Cabot Microelectronics Corporation
First Fiscal Quarter 2011 Conference Call Script
January 27, 2011

Good morning. 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 year 2011, which ended December 31, 2010. A copy of our earnings release is available in the investor relations section of our website, cabotcmp.com, or by calling our investor relations office at 630-499-2600. A webcast of today's conference call and the script of this morning's formal comments will also be available on our website.

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-K for the fiscal year ended September 30, 2010. 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 record financial results for our first fiscal quarter of 2011, which continues the strong positive momentum we experienced in fiscal 2010. In our view, the continued execution of our strategic initiatives has enhanced our competitive standing in the marketplace, and our financial discipline has improved our profitability. Our record financial performance this quarter was driven by strong demand for our products, with record quarterly revenue for our data storage and tungsten slurries. In addition, solid productivity improvements and high manufacturing capacity utilization drove increased profitability. Overall, we are encouraged by the strong start to what has the potential to be another impressive year for Cabot Microelectronics.

A few weeks ago I participated in SEMI's Industry Strategy Symposium in Half Moon Bay, California, and I was encouraged by the general optimism that I observed at this event. Following a very strong year for the semiconductor industry in 2010, companies and industry analysts are predicting another solid year in 2011, with annual semiconductor revenue growth estimates generally in the range of 5 to 10 percent. We expect corporate and enterprise IT spending to continue to drive a significant portion of semiconductor device demand, and recent strong announcements from Intel and IBM bode well for this area. Along with demand from this traditional segment, we expect increasingly important semiconductor market growth drivers in 2011 to include wireless multimedia platforms, such as smart phones and tablets, as well as connected home devices. In addition, an increasing amount of semiconductor content is being added to automobiles in areas such as information and entertainment systems, power-trains, fuel efficiency and safety mechanisms. As a supplier to all of the semiconductor manufacturers in the world, we are a beneficiary of the strong growth trends in these areas. In general, as worldwide semiconductor production increases, we expect CMP consumables demand to also increase, regardless of the type of electronic systems for which these devices are manufactured.

Further, increasing semiconductor content within electronic systems is driving additional chip demand. According to research firm, IC Insights, semiconductor content reached an all time high in 2010 with semiconductor content representing approximately 25 percent of the total cost of electronic systems. This is a 2.3 percentage point increase from the prior peak in 2006.

In addition, a number of surveys by industry analysts show normal levels of semiconductor inventory within the supply chain. Although we have historically experienced seasonal softening in the March quarter, we remain optimistic regarding the demand outlook for our full fiscal year.

Last year, we discussed how high capacity utilization at our customers had the potential to limit growth of semiconductor production, which in turn could limit the growth in demand for CMP consumables. In the second half of 2010, some of our customers started to bring new capacity on-line and we see this trend continuing and accelerating through 2011. Certain industry analysts are predicting that semiconductor manufacturing capacity will grow by almost 10 percent in 2011, which should help to ease production constraints and provide room for long-term growth in global CMP consumables demand.

Turning now to company-related matters, we continue to develop our focused strategy of strengthening and growing our core CMP consumables business through the execution of our strategic initiatives. Historically we have described these initiatives as: Technology Leadership, Operations Excellence and Connecting with Customers. Over the past year or so we have modified our mission and vision statements to become more customer-centric, while still focusing on technology and operational efficiency. In light of this modification, our strategic initiatives have also evolved, and I would now like to update you on this evolution and how we are executing on these initiatives.

Expanding upon our Technology Leadership initiative, we are now focusing our development efforts on providing “solutions” to our customers. This involves a more customer-oriented approach to product development. Like before, we continue to collaborate early with our customers through joint development agreements and other less formal arrangements. We also continue to develop product “platforms” that can be tuned to fit our customers’ specific needs. The evolution of this initiative is that we are expanding upon our collaboration with customers to encompass not only the products we sell, but also to give greater consideration to the process in which they are integrated within our customers’ operations. Our goal is to provide innovative, customized solutions while delivering superior cost of ownership and ease of use to our customers.

Let me now provide a recent example of our progress on this initiative. As you know, we are in the process of alpha testing our second generation polishing pad platform, the Epic® D200. This pad platform is unique in that it allows us to tune the hardness, porosity and pore size of the pad, so that it can be optimized for our customers' unique polishing needs. Recently, we have made progress in the commercialization of this new product platform. A couple of the companies alpha-testing our D200 pads have advanced their evaluations, and we believe we are near our first D200 qualification decision for an advanced node application. Meaningful revenue from this new pad platform is certainly several quarters away, but we are encouraged to see this type of progress.

At the same time, we continue to advance the adoption of our D100 pad products. This quarter, we were successful in winning business with three new customers. We continue to believe that our pad business represents the most significant organic growth opportunity for our company, and we are pleased to supply our pads to approximately 25 customers worldwide. Three of these customers are among the ten largest semiconductor manufacturers in the world, in terms of semiconductor revenue.

On the CMP slurry side of our business, we have launched a number of new products across each of our slurry application areas, which we believe positions us well at advanced technology nodes. Earlier this week, we announced our Novus™ A7000 series Aluminum slurry product offering, which has been gaining traction with our technology-leading customers over the past year. Although the Aluminum slurry market is currently small, we expect this emerging application to grow significantly over the next several years as our customers increase their sales of advanced technology node products.

Next, I would like to discuss the evolution of our Operations Excellence initiative. In parallel with our traditional focus on productivity improvement and variation reduction, we are also looking to differentiate our business in the eyes of our customers, through our robust quality and supply chain management systems. Our ability to consistently supply high quality products, with on-time delivery, is a key reason why our customers choose to partner with us. In this business, a supply interruption can cost our customers millions of dollars in yield or lost business, so IC device manufacturers are very cautious and deliberate when evaluating suppliers and their products. As the leader in CMP slurries, we have the experience, scale and infrastructure to invest in and develop robust quality systems, and we have made it a key component of our culture and way of doing business. We believe the numerous customer awards that we have received are a reflection of this commitment to quality.

Over the past several quarters we have seen increasing momentum in demand for our products. Compared to our pre-recession peak, our quarterly revenue is up nearly 20 percent and our diluted EPS is up almost 40 percent. To enhance our ability to meet our customers' demand, we are actively expanding our manufacturing capacity, particularly in the Asia Pacific region, where we derive approximately 80 percent of our revenue. To optimize our investment in capacity, we are installing additional production equipment within our existing facilities in Japan and Singapore.

We also recently began construction of a manufacturing and research and development center in South Korea, which is the second largest market for CMP consumables. This new 56,000 square foot facility is expected to be completed by the end of the calendar year at a cost of approximately $12 million. Initially, we plan to utilize this facility to develop and manufacture advanced dielectric CMP slurry products, which represents a strategic application that we are looking to further develop and grow. The facility is also designed for further expansion, to support additional CMP consumables products, as needed.

I mentioned earlier that our new vision and mission statements are now more customer-centric. Therefore, our Connecting with Customers initiative is embedded in all that we do here at Cabot Microelectronics. From collaborating with customers on developing solutions, to ensuring that our customers receive consistent quality products and services at a low cost of ownership, our focus is to continue to build on the trust that we have earned with our customers.

Being physically close to our customers and interacting with them in the same language and customs with which they are comfortable is key to developing strong relationships and forming lasting partnerships. For example, by moving our data storage business to Singapore in 2005, we enhanced our capability to serve our data storage customers located in Southeast Asia. Over the past year, we successfully utilized our capabilities in the region and won business with three new data storage customers. These new business wins, combined with solid seasonal strength, have resulted in record quarterly revenue for our data storage business.

Given the importance of customer relationships and trust to our overall growth strategy, our recent inroads in South Korea, Singapore and Taiwan are great examples of our efforts to grow our presence in Asia. Our new facility under construction marks South Korea as the fourth country in the Asia Pacific region where we have a manufacturing and research and development presence. We believe this is a significant competitive advantage for the company and is valued by our customer base.

Concluding my remarks today, we are very pleased with our record financial results and progress in executing our strategy. Two years ago, we had a vision to emerge from the recession a stronger company. We leveraged the flexibility of our manufacturing operations, we continued to invest in and develop leading edge solutions, we retained our intellectual capital and we maintained our focus on the importance of our customers and the relationships we hold with them. Fast forward to today, and I believe we have been successful in building a stronger company and enhancing our competitive position. We are clearly outperforming pre-recession levels of revenue, gross profit margin and earnings per share, and we look forward to building on this positive momentum in the future.

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

Thanks, Bill, and good morning everyone.

Revenue for the first quarter of fiscal 2011 was a record $114.2 million, which was up by 16.9 percent from the first quarter of last year and up 3.5 percent from the prior quarter. The increase in revenue from the same quarter last year reflects increased demand across each of our business areas. Compared to the prior quarter, revenue increased within each of our business areas, except CMP slurries for copper and dielectric applications.

Drilling down into revenue by business area, Tungsten slurries contributed 36.7 percent of total quarterly revenue, with revenue up 16.4 percent from the same quarter a year ago and up 3.9 percent sequentially, reflecting strong demand from the memory segment.

Sales of Copper products represented 18.0 percent of our total revenue, and increased 18.7 percent from the same quarter last year and decreased 2.5 percent sequentially. Also included in our Copper business is our Barrier removal product line, revenue from which increased 5.8 percent sequentially.

Dielectric slurries provided 27.3 percent of our revenue this quarter, with sales up 16.2 percent from the same quarter a year ago and down 1.6 percent sequentially.

Data Storage slurry products represented 6.2 percent of our quarterly revenue; this revenue was up 17.2 percent from the same quarter last year, and up 45.1 percent sequentially, which reflects several important customer wins as Bill mentioned earlier.

Sales of our polishing pads represented 7.3 percent of our total revenue for the quarter; and increased 25.9 percent from the same quarter last year and 1.6 percent sequentially.

Finally, revenue from our ESF business, which includes QED, generated 4.5 percent of our total sales, and was up 6.2 percent from the same quarter last year and up 24.1 percent sequentially.

Our gross profit this quarter represented 50.3 percent of revenue, which is slightly above our guidance range of 48 to 50 percent of revenue for full fiscal year 2011. This is down from 51.6 percent in the same quarter a year ago and up from 48.7 percent in the prior quarter. Compared to the year ago quarter, gross profit percentage decreased primarily due to the absence of a $1.6 million raw material supplier credit that we recognized in the first quarter of fiscal 2010, as well as higher fixed manufacturing costs, partially offset by the benefit of increased utilization of our manufacturing capacity. The increase in gross profit percentage versus the previous quarter was primarily due to increased utilization of our manufacturing capacity.

Now I'll turn to operating expenses, which include research, development and technical, selling and marketing, and general and administrative costs. Operating expenses this quarter of $33.0 million were $2.9 million higher than the $30.1 million reported in the first quarter of fiscal 2010. The increase was primarily driven by higher staffing related costs and travel expenses, partially offset by lower professional fees, including costs to enforce our intellectual property. This quarter, our operating expenses included $1.1 million in benefit expenses associated with the cash payment of our variable incentive compensation related to fiscal 2010 performance, and as such, should not represent a recurring cost at this level. Operating expenses were approximately $300 thousand higher than the $32.7 million reported in the previous quarter, mainly due to higher staffing related costs, partially offset by decreased professional fees, including costs to enforce our intellectual property. For full fiscal year 2010, we expect our operating expenses to be near the upper end of our guidance range of $125 million to $130 million.

Diluted earnings per share were a record 71 cents this quarter, which is up from the 56 cents reported in the first quarter of fiscal 2010 on higher revenue and a lower effective tax rate, partially offset by higher operating expenses. Compared to the previous quarter, diluted EPS was up from 66 cents, mainly due to the higher level of sales and gross profit margin.

Turning now to cash and balance sheet related items, capital spending for the quarter was $3.3 million, depreciation and amortization expense was $6.1 million and share-based compensation expense was $3.4 million. In addition, we purchased $10 million of our stock during the quarter under our $75 million share repurchase program, which now has $15 million remaining. We ended the quarter with a cash balance of $263.0 million.

As previously announced, in recognition of our robust cash generating business model and belief in the long-term value of our business, our Board of Directors authorized a $125 million share repurchase program in November, which represents our fourth and largest program. We also continue to look for ways to productively redeploy our cash in our business, such as through capital investments and acquisitions, as that remains our top priority for our cash.

I'll conclude my remarks with a few comments on recent sales and order patterns.

Examining revenue patterns within the three months of our first fiscal quarter, we saw demand for our CMP consumables products increase slightly month-to-month throughout the quarter. As we observe orders for our CMP consumables products received to date in January that we expect to ship by the end of the month, we see January results trending slightly lower than the average rate in our first fiscal quarter. 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.

Now I'll turn the call back to the operator, 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.