Cabot Microelectronics Corporation

2008 Fourth Fiscal Quarter and Full Year End Earnings Report

October 23, 2008

Good morning. 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 2008, which ended September 30th. 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 2008, ended June 30th, and Form 10-K for the fiscal year ended September 30, 2007. 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.

We are pleased with our performance in fiscal 2008, having achieved 11 percent revenue growth and 15 percent EPS growth. Over the course of the year, we also made steady progress in our strategic initiatives and have hit significant milestones in each of our business areas. As an example, we made inroads with our slurries for barrier and advanced dielectric applications, while sales of our slurry for tungsten applications grew an impressive 19 percent this year. In addition, the hard work, dedication, and persistence of our pads team resulted in over $15 million of pad revenue this year, signifying a break-out year for this growth business, which is highly complementary to our CMP slurry business. Last, we are leveraging our expertise from our CMP consumables business to continue to make headway in new ESF applications, which are gaining traction and contributed to the overall company performance this year.

We are very proud of our strong results and the significant progress we made toward strengthening our company in fiscal 2008, and we believe we are well positioned for what lies ahead. While we recognize that the macro economic environment and the semiconductor industry specifically, are expected to be soft in the near term, we are experienced with, and accustomed to successfully navigating through soft, cyclical demand environments. For example, we have weathered three semiconductor industry downturns since becoming a public company in 2000, and during each of these down cycles we continued to generate positive cash flow from operations, were profitable, and continued to invest in our future. In our view, challenging times like these weed out the marginal players from the strong ones and create opportunities for the stronger companies to strengthen and grow, while others might be struggling to survive. We are confident that our significant infrastructure and scale associated with our leadership position in CMP slurries, combined with our low capital intensity and solid balance sheet, make us one of the stronger players in our industry.

Recent press and analyst reports have forecasted protracted semiconductor industry softness, due in part to the current economic situation and the overall decrease in consumer confidence. Certain analysts have predicted the worst wafer start environment since 2001, a year in which the semiconductor industry contracted by more than 30 percent. Not only are the foundries expected to reduce their utilization rates by 20-30 percent, a number of memory manufacturers have announced that they have begun reducing production as well. This is uncharacteristic of the memory segment, which is known for running its fabs at full utilization, in order to drive down unit costs. Since the primary driver of revenue for our CMP consumables business is wafer starts, the downturn that we are now experiencing is expected to adversely affect our company in the near term. However, we expect any impact on our company will be partially offset by continued new wins in pads, as well as other growth opportunities, such as ESF and slurry products for advanced dielectric and barrier applications.

In our business, we began to see a reduction in demand for our CMP consumables products in August, and based on industry forecasts, we expect this softening of demand to persist well into calendar 2009. It is somewhat ironic, but a soft industry environment sometimes presents more opportunities for customer engagement and growth. As our customers lower their utilization rates, they have more engineering resources and available tool time to evaluate, and qualify new CMP slurry and pad products. We believe that over the past several years, we have made the necessary investments in Technology Leadership and continued strengthening our customer relationships, which has positioned us well, for capturing evaluation opportunities that may arise during a downturn.

Although we believe the current economic situation has begun to negatively impact orders for our CMP consumables products, it has not impaired our ability to run our operations. We have over $220 million in cash, an untapped $80 million credit facility, and no debt. In addition, we have a solid track record of generating strong cash flow. For example, during fiscal 2008, we generated over $70 million of cash from operating activities, but used less than $20 million for capital additions. The current environment has not changed our company strategy, and we feel we are well positioned to emerge from this industry downturn even stronger. Having said this, we will continue to be disciplined with our uses of cash, and are placing increased attention on managing costs.

During the year, we continued our emphasis on Technology Leadership, which has led to increased revenue from a variety of new, innovative products. These products are targeted to achieve high performance, while providing a low cost of ownership for our customers. Evidence of our success in this area can be seen in our "new product vitality" metric, which measures the portion of our sales that are driven by products commercialized within the last three years. This metric has increased by more than 50 percent from last year and has more than doubled over the last three years. Historically, our CMP products have enjoyed long life-cycles. In fact, some of our high quality, branded products that we introduced in the late 1990's are still in use today; and we work to keep them vibrant by continually improving them to meet the ever increasing performance requirements of our customers. By achieving new product wins today, we aim to secure a solid revenue stream far into the future.

Executing on our Operations Excellence initiative has also contributed to our strong financial performance. Our continued high level of product quality and consistency is a key competitive advantage, and has led to our achievement of a number of supplier awards during the fiscal year just completed. Furthermore, our strong focus on cost control, in our manufacturing operations has earned us a 5 percent productivity improvement in fiscal 2008, which builds on the 18 percent cumulative productivity gains over the prior three years. Excluding the adverse effect on our overall gross profit margin of our emerging pads operations, this year's productivity achievement, combined with continued pricing discipline, resulted in our second sequential year of gross profit margin improvement.

One reason we are able to earn an attractive gross profit margin is the value we bring to our customers, in terms of service and support, through our Connecting with Customers initiative. This past year, we improved our ability to collaborate more effectively with our Asia Pacific customers, by expanding our technology center in Japan to include a state-of-the-art 300mm polishing tool and related metrology. In addition, we are working toward strengthening our relationships with IBM, and other strategic customers, by working on various joint development programs. As we enter fiscal 2009, we expect to take advantage of the new opportunities that may arise to strengthen our customer relationships and win more business. We also plan to continue our disciplined focus on managing operating expenses, while maintaining our world-class customer service and technical support.

I would now like to turn to our pads business. In fiscal 2008, our pads business grew to $15 million in revenue, from less than $1 million in fiscal 2007. In addition, we nearly doubled our pad customer base, finishing the year with 15 customers, for over 20 distinct polishing applications, and tens of thousands of pads sold. I am pleased with the progress we've made in tuning and optimizing our pad production process, which combined with higher sales volume, resulted in our second sequential quarter of positive gross profit for our pads business.

We believe that the growth opportunity is significant in our pads business, and that we have demonstrated that a win with one customer application has the potential to rapidly translate into multiple application wins. For example, about a year ago, we discussed an important win at a leading-edge customer to supply 300 mm pads, for a 65nm copper process. Last quarter, we reported that this customer had back integrated our pads into its older 90 and 130nm copper processes. We are pleased that the same customer has now begun to utilize our pads for certain tungsten processes. Given the significant demand from this customer, we have entered into an agreement to establish on-site pad finishing capability, at one of its wafer fabrication facilities. Construction began this quarter and is expected to be completed in the first calendar quarter of 2009. This type of customer engagement exemplifies the confidence we are building with our customers for our pad offering, and for our Operations Excellence initiative.

Turning now to our Engineered Surface Finishes business, we remain optimistic about the potential in this area, despite the lower revenue this year. In fiscal 2008, our QED business strategy focused more on expanding its customer base and increasing sales of standard machines, and less on custom machines and research and development contracts. QED was successful at increasing its standard machine sales by more than 20 percent this year, even in this challenging capital equipment market, but it was not enough to offset a reduction in revenue from custom machines and research and development contracts. As we enter into fiscal 2009, we intend to continue our focus on standard machine orders, which we believe is the foundation of sustainable, long-term growth.

In summary, we believe the continued execution of our two-pronged growth strategy, and related key initiatives were instrumental in driving our strong performance in fiscal 2008, and we remain committed to the implementation of this strategy. From our perspective, our units based business, strong balance sheet, and history of solid cash flow and earnings generation throughout industry cycles makes us well positioned for solid performance, even during periods of industry softness.

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 2008 was $90.2 million, which was essentially even with the fourth quarter of fiscal 2007 and down 7.1 percent from the previous quarter. Quarterly revenue declined sequentially in all major business areas, except sales of polishing pads. During the quarter we started to experience reduced demand for our CMP consumables products, which we believe reflects the industry softening Bill referred to earlier.

Total revenue for the full fiscal year was $375.1 million, which represents a 10.9 percent increase from last year. Revenue for our core CMP consumables products, for semiconductor applications, increased by 14.7 percent, while revenue for our data storage and ESF businesses declined.

Drilling down into revenue by business area,
Tungsten slurries contributed 41.0 percent of total quarterly revenue, with revenue up 5.9 percent from the same quarter a year ago and down 5.4 percent sequentially. For

the full year, tungsten slurry revenue increased by 19.0 percent, driven by strong demand from our memory customers, especially in Korea where our annual sales were up nearly 50 percent from last year.

Sales of Copper slurries represented 13.9 percent of our total revenue, and decreased 25.1 percent from the same quarter last year and 13.2 percent sequentially. For the full year, copper slurry revenue decreased by 9.5 percent, reflecting the loss of some copper slurry business from one particular customer, which we previously discussed during our second quarter earnings call. While sales of copper slurries for bulk and soft-landing removal decreased in fiscal 2008, sales of copper slurries for barrier removal increased by more than 45 percent from last year.

Dielectric slurries provided 31.8 percent of revenue this quarter, with sales down 1.8 percent from the same quarter a year ago and down 7.5 percent sequentially. For the full year, dielectric slurry revenue increased by 9.6 percent. Included in this business is our rapidly growing advanced dielectrics product line, revenue from which was up more than 125 percent from last year.

Data Storage products represented 3.2 percent of our quarterly revenue; this revenue was down 43.2 percent from the same quarter last year and down 2.9 percent sequentially. For the full year, revenue for data storage products decreased by 23.8 percent. This decrease was due in part to the merger of two significant players in the data storage industry, as well as a loss of some business. However, we recently won an important new position which we began ramping at the end of our fourth fiscal quarter.

Sales of polishing pads represented 6.1 percent of our total revenue for the quarter, and increased 21.0 percent sequentially. For the full year, revenue increased nearly $15 million. During the quarter a significant customer completed its ramp of our product for its copper applications, which was an important contributor to our strong revenue growth in fiscal 2008.

Finally, revenue from our ESF business, which includes QED, generated 4.0 percent of our total sales, and our ESF revenue was down 14.3 percent from the same quarter last year and down 28.2 percent sequentially. Remember that our QED business is mainly capital equipment oriented, so quarter to quarter revenue fluctuations are common, and capital equipment spending was down this year in general. For the full year, ESF revenue decreased by 12.3 percent, driven by lower custom machine orders and research and development contracts in QED.

As a percentage of revenue, our gross profit was 46.6 percent this quarter, which was down from 49.1 percent in the same quarter last year and 46.8 percent in the previous quarter. Compared to the same quarter a year ago, our gross profit percentage decreased due to the effect of foreign exchange rate changes, increased logistics costs associated with higher energy prices, and higher fixed costs related to our pads business. These effects were partially offset by a higher valued product mix. Compared to the previous quarter, the slight gross profit percentage decrease was mainly due to a lower valued product mix and higher logistics costs, which were partially offset by lower manufacturing costs.

For the full year, gross profit as a percentage of revenue was 46.5 percent, which was down from 47.3 percent in fiscal 2007. The decrease was primarily attributable to higher fixed manufacturing costs and lower manufacturing yields, associated with our polishing pads business, that we have discussed throughout the year. Also contributing to the decrease was the effect of foreign exchange rate changes. As Bill mentioned earlier, excluding the impact of our emerging pads business, gross profit percentage would have been slightly higher in fiscal 2008 than in fiscal 2007.

Now I'll turn to operating expenses, which include research, development and technical, selling and marketing, and general and administrative costs. Operating expenses of $31.7 million this quarter were higher than the $30.3 million reported in the year ago quarter, primarily due to increased expenses for clean room materials and higher professional fees, including legal fees related to intellectual property enforcement. Compared to the prior quarter, operating expenses were $800 thousand lower, mostly due to decreased travel expenses and professional fees. The decline in professional fees was primarily driven by lower costs to enforce our intellectual property, but was partially offset by higher professional fees in our corporate development area.

For the full year, operating expenses of $125.0 million were 9.5 percent higher than fiscal 2007. Nearly half of this increase was driven by costs related to our intellectual property enforcement. In addition, higher staffing related costs and travel expenses were partially offset by lower clean room materials costs.

Diluted earnings per share were 36 cents this quarter, down from 43 cents reported in both the fourth quarter of fiscal 2007 and last quarter. Diluted EPS for the full year was one dollar and 64 cents, which is up 15.3 percent from one dollar and 42 cents reported in fiscal 2007.

Turning now to cash and balance sheet related items, capital additions for the quarter were $2.6 million, bringing our full year capital additions to $19.2 million. This includes costs associated with the addition of 300mm polishing and metrology capability to our Asia Pacific Technology Center, as well as the expansion of our pad manufacturing capacity. Depreciation and amortization expense was $6.3 million in the fourth quarter, and share-based compensation expense was $3.7 million. In addition, we repurchased $5 million of our stock during the quarter, bringing our total share repurchases to $39 million in fiscal 2008.

For the full year, cash flow from operations was $70.8 million, a record for the company. We ended the fiscal year with $226.4 million in cash and short term investments, which is $13.9 million higher than last year. We believe that our strong cash flow and solid balance sheet position us well for continued success through industry cycles, and will allow us to capitalize on certain M&A opportunities that may arise in the future.

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

Examining order patterns during the three months of the fourth fiscal quarter, we began to see a softening in demand for our CMP consumables products in August. As we observe orders for our CMP consumables products received to date in October that we expect to ship by the end of the month, we see October results trending significantly lower than August and September levels. 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.

As we have discussed in the past, we believe that our CMP consumables business for the semiconductor industry is driven by overall wafer starts. Based on recent public announcements from several players in the semiconductor space regarding production levels, we expect fiscal 2009 to be a challenging year for our company from a demand perspective. Despite the expected challenging demand environment, and given the limited capital intensity and relatively low fixed costs associated with our core CMP consumables business, our gross profit percentage guidance for fiscal 2009 remains unchanged at 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. Current uncertainty in economic conditions makes it particularly difficult to predict full year results, and makes it more likely that actual results could differ from expectations.

From an operating expense standpoint, we continue to manage costs, especially given the anticipated soft demand environment. For fiscal 2009, we expect our full year operating expenses to be in the range of $120 to $125 million, which represents a flat to slightly lower outlook from fiscal 2008.

Our full year tax rate is expected to be approximately 32 percent, compared to just over 30 percent in fiscal 2008.

Capital spending should be around $13 million, a small portion of which is allocated to the construction of pad finishing capability at our customer’s facility, which Bill discussed earlier.

Depreciation and amortization for fiscal 2009 is expected to be approximately $22 million, which is down from $26 million in fiscal 2008.

Should any of the variables impacting our guidance change going forward, we will update the provided guidance accordingly.

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