Cabot Microelectronics Corporation

2005 Fourth Fiscal Quarter and Full Year Earnings Report

October 27, 2005

Good morning everyone, 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 2005, which ended September 30. We also announced a new share repurchase program. 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 access will be available for three weeks via either telephone playback or webcast. The script of this morning's formal comments will also be available on our website.

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-Q for the third quarter of fiscal 2005 ended June 30, 2005, and Form 10-K for the fiscal year ended September 30, 2004. We assume no obligation to update any of this forward-looking information.

I will now turn the call over to Bill Noglows.

Thank you, Barbara. Good morning everyone.

Let me start by welcoming Barbara Ven Horst as our new Director of Investor Relations. We are glad to have Barbara join us; most recently she was Director of Investor Relations at McDonalds Corporation. I know she is eager to work with all of you.

This morning we announced financial results that reflect an upturn in our business following three relatively soft quarters. Recall that during our last conference call we cited what we believed was a "bottoming" of the semiconductor industry downcycle, but at that time we did not see clear evidence of an upturn. However, stronger sales in August and September resulted in a 13.6 percent sequential revenue increase in our fourth fiscal quarter. During our fourth fiscal quarter each of our CMP slurry product lines registered sequential revenue increases.

Recently we have made four announcements related to our strategic initiatives that I will discuss in greater detail this morning. These include our plan to sell directly to customers in Taiwan rather than through a distributor; our "Best in Value" supplier award from Samsung; our acquisition of the assets of Surface Finishes company, which supports our Engineered Surface Finishes, or ESF, initiative; and finally, this morning's announcement of the 40 million dollar share repurchase program authorized by our Board of Directors. I will also reflect on our accomplishments during the full fiscal year and share my perspective on how I believe we are positioned for the future.

Over the last two years we have been executing on three principal strategic initiatives, one of which is Getting Closer to our Customers. We want to work more collaboratively and directly with them to jointly develop CMP solutions for their existing and next generation polishing applications. To that end, in August we announced plans to transition to selling directly to our customers in Taiwan, one of our most important markets, rather than through our distributor, Marketech. Currently our largest customer, Marketech represented almost 35 percent of our revenue in fiscal 2005. We have had a long and successful relationship with this distributor; however, where we have sufficient business scale to support direct sales and where we see strategic benefit, as we do here, we believe it is best to work directly with our customers. Marketech will continue to serve as our distributor in China, where we have a strong position in a small but rapidly growing market.

Given the scale of our business with Marketech in Taiwan, we announced our plans well ahead of the April 1, 2006 effective date to ensure sufficient time to plan for this important transition. We are committed to making this transition as seamless and invisible to our customers as our transition two years ago from a distributor arrangement to direct sales in Southeast Asia and Europe. Later, Bill Johnson will comment on the financial implications of this move.

Last week we made another important announcement that we believe is further evidence of our progress in Getting Closer to our Customers. On October 13 Samsung Electronics honored us with its "Best in Value" supplier award at its annual supplier appreciation day. This award is the highest honor Samsung grants to its suppliers, and we were one of only five companies, and the only CMP provider, to receive it at this event. Samsung is a world leader in semiconductor manufacturing, and we are delighted with the close and collaborative relationship we have with them. During our fourth fiscal quarter we also won a supplier award for outstanding technical service from another important Asian customer, and you may recall that last quarter I mentioned three supplier awards we received during our third fiscal quarter. We believe that these awards are objective evidence that we are strengthening our partnerships and our credibility with our customers, and we expect this recognition will translate into more design wins over time.

Over the past year, I have discussed our Engineered Surface Finishes initiative. Through this initiative we intend to leverage our expertise in CMP formulation, materials and polishing techniques into other high performance polishing applications. We accomplished an important step in this initiative with our recent acquisition of the assets of Surface Finishes, a small, privately-owned company that is a leader in precision machining and polishing techniques at the sub-nanometer level. We expect this acquisition will provide us with commercial polishing capabilities that will take our internal technology development efforts out of the laboratory to customers beyond the semiconductor industry. It should also provide access to a variety of high performance polishing markets that we do not currently serve.

Because Surface Finishes is a small business, we expect its immediate value will be providing us capabilities and market visibility, rather than having a material impact on our financial performance. We look forward to pursuing other opportunities that complement our expanding ESF efforts.

The fourth item I want to discuss is the new 40 million dollar share repurchase program. This program provides continuity with the 25 million dollar share repurchase program we began in August of 2004 and completed during our fourth fiscal quarter. We believe that purchasing our stock is an attractive and flexible means of returning cash to our shareholders. Given our strong financial model and cash generation capability, we believe we can execute this share repurchase program, meet the capital needs of our core CMP business <u>and</u> fund growth opportunities under our ESF initiative.

Our comments this morning are focused primarily on fourth quarter results, but this is also an opportunity to reflect on what we have accomplished throughout the full fiscal year. Each quarter I have discussed our progress on our three principal strategic initiatives – Technology Leadership, Operations Excellence and Getting Closer to our Customers. Fiscal 2005 was a disappointing year for our company financially, but I am pleased with the steady progress we've made so far in each of these three areas.

Under Technology Leadership we have revitalized and refilled our product development pipeline. Because this pipeline represents the lifeblood of our company, it is imperative that it be full and robust. As I have previously discussed, we have new and exciting products both in development and commercialization in each of our major application areas – copper and barrier, tungsten, dielectric, data storage and polishing pads -- to serve a range of technology nodes from 250 to 22 nanometers.

By executing our Operations Excellence initiative we made significant productivity gains in fiscal 2005. Through the Six Sigma projects we have discussed with you in the past, we captured productivity improvements of approximately 9 percent in manufacturing and logistics. These improvements allowed us to maintain gross margins within our guidance range in spite of selectively reducing some selling prices to address competitive situations. During the early years of our company's short history, we focused heavily on Research and Development and defined success primarily in terms of the new and higher performing products that we had invented. However we have improved the functional balance within our company where we are now achieving Operations Excellence while also continuing our emphasis on Technology Leadership.

We also made tremendous progress this year executing our third principal strategic initiative, Getting Closer to our Customers, especially in the Asia Pacific region. Asia is obviously a crucial geographic region for our company and for the semiconductor industry. I have discussed in previous conference calls the four long-term supply arrangements executed this year with key customers in that region covering products in all of our application areas and a range of technology nodes. Multi-year commitments are unusual in our industry and we believe they highlight the confidence our customers have in us. In addition, this year we built our Asia Pacific Technology Center. We are excited about the research and development capabilities this facility can bring to our customers within the region. Finally, last quarter we described the move of our Data Storage business to Singapore, since Southeast Asia is an important manufacturing region for a number of our customers in this industry.

As a result of our substantial progress on each of these three principal strategic initiatives, Cabot Microelectronics is a very different company from what it was two years ago, although there is still much to accomplish to achieve our ultimate goals. As our industry continues to mature and technology becomes more complex, our customers require more reliable CMP solutions. This requirement demands robust technical capability, a bullet proof supply chain, and a focus on service excellence, all of which we have worked very hard to build over the last two years. These capabilities, combined with our progress in getting closer to our customers, give us confidence that we are well positioned for continued success.

As we look to fiscal 2006, we are encouraged by indicators of improving business trends. Industry experts forecast solid end-use demand in a number of key semiconductor market areas, such as personal computers and consumer electronic devices, and our customers appear to be cautiously optimistic about the near term. The biggest uncertainty in the semiconductor industry seems to be what impact higher energy costs may have on disposable income and, in turn, on consumer demand for electronic devices. We will watch to see how this unfolds quarter by quarter in 2006.

Now I'll ask Bill Johnson to share a more detailed review of our financial and business performance, after which we will open the call for your questions.

Thanks, Bill.

You may recall that our financial results during the second half of fiscal 2004 were very strong, and the subsequent downturn in the semiconductor industry adversely impacted our results through the first three quarters of fiscal 2005. So the year-over-year financial comparisons that I will mention this morning reflect two very different industry environments.

Our revenue for the fourth quarter of fiscal 2005 was $73.9 million, which was up 13.6 percent sequentially from the $65.0 million we reported last quarter, and down 10.7 percent from $82.7 million in the same period last year.

On a geographic basis, we saw strong sequential revenue growth this quarter in the Asia Pacific region, with our sales in Korea up nearly 40 percent, Southeast Asia up 33 percent, Taiwan up 26 percent and China up by 24 percent versus the prior quarter.

Our average selling price for the quarter increased by 0.6 percent compared to last quarter, as effects of a higher priced product mix more than offset modest adverse effects of selected price reductions and the impact of the weaker Japanese yen versus the U.S. dollar.

Gross profit expressed as a percentage of revenue was 46.9 percent, down from the 48.0 percent of revenue that we reported last quarter and down from 48.6 percent in the year ago quarter. Gross profit as a percentage of revenue decreased this quarter largely due to the adverse effects of a lower margin product mix and higher manufacturing costs in certain areas. These effects were partially offset by the benefits of higher utilization of manufacturing capacity on the higher level of sales this quarter.

Now let me turn to operating expenses, which include research and development, selling and marketing, and general and administrative costs. Operating expenses totaled $24.0 million this quarter, up by $3.4 million or 16.7 percent from the $20.6 million we reported last quarter, and $3.3 million, or 16.0 percent, higher than in the comparable quarter last year. Approximately two thirds of the sequential operating expense increase was attributable to staffing related costs, including costs to support our activities in Asia. Higher operating expenses this quarter also reflect start up costs for our new Asia Pacific Technology Center.

Operating income represented 14.3 percent of revenue this quarter, down from the 16.3 percent that we reported last quarter, and down from 23.6 percent in the year ago quarter.

Our effective income tax rate was 27.8 percent this quarter.

Net income for the quarter was $8.3 million, down 1.0 percent from last quarter, and down 37.3 percent from $13.2 million in the same quarter last year.

The weighted average number of shares outstanding on a diluted basis was 24.5 million shares this quarter. This was slightly lower than in the prior quarter due to purchases of approximately 118 thousand shares of stock for roughly $3.5 million under our previous share repurchase program, which we completed during our fourth fiscal quarter.

Diluted earnings per share for the quarter was 34 cents, equal to last quarter and down from 53 cents in the year-ago quarter.

Turning now to cash and balance sheet related items, capital spending for the quarter was $16.1 million. The vast majority of this related to our Asia Pacific Technology Center. We also made capital investments to expand manufacturing capacity, including production capacity for new products, as well as to move our Data Storage business to Singapore. Depreciation and amortization expense was $4.7 million for the quarter.

We ended the quarter with $171.0 million in cash and short term investments, $5.3 million higher than last quarter. Cash flow this quarter reflects a $13.2 million decrease in working capital, largely due to an $11.0 million increase in accrued payables related to the Asia Pacific Technology Center. Accounts receivable increased in line with our sequential increase in revenue, and inventory of raw materials decreased by $3.9 million. Our cash flow also reflects the $3.5 million of share repurchases that I mentioned earlier.

I'll now comment on our performance by product line, beginning with slurries for copper and barrier polishing, which are used in advanced logic devices. Revenue from our slurries for copper polishing applications, including barrier, increased by 12.0 percent sequentially, and was down by 22.9 percent compared to the year ago quarter. Copper revenue represented 20.3 percent of our total revenue for the quarter, down slightly from the 20.6 percent we reported last quarter.

We believe we continue to have a solid position in copper slurries for 130 nanometer technology, which remains the dominant node for copper polishing, and we believe our competitive position at this node did not change materially this quarter.

In 90 nanometer technology for logic applications, we believe we continue to hold 5 Process of Record positions, or PORs, for copper polishing and 1 POR for barrier polishing, both unchanged from last quarter.

65 nanometer technology for logic devices represents the new competitive arena for copper and barrier, and a limited number of semiconductor manufacturers are in various stages of development and ramp of this technology. We believe we continue to hold three POR wins at this node for copper polishing and one POR for barrier polishing, unchanged from last quarter. Beyond 65 nanometer technology, we continue to develop products and work with a number of customers on copper and barrier solutions for 45 nanometer technology.

We are excited about our copper and barrier slurries. We believe our copper and tunable barrier slurry platforms, which we have described in detail in the past, provide an innovative and economic approach to customizing products for our customers' most advanced applications.

Turning to our other slurry products, revenue from our tungsten and dielectric CMP slurries taken together was up 15.4 percent sequentially, and down 8.6 percent compared to the year ago quarter. Tungsten and dielectric slurries are most heavily used in a range of memory devices, and older generation logic devices that use aluminum rather than copper wiring.

We continue to have confidence in our technology leadership in slurries for tungsten applications. We see a promising future for our tungsten slurry products, given the growth outlook for memory devices as well as the opportunity to convert a number of "homebrew" slurry users to our commercial slurry products. During our fourth fiscal quarter we achieved an important win as we converted one of the more significant of these players to one of our tungsten products for a 90 nanometer application. We hope that this win will create broader acceptance of our commercial products with this important customer, as well as with others in this category.

I will now turn to dielectric polishing applications. These include legacy inter layer dielectric, or ILD, applications, which represent the more mature and commodity-oriented part of the business, and advanced dielectric applications, which require much higher performing solutions for pre-metal dielectric, or PMD, and Direct Shallow Trench Isolation, or Direct STI, applications. We continue the introduction of our new dielectric slurries, which utilize a ceria-based abrasive particle and rely more heavily on chemical action rather than on mechanical abrasion compared to our legacy products. We believe our new 6600 solution can replace older slurry products for legacy ILD applications at a lower cost and with higher performance. And our new 8800 product is targeted for advanced dielectric applications. It is tunable for selectivity and removal rate, and is multifunctional since it can polish advanced ILD, PMD and Direct STI applications.

Sales of our slurry product for Direct STI applications, Silect 6000, continue with our customers' ramp of their 90 nanometer technology. We believe we have three POR's in Direct STI, unchanged from last quarter, and a number of other customers are evaluating our product.

We also captured our first two advanced polysilicon PORs for contact and floating gate polishing applications with one customer. Polysilicon polishing is a new dielectric application area for us and we hope this win is the first of many to come.

Finally, revenue from slurries for our data storage business increased by 2.5 percent sequentially. The data storage industry continues to demonstrate strength due to demand for hard disk drives in PC's and consumer electronic devices.

I'll conclude my remarks with some comments on our outlook for fiscal year 2006.

As Bill discussed, industry experts generally appear to be cautiously optimistic about the near term outlook for the semiconductor industry. However, keep in mind that in fiscal 2006 during our transition to selling directly to customers in Taiwan, we anticipate an adverse impact on our revenue in our second fiscal quarter, which ends on March 31, 2006. During the transition period our distributor will sell its remaining inventory of our products to our customers and we will begin building inventory required to begin servicing these customers directly. Therefore, we expect a short-term interruption in our sales attributable to these end-use customers, which we continue to anticipate will reduce our second quarter revenue by approximately $11.5 million. Following this transition period, we believe sales volume should return to the prior level.

Our guidance on gross margin remains unchanged at 48 percent of revenue, plus or minus 2 percent. This reflects our expectation that we will continue to offset ongoing pricing pressure with additional productivity improvements and sales of new, higher margin products.

We generally view our operating expenses in terms of absolute dollars rather than as a percentage of sales. We expect the run rate we saw for operating expenses in our fourth fiscal quarter to continue through fiscal 2006, with some incremental growth. We expect operating expenses for the full fiscal year 2006 to be higher than in 2005 primarily due to three factors -- reporting of options expense, which we estimate at $10 million, incremental costs of our Asia Pacific Technology Center, and additional costs associated with selling directly to customers in Taiwan. We expect our effective tax rate in fiscal 2006 will be 31.2 percent.

We plan to spend approximately $20 million on capital expenditures in fiscal 2006, down from $29.3 million in fiscal 2005, which included construction of our new Asia Pacific Technology Center. We expect depreciation and amortization expense to be roughly $21.8 million.

You are aware that we do not provide guidance on revenue, but as we look at business activity through the month to date in October, orders for our products that we expect to ship by the end of the month are roughly equal to orders during the comparable period in August and September, which were both stronger sales months than July. However, again 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 interest in Cabot Microelectronics. I look forward to speaking with you again.