Cabot Microelectronics Corporation

2009 Second Fiscal Quarter Earnings Report

April 23, 2009

Good morning. 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 year 2009, which ended March 31. Our announced results this morning follow our press release on April 14th in which we discussed certain preliminary results. Copies of these press releases are 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 first quarter of fiscal 2009, ended December 31, 2008, and Form 10-K for the fiscal year ended September 30, 2008. 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 2009, which we believe reflect the continued effect of the global recession on our business. We reported revenue of $45.4 million, which represented a more than 50 percent decline from the same quarter last year. As a result of the unprecedented low level of demand for our products, our gross profit percentage was adversely impacted by the significant underutilization of our manufacturing capacity during the quarter. Additionally, we recorded several specific expense items totaling $3.6 million, which added to our operating expenses this quarter. As a result, we reported a net loss of $10.1 million for the quarter. However, even during this challenging period, we generated positive cash flow from operations during the second fiscal quarter and for the fiscal year to date. In addition, we ended the quarter with a healthy cash balance of $159 million and no debt, even after our cash purchase of Epoch Material Company in February for $66 million.

We believe the company's financial performance in the second fiscal quarter is consistent with the weak economic environment. However, we are encouraged by recent signs of an upturn in our business. Following the low revenue levels of January and February, we saw a marked increase in demand for our products in March, and orders to date in April are tracking significantly higher than in the same period in March.

We are hopeful that this recent upturn may indicate that the worst is behind us, and that we are seeing the start of a recovery.

Based on some industry reports, it appears that a major correction of excess semiconductor device inventory occurred over the past two quarters. With semiconductor inventory adjustments expected to be completed in the first half of calendar 2009, and assuming traditional seasonal strength in demand in the second half of the year, some industry analysts expect IC device demand will accelerate in the second half of this calendar year. Additionally, the more than $2 trillion in worldwide economic stimulus could prove to be a positive growth driver for the global economy over the next two years, including the demand for electronics. There are already positive signs of increased demand in electronics stemming from China's adoption of 3G technology.

While we hope that the growth forecasted by some industry reports materializes in the near term, we know that limited visibility into the semiconductor industry and the global economy makes it too early to predict a recovery with any certainty. Given this lack of visibility, we continue to manage our business with a focus on cost management and cash flow.

In the December quarter, we implemented cost reduction initiatives to better align our costs with the declining demand for our products we began to experience at that time. For example, we implemented shorter work schedules in our production operations, a hiring freeze, and reduced discretionary spending. In response to the continued industry downturn and the opportunity to realize synergies and leverage resources through our acquisition of Epoch, we implemented additional cost reduction measures during the second quarter, including a modest reduction in force. Within the last two months we saw demand for our products increase, and we quickly increased work schedules in our manufacturing operations to meet demand. As a result of our focused cost reduction efforts and our ability to respond quickly to changing industry conditions, we achieved significant savings across our business in the second quarter without compromising our operations, quality or intellectual capital.

Despite the adverse economic and industry climate, our financial flexibility allows us to continue to invest in our company and execute on our primary strategy of strengthening and growing our core CMP consumables business, while at the same time, continuing our efforts to leverage our CMP technology into new applications and industries through our Engineered Surface Finishes business.

Our recently completed acquisition of Epoch allows us to strengthen and grow our core CMP consumables business. As semiconductor technology becomes more complex, and the cost of developing leading-edge products and supporting our customer's increases, we believe the benefits of scale become more important. The Epoch business adds to our scale, particularly in Taiwan, the world's largest geographic market for CMP consumables, and also expands our copper product portfolio. Now that the transaction has closed, we are working to effectively integrate our two businesses and leverage the natural synergies. For example, we recently implemented a reorganization of our research and development function as part of our Technology Leadership initiative, designed to capitalize on new capabilities and opportunities in Taiwan and to better leverage the strengths within our overall R and D team.

Our Epoch acquisition also supports our key initiative of Connecting with Customers. We have been working toward shifting more of our business resources to the Asia Pacific region to increase proximity to our significant customer base there. By acquiring Epoch, a Taiwan based business, not only have we partnered with a company that has existing strong customer relationships, but we have also significantly increased our physical assets in this very important region. Today, approximately 50 percent of our employees and fixed asset base is located in the Asia Pacific region, which is a significant increase from five years ago, when only 25 percent of our employees and fixed asset base was located in the region. By positioning ourselves physically closer to our customers in the Asia Pacific region, we expect to increase our ability to better serve and collaborate with them, on a comparable level to our customers in the US.

We also aim to strengthen and grow our core CMP consumables business through internal development efforts. We believe our CMP pad business represents the company's strongest internal growth opportunity, since pads represents a large adjacent business area to our core slurry business. By expanding our product portfolio into this adjacent area, we effectively increased our total addressable market by over 70 percent. We have steadily grown our pad customer base over the past two years, across a wide range of polishing applications, technology nodes and polishing tools; and, we are pleased to report that we gained two new pad customers this quarter, and one new application with an existing customer.

Additionally, we made significant progress in improving our pad manufacturing yields. Through our Operations Excellence efforts, our Pad team exceeded the targets we established last year, and we are continuing to pursue additional yield improvements in fiscal 2009. We also completed the installation of our on-site pad finishing capability at TSMC, and achieved ISO 9001 certification for this facility in our second fiscal quarter. This pad capacity was installed on schedule and fully operational in less than six months. We believe this is an important milestone in our pad business, potentially driving increased customer engagement and reducing logistics costs.

In summary, we remain confident in the long term strength of our business despite the negative impact from the current economic downturn. Recall that we are primarily a units-driven, consumables company, so our business is quick to respond to increased production of IC devices by our customers.

Unlike some other players in the industry, for us, this downturn is not a question of survival -- it is a question of prudently seeking and leveraging opportunities, as well as executing on our strategies to further strengthen our business. We believe that our acquisition of Epoch and our installation of on-site pad finishing capability at TSMC are excellent examples of Cabot Microelectronics seizing opportunities where others might not have the ability to do so. We are managing our business to optimize our performance during challenging industry and economic conditions. We believe that we have implemented an appropriate level of focused cost management initiatives in response to the current conditions. However, should the industry downturn be more protracted, we are prepared to further adjust our costs and infrastructure. Overall, we hope that the recent upturn in our business continues and that we will benefit from improved economic and industry conditions, as well as the addition of Epoch, in the near future.

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

Thanks, Bill, and good morning everyone.

Revenue for the second quarter of fiscal 2009 was $45.4 million, which was down by 52.0 percent from the second quarter of fiscal 2008 and down 28.0 percent from the previous quarter. Our reported revenue is consistent with the preliminary revenue we provided in our press release on April 14th. We believe the decrease versus both previous periods reflects the impact of the global economic recession on electronics demand, an inventory correction of excess semiconductor devices and traditional seasonal weakness. Revenue for each of our business areas declined year-over-year and sequentially, except revenue from our data storage slurry products, which increased significantly from last quarter. Despite the sharp reduction in our revenue, the average selling price for our CMP slurries increased year-over-year and was even with the prior quarter.

Drilling down into revenue by business area, Tungsten slurries contributed 42.1 percent of total quarterly revenue, with revenue down 50.4 percent from the same quarter a year ago and down 26.7 percent sequentially.

Sales of Copper products represented 15.9 percent of our total revenue, and decreased 45.5 percent from the same quarter last year and 18.6 percent sequentially. Included in this business is our barrier removal product line; our barrier revenue decreased by 8.9 percent from the same quarter a year ago.

Dielectric slurries provided 25.2 percent of our revenue this quarter, with sales down 61.7 percent from the same quarter a year ago and down 41.5 percent sequentially.

Data Storage products represented 7.4 percent of our quarterly revenue; this revenue was down 12.1 percent from the same quarter last year and up 38.4 percent sequentially. The increase in revenue from the prior quarter was primarily driven by the ramp in demand from an important new customer win for this business that we mentioned last quarter.

Sales of polishing pads represented 5.4 percent of our total revenue for the quarter; and decreased 24.9 percent from the same quarter last year and 28.8 percent sequentially.

Finally, revenue from our Engineered Surface Finishes, or ESF business, which includes QED, generated 3.9 percent of our total sales, and our ESF revenue was down 68.6 percent from the same quarter last year and down 32.1 percent sequentially. As primarily an equipment-oriented business, our QED business is subject to capital equipment cycles, and the current cycle has significantly adversely affected revenue in this area.

Our gross profit this quarter represented 28.0 percent of revenue, which is consistent with the preliminary results we discussed in our release of April 14th. The significantly lower gross profit percentage this quarter, compared to 44.7 percent in the same quarter last year and 45.6 percent in the previous quarter, primarily resulted from unprecedented underutilization of our manufacturing capacity. We are accustomed to operating in volatile demand environments, and historically our relatively low fixed manufacturing costs have allowed us the flexibility to quickly change production levels while maintaining a mid-40 percent gross profit margin range, such as we reported last quarter. However, we have never experienced two back-to-back quarters of such significant revenue declines, and this was enough to materially impact our gross profit percentage for the quarter. Fundamentally, our business model has not changed. As Bill mentioned earlier, we recently began to see an increase in demand and we are hopeful that the negative impact of the economic downturn will be relatively short-lived.

Year to date, gross profit represents 38.2 percent of revenue. In light of our gross profit performance for the first half of the fiscal year, we no longer expect to achieve fiscal 2009 gross profit within our previous full year guidance range of 46 to 48 percent of revenue.

Now I'll turn to operating expenses, which include research, development and technical, selling and marketing, and general and administrative costs. Operating expenses of $30.0 million this quarter included the negative impact of three specific items: first, a $1.5 million write-off of in-process research and development expenses related to our acquisition of Epoch, which is subject to finalization of purchase accounting; second, a $1.1 million impairment related to certain research and development equipment; and third, a $1.0 million increase in our reserve for bad debt expense due to the impact of adverse economic conditions on customer collections, including customer bankruptcies. Excluding these specific items, operating expenses would have been $26.4 million in the second fiscal quarter. On this basis of comparison, this represents an 18.1 percent reduction from the $32.2 million reported in the same quarter a year ago and a reduction of 10.3 percent from the $29.4 million reported in the prior quarter. Similarly, the decrease from both periods was primarily driven by lower staffing related costs, professional fees, including legal fees to enforce our intellectual property, and travel expenses.

Reflecting the closing of our acquisition of Epoch this quarter, as well as additional actions we took this fiscal year to improve our operating effectiveness and capitalize on acquisition-related synergies, we now anticipate our fiscal 2009 operating expenses to be in the range of $115 million to $120 million, including the three specific items I described earlier. This is down from full fiscal year 2008 operating expenses of $125.0 million, which was a period of time during which we did not own Epoch.

Diluted loss per share was 44 cents this quarter, down from earnings per share of 34 cents reported in the second quarter of fiscal 2008 and 1 cent last quarter, primarily due to the significantly lower level of revenue and accompanying lower gross profit percentage, both driven by the global economic downturn. The adverse specific operating expense items I described earlier accounted for approximately 10 cents of the diluted loss per share this quarter.

Turning now to cash and balance sheet related items, capital additions for the quarter were $2.3 million, depreciation and amortization expense was $6.1 million and share-based compensation expense was $2.9 million. Reflecting our acquisition of Epoch in February, we ended the quarter with a healthy cash balance of $159 million and no debt outstanding. Despite reporting a net loss, we generated positive cash flow from operations during the quarter and fiscal year to date. Due to our strong cash generating business model and solid balance sheet, we have the flexibility to continue to focus on strengthening our business during the current downturn, while other companies in our industry may be struggling just to survive.

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

As we have discussed, looking at our revenue pattern during the three months of the second fiscal quarter we saw continued softening in demand for our CMP consumables products in January and February, with revenue in each of these months of only $13 to $14 million. However, in March we experienced a marked increase in demand, and we recorded monthly revenue of $18.5 million, approximately 40 percent higher than in January and February. As we observe orders for our CMP consumables products received to date in April that we expect to ship by the end of the month, we see April results trending significantly higher than in the same period in March. We are encouraged by the recent uptick in demand for our products; 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.

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.