Cabot Microelectronics Corporation

2007 Fourth Fiscal Quarter and Full Year End Earnings Report

October 25, 2007

Good morning. This is Amy Ford, Director of Investor Relations for Cabot Microelectronics Corporation. With me today are Bill Noglows, Chairman and CEO, and Bill Johnson, Chief Financial Officer.

This morning we reported results for our fourth quarter and full fiscal year 2007, which ended September 30. A copy of our press release is available in the investor relations section of our website, 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 third quarter of fiscal 2007 ended June 30, 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, Amy. Good morning, everyone, and thanks for joining us.

This morning we announced our financial results for the fourth quarter and the full fiscal year 2007, which represent several significant milestones and accomplishments our company has achieved this year. Demonstrating our continued successful execution of our core CMP consumables strategy, we received several supplier awards during the year including the attainment of Intel's Preferred Quality Supplier award for the first time. We also introduced several new and improved slurry products to the market and brought our new polishing pad manufacturing capacity on line to serve our growing base of pad customers. All of this was accomplished while we successfully integrated our acquisition of the QED business. It's been a very busy and rewarding year.

Total revenue for the quarter of $90.4 million represents our second consecutive quarter of record revenue. For the full year, we achieved record revenue of $338.2 million, despite the semiconductor device inventory correction that adversely impacted our revenues in the first half of the year. During our fourth fiscal quarter we experienced our highest quarterly gross margin percentage in three years. More important, fiscal 2007 was the first year in our history that our annual gross profit as a percentage of revenue increased from the prior year. We believe these accomplishments were driven by our focus and execution on the company's three strategic initiatives within our core CMP business -- Technology Leadership, Operations Excellence, and Connecting with Customers.

Historically, Technology Leadership has meant developing higher performing products because this was the most important factor in our customers' purchasing decisions when CMP technology was first being employed in the manufacture of IC devices. However, as end use consumer demand for lower cost devices has continued to grow, in parallel with the industry's traditional emphasis on PC's, our customers are becoming much more cost sensitive than they had been previously. As a result, we have refined our Technology Leadership initiative over the past couple of years to innovate for low <u>cost</u> of use as well as high performance. We believe that innovating for lower cost is a win / win proposition. By introducing new, more cost effective, high performing products to the market, we believe we can reduce the overall cost of ownership for our customers while maintaining our gross profit margin.

To illustrate this point, we have improved the cost effectiveness of certain CMP slurries by designing products with more chemically aggressive solutions that rely on lower concentrations of abrasive particles, which are the costly mechanical element of "chemical mechanical planarization" slurries. We have also utilized our extensive knowledge of CMP chemistry to formulate concentrated slurry products that can be diluted by our customers before use in their fabs, which saves on shipping and packaging costs and lowers our capital needs by effectively increasing our manufacturing capacity. As a result of this focus, in this year, we have introduced new, lower cost of use products across several application areas.

Next, I'd like to discuss how achievements through our Operations Excellence initiative have contributed to our strong performance this year. First, we achieved a 6 percent productivity improvement in our manufacturing operations in fiscal 2007, which builds on the 12 percent cumulative improvement we captured over the previous two years. For the third consecutive year, our productivity enhancements have been driven by a long list of variation reduction projects implemented under our Six Sigma program, which have resulted in improvements in areas such as higher manufacturing yields, shorter cycle times and increased labor efficiency.

In previous years, our annual productivity improvements have been largely offset by corresponding decreases in the average selling price for our slurries, reflecting competitive pricing pressures. However, with the recent advantage of stabilizing prices, the effect of our productivity initiatives and the improvements we achieved this year are more readily visible in our financial results in the form of higher gross profit margins.

As we saw earlier this year, utilization of our manufacturing capacity affects our profitability at the gross margin level. While we are subject to industry demand swings, we are able to proactively optimize and manage our manufacturing capacity. To this end, during the fourth quarter, we decided to close the company's manufacturing facility in Barry, Wales, which is our smallest manufacturing plant and has been underutilized over the past several years. Although it is always difficult to decide to close a plant, the decision was made to improve our operational efficiency and competitiveness in this cost sensitive environment. We are transitioning this plant's production to other manufacturing facilities in the US, Japan and Singapore over the next nine months and are working closely with our customers to make this transition seamless to them.

We continue to make progress on our third strategic initiative, Connecting with Customers. As part of this initiative we are actively collaborating with customers to understand their processes and requirements, so that we can supply them with solutions that meet their performance and cost requirements. Recently, much of our customer collaboration efforts have revolved around our D100 polishing pad offering. Given the broad applicability of our pad technology, we see numerous opportunities for our pads in all major CMP application areas, and across a wide range of technology nodes and tool sets.

During the fourth quarter, we secured another customer win in our pad business. We are especially excited about this new customer since it represents our first pad adoption for use in a copper polishing application. It also demonstrates our ability to win pad business in leading edge technologies, as our pad is being used to polish 300mm wafers in this customer's 65nm technology node process. This brings our total number of pad customers to eight with another 20 customer locations in various stages of testing, evaluating and qualifying our pad. We are energized by the progress that we have made this year in our pad business, and we remain encouraged that in addition to the opportunities that we see for new customer adoptions, significant opportunities exist for additional business with our current customer base, positioning us for further success in 2008.

Another indicator of success from our Connecting with Customers initiative was evident when we were honored with Samsung's supplier appreciation award for "Best in Value" at their Supplier Appreciation Day in California two weeks ago. We are proud to be one of only four suppliers to be recognized with an award at this event. We believe this award demonstrates our strong partnership and collaboration with this important and strategic customer.

Finally, as part of our Connecting with Customers initiative, we are always actively looking for ways to better serve our customer base around the world. As a result, we are planning to invest in a new, state-of-the-art 300mm polishing tool and related metrology equipment, for our Asia Pacific Technology Center in Japan, which will represent a significant capital investment in fiscal 2008. We believe this investment will complement our existing 300mm capabilities in the US and enhance our ability to develop next generation copper and barrier products, as well as provide real time 300mm service and support to our Asia Pacific customers.

In conjunction with this investment in the Asia Pacific region, we plan to add to our research and development talent there. We recently implemented a small workforce reduction in the US, as part of our ongoing efforts to manage costs. By initiating this staffing reduction in the US, we believe we can invest in 300mm tools and talent for the Asia Pacific region without significantly increasing total operating expense. We believe that our investment in this tool, as well as our additional research and development resources in Asia, will allow greater collaboration with our customers in the region, increase our responsiveness, and facilitate quicker and more efficient new product development.

To broadly summarize our approach within our CMP business, we strive to maintain our gross profit percentage by innovating new products for high performance AND low cost, improving productivity, and pricing our products for the value they bring and to reflect the investment in research that went into developing and improving them. We also aim to contain operating expenses by SHIFTING resources to Asia, rather than ADDING overall resources, to support our customer relationships.

We believe that continued execution of our strategic initiatives has resulted in our solid profitability and consistent cash flows, which allow us to weather industry cycles, such as the one we experienced in the first half of the fiscal year, and to invest further in our business by funding research and development, capital expenditures and M and A activity.

I'll close my comments this morning with an update on our Engineered Surface Finishes, or ESF, initiative.

In addition to the accomplishments we achieved in our core CMP consumables business in fiscal 2007, we are also encouraged by the success of our ESF business. In fiscal 2007 we began to reap the benefits of our QED acquisition, through leveraging of technical knowledge and the global infrastructure of the two organizations. The QED acquisition has exceeded our expectations, as the integration was seamless and the business posted revenue of $18 million in fiscal 2007 compared to $13 million in the twelve months preceding the acquisition.

As we look toward the future, we look forward to continued expansion in this area, both through organic growth and M & A opportunities.

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

Thanks, Bill, and good morning everyone.

Our revenue for the fourth quarter of fiscal 2007 was $90.4 million, which as Bill mentioned, represented our second sequential quarterly revenue record. Total revenue this quarter was up by 1.5 percent from the prior quarter, and revenue from our CMP business was up 5.3 percent; we saw sequential revenue increases in all business areas except ESF, which primarily reflects revenue from our QED acquisition. You may recall that in our third fiscal quarter we achieved record revenue in our QED business, so we're not surprised that our fourth fiscal quarter was lower since this equipment-oriented business can be uneven.

Total revenue for the full fiscal year was $338.2 million, which was a record for our company. Total revenue in fiscal 2007 represented a 5.4% increase from the previous year, and reflects the addition of the QED business, acquired in July 2006.

Drilling down into the quarterly revenue number, Tungsten slurries contributed 38.6 percent of total quarterly revenue, with revenue up 1.5 percent sequentially. And we achieved our second sequential quarterly revenue record in our Tungsten business.

Sales of Copper slurries represented 18.5 percent of our total revenue, and increased 14.7 percent sequentially.

Dielectric slurries provided 32.3 percent of revenue this quarter, with sales up 3.4 percent sequentially.

Data Storage products represented 5.5 percent of our quarterly revenue; this revenue was up 11.7 percent sequentially.

Finally, revenue from our ESF business, which includes QED, generated 4.7 percent of our total sales, and our ESF revenue was down 41.1 percent sequentially.

On a geographic basis, sales in all regions of Asia grew sequentially, except Korea. Our revenue in both the US and Europe also decreased.

Our average selling price for slurry products increased slightly compared to the June quarter. For the full year, average selling prices increased by 1.6 percent mainly due to a higher-priced product mix.

As a percentage of revenue, gross profit was 49.1 percent this quarter, which is 1.4 percentage points higher than the 47.7 percent of revenue we reported in the prior quarter, and 4.7 percentage points higher than in the year ago quarter. Gross profit this quarter benefited by higher utilization of manufacturing capacity based on the higher level of sales. Contributing to the increase over the prior year was the absence of the $1.1 million one-time write-off of production assets in the fourth quarter of 2006, associated with retrofitting a building for our pad business.

For the full year, gross profit percentage was 47.3 percent, higher than 46.5 percent in fiscal 2006. As Bill mentioned, this was the first annual increase in gross profit percentage in the history of our company.

Now I'll turn to operating expenses, which include research, development and technical, selling and marketing, and general and administrative costs. Operating expenses of $30.3 million increased by $2.4 million sequentially, and were $2.1 million higher than in the same quarter last year. The sequential increase was primarily driven by higher accruals for the company's annual cash bonus program and higher professional fees, which were partially offset by lower expenses for clean room materials.

The year-over-year comparison was impacted by higher accruals for the company's annual cash bonus program and higher professional fees, partially offset by the absence of $1.8 million of one-time research and development write-offs taken in the fourth quarter of 2006.

For the full year, operating expenses increased by $9.6 million, from $104.6 million to $114.2 million, primarily due to the inclusion of a full year of operating expenses related to our QED business and higher professional fees.

Reflecting our record revenue, increased gross profit, but also higher operating expenses, net income for the quarter was $10.2 million, up slightly from $10.1 million last quarter, and up from $8.2 million in the same quarter a year ago.

The weighted average number of shares outstanding on a diluted basis this quarter was 23.8 million.

Diluted earnings per share were 43 cents this quarter, up from 42 cents last quarter and up from 34 cents in the year ago quarter. For the full year EPS was $1.42, up from $1.36 reported in fiscal 2006.

Turning now to cash and balance sheet related items, capital additions for the quarter were $2.6 million. This brings our full year capital additions to $9.5 million, which includes investments to establish our pad manufacturing capacity in the U.S. and Taiwan. This represents the lowest annual capital spending in the company's history, which I think reflects our continued prudent management of capital expenditures as well as the low capital intensity requirements of our CMP business model. Depreciation and amortization expense was $6.0 million in the fourth quarter, and share-based compensation expense was $3.4 million.

We ended the quarter with $212.5 million in cash and short term investments, which was $28.5 million higher than last quarter. Cash flow reflects $6.0 million contributed from the exercise of stock options during the quarter and a $3.7 million decrease in working capital.

We are delighted with our continued strong cash flow, since this allows us to continue investing in our businesses through industry cycles. Our cash flow enables us to fund research and development projects, capital expenditures and pursue strategic acquisition opportunities. It also affords us the flexibility to return cash to shareholders, such as through our share repurchase program.

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

As we have discussed in the past, we believe that our core CMP business is unit-based and driven by overall wafer starts. Examining our revenues in each of the three months of the fourth fiscal quarter, sales activity remained relatively constant throughout the quarter and generally consistent with our sales levels in May and June. As we observe orders for our CMP products received to date in October that we expect to ship by the end of the month, we see October results trending generally in-line with the fourth quarter of fiscal 2007. 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.

I would also like to remind you that since the Asian foundries represent a significant portion of our business, there has been a strong historical correlation between our revenue and that of the foundries.

Although 2007 has been a challenging year for the semiconductor industry, certain industry analysts are predicting a stronger industry environment in 2008. Having said that, we remain cautious given the historical volatility of the industry, and limited visibility into downstream end-use demand.

Given our strong gross profit percentage performance in fiscal 2007, our full fiscal year 2008 guidance remains unchanged from fiscal 2007, which is 46 to 48 percent of revenue. This guidance is for the full fiscal year, and quarter to quarter our gross profit percentage may be above or below this range.

As for operating expenses, we plan to continue our commitment to managing costs and therefore we expect our quarterly operating expenses to remain within the $27 to $30 million range for the coming year. This is also unchanged from our guidance for fiscal 2007.

Our full year tax rate is expected to be approximately 32 percent during fiscal 2008.

Capital spending should be around $20 million, which reflects our anticipated investment in the 300mm polishing tool and the associated metrology equipment for the Asia Pacific region, that Bill discussed earlier.

Depreciation and amortization for fiscal 2008 should be approximately $25 million.
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.