Cabot Microelectronics Corporation

2007 Third Fiscal Quarter Earnings Report

July 26, 2007

Good morning. This is Bill Johnson, Vice President and Chief Financial Officer for Cabot Microelectronics Corporation. With me today is Bill Noglows, Chairman and CEO.

This morning we reported results for our third quarter of fiscal 2007, which ended June 30. A copy of our press release is available in the investor relations section of our website, www.cabotcmp.com, or by calling our investor relations office at 630-499-2600. Today's conference call is being recorded and will be archived for four weeks on our website. The script of this morning's formal comments will also be available there.

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-Q for the second quarter of fiscal 2007 ended March 31, 2007, and Form 10-K for the fiscal year ended September 30, 2006. We assume no obligation to update any of this forward-looking information.

I will now turn the call over to Bill Noglows.

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

This morning we announced strong financial results for our third quarter of fiscal 2007 which represent record performance in a number of areas, including record quarterly revenue of $89 million, record revenue for both our tungsten business and our recently acquired QED business, as well as record gross profit. We believe these results reflect continued successful execution of our three strategic initiatives – Technology Leadership, Operations Excellence and Connecting with Customers, as well as improved semiconductor industry conditions following an inventory correction of IC devices which adversely impacted our results in the first two quarters of fiscal 2007.

Our revenues this quarter were up almost 16 percent from last quarter. During last quarter's conference call we discussed the strong historical correlation between demand for our CMP products and revenue reported by the large Taiwan foundries, which represent a very important part of our business. This historical correlation continued this quarter. As you remember, at the time of our last earnings call, we were hopeful that the upturn reported by the major Taiwan foundries in the month of March might represent an end to the broad industry inventory correction, but we felt it was too early to predict this turning point with confidence at that time. With the 12 percent increase in revenue from our core CMP consumables business over the quarter just completed, we believe that our customers' inventory correction is now behind us. Having said that, we remain cautious given the historical volatility of the industry, and our limited visibility into downstream end use demand.

As you know, our core CMP slurry business generates a strong and consistent flow of cash, and along with our disciplined fiscal management of our business, provides us with a sound balance sheet. This fundamental financial strength has allowed us to continue to invest through all industry cycles, whether during an industry downturn or a strong market.

Now I'd like to provide a more detailed account of the progress we have made in each of our three strategic initiatives, starting with Technology Leadership.

During the third quarter, we made several public announcements that serve as evidence of our continued leadership in CMP technology. In May, we announced a major breakthrough in our CMP technology with our trademarked WIN product platform of tungsten CMP slurries for advanced technology nodes. This product line is designed to deliver ease of use and flexibility to various integration schemes. These products have been qualified and adopted by a number of memory customers and are currently in widespread evaluation by other potential customers in Asia and the United States.

Second, we announced significant technical improvements in our B6600 series of CMP slurries. This copper barrier slurry platform is intended to deliver an integrated solution to customers for advanced technology nodes. This product series is designed to provide customers with enhanced customization flexibility, superior electrical performance, and an attractive cost of ownership, and is being used for technology nodes from 90 nm through 45 nm.

Finally, our new CMP pad technology continues to gain traction and we have made significant progress this past quarter. I will discuss this further in a few minutes.

We are very proud of these accomplishments and we are committed to the successful execution of our Technology Leadership strategic initiative.

As we look to grow our business both domestically and globally, executing on our second strategic initiative, Operations Excellence, is vital to achieving our long-term growth goals. Over the last several years, improvements to our supply chain have helped drive the quality and consistency of the products, processes, and raw materials that make up our business. The result has been material savings achieved through productivity gains, as well as accolades from customers that have clearly recognized the results of our efforts to improve the quality and consistency of our products. Our focus is to win the trust and loyalty of our customers and we believe our efforts over the past three years have been successful in gaining that trust. Last quarter, we discussed our distinction of being the only CMP supplier to be awarded

Intel's Preferred Quality Supplier, or PQS, award for 2006. This quarter we were honored in a similar fashion by SMIC when it awarded us its Excellent Supplier Award in Shanghai on July 9th. We are very proud of this accomplishment and all the hard work and dedication that the team at Cabot Microelectronics put forward to achieve it.

We continue to make progress executing our third and final strategic initiative, Connecting with Customers. A great example of this is our intensive effort with customers to qualify our new D100 polishing pad. By working side by side with our customers during the testing, evaluation and qualification stages, we are able to directly share our extensive CMP process experience and knowledge with our customers and rapidly accelerate the qualification process. As we collaborate with more and more customers, we believe that we are beginning to reduce the time it takes for customer adoption of our technology. The list of customers that currently buy our pads has now grown from 4 customers last quarter to 7 customers this quarter, and we have another 20 customer locations in various stages of testing, evaluating and qualifying our pad. We are encouraged by the fact that one of these new customers was able to complete all testing and qualification phases in just over 3 months. This is a substantial reduction from the 9 to 12 month lead time that it took our first customers to qualify our polishing pad.

We are particularly pleased with the broad applicability of our pad technology. We are finding applications for our pad in all major CMP areas – dielectric, tungsten and copper, and in each of the logic, memory and foundry segments. Our pad is being used or evaluated in every geographic region, for 200mm and 300mm wafer fabs, across a wide range of technology nodes from 180nm to 65nm, and for the Applied Materials and Ebara tool sets.

We are happy with the momentum that we are generating in our CMP polishing pads business and look forward to building meaningful revenue from it in the near term.

A second success indicator from our Connecting with Customers initiative is the positive feedback we are receiving from our customers in the Asia-Pacific region. Recently completed infrastructure and customer support projects in Japan, Taiwan and Singapore have meaningfully increased our responsiveness and service to our customers in this key area.

I'll close my comments this morning with a one-year anniversary update of our QED Technologies acquisition. As you may recall, QED Technologies specializes in unique, patented polishing and metrology systems for high precision optics. As part of our Engineered Surface Finishes, or ESF, initiative, we acquired the company last July to gain commercial entry into the precision optics market with leading edge technology and to gain access to an outstanding team of scientists, engineers and associates. Looking back on the past year, we are delighted with our choice to partner with this company. The integration was completed seamlessly and on schedule and revenues for the first year were approximately 45% higher than during the 12 months preceding the acquisition. This performance has exceeded our expectations.

As with our core CMP business, the QED business is technology driven. As evidence of this, QED, in conjunction with Lawrence Livermore National Laboratory and Zygo Corporation, recently won a coveted R&D 100 Award for 2007. This award was received for technology that enables the manufacture, precision, and world class performance of continuous phase plates used in the optics chain for very large laser systems. This prestigious award is granted by R&D Magazine for the 100 most technologically significant products introduced into the marketplace in the past year.

Scientists and engineers in our core CMP and ESF businesses are actively collaborating with the QED scientists and engineers to leverage their respective capabilities. In addition, we are using our global CMP infrastructure to support QED's growing global presence, especially in areas like Japan. For example, we plan to utilize our Asia Pacific Technology Center to house optics equipment for QED customer demonstrations.

We continue to believe that there is value in diversifying our business into areas outside of the semiconductor industry, where shaping, enabling and enhancing the performance of surfaces is critical to success. We are pleased with the performance of the acquisitions that we have made to date. And, we believe that additional acquisitions to fulfill our ESF growth initiative, as well as to grow our core CMP consumables business, can represent productive uses of our available capital.

And with that, I'll turn the call over to Bill Johnson. Bill?

Thanks, Bill, and good morning everyone.

Our revenue for the third quarter of fiscal 2007 was $89 million, which as Bill mentioned represented a record level for our company. Revenue this quarter was up by 15.6 percent from the prior quarter, and we saw sequential revenue increases in all business areas except slurries for data storage polishing applications. Notably, our QED business reported its highest quarterly revenue in its 10 year history. Revenue in our third quarter was up by 4.8 percent from the same quarter a year ago.

Drilling down into the quarterly revenue number, Tungsten slurries contributed 39.7 percent of total quarterly revenue, with revenue up 17.3 percent sequentially. And we achieved a new quarterly revenue record in our Tungsten business last quarter. Sales of Copper slurries represented 16.4 percent of our total revenue, and increased 3.7 percent sequentially.

Dielectric slurries provided 30.7 percent of revenue this quarter, with sales up 15.0 percent sequentially. Data Storage products represented 5.0 percent of our quarterly revenue; this revenue was down 10.2 percent sequentially.

Finally, revenue from our ESF business, which includes the QED business, generated 8.1 percent of our total sales, and our ESF revenue was up 78.5 percent sequentially.

On a geographic basis, sales in all geographies except Southeast Asia grew sequentially. Of special note, sales in Korea increased sequentially by over 70 percent, sales in Europe grew by 32 percent, and sales in Taiwan were up almost 16 percent.

Our average selling price for slurry products increased by 1.0 percent compared with the March quarter, mainly due to a higher-priced product mix. The average selling price was 0.9 percent higher than in the same quarter a year ago, primarily as a result of a higher-priced product mix and the benefits of our recent dielectric price increase, partially offset by price reductions in certain other areas.

As a percentage of revenue, gross profit was 47.7 percent this quarter, which was 3.8 percentage points higher than the 43.9 percent of revenue we reported in the prior quarter, and 0.1 percentage points higher than 47.6 percent in the year ago quarter. Gross profit this quarter benefited by higher utilization of manufacturing capacity based on the higher level of sales, as well as higher yields in our production operations and lower fixed manufacturing costs.

Gross profit for the first 9 months of the fiscal year was 46.6 percent of revenue. This is consistent with our full year guidance range of 46 to 48 percent of revenue, which remains unchanged.

Now I'll turn to operating expenses, which include research, development and technical, selling and marketing, and general and administrative costs. Operating expenses were $27.9 million, which is within our guidance range of $27 to $30 million per quarter. This quarter's expenses were $1.0 million lower than the $28.9 million we reported last quarter. Key factors affecting operating expenses this quarter were lower depreciation expense and lower staffing and compensation related expenses.

This quarter's operating expenses were $1.2 million higher than the $26.7 million in the same quarter last year primarily due to the acquired QED business.

We expect operating expenses to continue to fall within the range of $27 to $30 million in our fourth fiscal quarter.

Below the operating expense line of our income statement is a line labeled "other income and expense", and ordinarily this mainly reflects interest income on our cash balance. However this quarter, this line item also includes a $2.1 million charge to reflect the write-off of our minority equity investment in NanoProducts Corporation, which develops and produces specialty nanoscale materials. You may remember that three years ago, we took a minority ownership position in NanoProducts and entered into a collaboration agreement to co-develop innovative nano-abrasive particles for use in next generation CMP slurries and other specialty polishing applications. We have now chosen to not renew our collaboration agreement with NanoProducts. In addition, while we continue to hold an equity interest in the company, NanoProducts recently entered into funding arrangements that included commercial terms that we believe will make it difficult for us to recover the value of our investment. As such, it was appropriate to write-off the remaining value of our investment this quarter, which as I mentioned before, was $2.1 million pre-tax.

Reflecting our record revenue and gross profit, as well as operating expenses and the burden of the NanoProducts write-off, net income for the quarter was $10.1 million, up from $4.5 million last quarter, and up from $9.8 million in the same quarter a year ago.

The weighted average number of shares outstanding on a diluted basis this quarter was 23.7 million, essentially unchanged from the prior quarter.

Diluted earnings per share were 42 cents this quarter, up from 19 cents last quarter and up from 40 cents in the year ago quarter. Excluding the non-operating write-off of NanoProducts, EPS would have been 48 cents, which would represent one of the highest levels in our company's history.

Turning now to cash and balance sheet related items, capital additions for the quarter were $1.8 million. Depreciation and amortization expense was $5.9 million and share-based compensation expense was $3.2 million for the quarter.

We ended the quarter with $184.0 million in cash and short term investments, which was $20.4 million higher than last quarter. Cash flow reflects a $6.8 million decrease in working capital, primarily due to a reduction in raw material inventory. In addition, accounts receivable days of sales outstanding, or DSOs, improved from 54 to 50.days.

We are pleased with our continued strong cash flow, since this allows us to continue investing in our core CMP consumables business, as well as pursue potential growth opportunities through M and A activity in our ESF business.

I'll conclude my remarks with a few comments on our current outlook.

After a challenging first half of the fiscal year, we were pleased to see demand for our products turn up in our third fiscal quarter. Looking at our revenues in each of the three months of the third fiscal quarter, we saw a significant increase from April to May, and sales activity remained at the same higher level from May through June.

As we observe orders for our CMP products received to date in July that we expect to ship by the end of the month, we see July results trending generally in line with May and June results. 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. Also, I would like to remind you that QED's business, which is mainly equipment oriented, generates lumpy or uneven quarterly revenue and the record revenue experienced by the QED business this quarter may not occur again next quarter.

I would like to update our guidance on capital spending for fiscal 2007. We entered the year with an expectation to spend approximately $17 million. Through three quarters of the year, we have spent approximately $7 million and we now expect our full year capital spending to be around $10 million. Our full year estimate reflects lower than expected spending for the QED business, timing of CMP related projects, and continued prudent management of our capital expenditures.

Thank you for your time this morning and your interest in Cabot Microelectronics. We look forward to the next opportunity to speak with you. Goodbye.