CABOT MICROELECTRONICS CORPORATION
THIRD QUARTER FISCAL 2019 CONFERENCE CALL SCRIPT
August 8, 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 third quarter of fiscal 2019, which ended June 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, our Form 10-Q for the quarter ended March 31, 2019, and our Form 10-Q for the quarter ended June 30, 2019, which we expect to file by August 9, 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 third quarter of fiscal 2019. We set another record for revenue, achieving $272 million this quarter, which is up 2% sequentially, and in line with our previously provided guidance. We believe our results this quarter demonstrate our continued strong execution as well as the benefits of having a broader portfolio of solutions that enable performance in multiple industries, with greater worldwide geographic balance, following our successful acquisition of KMG last year.

On a segment level, and as expected, revenue in Electronic Materials was essentially flat sequentially. Within the backdrop of an ongoing soft semiconductor industry environment, we believe these results are reflective of the resilience of our business, as well as the breadth of our product offerings, as we saw increased demand from advanced logic customers as well as stabilization in the foundry segment which helped balance weakness from memory customers.

Revenue in Performance Materials was a record, and increased significantly sequentially, primarily driven by our pipeline performance business, with higher demand for our drag-reducing agents, or DRA's, which enable pipeline operators to optimize the efficiency and throughput of oil transport in both U.S. and international oil production.

As we have discussed, we continue to see a bright future and strong growth potential for our Performance Materials segment, driven by our critical solutions that enable performance for pipeline operations and energy industries.

Total adjusted pro forma EBITDA was $86 million, or 31.5% of sales, consistent with the guidance we provided during our recent Investor Day. This is $6 million higher compared with the adjusted pro forma EBITDA in the prior year. This continues our track record of delivering best in class profitability for specialty materials companies and, as we have discussed previously, we have the expectation to further expand profitability in the future.

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

Starting with Electronic Materials, despite continued semiconductor industry uncertainty in the near term, we have seen signs of stabilization in demand from memory customers and expect recovery to continue over the next several quarters, as channel inventories are reduced and demand from multiple end markets improves.

CMP pads and electronic chemicals showed growth over the same quarter last year. Lower CMP slurries revenue, due to the softer industry conditions, especially in the memory sector, led to Electronic Materials pro forma revenue decreasing 5% compared to the same quarter last year. As previously discussed, our CMP slurries have a high participation in memory, and were adversely impacted by DRAM and NAND production cuts at our customers this year.

In logic applications, the transition to advanced nodes by many of our top customers is driving increased demand for materials, particularly electronic chemicals. We remain optimistic about the long-term opportunities this creates for our company as increasing device complexity should translate into additional manufacturing steps and higher demand for our broad portfolio of products. Lastly, in the foundry segment, we also expect continued stabilization in demand as customers migrate to advanced technology nodes where we are well positioned with our next generation CMP slurry and pad solutions.

Turning to Performance Materials, on a pro forma basis, we had another record quarter. The robust growth we continue to see in demand for our DRA's drove an 18% increase in revenue year over year, and a 14% increase sequentially, which exceeded our expectations and continues to demonstrate a key aspect of our investment thesis for our acquisition of KMG. Similar to our investment in the CMP space over the years, we are prepared to make investments in our pipeline business to increase capacity and to improve the quality and technology of our offerings, as we continue to further differentiate ourselves from other providers.

Finally, as to our ongoing integration of KMG, we are now almost 9 months post the close of the acquisition, and we continue to be pleased by our progress. Customer and employee reaction continues to be very positive, and we are delighted with the growth and health of the acquired businesses. As Scott will discuss, we have now taken actions to achieve almost our entire announced synergy target of $25M, which is ahead of schedule.

Overall, we are proud of the results we delivered in the quarter, which we believe demonstrate the resiliency of our core CMP business as well as the strength of our acquired KMG businesses. Looking forward, we believe we are well positioned to deliver another strong quarter of results to finish our fiscal year. From our perspective, our future growth prospects remain bright, which along with our expectation for continued best in class profitability, position us as the premier specialty materials provider globally.

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 and on slides 11 and 12 of the slide presentation.

Revenue for the third quarter of fiscal 2019 was $272 million, which is a record for our company, and $121 million, or 81%, 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 volumes.

Our reported net income was $19 million, and diluted EPS was $0.64 in the quarter. Adjusted pro forma net income was $47 million, which was essentially flat compared with the adjusted pro forma net income in the third quarter last year. Adjusted pro forma EPS was $1.59, which was $0.02 higher than last year.

Adjusted pro forma EBITDA was $86 million, or 31.5% of revenue, in line with expectations provided at our recent Investor Day and is 210 basis points higher than last year.

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 42.4% this quarter, compared to 53.6% reported in the same quarter last year. When comparing to the prior year on a pro forma basis, I would like to remind everyone that this year's metric is negatively impacted by a reclass of distribution expenses related to the KMG acquisition, which moved from operating expenses into cost of goods sold.

On an adjusted pro forma basis, gross margin was 45.3%, which was essentially flat compared to 45.4% in the same quarter last year. This quarter's adjustments include a $3.5 million amortization on acquired production-related assets from the KMG acquisition, and a $4.2 million impact from a warehouse fire and resulting cleanup activities at our Tuscaloosa wood treatment facility. As described at the time of the incident, fortunately, no one was injured. The fire, which affected only the warehouse, was extinguished quickly, and production remained on target.

Also, we had some amortization and acquisition-related charges impacting our operating expenses in the quarter. Excluding these charges, our pro forma operating expenses declined approximately $7 million year over year. Synergies reduced OPEX by approximately $4 million, and the remainder was mostly due to a lower accrual for performance-based compensation.

Our adjusted proforma net income of $47 million was essentially flat compared to last year, as improvement in operating expenses was offset by higher taxes.

Our adjusted pro forma EBITDA was $86 million, or 31.5% of revenue, and $6 million higher than the comparable metric in the prior year. This improvement was driven primarily by lower selling and general administrative expenses, which demonstrates our continued cost discipline, particularly during a softer semiconductor demand environment. You may recall that we previously mentioned that 31% is a reasonable near-term expectation for Adjusted EBITDA as a percent of revenue. This is lower than the 32.2% EBITDA margin reported in the second fiscal quarter primarily due to lower slurries volume.

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 5%, decline year over year. CMP slurries revenue declined 12% year over year, as strong demand from advanced logic customers was offset by weakness in memory and foundry.

CMP pads reported a 12% increase in revenues from last year due to continued customer adoption of our NexPlanar product line.

Our electronic chemicals revenues grew 2% 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 $10 million, or 18%, over the prior year to a record level in the quarter. As mentioned, this increase was driven primarily by strong demand for DRA’s from both domestic and international markets.

Slide 6 shows revenue and adjusted EBITDA by segment. Electronic Materials delivered $71 million of EBITDA, which was 33% of segment revenue, while Performance Materials EBITDA was $27 million, which was 46% of segment revenue.

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

We ended the quarter with $169 million cash on hand. We prepaid $55 million of debt in April, which reduced our total debt to $944 million at the end of the quarter. Year-to-date we prepaid $100 million of our 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 $117 million and our capital expenditures were $33 million. As a result, our free cash flow was $84 million.

Overall, we are very pleased with our strong cash flow generation ability, and we intend to continue to be prudent stewards of the significant cash we generate. In particular, our stated capital deployment priorities remain: investing in our existing businesses to support organic growth, paying ongoing and increasing dividends over time, de-leveraging and executing M&A, and finally repurchasing shares.

I will now provide some closing remarks on slide 8.

From a financial perspective, we are encouraged to see continued strength in our newly acquired businesses as well as the resilience of our heritage businesses. Despite a challenging semiconductor industry operating environment, adjusted pro forma gross margin and net income were essentially flat compared to last year, and EBITDA grew, benefiting from synergies, and continued overall control of operating expenses.

Specifically, we delivered $4 million of synergies to OPEX in our third fiscal quarter P&L and have implemented actions that should contribute to $24 million in synergies on a run-rate basis. We are pleased with our progress to achieve nearly $25 million in run-rate synergies ahead of our previously communicated schedule. As we have done over time, we will continue to look for additional opportunities to drive improvements in operating expenses for the company.

Accretion from the KMG acquisition added approximately $0.49 to EPS this quarter, and approximately $1 per share since the acquisition closed.

We delivered on accretion ahead of our original expectations and are delivering synergies faster than originally planned. We continue to be delighted with our growth prospects as well as the earnings and cash flow power of the combined company.

On slide 9 we provide some forward-looking expectations.

For the fourth quarter of fiscal 2019, we currently expect total company revenue to be approximately flat compared to our third fiscal quarter, as the semiconductor industry continues to stabilize. Electronic Materials and Performance Materials revenue is expected to be approximately flat sequentially. Consistent with Dave's comments, we are expecting further stabilization in our Electronic Materials revenue in the fourth quarter, but the timing of the semiconductor industry recovery remains uncertain. In Performance Materials, we are forecasting continued strong growth in DRA's. However, for the fourth quarter there may be some timing impacts for orders from other businesses within the segment.

With one quarter remaining in our fiscal year, we are narrowing our full year guidance. We now expect full year adjusted EBITDA to be in the range of $325 to $335 million, compared to the prior estimated range of $325 to $345 million.

We currently expect our full-year interest expense to be between $45 and $46 million, with approximately $13 million expected in the fourth quarter.

Depreciation and amortization is now expected to be between $35 and $40 million, which excludes approximately $60 million in acquisition-related amortization.

Our current capital spending expectation for the full fiscal year is between $55 and $60 million as we expect to initiate some organic growth projects in the fourth quarter. We now expect our effective tax rate for the full fiscal year to be in the range of 24% to25%.

As we step back, our third fiscal quarter results confirm the following themes: the resiliency of our CMC heritage businesses, the strength of our acquired businesses, our continued focus on managing costs, and ultimately, the cash generating power of the combined company along with appropriate capital deployment execution.

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.