

Cabot Microelectronics Corporation

2006 First Fiscal Quarter Earnings Report

January 26, 2006

Good morning, everyone and thank you so much for joining us this morning. As Candice said, I am 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 first quarter of fiscal 2006, which ended December 31, 2005. 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 available for three weeks on our website. The script of this morning's formal comments will also be available there.

Please remember that our discussion 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-K for the fiscal year ended September 30, 2005. We assume no obligation to update any of this forward-looking information.

And with that, I will now turn the call over to Bill Noglows.

Thanks, Barbara. Good morning everyone.

We are pleased with our strong revenue growth and profitability this quarter. Especially given the adverse financial impact of expensing stock options, which we began this quarter under FAS 123R.

Our revenue this quarter grew sequentially by 10.3 percent. This was the second consecutive quarter in which the company's revenue grew by more than ten percent. In addition, we achieved record sales volume this quarter, selling more gallons of CMP slurries than in any other quarter in our history. It appears that our customers continue to run at high capacity utilization, and industry experts forecast continued

strength for the next couple of quarters. Visibility is more limited beyond that timeframe, but we are cautiously optimistic about the remainder of the fiscal year.

This morning I want to offer my thoughts on two industry trends and their impact on the CMP industry and our business

The first trend is one which we have discussed in past calls – the fragmentation of CMP technology that is occurring as a result of the introduction of new materials, diverging integration schemes, and highly specific customer process designs. This shift away from “one CMP slurry fits all” in a given application at a specific node became apparent with 90 nanometer technology and we expect this trend to accelerate as feature sizes continue to shrink.

This was a major topic at Semi’s annual Strategic Materials Conference a few weeks ago. One expert observed that in moving from 130 to 90 nanometer technology, three or four new materials were introduced in the semiconductor manufacturing process. As the industry transitions from 90 to 65 nanometers, up to a dozen new materials are being introduced. And in the future transition from 65 to 45 nanometers, up to 30 new materials may be introduced. At each transition, CMP technology has and we believe will continue to become more fragmented. In fact, complexity within the CMP process is increasing even faster than new materials are being introduced. Here’s why.

First, smaller line widths introduce new physical constraints and greater complexity. As dimensions get smaller and smaller, the microstructure of the conductors, insulators and barriers and the spacing and interfaces between them have a greater influence on the thermal and electrical properties of the chip. In addition, many of the new materials being used interact with each other, and these interactions must be understood and controlled. Finally, advanced CMP solutions can become so sensitive that subtle, yet meaningful differences in process integration schemes from one customer to another can require still more customization. All of these factors contribute to the explosive increase in complexity, requiring a wide range of ever more sophisticated and specialized CMP solutions.

In addition to the demands of increasing complexity, this industry also deals with relatively long product development times. We devote a year to a year and a half to fully develop a new CMP slurry product platform and the supply chain to produce it commercially, and then another 6 months to a year for a customer to qualify it. I might add that our development cycle may be longer than that of some of our competitors. We spend whatever time we feel necessary to analyze and test our products so they are robust and reliable and can be produced at high volume before they are sent to the customer. We have learned the importance of this validation over many years of experience in providing CMP solutions to our customers.

The intersection of these two realities – complexity and customization with long lead times – is making the CMP industry much more challenging. And the costs, technical skills and capabilities required to meet and exceed our customers' needs are large and growing.

The second industry trend I want to discuss is the customer's expectation of ever higher levels of predictability in CMP solutions, even as the technology becomes more complex. Once customers introduce a new technology into high volume manufacturing, their need for consistency and predictability surpasses all others. Suppliers must develop and deliver solutions that perform exactly the same, time and time again, over the lifecycle of the technology. In our specific case, this means we must continue to deliver millions of gallons of CMP slurries around the world that are increasingly complex, yet perform consistently, day to day, batch to batch.

We believe the ability to manage this paradox will ultimately determine who will be successful in our industry. To win new business, a supplier may race through product development and produce a sample that meets near-term needs in the development phase of a new technology. However, without rigorous testing for manufacturability and supply chain assurance, that product is very likely to fail as the process is being readied for production or later when production is at high volume. This causes expensive disruptions and extreme customer dissatisfaction.

We think managing this paradox falls right in our sweet spot and we believe we have a number of capabilities that uniquely position us for continued success in the CMP industry.

First, we have a robust product portfolio and product development pipeline for all major application areas. Second, we have a substantial technology infrastructure. Our team of scientists, engineers, chemists and technicians is broad and deep. And we have laboratories and cleanrooms with polishing and metrology equipment that can replicate our customers' activities as we develop next generation CMP solutions, which makes our development process more productive and efficient. We don't think there's another company that can match our intellectual capability and capacity to bring this level of intellect or facilities to the development process and the market. Finally, our manufacturing and supply chain infrastructure is robust, operating on three continents, with a proven track record of delivering high-performance products on time and on spec.

Although the CMP industry is relatively young, it has already gone through significant change and we think the trends I've discussed this morning will change it even more. We welcome these changes, because we think our capabilities and our continued execution of our strategies uniquely position us to meet our customers' requirements and expectations in the years to come.

Now I'll turn the floor over to Bill Johnson to review our financial results and our progress on some key initiatives and then we will open the call for your questions.

Thanks, Bill.

Our revenue for the first quarter of fiscal 2006 was \$81.5 million, up 10.3 percent from \$73.9 million last quarter, and up 21.5 percent from \$67.1 million in the same period last year.

All of our CMP slurry product applications, except data storage, recorded sequential revenue increases.

Revenue from our slurries for copper polishing applications, including barrier, increased by 8.4 percent sequentially, and was up by 12.7 percent compared with the year ago quarter. Copper slurries represented 20.0 percent of our total revenue for the quarter.

Combined revenue from our tungsten and dielectric CMP slurries was up 11.8 percent sequentially, and up 26.8 percent year over year.

Revenue from slurries for our data storage business decreased by 4.0 percent sequentially.

We saw sequential revenue growth in all geographic regions – Asia Pacific, the U.S. and Europe.

Our average selling price for the quarter decreased by 1.1 percent compared with last quarter, as effects of selected price reductions and the impact of the weaker Japanese yen versus the U.S. dollar more than offset the benefits of a higher priced product mix.

Gross profit this quarter represented 47.2 percent of revenue, up from 46.9 percent last quarter and down from 50.1 percent in the year ago quarter. Gross profit as a percentage of revenue increased this quarter largely due to benefits of higher utilization of manufacturing capacity on the higher level of sales this quarter and lower fixed manufacturing costs in certain areas. These were partially offset by higher variable “costs of goods sold”, including costs of resolving a product quality issue identified with a dielectric product.

Now I’ll turn to operating expenses, which include research and development, selling and marketing, and general and administrative costs. Operating expenses of \$25.1 million increased by \$1.1 million sequentially from \$24.0 million last quarter, and were \$5.7 million higher than \$19.4 million in the same quarter last year. The sequential increase was primarily because we began to record stock option expense this quarter, as required by accounting rules, rather than merely disclosing it in the footnotes to our financial statements as we have done in the past. Total stock option expense was \$2.4 million, of which \$2.2 million was classified in operating expenses. This is consistent with our forecast pre-tax stock option expense for fiscal 2006 of approximately \$10 million. These non-cash costs were partially offset by lower expenses in several areas, including cleanroom materials and laboratory supplies for our research and development activities.

Operating income represented 16.4 percent of revenue this quarter, up from 14.3 percent last quarter, and down from 21.2 percent in the year ago quarter.

Net income for the quarter was \$9.6 million, up 16.0 percent from \$8.3 million last quarter, despite the inclusion of this quarter of stock option expense. Net income in the same quarter last year was \$9.8 million.

The weighted average number of shares outstanding on a diluted basis was 24.4 million shares this quarter. This was slightly lower than in the prior quarter due to \$4.0 million of stock purchases under our new \$40 million share repurchase program that we announced last October.

Diluted earnings per share were 39 cents this quarter, up from 34 cents in the previous quarter, even with the adverse impact of approximately 7 cents of stock option expense. EPS in the first quarter of fiscal 2005 was 40 cents.

Turning now to cash and balance sheet related items, capital additions for the quarter were \$3.4 million. Most of this related to investments for commercialization of new products and costs of moving our data storage business to Singapore. Depreciation and amortization expense was \$4.8 million for the quarter.

We ended the quarter with \$178.7 million in cash and short term investments, \$7.7 million higher than last quarter. Cash flow this quarter reflects a \$1.0 million decrease in working capital, as an increase in receivables driven by the higher level of sales this quarter was more than offset by reduced raw material inventories. Our cash flow also reflects the \$4.0 million of share repurchases that I mentioned earlier.

Before I close, I'd like to update you on two key initiatives. The first is our business in the Asia Pacific region. Because it's such an important part of our business, we continue to build our strong presence in that region. Our new Asia Pacific Technology Center is operational and we have begun performing customer demos and product development activities in support of our regional customers there. Second, the move of our data storage business to Singapore is nearly complete. We're fully staffed and manufacturing capability is in place. Third, we are in the midst of establishing advanced copper slurry development capability

in Taiwan. Finally, and of greatest immediate impact to our business, during our March quarter, we will transition from a distributor to a direct sales model in Taiwan. Given the scale and importance of our business in Taiwan, we announced these plans last August, well ahead of the April 1 effective date, in order to allow sufficient time to plan for this important change. Since then, we have been implementing our transition plan and we expect a smooth transition.

As we've discussed before, this transition will adversely impact financial results in our March quarter. During the transition period, our distributor will sell its remaining inventory of our products to our customers and we will begin building inventory needed to serve these customers directly. We anticipate the resulting short-term interruption in our sales will reduce our March quarter revenue by approximately \$11 million and will reduce EPS by approximately 17 cents. We expect these transition effects to be concentrated in our March quarter, and therefore they should not materially impact results for the June quarter.

I'd also like to update you on our Engineered Surface Finishes initiative, or ESF. We believe this initiative can provide an attractive growth vehicle to complement our core CMP business, while being less subject to semiconductor industry cycles. Through ESF, we intend to leverage our expertise in CMP solutions for the semiconductor industry into other high-performance polishing applications. These could include optics, optoelectronics, compound semiconductors, health care, displays and precision metal finishing.

Toward this end, in early October we purchased the assets of Surface Finishes Company, a leader in precision machining and polishing techniques at the sub-nanometer level. We've been integrating the commercial polishing capabilities of Surface Finishes with our internal development efforts and we're excited about the visibility we're gaining into high performance polishing markets that we did not previously serve.

I'll conclude my remarks with a comment on our outlook for next quarter's revenue.

As you know, we don't provide guidance on revenue, but as we look at business activity through the month to date in January, orders that we

expect to ship by the end of the month are running somewhat below the average run rate for the previous quarter. During our first fiscal quarter we saw successive revenue increases month by month from October through December, with very strong sales in December. Business activity in January continues strong, but somewhat below the level we saw last quarter. However, I would caution that the first four weeks of orders out of a quarter represent a limited window on quarterly results.

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!