Cabot Microelectronics Corporation

2006 Fourth Fiscal Quarter and Full Year Earnings Report

October 26, 2006

Good morning, this is Barbara Ven Horst, 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 of fiscal 2006, 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 2006 ended June 30, 2006, and Form 10-K for the fiscal year ended September 30, 2005. We assume no obligation to update any of this forward-looking information.

I will now turn the call over to Bill Noglows.

Thanks, Barbara. Good morning everyone, and thank you for joining us today.

This morning, I'll highlight some of our accomplishments of the year just completed. These achievements are all part of our long-term growth plan, which has two parts: build on our global leadership in chemical mechanical planarization for the semiconductor industry, and develop opportunities to leverage our strength in surface modification and materials into other areas adjacent to our core CMP business.

Our efforts have been guided in the past few years by our three key strategic initiatives – technology leadership, connecting with customers and operations excellence. These initiatives will continue to be our compass in 2007.

Cabot Microelectronics has been the technology leader since the beginning of the CMP industry, and we work hard to maintain that position. During this past year, we continued to refine our product and technology development processes and to enhance the vitality of our new product pipeline. At CMC, this cross-functional effort involving sales, marketing, R&D, and operations, has resulted in the introduction of 8 new products in fiscal 2005 and 10 new products in the year just finished and we expect to introduce a similar number in fiscal 2007.

These new products are not merely beaker-scale, experimental samples. These are robust offerings with dedicated supply chains and manufacturing capability. This is true of our new pad offering, which has been fully qualified on our installed manufacturing equipment with a dedicated supply chain to back it up. These products have been well-received by our customers and are currently generating revenue for Cabot Microelectronics.

As part of our "connecting with customers" initiative, we completed several infrastructure and customer support projects in the Asia Pacific region, and believe that these initiatives will greatly enhance our ability to grow in this critically important region.

The first of these projects was the opening of our Asia Pacific Technology Center in Geino, Japan, in November of 2005. We are now conducting product demos in the Center's labs and clean room, allowing customers to witness firsthand our product and scientific capabilities, while working side by side with our scientists and engineers.

In April, we began selling directly to customers in Taiwan rather than through a distributor. We also opened our Taiwan Technical Service Center, which provides our customers better and more rapid technical support and service.

Singapore and the surrounding region is the home to many participants in the data storage business. In fiscal 2006 we moved our data storage manufacturing, R&D, and business leadership there, bringing our expertise closer to our customers. Our customers benefit because our location is much more convenient for them, and thus we are able to be more responsive. We also expect to benefit from lower shipping and logistics costs.

Along with all our other achievements in the Asia Pacific region, I am particularly proud of the people we have assembled there to manage and lead our business. Their dedication to our company and passion for our business are outstanding and I have very high expectations for their success as we grow with our Asia Pacific customers.

Our third strategic initiative is operations excellence and this year we continued to improve our productivity within our manufacturing, logistics and supply chain operations. We achieved a 3 percent improvement in yield, raw material utilization and labor efficiency, driven by higher volumes and variation reduction initiatives across the supply chain. This was below our internal goal, but it reflects some higher costs associated with our data storage move to Singapore, a slower-than-anticipated pad ramp and a dielectric slurry quality issue that we reported earlier in the year. On balance, we are not comfortable with the year's level of improvement but we know we can do much more. Our initiatives incorporate Six Sigma, which is a discipline we've employed for the past three years. Our results this year built on the 9 percent productivity improvement we achieved in fiscal 2005, and we've set aggressive targets for fiscal 2007.

An added benefit of our efforts to improve productivity and drive out variability is that our customers' ratings of our company have gone up. Our customers periodically conduct a formal and systematic evaluation of our processes, performance and quality, and they share these results with us. We also know that they consider those evaluations when making purchasing decisions. We've seen many of these scores steadily increase, and a number of customers have recognized us for substantial improvement in service and quality performance. The goal of reducing variability and increasing productivity is now part of the fabric of Cabot Microelectronics and is factored into everything we do.

I'm particularly excited with the progress we made with our pad business in 2006. We have established manufacturing capacity in the United States and will be adding capability in Taiwan. Our U.S. pad plant is located in a retrofitted building we previously used for slurry manufacturing. By converting this existing building that we already owned, we created production capability at an extremely low cost. We believe the opportunity to use our existing assets and the continuous process pad manufacturing technology that we utilize should give us a significant cost advantage over existing technologies.

We think our pad can offer a longer life, lower defectivity and less erosion, and customer evaluations have supported this. We have made commercial sales to 2 customers for use at 3 different fabs, and we are working with a number of other customers who are evaluating and qualifying our pad.

Last but not least, we are pleased with our progress under our Engineered Surface Finishes initiative. Our two acquisitions in fiscal 2006 brought this initiative to life. Our first acquisition, Surface Finishes, specializes in precision machining techniques at the sub-nanometer level. This acquisition is providing valuable access to a host of demanding, high-performance polishing applications, where we believe our knowledge of materials and perfecting surfaces can create value.

Our second acquisition was QED Technologies. We are confident about its future potential as a revenue generator and as a gateway to the high precision optics industry. Precision polishing in the optics industry is transitioning from an artisan-based, manual process to more automated, predictable and reliable manufacturing techniques. We believe QED is leading this transition with its MRF and SSI technologies.

QED generated $5 million in revenue in the September quarter. We are delighted with that result. However, remember that QED sells equipment and services, so their revenue may fluctuate quite a bit, quarter to quarter.

Finally, and perhaps most important to this audience, our achievements this year allowed us to set quarterly and annual records in slurry volumes sold and revenues. Bill Johnson will discuss our results in more detail in a minute.

I'm proud of what the Cabot Microelectronics team has achieved this past year, and I'm excited about what lies ahead. My confidence stems in part from the way our key customers are reaching out to us to partner in developing semiconductor technology several nodes into the future.

Going forward, as I've discussed on previous conference calls, this technology is demanding more sophisticated designs and materials than ever before. As outlined at the International Conference on Planarization and CMP Technology, held earlier this month in California, device designs at smaller feature sizes are introducing more new materials and processes into next generation chips. To put this in perspective, consider that the move from 130 to 90 nanometer technology introduced three or four new materials. In the transition from 90 to 65 nanometers, up to a dozen new materials are being introduced. And in the future transition from 65 to 45 nanometers, some believe up to 30 new materials may need to be introduced. This proliferation of materials means the end of "one size fits all" CMP slurry. We have been discussing and incorporating this important emerging customization into our growth and product development plans for over two years now.

As the material combinations and designs become more complex, IC manufacturers are paying even closer attention to the CMP process – a process some describe as "more art than science". They want greater understanding and expertise in CMP, at a time when some in the industry are cutting back on resources. Chipmakers are now turning to suppliers to fill this need, suppliers who understand these materials, design and process complexities.

All of this bodes well for Cabot Microelectronics. We are widely recognized as having the most sophisticated research facilities and the most talented research staff in the CMP industry. We believe that CMP is not "art". We deal in predictive science, aimed at rapidly and efficiently meeting customers technical and production needs.

To the best of our knowledge, *none* of our competitors operates on as comprehensive a level as we do; at all nodes; in all CMP slurry application areas; and on a global basis. Nor do any of them have the depth and breadth of our resources dedicated solely to CMP technology. The CMP process is getting harder and more demanding and we like that. It requires what we do best.

Over the last couple of years we have made a determined effort to be far more open and willing to share knowledge and expertise with our customers; to listen carefully to their needs and requirements; and to tailor our responses to meet those needs. I believe this approach and our customers' recognition of our unique skills and capabilities are paying dividends in improved relationships and joint development opportunities. Partnering with customers creates trust and strengthens the desire to continue working together. As technology advances, we're finding chipmakers are selecting suppliers much earlier in their development processes and we plan to be the supplier they choose.

We go into the 2007 fiscal year with the confidence and determination that results from success. We believe we had a great year in fiscal 2006 and that fiscal 2007 will build on that success.

And with that, I'll ask Bill Johnson to review our business results in more detail and then we will turn the call over to questions. Bill?

Thanks, Bill, and good morning everyone.

Our revenue for the fourth quarter of fiscal 2006 was $87.0 million, which set another quarterly record for our company. Revenue was up by 2.4 percent versus the prior quarter and up by 17.8 percent versus the same quarter a year ago. Revenue for the full fiscal year was $320.8 million, 18.6 percent higher than in fiscal 2005.

Drilling down into the quarterly revenue number, Sales of copper slurries, which represented 19.3 percent of our total revenue this quarter, fell 5 percent sequentially. However, they were 11.9 percent higher than the same quarter last year. Tungsten slurry sales achieved another quarterly record and contributed 38.0 percent of total revenue this quarter. Tungsten slurry revenue increased 3.4 percent sequentially and 22.8 percent year over year.

Dielectric slurries provided 30.7 percent of total revenue this quarter, with sales down 9.1 percent sequentially and up 2.6 percent compared with the year ago quarter.

Data Storage products represented 5.6 percent of our quarterly revenue; this revenue was down 4.9 percent sequentially and down 7.8 percent year over year.

Finally, our new QED business, which we acquired early in the September quarter, generated 5.9 percent of our total sales. This was one of QED's strongest sales quarters in its history. You should note that this is our first quarter with QED revenue so the percentage revenue split by application area this quarter may not be comparable to prior quarters.

On a geographic basis, sales in Europe, Japan and the U.S. grew sequentially, mainly driven by QED revenue. Sales in other geographies declined sequentially.

Our average selling price for slurry products increased by 1.6 percent compared with the June quarter. This increase was driven by a higher-priced product mix, partially offset by selected price reductions.

Gross profit this quarter represented 44.4 percent of revenue which is consistent with the updated outlook we issued on October 12th, this was down by 3.2 percentage points from 47.6 percent last quarter, and down from 46.9 percent in the year ago quarter. Three unique accounting items caused most of this decrease, as we addressed in our October 12th press release on October 12. First, we wrote-off assets in conjunction with establishing polishing pad manufacturing capability through the building conversion that Bill mentioned and this is a non-recurring item. The second factor was amortization expense associated with intangible assets we acquired through our QED Technologies transaction and the portfolio of CMP technology patents we bought from IBM. This will be an ongoing cost over the next couple of years. The third item was the write-up to market value of acquired QED inventories according to purchase accounting rules. This increased the cost of goods sold on those acquired inventories that we sold during the quarter. This impact will continue as we sell the remainder of that acquired inventory. The combined effect of the three factors reduced gross profit this quarter by approximately 3 percentage points.

Other factors impacting gross profit this quarter were higher costs in certain areas, including lower yields in our manufacturing operations, partially offset by a higher-valued product mix.

Now I'll turn to operating expense, which includes research, development and technical, selling and marketing, and general and administrative costs. Operating expenses of $28.2 million increased by $1.6 million sequentially, and were $4.2 million higher than in the same quarter last year. This is also consistent with our October 12th update. The sequential increase was mainly due to the addition of operating expenses of the QED business; a one-time write-off required under purchase accounting related to in-process research and development activities at QED; and a one-time write-off of research and development assets in conjunction with the building retrofit. These increases were partially offset by lower costs of materials used in our research and development activities and lower professional fees, including costs to enforce the company's intellectual property portfolio.

The year-over-year increase in operating expenses was primarily due to share-based compensation expense. As you know, we began expensing stock options in the current fiscal year as required by accounting rules. Pre-tax share-based compensation expense was $2.8 million this quarter, of which $2.6 million was classified in operating expenses. Higher staffing costs, including costs to support our initiatives in the Asia Pacific region also contributed to the year-over-year increase.

Net income for the quarter was $8.2 million, down 16.6 percent from $9.8 million last quarter. However, the combined effect of the asset write-off and purchase accounting reduced net income for the quarter by approximately $3 million. Net income this quarter was only 1.1 percent lower than the $8.3 million we reported in the same quarter last year, despite these accounting items along with $1.9 million in after-tax share-based compensation expense this quarter. Net income for the full fiscal year was $32.9 million, which exceeds fiscal 2005 net income of $32.5 million, even with share-based compensation expense and the accounting items I just described.

The weighted average number of shares outstanding on a diluted basis this quarter was 24.1 million shares. This was down from the prior quarter, due to $8 million of share repurchases in our fourth fiscal quarter.

Diluted earnings per share were 34 cents this quarter, which includes an adverse impact of approximately 12 cents from the asset write-off and purchase accounting and approximately 8 cents of share-based compensation expense. Earnings per share were 6 cents lower than in the previous quarter and equal to EPS reported for the year ago quarter.

Earnings per share for the full fiscal year were $1.36, compared with $1.32 for the previous fiscal year, despite the effects of the asset write-off, purchase accounting, and approximately 28 cents of share-based compensation expense this year. So, on a comparable basis, we achieved significant EPS growth year over year.

Turning now to cash and balance sheet related items, capital additions for the quarter were $2.7 million. This included investments to establish pad manufacturing capacity.

Depreciation and amortization expense was $6.2 million for the quarter. This includes approximately $0.6 million of incremental expense due to the QED and patent portfolio acquisitions.

We ended the quarter with $165.9 million in cash and short term investments, which was $3.6 million lower than last quarter. Our cash balance reflects the $19 million we paid for the QED acquisition and $8 million of share repurchases.

I'll conclude my remarks with a few comments on our outlook for the future.

We have frequently characterized our business as unit-based. Overall demand for our products is driven by wafer starts at sub- quarter micron technologies. But variables such as production of logic versus memory devices, 200 versus 300 millimeter wafers, customer integration schemes, share gains and losses, and pricing changes all affect how that demand translates into revenue.

Taking all these factors into account, our long-term goal is to grow our revenue by 15 percent per year. This includes our core CMP slurry and pad business, and areas adjacent to our core, such as our two recent acquisitions. I would point out that timing of both industry cycles and acquisitions by us will affect actual growth.

As you may know, we have limited visibility on near-term revenue and it can vary significantly quarter to quarter. So, as in the past, we will not provide quarterly revenue guidance.

Our full-year guidance for gross profit is 46 to 48 percent of revenue. This guidance reflects modest CMP slurry price erosion, continued productivity improvements from Six Sigma, benefits of commercialization of new CMP products, and contributions from the QED business.

Previously our gross profit guidance was on a quarterly basis. However, since fluctuations in our product mix can move our gross profit for a given quarter by a couple of percentage points, our guidance range was relatively wide – 4 percentage points. Our new range is narrower, but it applies to the full fiscal year only. Quarter to quarter we may see gross profit above or below this range.

In fiscal 2007 we expect operating expenses of $27 to $30 million per quarter, trending modestly upward within this range through the year. This reflects a run rate in our core CMP business similar to fiscal 2006, plus incremental costs of the QED business.

Our full year tax rate should be between 32 and 33 percent.

Capital spending should be around $17 million, which represents our steady state run rate. Beyond this, we are exploring options for providing CMP slurry manufacturing capability in Taiwan to better serve our important customers there.

Depending upon how we fulfill this initiative, our capital spending for the year could potentially double.

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

Finally – commenting on recent sales and order activity within our CMP business – during our fiscal fourth quarter, sales were strong in July and August, then dropped about 10 percent in September. Against those benchmarks, sales orders we have received to date in October that we expect to ship by month end imply October will be somewhat stronger than September, but not as strong as July and August.

Signals we are seeing in the public statements of several important semiconductor players suggest the December quarter as a whole may be lighter for parts of the industry than the September quarter was, and we may be seeing some of this in our October orders; however, as we always caution, four weeks of orders out of a quarter represent only a limited window on full quarter results.