Cabot Microelectronics Corporation

2007 Second Fiscal Quarter Earnings Report

April 26, 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 second quarter of fiscal 2007, which ended March 31. 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 first quarter of fiscal 2007 ended December 31, 2006, 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 financial results for our second quarter of fiscal 2007 that we believe reflect a continuation of the soft industry environment that we began experiencing last September, consistent with what many other semiconductor industry participants are reporting this quarter.

I will begin this morning by sharing our thoughts on the current market environment, and then talk about my continued confidence in the strategic direction of our company. We believe today's results reflect tough industry conditions, and overshadow some of the important initiatives on which we executed during the quarter, that we believe will drive shareholder value in the long-term. Bill Johnson will follow with a more detailed summary of our financial performance.

You will recall that during our first fiscal quarter, we experienced a revenue reduction that we attributed primarily to a decrease in the production of semiconductor devices by a number of our customers, particularly among the foundries, in an effort to correct excess inventory of semiconductor devices. Since demand for our products is primarily driven by wafer starts, and since foundries represent a very important part of our business, this general industry downturn adversely impacted sales of our slurry products.

During our second fiscal quarter, this trend continued, as the inventory correction has persisted. Certain industry experts have commented that semiconductor inventory levels have significantly decreased from their peak in the September quarter. However, it is uncertain how much excess inventory remains or how strong end-use demand will be going into the second half of the year. Bill will comment later on our order patterns during the quarter and what we are seeing during the first four weeks of April.

Consistent with what we stated last quarter, we do not believe that the slowdown in our revenues is representative of any material change in our business or market position. Recent data released from World Semiconductor Trade Statistics, or WSTS, indicated this year's January to February decline in the IC market was the largest January to February decline in 30 years. In addition, IC Insights and Gartner have both recently reduced their semiconductor industry revenue forecasts for 2007 based on year to date results.

Despite these industry conditions, we remain confident that our strategy supporting our three key initiatives – Technology Leadership, Operations Excellence, and Connecting with Customers, remains critical to maintaining our leadership position. Even in this soft market environment, in our view we are among the most aggressive in the industry at investing in people, products, and technology to stay ahead of the curve, and partnering with our customers to enable future expanding relationships. We believe our solid cash flow and strong balance sheet have consistently allowed us to successfully weather semiconductor industry downturns, and to continue to drive our strategies, which we believe makes us an attractive long term investment in the technology sector.

Our ability to invest through industry cycles should provide shareholders with the confidence that our continued execution in Technology Leadership will enable our product pipeline to remain productive and robust in the coming years. As you all know, long development and commercialization cycles are common in this industry, so investing early and continuously is necessary to secure wins 2 to 5 years down the road. As part of our Technology Leadership initiative, we seek to enter into long-term strategic co-development arrangements with a number of leading edge technology customers. A supplier to the semiconductor industry has to demonstrate credibility, advanced technical knowledge, and flexibility to be invited into these arrangements, and we are invited time and time again. We believe that our strong business model makes us unique in our capability to manage multiple joint development projects at the same time, with leading edge semiconductor manufacturers over a broad range of applications.

A successful new CMP slurry developed through one of these joint development programs is only as good as our ability to produce it consistently and reliably, over the life of the product. Over the last three years we have made significant improvements in our entire supply chain by driving out variability in our products, processes and raw materials as we have implemented our Operations Excellence initiative. Our continued successful execution of this very important initiative has resulted in material savings achieved through productivity gains, and many accolades from our customers. This initiative will continue to be a major focus as we move forward and expand our business around the world.

As part of our Connecting with Customers initiative, we have completed several infrastructure and customer support projects in the Asia Pacific region. We believe that these initiatives have meaningfully increased our responsiveness and service to our customers in this very important area. For example, we have new technology centers in Japan, Taiwan and Singapore, which provide our customers better and more rapid technical support and service. Our response time has improved because we are now working in the same time zones and speaking the same languages as many of our customers.

Our belief that we are successfully executing on these strategic initiatives is reinforced by the performance ratings that we are receiving from our customers. Supplier scorecards are a formal means by which customers give us systematic feedback on our performance in various areas, such as technology, quality, supply assurance, cost targets, availability and responsiveness goals. Over the past three years, our average scorecard rating has increased in aggregate by over 20%, which we believe is evidence that we are executing and improving on our Technology Leadership, Operations Excellence, and Connecting with Customers' strategic initiatives; all areas that are typically evaluated on these scorecards. Remember, our relationships with our customers are long-lasting. As we continue to build their trust and confidence in our company, we would hope to have more opportunities to expand our relationship with them going forward.

One specific recent example was our winning Intel's Preferred Quality Supplier, or PQS, award for 2006 based on improvements that we have made across all areas of its supplier scorecard. Out of approximately 1500 suppliers, 44 companies were granted this award, and we were the only CMP consumables supplier chosen to receive the PQS award for 2006. In all of our years of working with Intel, this is the first year that we received this prestigious award. We are very proud of this accomplishment and I am delighted with all the hard work and dedication that the team at Cabot Microelectronics put forward in our effort to continue to build upon our relationship with this very important customer.

I'll close my comments with an update on our CMP polishing pads business, which is an important future growth initiative for us within our core CMP consumables business. Last quarter we discussed our ongoing sales of our Epic D100 pad to 2 customers, and in February we announced that one of those customers is Freescale. As our pad is qualified and incorporated by early adopters of our technology and our value proposition is being realized, we believe that this enhanced value will be the driving force for more rapid adoption by others. We continue to believe this is an important revenue stream in the years to come for Cabot Microelectronics.

During the second quarter we experienced increased customer pull for our polishing pads, and we are currently selling pads to 4 customers and have over 20 customers testing, evaluating and qualifying our pad. Test results continue to reveal significantly longer pad life and lower cost of ownership.

Additionally, our new pad manufacturing facility in the United States went into full commercial service this quarter. With this plant now up and running, customers evaluating our pads are able to directly sample from this automated high-volume manufacturing line, rather than from a pilot line. We believe that this is an important step in speeding up the pad qualification and commercialization process at our customers' sites.

We also opened a fully capable satellite pad finishing facility in Hsin Chu Taiwan this quarter. In the finishing process, grooves are cut into the pad surface, and the final pad is cleaned and packaged for shipment. This grooving process can be highly customized based on a customer's specific application, integration scheme and tool set. By opening this facility close to a number of key pad consumers in the region, we believe we can be more responsive to these regional customers' needs, by offering customization capability with very fast turn around.

As we have discussed in previous calls, the pad qualification process has taken longer than we would have liked or expected. It is a difficult qualification that requires several long marathons of testing, utilizing large quantities of wafers and CMP tool time. The current industry slowdown has helped the process, by providing additional tool and engineering time to do the qualification work at many of our customers' fabs. We are hopeful that things will begin to move more quickly and we will start to generate material revenues to cover the fixed costs associated with our investment in pad manufacturing, testing and support that we are currently bearing as part of our gross profit margin.

Despite the challenging industry conditions, we remain committed to staying the course and executing on our proven strategic initiatives. We believe that our business is well positioned to both weather market downturns and accelerate forward during better times.

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

Thanks, Bill, and good morning everyone.

Our revenue for the second quarter of fiscal 2007 was $77 million, which was down by 5.9 percent from the prior quarter. As Bill mentioned, our revenue this quarter was affected by continued softness in the industry that we first saw last September. We believe that the sequential revenue reduction we experienced this quarter was primarily due to a continuation of these industry conditions and does not represent any material change in our market position or business.

Revenue in our second quarter was up by 14.2 percent from the same quarter a year ago. You may recall that in the year ago quarter we transitioned to selling directly to customers in Taiwan rather than through a distributor. This adversely affected revenue in our second fiscal quarter last year, making year over year comparisons more difficult. Also, last year's second quarter results did not include revenue from the QED business that we acquired last July.

Drilling down into the quarterly revenue number,
Sales of Copper slurries represented 18.3 percent of our total revenue, and decreased 4.3 percent sequentially.

Tungsten slurries contributed 39.1 percent of total quarterly revenue, with revenue down 3.7 percent sequentially.

Dielectric slurries provided 30.8 percent of revenue this quarter, with sales down 10.2 percent sequentially.

Data Storage products represented 6.5 percent of our quarterly revenue; this revenue was up 10.6 percent sequentially.

Finally, revenue from our ESF business, which includes the QED business, generated 5.2 percent of our total sales, and our ESF revenue was down 16.4 percent sequentially.

On a geographic basis, sales in Korea grew sequentially, while sales in all other geographies declined.

Our average selling price for slurry products increased by 0.6 percent compared with the December quarter, due primarily to a higher-priced product mix. The average selling price was 4.9 percent higher than in the same quarter a year ago mainly as the result of a higher-priced product mix and higher selling prices.

As a percentage of revenue, gross profit was 43.9 percent this quarter, which was 4.2 percentage points lower than the 48.1 percent of revenue we reported in the prior quarter, and 2.9 percentage points lower than 46.8 percent in the year ago quarter. Gross profit this quarter was adversely affected by lower utilization of manufacturing capacity based on the lower level of sales, as well as lower yields in our production operations and higher fixed manufacturing costs. These effects were partially offset by the benefits of a higher-valued product mix.

Gross profit for the first half of the fiscal year was 46 percent of revenue, which is consistent with our full year guidance range of 46 to 48 percent of revenue. We continue to expect gross profit margin for the full year to be between 46 and 48 percent; however, given performance in the first half of the year it is likely that it will fall at the low-end of this range. Remember that this is full year guidance, and given the variability of our gross profit, it may fall above or below the guidance range in specific quarters, as it has demonstrated in the last two quarters.

Now I'll turn to operating expenses, which include research, development and technical, selling and marketing, and general and administrative costs. Operating expenses were $28.9 million, which is within our guidance range of $27 to $30 million per quarter. This quarter's expenses were $1.7 million higher than the $27.1 million we reported last quarter. Factors affecting operating expenses were higher professional fees, including costs to enforce our intellectual property portfolio, higher costs for laboratory materials for our research and development activities, and higher compensation-related costs typical of our second fiscal quarter.

This quarter's operating expenses were $4.2 million higher than the $24.6 million in the same quarter last year. The year-over-year increase in operating expenses was primarily due to costs of the acquired QED business, higher professional fees and higher costs for laboratory materials.

We expect operating expenses to continue to fall within the range of $27 million to $30 million per quarter this fiscal year.

Net income for the quarter was $4.5 million, down from $9.1 million last quarter, and down from $5.4 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. This was down from the prior quarter, due to $4 million of share repurchases in our second fiscal quarter.

Diluted earnings per share were 19 cents this quarter, down from 38 cents last quarter and down from 22 cents in the year ago quarter.

Turning now to cash and balance sheet related items, capital additions for the quarter were $1.8 million. Depreciation and amortization expense was $6.1 million and share-based compensation expense was $3.3 million for the quarter.

We ended the quarter with $163.6 million in cash and short term investments, which was $3.2 million higher than last quarter. Cash flow reflects a $5.5 million increase in working capital, mainly due to the timing of income tax payments. Our cash balance also reflects the $4 million of share repurchases I mentioned earlier. We are pleased with our continued strong cash flow, as this allows for the continued investment in our three strategic initiatives in the CMP consumables business, as well as the pursuit of growth opportunities in our ESF business.

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

Earlier in the year, we described our long term goal to grow revenue by 15 percent per year, including revenue from our core CMP slurry and pad products, demand for which is driven by wafer starts, and from our ESF business, which has been driven primarily by acquisition activity. We had qualified this 15 percent revenue growth goal as being subject to timing of semiconductor industry cycles that affect our core CMP business, and timing of acquisitions in our ESF business. Given the downturn we have seen in demand for our CMP products in the first half of fiscal 2007, we no longer expect to achieve this goal this year.

We are eagerly awaiting an upturn in demand for our products, which would be an indication of an end to the soft industry environment that has impacted our financial results in the last two quarters. Looking at our revenues in each of the three months of the second fiscal quarter, we saw a modest increase in CMP revenue in the month of March relative to January and February. This appears consistent with the upturn in monthly revenue that was publicly reported for March by a couple of large Taiwan foundries, after 6 successive months of reporting decreasing revenues. Since the Asian foundries represent a significant part of our business, we are hopeful that the upturn reported by the foundries in Taiwan may be an indication of an end to the industry inventory correction.

As we observe orders received to date in April that we expect to ship by the end of the month, we see April results trending slightly higher than March. However, I would caution as I always do that several weeks of orders out of a quarter represent only a limited window on full quarter results.

Now I'll turn the call back to Amy as we prepare to take your questions.
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.