CABOT MICROELECTRONICS CORPORATION
FIRST QUARTER FISCAL 2018 CONFERENCE CALL SCRIPT
JANUARY 25, 2018

Good morning. With me today are David Li, President and CEO, Scott Beamer, who joined us as our new CFO earlier this month, and Bill Johnson, who recently retired as CFO.

This morning we reported results for our first quarter of fiscal 2018, which ended December 31, 2017. 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 prepared comments will also be available on our website, shortly after this live conference call.

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, 2017. We assume no obligation to update any of this forward-looking information.

Also, our prepared remarks this morning reference non-GAAP financial measures. Our earnings release includes a reconciliation of GAAP to non-GAAP financial measures.

I will now turn the call over to David.

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

Before we get started, I would like to note that on December 12 we announced Bill Johnson's retirement after nearly fifteen years of service as our CFO, and the appointment of Scott Beamer as our new CFO. I want to thank Bill for his many contributions to the company over the years, and welcome Scott to his new role. Bill, we will definitely miss your leadership and I want to thank you for your service to the company -- we all wish you the best in your future endeavors.

Thanks, Dave. It's been my sincere pleasure to serve as CFO of Cabot Microelectronics. I'm very proud of what we have accomplished over the years, and look forward to the company's continued success in the future. In particular, I have really enjoyed my interactions with all of our investors and analysts. I think Cabot Microelectronics is a great company, and it has been an honor to help tell our story. I look forward to working with Scott to assure a smooth and seamless transition.

Thanks, Bill. I am delighted to introduce Scott, who brings over twenty years of broad and deep experience in a range of business environments, most recently as the CFO at Stepan Company, a $1.8 billion publicly-traded specialty chemicals company supplying materials to a variety of consumer and industrial end-markets. I look forward to the leadership and expertise that he will bring to his new role. Scott will discuss our financial results later in the call.

This morning we announced results for our first quarter of fiscal 2018, and we are excited about our continued strong execution and performance. We achieved another record level of quarterly revenue and very strong operating performance, driven by the continued successful execution of our strategic initiatives and healthy semiconductor industry demand. We continued our momentum from last year in three key product areas – CMP slurries for polishing tungsten, dielectrics slurries, and CMP pads.

During the quarter, we realized record revenue of $140 million, approximately 14 percent higher than in the same quarter last year. Our gross profit margin was 52.9 percent of revenue – our highest level since 2002. Like most publicly-traded U.S. companies, our net income was significantly impacted this quarter by the one-time effects of U.S. tax reform enacted in December, which resulted in a GAAP loss of $3.1 million, or twelve cents per share. However, non-GAAP net income this quarter was a record $31 million and non-GAAP diluted earnings per share were $1.19, both excluding the one-time impact of tax reform, as well as amortization expense related to our 2015 acquisition of NexPlanar. Non-GAAP net income increased by approximately 33 percent and non-GAAP earnings per share increased by approximately 29 percent compared to last year. In addition, we continued our strong cash flow generation trend, with cash from operations of $31 million.

Scott will provide more detail later in the call.

To provide some context for our first quarter results, let me offer some perspectives on the global semiconductor industry environment. As forecast by several of our customers and industry analysts, industry demand was firm during the December quarter and our results are consistent with this, as well as with the expectations we discussed during our fourth quarter conference call in October. Reports suggest that overall semiconductor demand was driven by a continued robust memory market, generally due to the growing requirements for storage in a wide range of end-use applications, as well as a healthy logic market driven by mobile product launches.

As for the March quarter, recall that it is historically seasonally soft, although the consensus is for an overall continued strong demand environment in calendar 2018. Views from various sources suggest that memory demand should remain firm, but industry participants more closely tied to logic may experience softer demand conditions during the March quarter. We serve all semiconductor manufacturers and have broad exposure across the memory, foundry and logic sectors, and through January, we are seeing continued solid demand for our IC CMP consumables products. As in previous years, we remain mindful of potential order fluctuations and volatility around the Lunar New Year which this year begins on February 16th. Later in the call, Scott will provide commentary on our current view on revenue for the March quarter.

Considering a longer-term view, two weeks ago our company participated in SEMI's Industry Strategy Symposium, or ISS, in California. This annual event, early in the calendar year, represents a great opportunity to compare views with other industry participants. The theme of this year's conference was "smart, intuitive and connected – semiconductor devices transforming the world." Discussion focused on future drivers of semiconductor demand, including cloud connectivity, which should continue to drive strong memory demand, as well as augmented reality, artificial intelligence, automotive applications, high performance computing, and cryptocurrencies, which should all be drivers of advanced logic. The event emphasized that the semiconductor industry is delivering ever more sophisticated semiconductor devices through collaboration across the supply chain, which are transforming electronics. Higher performing chips, with smaller feature sizes and requiring lower power consumption, can only be realized through innovations in equipment, materials, design, and packaging technologies. We believe we are well-positioned to benefit from these longer-term industry trends and remain confident about the critical role highly-engineered materials and highly-formulated CMP solutions like ours will play in the semiconductor industry going forward.

Now let me turn to company-related matters. During the quarter, we experienced strong demand for our tungsten and dielectrics slurries and pads solutions across a wide range of applications and technology nodes. This drove approximately eleven percent year-on-year revenue growth for the quarter from our IC CMP consumables products. Of particular significance, we also achieved year-on-year revenue growth for the quarter of approximately 34 percent in China, and 36 percent in Korea. Our strong positions in these countries are notable, given industry expectations for long-term overall semiconductor growth in China, and continued memory growth in Korea.

Turning to CMP slurries, during the quarter we continued to grow with the ramp of our customers' advanced technologies, including 3D NAND and FinFET. As we have discussed in the past, 3D NAND and FinFET applications require more CMP steps, mainly tungsten and dielectrics. In particular, 3D memory requires roughly twice the number of CMP steps as 2D, and many of those steps are tungsten; this growth opportunity is significant for our business given our leadership in this product area. We expect the industry transition from 2D to 3D memory will continue over the next several years. As a result, we achieved record revenue in our tungsten product area in the first fiscal quarter, and year-over-year revenue growth of approximately fourteen percent. Over the years, we have seen sustained revenue growth from our tungsten products, which reflects our continued leadership and commitment to this important product area.

In addition, we achieved significant growth from our dielectrics slurries, with revenue up approximately eight percent compared to the same quarter last year. This was primarily driven by demand for our ceria and colloidal-silica based dielectrics solutions for advanced applications. We believe these CMP solutions provide benefits of higher removal rate, improved defectivity and lower cost of ownership. Dielectrics represents the largest application within the CMP slurries market. Here, we expect continued growth as we aim to displace incumbents and replace some of our own legacy solutions, and continue to improve profitability.

Turning to CMP pads, this quarter we achieved record revenue, and year-over-year revenue growth of approximately 16 percent. This was driven by continued strong customer pull for our products. We have a rich pipeline of new pad business opportunities spanning a wide range of customers and applications. We continue to leverage our global sales channel and technical resources to speed the qualification and adoption of our pad offerings, and as we have previously discussed, we continue to experience significantly shorter qualification times than in years past given the unique attributes of our NexPlanar technology. We have recently broadened our product portfolio with a family of new pad configurations and continue to win new business for advanced and legacy applications. We continue to believe we can grow our pads revenue to over $100 million in fiscal 2019, which would reflect compound annual growth of at least 20 percent.

I am pleased to report that during the quarter we were awarded a Best Supplier Award from SK Hynix, a leading memory device company and a strategic customer. We were one of only five recipients, and the only CMP slurry and pad supplier, to be honored by SK Hynix. This award is their highest level of supplier recognition. Our company was recognized for delivering best-in-class CMP slurries and pads solutions for their NAND flash and DRAM applications, and demonstrating outstanding performance in technology innovation. We believe this recognition, along with the many other awards we have won over the years from a number of other important customers, is evidence of our long-term commitment to collaborating closely with our customers, and our ability to deliver a broad portfolio of best-in-class CMP solutions, to the highest standards for quality, performance and technology.

Over the last several years we have been very focused and committed to performance and growth in our three key product areas – slurries for polishing tungsten, dielectrics slurries and CMP pads, including slurry and pad consumable sets. Looking forward, I am confident of continued momentum in these areas, which we believe provide the foundation for continued profitable growth for our company. We remain focused on delivering innovative, high-performing and high-quality CMP solutions. We believe that ongoing effective execution in these key product areas, combined with our focused business model and global resources, capabilities and infrastructure, continue to differentiate us among leading suppliers of specialty materials to the semiconductor industry, and position us well to deliver another year of strong performance.

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

Thanks, Dave, and hello everyone. I am honored to join the leadership team of Cabot Microelectronics and look forward to building upon the very strong foundation that already exists within the company. We have a tremendous opportunity for continued growth given the strength of our business and the industry in which we operate.

Revenue for the first quarter of fiscal 2018 was a record $140 million, which represents an approximately 14 percent increase from the same quarter last year. This increase reflects the continued successful execution of our strategic initiatives and continued strong global semiconductor industry demand that we have seen over the last seven quarters.

Drilling down into revenue by product area,

Tungsten slurries accounted for 45 percent of total quarterly revenue. Revenue in this area was up 14 percent compared to the same quarter last year, and we achieved record revenue of $63 million in the current quarter. Our tungsten growth was driven by strong demand from both memory and logic applications, including 3D memory and FinFET; we expect this key product area will continue to drive profitable growth for our company.

Dielectrics slurries, representing the second key product area, provided 23 percent of our revenue this quarter, with sales up 8 percent from the same quarter a year ago. We look forward to winning more business in this area with our higher performing, lower cost and higher profitability products.

Sales of polishing pads – our third key product area – represented 13 percent of our total revenue for the quarter, and increased 16 percent compared to the same quarter last year. This product area achieved record revenue during the quarter.

Sales of slurries for polishing metals other than tungsten, including copper, aluminum, and barrier, represented 12 percent of our total revenue, and increased 4 percent from the same quarter last year.

Finally, quarterly revenue from our Engineered Surface Finishes business, or ESF, which includes QED Technologies, represented 6 percent of our total quarterly sales and was up 70 percent compared to the same quarter last year.

Gross profit for the quarter was 52.9 percent of revenue, compared to 49.9 percent in the same quarter a year ago. This includes $1.2 million of amortization expense related to the NexPlanar acquisition. Excluding this, non-GAAP gross profit was 53.8 percent of revenue, which is up 290 basis points compared to last year. Factors impacting gross profit for the quarter compared to last year include higher sales volume and a higher valued product mix, partially offset by higher fixed manufacturing costs, including higher incentive compensation expense. Our full fiscal year GAAP gross profit guidance range is 50 to 52 percent of revenue, which remains unchanged. This includes approximately 100 basis points of NexPlanar amortization expense.

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 $36.9 million, including half million of NexPlanar amortization expense. Operating expenses were $3.5 higher than the $33.4 million reported in the same quarter a year ago, primarily due to higher staffing related expenses, including costs related to the company's CFO transition and higher incentive compensation expense. We currently expect our GAAP operating expenses for the full fiscal year to be between $145 and $150 million; our prior guidance range was $142 to $147 million. This includes approximately $2 million of NexPlanar amortization expense. Recall that we typically experience an increase in expenses in the March quarter due to certain factors related to the new calendar year, such as merit salary increases and higher payroll taxes, and also costs around our annual meeting in March.

Operating income for the quarter represented 26.5 percent of revenue, which was 370 basis points higher than in the same quarter last year. The significant year-over-year increase represents operating leverage driven by revenue growth, combined with the company's ongoing attention to controlling costs, and progress toward achieving our multi-year financial objective of expanding profit margins, which we introduced during fiscal 2017.

Our reported effective tax rate for the quarter was 108.4 percent, compared to 20.3 percent in the same quarter last year. The significant increase is primarily related to the one-time impact of U.S. tax reform, which increased our income tax expense by approximately $33 million. Excluding this one-time effect, our tax expense would have been approximately $7 million, and our tax rate would have been 19 percent. We currently expect our effective tax rate for the rest of the fiscal year to be within the range of 21 to 24 percent, including the benefit of a lower tax rate in the U.S. Before the enactment of tax reform, we had estimated between 24 and 27 percent for the full fiscal year.

The significant additional income tax associated with tax reform resulted in a net loss for the quarter of $3.1 million. But non-GAAP net income was $31.1 million, excluding this one-time impact and the previously mentioned amortization expense. Non-GAAP net income was approximately 33 percent higher than in the same quarter last year, and increased primarily due to higher revenue and a higher gross profit margin, partially offset by higher operating expenses.

We reported a diluted loss per share of twelve cents this quarter, or diluted earnings per share of $1.19 on a non-GAAP basis, excluding the one-time impact of tax reform and the referenced amortization expense. Non-GAAP diluted earnings per share were approximately 29 percent higher than in the first quarter of fiscal 2017.

Turning now to cash and balance sheet related items, capital investments for the quarter were $4 million. For the full fiscal year, we continue to expect capital spending to be within the range of $18 to $22 million. Depreciation and amortization expense for the quarter was $6 million, and we generated cash flow from operations of $31 million. We ended the quarter with $426 million in cash and short-term equivalents, and $141 million of debt outstanding so net cash is approximately $285 million.

Our strong cash generation model has enabled us to implement a balanced capital deployment strategy over the years, for which our priorities continue to be funding organic investments to improve our global capabilities in our core CMP consumables business, dividends, acquisitions in closely-related areas, and share repurchases. We expect the tax reform will provide greater flexibility as we continue to implement this balanced approach, with less friction in repatriating cash to the U.S.

I'll conclude my remarks with a few comments on demand for our IC CMP consumables products.

During the first fiscal quarter, we saw a three percent sequential increase in revenue from our IC CMP consumables products compared to the fourth quarter of fiscal 2017. This is in line with the expected slight increase that we referenced during our conference call in October. Earlier, Dave talked about a range of general industry expectations for continued firm demand for memory devices and somewhat softer demand for logic devices during our second quarter of fiscal 2018. Within this environment, we currently expect demand for our IC CMP consumables products in the March quarter to be flat to slightly higher than the record level of revenue we achieved in our first fiscal quarter. This is notable, since the March quarter is traditionally seasonally softer than the December quarter, and sometimes includes volatility in orders around the Lunar New Year holiday. However, I would caution, that we have limited visibility to near-term revenue.

To summarize, from a financial standpoint, we have now delivered strong performance for seven consecutive quarters, and achieved another record level of quarterly revenue, along with strong operating performance and cash flow for our first quarter of fiscal 2018. Our expectations are for continuing firm near-term demand, sustained solid gross margin performance, and ongoing prudent management of operating costs. Based on all of this, we believe we are well-positioned to deliver another year of successful performance in fiscal 2018.

Those are all the questions we have this morning. Thank you for your time and your interest in Cabot Microelectronics; we look forward to talking with you again soon.