as it faces another quarter of strong comparisons versus the prior year.

For the full year fiscal 2020, we expect adjusted EBITDA to be in the range of $350 to $380 million. We will likely narrow this range as we move through the year and get more clarity on the timing of semiconductor industry recovery. Our fiscal 2020 EBITDA guidance implies approximately 6% growth at midpoint despite continued uncertainty in the semiconductor industry and increased investments in growth opportunities for our businesses.

Consistent with our long-term objectives, we continue to expect our profitability will increase to a 35% EBITDA margin in the future. This is unlikely to be a linear increase as we will be making some strategic investments in both CapEx and OpEx in fiscal 2020 and 2021. As a result, we expect our fiscal 2020 EBITDA margin to remain at or slightly better than EBITDA margin delivered in fiscal 2019.

In addition, starting in fiscal 2020, we will be updating our methodology for assigning corporate allocations by pushing some more of the corporate costs directly into the segments. As a result, corporate unallocated costs should decline while corporate costs allocated to the segments should increase.

Depreciation and amortization is expected to be between $40 and $45 million, which excludes approximately $90 million in acquisition-related amortization.

We currently expect our full-year interest expense to be between $45 and $48 million, with approximately $12 million expected in the first quarter.

Our effective tax rate for the full fiscal year is likely to be in the range of 22% to 25%.

Our current capital spending expectation for the full fiscal year is between $100 and $130 million, primarily to support growth opportunities in our pipeline performance and CMP pads businesses. We continue to expect approximately $200 million in total capital spending over the next two years to support our future growth as a company.

I will now provide some closing remarks on slide 11.

We are proud of our strong results in the fourth fiscal quarter and full fiscal year of 2019. Despite some industry headwinds that impacted demand for our CMP slurries, solid performance in CMP pads and the acquired KMG businesses more than offset these headwinds. With the strength of our acquired businesses and resiliency of our legacy CMP business, we delivered a 3% growth in revenue and were able to grow our EBITDA by 11%, delivering operating leverage with continued focus on gross margin expansion and prudent management of our SG&A expenses, which benefited from synergies and control of operating expenses.
We also delivered on synergies and accretion ahead of our original expectations.
As you may remember, we committed to $25 million in synergies within the first two years after we announced the acquisition of KMG. We ended the year at a $26 million run rate, and delivered $5 million in synergies to the P&L in the fourth quarter, some of which we invested back into the business.

Accretion from the KMG acquisition added approximately $0.60 to EPS this quarter, and approximately $1.60 per diluted share since the acquisition closed, also ahead of our initial expectations.

We continue to be delighted with our growth prospects, as well as the earnings and cash flow power of the combined company.

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.