Cabot Microelectronics Corporation
Fourth Quarter and Full Fiscal Year 2015 Conference Call Script
October 29, 2015

Good morning. With me today are David Li, President and CEO, and Bill Johnson, Executive Vice President and CFO.

This morning we reported results for our fourth quarter and full fiscal year 2015, which ended September 30. A copy of our earnings release is available in the investor relations section of our website, cabotcmp.com, or by calling our investor relations office at 630-499-2600. A webcast of today's conference call and the script of this morning's formal comments will also be available on our website.

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 report filed on Form 10-K for the fiscal year ended September 30, 2014, our quarterly report filed on Form 10-Q for the quarter ended June 30, 2015, and our current reports filed on Form 8-K on October 22, 2015 and today. We assume no obligation to update any of this forward-looking information.

I will now turn the call over to David.

Thanks, Trisha. Good morning, everyone, and thanks for joining us.

This morning we announced financial results for our fourth quarter and full fiscal year 2015. During the quarter, we achieved revenue of approximately $100 million dollars, a gross profit margin of 52.0 percent of revenue, which is 290 basis points higher than in the same quarter last year, and diluted earnings per share of 50 cents. For full fiscal 2015, we reported revenue of approximately $414 million dollars, including record annual revenue from our CMP slurries for polishing tungsten, which grew ten percent year-over-year. We also achieved a gross profit margin of 51.3 percent of revenue, or 350 basis points higher than last year. And, we achieved record diluted earnings per share of $2.26 for the full year.

Based on the successful execution of our business initiatives in fiscal 2015, we expanded our gross margin percentage to its highest level since 2002, and achieved a record level of profit for our company, representing approximately eleven percent earnings growth compared to the prior year. We achieved this increased profit and profitability within a challenging industry environment.

Bill will provide more detail on our financial results later in the call.

On the topic of overall industry demand, let me offer our perspectives on the global semiconductor industry environment. As we have discussed with you previously, this year seasonal demand trends differed from the trends the industry and our company have experienced over the past three years. We experienced stronger than normal seasonal demand in the first half of our fiscal year, but weaker than normal seasonal demand during the second half of the year. When we reported results for our third fiscal quarter in July, we mentioned that orders for our CMP consumables products through that time were trending in line with the average rate in our third fiscal quarter. When we spoke with you on September 28, as we announced our acquisition of NexPlanar Corporation, we confirmed that orders continued to track in line with what we were seeing in late July. The softness in demand that we saw throughout our fourth fiscal quarter appears to be consistent with what a number of others in the semiconductor industry have been reporting.

Further, reports from some industry analysts and strategic customers suggest that this soft demand environment will persist into our first quarter of fiscal 2016. Semiconductor device inventory levels appear to generally remain above normal, likely due to continued sluggish demand for smartphones, particularly in China and other emerging markets. In addition, the strong US dollar and challenging macroeconomic conditions may be dampening broader demand for electronic devices. In response to this, we believe IC manufacturers are carefully monitoring wafer output, and in some cases are lowering utilization rates, in order to decrease excess chip inventories.

Based on the soft near term demand environment, some industry experts have reduced their 2015 semiconductor market forecasts. Certain analysts currently forecast that the market will be flat to down five percent versus 2014, including price erosion related to the elevated inventories of some ICs.

Despite the potential for continued soft near term demand, longer term expectations for IC demand appear healthy. For calendar year 2016, industry analysts continue to forecast low double digit growth for smartphones, and for the automotive and industrial markets, and low to mid-single digit growth for the enterprise and IT markets, driven by cloud computing and data center demand. In addition, analysts continue to look for signs of stabilization in the PC market, after over two years of declining demand.

Within that semiconductor industry context, now let me turn to our IC CMP consumables business.

For a number of years, we have placed a high priority on growing our revenue in the CMP pads area, which is a large and very closely adjacent market to CMP slurries, where we are the leader. On September 28, we announced a significant step forward in executing our strategy to strengthen and grow our CMP consumables business, and in particular our CMP pads product area, with our agreement to acquire NexPlanar. NexPlanar is a U.S.-based company that specializes in advanced CMP pad solutions for the semiconductor industry, and they have been very successful in recent years in winning meaningful supply positions with technology leading customers, including six of the top ten semiconductor manufacturers in the world. On October 22, less than a month after announcing our deal, and ahead of our anticipated timeline for closing the transaction, we completed the acquisition.

We are excited about expanding our pads product offerings with NexPlanar’s portfolio. NexPlanar’s innovative technology is based on thermoset polyurethane, which we believe will complement our thermoplastic polyurethane pad technologies, and enhance our capabilities to grow in an important materials space that has traditionally relied on thermoset polyurethane offerings from one supplier. Furthermore, NexPlanar’s value proposition to customers is based on product performance and speed of iteration. This is closely aligned with our overall approach to business, and with our vision to be a trusted industry partner, providing high-quality solutions with speed, and delivering superior cost of ownership. NexPlanar’s trailing four quarter revenue is approximately $23 million, and it has nearly tripled its revenue over the past two years. We believe that this acquisition will be accretive on a non-GAAP basis in fiscal 2016, and will accelerate growth in CMP pads and contribute to continued meaningful profitable growth for our company.

Over the next several months, we will be integrating NexPlanar with our CMP consumables business. We are focused on leveraging our extensive global infrastructure, including our direct sales channel, supply chain capabilities and quality systems, to speed the adoption of NexPlanar's advanced CMP pad solutions. Combining NexPlanar into our CMP consumables business, we expect to deliver a broader range of innovative, high-quality, high-performing CMP solutions to better meet the needs of our customers around the world, including providing performance differentiated slurry and pad consumable sets. We see an excellent strategic, operational and cultural fit with NexPlanar, and look forward to updating you in the future on our progress in CMP pads.

Turning to CMP slurries, during the fiscal year we experienced strong demand for our tungsten slurry products across a wide range of applications and technology nodes. We achieved record revenue in our tungsten product area in the fourth fiscal quarter and for the full year. Over the past year, we have been working closely with our strategic customers to support their transitions to FinFET for advanced logic IC devices and 3D memory. For fiscal 2015, approximately thirteen percent of our tungsten revenue was driven by early production of these advanced technologies. These applications require additional CMP steps, in particular tungsten, which we have confidence will continue to drive profitable growth for our company. During the fiscal year, we remained focused on the broad transformation of our dielectrics slurry product area. More specifically, we advanced the commercialization of a new family of much higher performing solutions, which target around $100 million of new business opportunities. We are seeing validation of our efforts, as a number of customers are evaluating and qualifying these solutions, and we are encouraged by the positive customer feedback on performance across a range of technology nodes and on both 200 and 300mm platforms. Our customers are seeing better performance through significantly improved defectivity, and we believe they should also realize lower cost of ownership. As a result, during the fiscal year we secured several new business opportunities, and we look forward to supporting our customers' ramps. Over time, we also look forward to securing more business opportunities in this product area, either through replacing our own legacy products, or by displacing competitors. We expect this dielectrics transformation will be another driver of profitable growth for our company.

In summary, we are confident that our leadership in CMP slurries, combined with an expanded CMP pad portfolio, will enable us to better serve the needs of our customers around the world. We continue to believe our global capabilities, resources and infrastructure are unmatched, and differentiate our company as a leader within the industry. Looking ahead, our focus is on close collaboration with our technology leading customers to deliver a broader range of innovative, high-quality, high-performing and reliable CMP solutions, all of which we believe will fuel continued profitable growth for our company. Furthermore, we believe that our performance this year continues to demonstrate the strength of our business model and our ability to execute our strategies over a range of industry environments as we continue to provide value to our shareholders. Based on our achievements in fiscal 2015 to strengthen and grow our CMP consumables business, along with our very recent acquisition of NexPlanar, I am confident that we enter fiscal 2016 as a stronger company.

And with that, I will turn the call over to Bill for more detail on our financial results.

Thanks, David, and good morning everyone.

Revenue for the fourth quarter of fiscal 2015 was $100.1 million, which represents a 13.9 percent decrease from the record revenue in the same quarter last year. Total revenue for the full fiscal year of $414.1 million represents a 2.5 percent decrease from the prior year. Our fourth quarter and full year revenue results reflect continued soft global semiconductor industry demand, which David addressed, and business losses in slurries for dielectrics and data storage applications, that we have previously discussed. Foreign exchange rate changes, primarily the weaker Japanese yen and Korean won versus the U.S. dollar, reduced year-over-year revenue by $3.0 million for the quarter and $7.5 million for the full year.

Drilling down into revenue by product area:
Tungsten slurries contributed 46.4 percent of total quarterly revenue, with revenue up 3.1 percent from the same quarter a year ago. Our tungsten product area achieved record revenue during the quarter, and year-over-year revenue growth for the seventh consecutive quarter. We also achieved record tungsten slurry revenue for the full year, with revenue up by 10.3 percent compared to the prior year, driven by strong demand from both logic and memory areas.

Dielectrics slurries provided 22.0 percent of our revenue this quarter, with sales down 24.9 percent from the same quarter a year ago. For the full year, dielectric slurry revenue decreased by 18.4 percent. The revenue decreases primarily reflect the loss of lower performing, legacy dielectrics business that we began to see in the first quarter of fiscal 2015, which we previously have discussed. As Dave mentioned earlier, during the fiscal year, we made notable progress on the commercialization of our new family of much higher performing dielectrics slurry products, which we believe will enable us to profitably grow this product area in the future.

Sales of slurries for polishing metals other than tungsten, including copper, aluminum and barrier, represented 16.5 percent of our total revenue, and decreased 24.5 percent from the same quarter last year. For the full year, revenue decreased by 6.5 percent. We believe the revenue decreases are primarily due to customer efficiencies and repurposing capacity for the next technology node, particularly with respect to our aluminum slurries.

Sales of polishing pads represented 6.7 percent of our total revenue for the quarter, and decreased 32.2 percent compared to the record revenue in the same quarter last year. Revenue for pads was down by 5.3 percent for the full year compared to last year's record revenue.

Data storage products represented 2.4 percent of our quarterly revenue. Our data storage revenue was down 41.3 percent from the same quarter last year and down 23.1 percent for the full year on continued soft PC demand, and business losses we have previously discussed.

Finally, revenue from our Engineered Surface Finishes, or ESF area, which includes QED, generated 6.0 percent of our total quarterly sales. Our ESF revenue was down 0.9 percent from the same quarter last year and up 33.3 percent for the full year.

Our gross profit this quarter represented 52.0 percent of revenue. This is up 290 basis points from 49.1 percent in the same quarter a year ago. Compared to the year ago quarter, our gross margin benefited from a richer product mix, with relatively more tungsten revenue and less from legacy dielectrics products. Other factors affecting gross margin were benefits associated with foreign exchange rate changes, primarily the weaker Japanese yen, partially offset by lower sales volume.

For the full fiscal year, gross profit was 51.3 percent of revenue, which represents a 350 basis point improvement year-on-year. Our full fiscal year 2015 guidance range was 50 to 51 percent of revenue. Gross profit margin increased from 47.8 percent of revenue in fiscal 2014, primarily due to product mix, foreign exchange rate changes, and the absence of an asset impairment charge we recorded last year. These benefits were partially offset by higher costs associated with inventory write-offs related to raw material quality recorded during the third fiscal quarter, which we previously discussed. For full fiscal year 2016, we currently expect our gross profit margin to be between 49 and 51 percent of revenue, including NexPlanar.
Now I'll turn to operating expenses, which include research, development and technical, selling and marketing, and general and administrative costs. Operating expenses this quarter were $34.2 million, including approximately half a million dollars in professional fees related to the NexPlanar acquisition. Operating expenses in the same quarter last year were $34.1 million.

For the full year, total operating expenses were $137.2 million. Our guidance range for full fiscal year 2015 was $135 million to $137 million. The 4.5 percent increase from the $131.3 million reported in fiscal 2014 was driven primarily by costs associated with certain executive officer transitions that occurred earlier in the fiscal year, which we have previously discussed, and higher staffing related costs, including incentive compensation costs, partially offset by lower travel costs and depreciation expense. We currently expect our operating expenses for full fiscal year 2016 to be between $143 million and $147 million, including NexPlanar.

Diluted earnings per share were 50 cents this quarter, down from 65 cents in the same quarter last year. Earnings per share decreased primarily due to lower revenue, partially offset by a higher gross profit margin and a lower effective tax rate. We achieved record diluted earnings per share of $2.26 for the full year, which represents an increase of 10.8 percent compared to $2.04 last year. Earnings per share increased primarily due to a higher gross profit margin and a lower effective tax rate, partially offset by lower revenue and higher operating expenses.

Our effective tax rate for the fourth fiscal quarter was 23.9 percent, and 21.1 percent for the full year. We currently expect our effective tax rate for full fiscal year 2016 to be between 21 and 24 percent, including NexPlanar.

Turning now to cash and balance sheet related items, capital investments for the quarter were $4.9 million, bringing our full year capital spending to $13.8 million, which is within our guidance range of $12 million to $15 million for the year. For full fiscal year 2016, we currently expect our capital spending to be within the range of $15 million to $20 million, including NexPlanar. Depreciation and amortization expense for the quarter was $4.8 million. We generated cash flow from operations of $24.9 million in the fourth fiscal quarter, and $98.7 million for the full year. We ended the year with a cash balance of $354.2 million and we have $164.1 million of debt outstanding.

As Dave mentioned and as we separately announced on October 22, we completed our acquisition of NexPlanar, and funded the acquisition price of approximately $142.3 million with our available cash balance.

We believe the acquisition of NexPlanar represents an attractive opportunity to reinvest capital into our core CMP consumables business. Our balance sheet remains strong with a post-acquisition cash balance of approximately $225 million, including approximately $15 million of cash from NexPlanar. Given our highly profitable financial model and strong cash generation capabilities, we will continue to consider a range of capital deployment alternatives to create value for our shareholders.

I'll conclude my remarks with a few comments on recent sales and order patterns.

During the fourth fiscal quarter, we saw a slight increase in revenue for our CMP consumables products, compared to the third quarter of fiscal 2015. Orders to date in October for our CMP consumables products are trending approximately three percent lower than the average rate in our fourth fiscal quarter. In addition, orders for NexPlanar pads are slightly higher than in the September quarter. However, I would caution, as I always do, that several weeks of CMP related orders out of a quarter represent only a limited window on full quarter results.

Now I'll turn the call back to the operator, as we prepare to take your questions.

That concludes our conference call. Thank you for your time and your interest in Cabot Microelectronics.