CABOT MICROELECTRONICS CORPORATION
FIRST QUARTER FISCAL 2020 CONFERENCE CALL SCRIPT
February 6, 2020

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 first quarter of fiscal 2020, which ended December 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, 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 and 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 who is joining us from Asia.

Thanks, Colleen.

Last night we announced results for our first quarter of fiscal 2020. We set another record for quarterly revenue, achieving $283 million, which is 28% higher compared to the same period last year. First quarter revenue, which increased by 2% sequentially and exceeded our previously provided guidance, was driven by a strong increase in sales of CMP slurries and drag reducing agents, or DRAs. We believe our results reflect continued recovery in the semiconductor industry, as we saw stabilization in demand in the memory sector and ongoing improved demand from our foundry and logic customers. In our pipeline performance products, higher DRA sales were broad-based and came from both U.S. and international customers. We also continued our track record of delivering best in class profitability as well as strong free cash flow which we believe is a reflection of the strength our business model as well as our continued operational discipline and execution.

Now let me provide some additional thoughts on industry conditions and outlook:

Starting with Electronic Materials, as stated, we have seen continued stabilization in demand from our memory customers. Growing demand for memory has resulted in lower chip inventories and should lead to increased utilization, which in turn should drive higher demand for our products. In addition, recent indications of improved DRAM and NAND memory chip pricing has given us additional optimism of continued recovery. We also saw strength in demand from foundry and logic customers this quarter and we would expect this trend to continue through fiscal 2020, as these customers ramp up their production of advanced technology nodes to support new consumer devices as well as emerging trends, such as 5G technology. Lastly, we are also seeing encouraging forecasts from legacy logic customers in U.S. and Europe, driven by higher demand expectations from infrastructure, IoT and automotive markets.

Looking ahead, while our fiscal second quarter is historically seasonally soft, based on what we saw in our first quarter and the positive signals we had been seeing prior to the Lunar New Year from a number of our customers and industry analysts, we expect Electronic Materials revenue for the second quarter to be approximately flat to up low single digits compared with the our strong first fiscal quarter results.

In the Performance Materials segment, we are seeing continued oil production increases in the U.S., primarily in the Permian region, and expect for this trend to continue through 2021 and beyond. Our North American customers are building additional pipeline infrastructure to improve takeaway capacity and we see increasing adoption of DRAs internationally, which should translate into additional demand for our products. Our targeted investment to add significant capacity to our DRA business is already underway and will be an important addition to support future growth for this exciting business. Looking forward we expect revenue from our Performance Materials segment to be up low single digits sequentially in the second quarter, driven by continued strength in DRA demand.

Lastly, I would note that we are closely following the situation related to the novel coronavirus and are working closely with our teams and customers around the world to ensure we are in the best position to support them given this uncertain and challenging environment.

We are proud of our record results this quarter, which we believe were driven by continued strong execution, participation in the most challenging and leading-edge technologies, and an improving semiconductor demand environment. Looking forward, we expect to build upon our strong results from this quarter and continue driving best-in-class performance and profitability from our businesses in 2020.

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 slide presentation we posted on our website last night, along with our press release.

I will start on slide 4, which provides some higher-level quarterly P&L comparisons for both reported and adjusted results.

First quarter revenue of $283 million was a record for our company and increased 28% compared with the same quarter last year. When we include the six weeks of the KMG businesses that we did not own in the prior year's results, revenue was essentially flat as growth in the Performance Materials segment offset declines in the Electronic Materials segment.

Adjusted gross margin was up slightly versus the prior year due to a favorable impact of certain manufacturing costs, which was mostly offset by unfavorable product mix as slurries volumes were lower. These manufacturing costs are likely to reverse throughout the remaining quarters and should have a net zero impact for the full fiscal year.

Even with flat revenue, Adjusted EBITDA improved by approximately $6 million mostly from lower SG&A expenses, primarily incremental synergies delivered to the P&L. Overall, our adjusted operating expenses declined approximately $4 million year over year. Synergies reduced operating expenses by approximately $5 million and were partially offset by higher professional fees.

Adjusted EBITDA was $95 million, or 33.6% of revenue. However, excluding the impact of the timing of certain manufacturing costs, adjusted EBITDA margin would have been closer to the full year fiscal 2019 EBITDA margin of 31.4%. I would like to remind everyone that we believe that our fiscal 2019 EBITDA margin continues to be an appropriate short-term expectation while our long-term estimate continues to be 35%. Also, our second fiscal quarter is typically lower in terms of EBITDA margin compared to our first quarter due to additional costs such as merit increases.

Our reported net income was $39 million, or $1.30 per diluted share in the quarter.

Adjusted net income was $57 million, flat compared with the adjusted pro forma net income in the first quarter last year. Overall, net income benefited from lower SG&A expenses, the timing of certain manufacturing costs and lower interest expense. These items were offset by unfavorable product mix and our tax rate returning to a normalized level after being abnormally low in the prior year. The prior year tax rate benefitted from a higher level of acquisition-related expenses and an increased quantity of stock options exercised during that period.

Diluted EPS was $1.30. Adjusted diluted EPS was $1.92, 1.5%, lower than adjusted pro forma EPS in the same quarter last year, primarily due to a higher number of shares outstanding.

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

Electronic Materials, which contributed 78% of our quarterly revenue, reported a $10 million, or approximately 4% decline in revenue compared to pro forma revenue last year. CMP slurries revenue declined 3%, primarily driven by difficult year-over-year comparisons and softer demand from memory customers.

Electronic chemicals revenue also declined 3% versus pro forma revenue in the same period last year as a result of lower demand from legacy logic applications in the U.S. and Europe.

After several years of robust growth, CMP pads reported a revenue decrease of approximately 15% from last year, due to lower demand from certain memory customers as well as the phasing out of legacy pads at certain foundry customers. Looking ahead, we believe that we have a strong pipeline of opportunities to continue to gain business with customer adoption of our NexPlanar product line in both legacy and emerging applications.

Moving to Performance Materials, revenue increased approximately $9 million, or 18%, over the pro forma revenue in 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 6 shows revenue and adjusted EBITDA by segment.

As a reminder, we updated our methodology for assigning corporate allocations by assigning some more of the corporate costs directly into the segments to better reflect the true costs within the businesses. As a result, corporate unallocated costs declined while corporate costs allocated to the segments increased during the quarter.

Electronic Materials delivered around $81 million of adjusted EBITDA, which was 37% of segment revenue, a decline versus 39% reported last year due to the change in allocations, the additional 6 weeks of electronic chemicals revenue and lower CMP slurries revenue.

Performance Materials adjusted EBITDA was approximately $27 million, which was 44% of segment revenue, an increase from 42% in the prior year due to the additional 6 weeks of pipeline performance revenue, partially offset by the change in allocations.

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

We ended the quarter with $194 million cash on hand and $937 million of total debt.

We generated cash flow from operations of $48 million and our capital expenditures were $26 million in the quarter. As a result, our free cash flow was $22 million.

Finally, on slide 8 we provide some forward-looking expectations.

For the second quarter of fiscal 2020, we currently expect total company revenue to be approximately flat to up low single digits compared to our first fiscal quarter. We expect revenue in Electronic Materials to be approximately flat to up low single digits and revenue in Performance Materials to be up low single digits.

Within the Electronic Materials segment, the expectation is approximately flat to up low single digits even though our second quarter is typically softer on total revenue as there are fewer shipping days than our first quarter because of the Lunar New Year and February being a shorter month. This guidance does not include any potential impact on demand for our products due to the coronavirus.

For the full year fiscal 2020, we continue to expect adjusted EBITDA to be in the range of $350 to $380 million. We expect our fiscal 2020 EBITDA margin to remain at or slightly better than the 31.4% EBITDA margin we delivered in fiscal 2019.

After successfully refinancing our debt at the end of last quarter, we now expect our full-year interest expense to be between $45 and $46 million, reducing the top end of the range by $2 million.

To support future growth opportunities in our businesses, particularly in our pipeline products business, we plan to invest between $100 million and $130 million in capital expenditures this year. We believe that the spending is likely to be at the upper end of that range and we remain committed to meeting all of the stated objectives in our Capital Deployment program. We continue to expect to meet our deleveraging target of 2 times net debt to EBITDA by the end of fiscal 2020.

In closing, we believe our performance this quarter shows the strength of both our legacy CMC businesses and the acquired KMG businesses. We delivered strong earnings in an uneven demand environment and consistent with our track record, continued to convert those earnings into positive free cashflow. We then deployed the cash according to our stated priorities and believe we are making the appropriate investments to support the future growth and sustainability of our businesses.

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.