

CABOT MICROELECTRONICS CORP  
Form 10-Q  
August 08, 2007

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended

JUNE 30, 2007

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-30205

CABOT MICROELECTRONICS CORPORATION  
(Exact name of registrant as specified in its charter)

DELAWARE  
(State of Incorporation)

36-4324765  
(I.R.S. Employer Identification No.)

870 NORTH COMMONS DRIVE  
AURORA, ILLINOIS  
(Address of principal executive offices)

60504  
(Zip Code)

Registrant's telephone number, including area code: (630) 375-6631

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

X

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Large accelerated filer	Accelerated filer	Non-accelerated filer
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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO X

As of July 31, 2007, the Company had 23,836,946 shares of Common Stock, par value \$0.001 per share, outstanding.

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**CABOT MICROELECTRONICS CORPORATION**

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**PART I. FINANCIAL INFORMATION**  
**ITEM 1.**

**CABOT MICROELECTRONICS CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(Unaudited and in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Revenue	\$ 89,023	\$ 84,936	\$ 247,826	\$ 233,813
Cost of goods sold	46,552	44,524	132,241	123,430
Gross profit	42,471	40,412	115,585	110,383
Operating expenses:				
Research, development and technical	12,033	12,060	37,761	35,040
Selling and marketing	6,469	5,486	17,792	15,587
General and administrative	9,387	9,105	28,349	25,763
Total operating expenses	27,889	26,651	83,902	76,390
Operating income	14,582	13,761	31,683	33,993
Other income (expense), net	(148)	764	2,286	2,570
Income before income taxes	14,434	14,525	33,969	36,563
Provision for income taxes	4,373	4,743	10,292	11,773
Net income	\$ 10,061	\$ 9,782	\$ 23,677	\$ 24,790
Basic earnings per share	\$ 0.43	\$ 0.40	\$ 1.00	\$ 1.02
Weighted average basic shares outstanding	23,662	24,205	23,737	24,276
Diluted earnings per share	\$ 0.42	\$ 0.40	\$ 1.00	\$ 1.02
Weighted average diluted shares outstanding	23,687	24,205	23,741	24,276

The accompanying notes are an integral part of these consolidated financial statements.

**CABOT MICROELECTRONICS CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
(Unaudited and in thousands, except share amounts)

	June 30, 2007	September 30, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 49,516	\$ 54,965
Short-term investments	134,445	110,965
Accounts receivable, less allowance for doubtful accounts of \$611 at June 30, 2007, and \$551 at September 30, 2006	51,435	48,028
Inventories	35,746	40,326
Prepaid expenses and other current assets	5,920	4,785
Deferred income taxes	2,910	2,436
Total current assets	279,972	261,505
Property, plant and equipment, net	118,704	130,176
Goodwill	7,069	4,565
Other intangible assets, net	12,358	11,447
Deferred income taxes	7,112	1,365
Other long-term assets	606	3,075
Total assets	\$ 425,821	\$ 412,133
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 10,592	\$ 15,104
Capital lease obligations	1,320	1,254
Accrued expenses, income taxes payable and other current liabilities	18,678	22,475
Total current liabilities	30,590	38,833
Capital lease obligations	3,611	4,420
Other long-term liabilities	1,299	1,109
Total liabilities	35,500	44,362
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Common stock:		
Authorized: 200,000,000 shares, \$0.001 par value		
Issued: 25,424,019 shares at June 30, 2007, and 25,254,719 shares at September 30, 2006	24	24
Capital in excess of par value of common stock	168,091	157,463
Retained earnings	274,684	251,007
Accumulated other comprehensive income (loss)	(1,487)	272
Treasury stock at cost, 1,627,337 shares at June 30, 2007, and 1,297,167 shares at September 30, 2006	(50,991)	(40,995)
Total stockholders' equity	390,321	367,771
Total liabilities and stockholders' equity	\$ 425,821	\$ 412,133

The accompanying notes are an integral part of these consolidated financial statements.



**CABOT MICROELECTRONICS CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited and amounts in thousands)

	<b>Nine Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
Cash flows from operating activities:		
Net income	\$ 23,677	\$ 24,790
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,147	14,996
Impairment of investment	2,052	-
Loss on equity investment	-	566
Share-based compensation expense	9,489	7,872
Deferred income tax benefit	(6,259)	(4,828)
Non-cash foreign exchange loss	804	1
Other	724	807
Changes in operating assets and liabilities:		
Accounts receivable	(3,971)	(11,286)
Inventories	4,180	(3,425)
Prepaid expenses and other assets	(779)	379
Accounts payable	(3,680)	130
Accrued expenses, income taxes payable and other liabilities	(5,973)	3,101
Net cash provided by operating activities	38,411	33,103
Cash flows from investing activities:		
Additions to property, plant and equipment	(7,607)	(19,642)
Proceeds from the sale of property, plant and equipment	172	18
Acquisition of business	-	(2,282)
Acquisition of patent license	(3,000)	-
Purchase of patents	-	(5,000)
Purchases of short-term investments	(114,725)	(114,755)
Proceeds from the sale of short-term investments	91,245	121,392
Net cash used in investing activities	(33,915)	(20,269)
Cash flows from financing activities:		
Repurchases of common stock	(9,995)	(7,995)
Net proceeds from issuance of stock	1,138	789
Principal payments under capital lease obligations	(743)	(693)
Net cash used in financing activities	(9,600)	(7,899)
Effect of exchange rate changes on cash	(345)	46
Increase (decrease) in cash	(5,449)	4,981
Cash and cash equivalents at beginning of period	54,965	44,436
Cash and cash equivalents at end of period	\$ 49,516	\$ 49,417
Supplemental disclosure of noncash investing and financing activities:		
Purchases of property, plant and equipment in accrued liabilities and accounts payable at the end of the period	\$ 270	\$ 822
Issuance of restricted stock	4,515	68
Increase in goodwill related to accrued earnout	2,500	-

The accompanying notes are an integral part of these consolidated financial statements.



**CABOT MICROELECTRONICS CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited and in thousands, except share and per share amounts)**

## 1. BACKGROUND AND BASIS OF PRESENTATION

Cabot Microelectronics Corporation ("Cabot Microelectronics", "the Company", "us", "we" or "our") supplies high-performance polishing slurries used in the manufacture of advanced integrated circuit (IC) devices within the semiconductor industry, in a process called chemical mechanical planarization (CMP). CMP polishes surfaces at an atomic level, thereby enabling IC device manufacturers to produce smaller, faster and more complex IC devices with fewer defects. We believe we are the world's leading supplier of slurries for IC devices. We also develop, manufacture and sell CMP slurries for polishing certain components in hard disk drives, specifically rigid disk substrates and magnetic heads, and we believe we are one of the leading suppliers in this area. In addition, we have commercialized CMP polishing pads, which are used in conjunction with slurries in the CMP process. We also pursue a variety of surface modification applications outside of the semiconductor and hard disk drive industries for which our capabilities and knowledge may provide previously unseen surface performance or improved productivity. For additional information, refer to Part 1, Item 1, "Business", in our annual report on Form 10-K for the fiscal year ended September 30, 2006.

The unaudited consolidated financial statements have been prepared by Cabot Microelectronics Corporation pursuant to the rules of the Securities and Exchange Commission (SEC) and accounting principles generally accepted in the United States of America. In the opinion of management, these unaudited consolidated financial statements include all normal recurring adjustments necessary for the fair presentation of Cabot Microelectronics' financial position as of June 30, 2007, cash flows for the nine months ended June 30, 2007, and June 30, 2006, and results of operations for the three and nine months ended June 30, 2007, and June 30, 2006. The results of operations for the three and nine months ended June 30, 2007, may not be indicative of the results to be expected for future periods, including the fiscal year ending September 30, 2007. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in Cabot Microelectronics' annual report on Form 10-K for the fiscal year ended September 30, 2006. We currently operate predominantly in one industry segment - the development, manufacture and sale of CMP slurries.

The consolidated financial statements include the accounts of Cabot Microelectronics and its subsidiaries. All intercompany transactions and balances between the companies have been eliminated. Certain reclassifications of prior fiscal year amounts have been made to conform to the current period presentation.

## 2. INVENTORIES

Inventories consisted of the following:

	<b>June 30,</b>	<b>September</b>
	<b>2007</b>	<b>30,</b>
		<b>2006</b>
Raw materials	\$ 17,319	\$ 18,623
Work in process	1,702	1,805
Finished goods	16,725	19,898
<b>Total</b>	<b>\$ 35,746</b>	<b>\$ 40,326</b>



**CABOT MICROELECTRONICS CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited and in thousands, except share and per share amounts)**

### 3. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill was \$7,069 and \$4,565 as of June 30, 2007, and September 30, 2006, respectively. The increase resulted from recording a \$2,500 earnout related to our purchase of substantially all of the assets and assumption of certain liabilities of QED Technologies, Inc. (QED) in July 2006. The earnout was based on the performance of QED during the first year following the purchase; the acquisition agreement includes a provision for an additional \$2,000 earnout in the second year following the purchase if QED meets certain financial performance goals.

The components of other intangible assets were as follows:

	June 30, 2007		September 30, 2006	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<u>Other intangible assets subject to amortization:</u>				
Product technology	\$ 5,380	\$ 538	\$ 5,380	\$ 135
Acquired patents and licenses *	8,000	2,021	5,000	479
Trade secrets and know-how	2,550	2,550	2,550	2,550
Distribution rights, customer lists and other	1,457	1,199	1,457	1,059
Total other intangible assets subject to amortization	17,387	6,308	14,387	4,223
Total other intangible assets not subject to amortization **	1,279		1,283	
Total other intangible assets	\$ 18,666	\$ 6,308	\$ 15,670	\$ 4,223

\* We acquired a license of patents for \$3,000 in the first fiscal quarter of 2007.

\*\* Total other intangible assets not subject to amortization primarily consist of trade names.

Amortization expense was \$720 and \$2,085 for the three and nine months ended June 30, 2007, respectively. Amortization expense for the three and nine months ended June 30, 2006, was \$19 and \$27, respectively. Estimated future amortization expense for the five succeeding fiscal years is as follows:

Fiscal Year	Estimated amortization expense
Remainder of 2007	\$ 720
2008	2,838
2009	1,663
2010	854
2011	847



**CABOT MICROELECTRONICS CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited and in thousands, except share and per share amounts)**

**4. OTHER LONG-TERM ASSETS**

Other long-term assets consisted of the following:

	<b>June 30, 2007</b>	<b>September 30, 2006</b>
Investment in NanoProducts Corporation	\$ -	\$ 2,446
Other long-term assets	606	629
<b>Total</b>	<b>\$ 606</b>	<b>\$ 3,075</b>

In fiscal 2004 and 2005, we invested a total of \$3,750 to acquire a minority interest in NanoProducts Corporation (NPC) and entered into a technology collaboration agreement with NPC. In the third quarter of fiscal 2007, the Company chose to not renew the collaboration agreement. Additionally, during the third quarter NPC entered into funding arrangements that we believe significantly reduced the likelihood that the Company would recover the value of our minority investment. Accordingly, we recorded a \$2,052 impairment of our investment, which reduced the carrying value to zero. This impairment loss is included in other income and expense in the consolidated statement of operations.

**5. ACCRUED EXPENSES, INCOME TAXES PAYABLE AND OTHER CURRENT LIABILITIES**

Accrued expenses, income taxes payable and other current liabilities consisted of the following:

	<b>June 30, 2007</b>	<b>September 30, 2006</b>
Accrued compensation	\$ 9,992	\$ 12,948
Accrued earnout (refer to Note 3)	2,500	-
Goods and services received, not yet invoiced	1,688	3,088
Warranty accrual	481	924
Income taxes payable	1,046	764
Taxes, other than income taxes	1,311	2,270
Other	1,660	2,481
<b>Total</b>	<b>\$ 18,678</b>	<b>\$ 22,475</b>



**CABOT MICROELECTRONICS CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited and in thousands, except share and per share amounts)**

## 6. CONTINGENCIES

While we are not at present involved in any legal proceedings that we currently believe will have a material impact on our consolidated financial position, results of operations or cash flows, we periodically become a party to legal proceedings in the ordinary course of business. For example, in January 2007, Cabot Microelectronics filed a legal action against DuPont Air Products NanoMaterials LLC (DA Nano), a competitor of ours, in the United States District Court for the District of Arizona, charging that DA Nano's manufacture and marketing of certain CMP slurries infringe five CMP slurry patents that we own. The affected DA Nano products include those used for tungsten CMP. We filed our patent infringement complaint as a counterclaim in response to an action filed by DA Nano in the same court in December 2006 that seeks declaratory relief and alleges non-infringement, invalidity and unenforceability regarding some of the patents at issue in our complaint against DA Nano. DA Nano filed its complaint following our refusal of its request that we license to it our patents raised in its complaint. DA Nano's complaint does not allege any infringement by Cabot Microelectronics' products of intellectual property owned by DA Nano. While the outcome of this and any legal matter cannot be predicted with certainty, we believe that our claims and defenses in the pending action are meritorious, and intend to pursue and defend them vigorously.

Refer to Note 15 of "Notes to the Consolidated Financial Statements" in Item 8 of Part II of our annual report on Form 10-K for the fiscal year ended September 30, 2006, for additional information regarding commitments and contingencies.

## PRODUCT WARRANTIES

We maintain a warranty reserve that reflects management's best estimate of the cost to replace product that does not meet customers' specifications and performance requirements, and costs related to such replacement. The warranty reserve is based upon a historical product replacement rate, adjusted for any specific known conditions or circumstances. Adjustments to the warranty reserve are recorded in cost of goods sold. Our warranty reserve requirements changed during our third quarter of fiscal 2007 as follows:

Balance as of		
September 30, 2006	\$	924
Additions charged to expense		-
Deductions		(443)
Balance as of June 30, 2007	\$	481

## 7. SHARE-BASED COMPENSATION PLANS

Effective October 1, 2005, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (SFAS 123R), which requires all share-based payments, including stock option grants, restricted stock and discounts on employee stock purchase plan purchases, to be recognized in the consolidated statement of operations based on their fair values. We currently issue share-based payments under the following programs: our Second Amended and Restated Cabot Microelectronics Corporation 2000 Equity Incentive Plan, as

amended and restated September 26, 2006 (“2000 Equity Incentive Plan”); our Directors’ Deferred Compensation Plan, as amended September 26, 2006; our 2001 Executive Officer Deposit Share Program; and our Cabot Microelectronics Corporation Employee Stock Purchase Plan, as amended (“Employee Stock Purchase Plan”). For additional information regarding these programs, refer to Note 10 of “Notes to the Consolidated Financial Statements” included in Item 8 of Part II of our annual report on Form 10-K for the fiscal year ended September 30, 2006.



**CABOT MICROELECTRONICS CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited and in thousands, except share and per share amounts)**

Prior to fiscal 2007, under our 2000 Equity Incentive Plan, awards and grants made to employees as part of our annual equity incentive award program and to non-employee directors for initial and annual grants as part of our non-employee directors' compensation program consisted solely of non-qualified stock option grants. As permitted by the 2000 Equity Incentive Plan, in fiscal 2007 the compensation committee of our Board of Directors decided to begin to award a blend of non-qualified stock option grants and restricted stock awards (restricted stock units for our non-United States employees) to eligible employees and non-employee directors according to an approximate three-to-one ratio of non-qualified stock options granted to shares of restricted stock awarded. Our Board of Directors made these decisions primarily to address the financial impact of the expensing of equity-based compensation now required pursuant to SFAS 123R, as well as to provide a more competitive balance of equity incentives being awarded to our employees and non-employee directors under the 2000 Equity Incentive Plan.

Share-based compensation expense under SFAS 123R for the three and nine months ended June 30, 2007, and June 30, 2006, was as follows:

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Cost of goods sold	\$ 193	\$ 164	\$ 576	\$ 477
Research, development and technical	272	239	843	715
Selling and marketing	329	262	959	766
General and administrative	2,438	2,062	7,111	5,914
Total share-based compensation expense	3,232	2,727	9,489	7,872
Tax benefit	1,155	1,009	3,390	2,912
Total share-based compensation expense, net of tax	\$ 2,077	\$ 1,718	\$ 6,099	\$ 4,960

For additional information regarding the estimation of fair value, refer to Note 10 of "Notes to the Consolidated Financial Statements" included in Item 8 of Part II of our annual report on Form 10-K for the fiscal year ended September 30, 2006.

## 8. OTHER INCOME AND EXPENSE, NET

Other income and expense, net, consisted of the following:

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Interest income	\$ 1,509	\$ 1,448	\$ 4,300	\$ 3,992
Interest expense	(112)	(291)	(369)	(563)
Other expense	(1,545)	(393)	(1,645)	(859)

Total other income (expense), net	\$	(148)	\$	764	\$	2,286	\$	2,570
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Other expense includes \$2,052 for the impairment of our investment in NPC, which is described in Note 4 above.

**CABOT MICROELECTRONICS CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited and in thousands, except share and per share amounts)**

**9. COMPREHENSIVE INCOME**

The components of comprehensive income were as follows:

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Net income	\$ 10,061	\$ 9,782	\$ 23,677	\$ 24,790
Other comprehensive income:				
Net unrealized gain on derivative instruments	9	9	27	27
Foreign currency translation adjustment	(2,147)	1,957	(1,786)	542
Total comprehensive income	\$ 7,923	\$ 11,748	\$ 21,918	\$ 25,359

**10. EARNINGS PER SHARE**

Statement of Financial Accounting Standards No. 128, "Earnings per Share", requires companies to provide a reconciliation of the numerator and denominator of the basic and diluted earnings per share computations. Basic and diluted earnings per share were calculated as follows:

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Numerator:				
Earnings available to common shares	\$ 10,061	\$ 9,782	\$ 23,677	\$ 24,790
Denominator:				
Weighted average common shares (Denominator for basic calculation)	23,662,330	24,204,586	23,736,727	24,276,302
Weighted average effect of dilutive securities:				
Share-based compensation	24,311	19	4,375	49
Diluted weighted average common shares (Denominator for diluted calculation)	23,686,641	24,204,605	23,741,102	24,276,351

Earnings per share:

Basic	\$	0.43	\$	0.40	\$	1.00	\$	1.02
Diluted	\$	0.42	\$	0.40	\$	1.00	\$	1.02

**CABOT MICROELECTRONICS CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited and in thousands, except share and per share amounts)**

For each of the three-month periods ended June 30, 2007 and 2006, approximately 4.6 million shares attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive. For the nine months ended June 30, 2007 and 2006, approximately 4.5 million and 4.3 million shares, respectively, attributable to outstanding stock options were excluded from the calculation of diluted earnings per share for the same reason.

**11. EFFECTS OF RECENT ACCOUNTING PRONOUNCEMENTS**

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115" (SFAS 159). SFAS 159 allows measurement at fair value of eligible financial assets and liabilities that are not otherwise measured at fair value. If the fair value option for an eligible item is elected, unrealized gains and losses for that item shall be reported in current earnings at each subsequent reporting date. This SFAS is effective for fiscal years beginning after November 15, 2007. We do not expect the adoption of SFAS 159 to have a material impact on our consolidated financial position, results of operations or cash flows.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following "Management's Discussion and Analysis of Financial Condition and Results of Operations", as well as disclosures included elsewhere in this Form 10-Q, include "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. This Act provides a safe harbor for forward-looking statements to encourage companies to provide prospective information about themselves so long as they identify these statements as forward-looking and provide meaningful cautionary statements identifying important factors that could cause actual results to differ from the projected results. All statements other than statements of historical fact we make in this Form 10-Q are forward-looking. In particular, the statements herein regarding future sales and operating results; Company and industry growth or trends; growth of the markets in which the Company participates; international events; product performance; the generation, protection and acquisition of intellectual property, and litigation related to such intellectual property; new product introductions; development of new products, technologies and markets; the acquisition of or investment in other entities; the construction of new or refurbishment of existing facilities by the Company; and statements preceded by, followed by or that include the words "intends", "estimates", "plans", "believes", "expects", "anticipates", "should", "could" or similar expressions, are forward-looking statements. Forward-looking statements reflect our current expectations and are inherently uncertain. Our actual results may differ significantly from our expectations. We assume no obligation to update this forward-looking information. The section entitled "Risk Factors" describes some, but not all, of the factors that could cause these differences.

This section, "Management's Discussion and Analysis of Financial Condition and Results of Operations", should be read in conjunction with Cabot Microelectronics' annual report on Form 10-K for the fiscal year ended September 30, 2006, including the consolidated financial statements and related notes thereto.

### **THIRD QUARTER OF FISCAL 2007 OVERVIEW**

We believe we are the world's leading supplier of high-performance polishing slurries used in the manufacture of advanced integrated circuit (IC) devices within the semiconductor industry, in a process called chemical mechanical planarization (CMP). CMP is a polishing process used by IC device manufacturers to planarize or flatten many of the multiple layers of material that are built upon silicon wafers in the production of advanced ICs. We develop, produce and sell CMP slurries for polishing materials such as copper, tungsten and dielectric in IC devices, and also for polishing the coatings on disks in hard disk drives and magnetic heads. In addition, we have commercialized CMP polishing pads, which are used in conjunction with slurries in the CMP process. Demand for our CMP products for IC devices is primarily based on the number of wafers, or "wafer starts", of these advanced devices produced by semiconductor manufacturers.

In addition to strengthening and growing our core CMP business, through our Engineered Surface Finishes (ESF) growth initiative we are exploring a variety of surface modification applications where we believe our technical ability to shape, enable and enhance the performance of surfaces at an atomic level may provide previously unseen surface performance or improved productivity. By supplementing our internal development efforts with some externally acquired technologies and businesses, we seek to leverage our expertise in CMP formulation, materials and polishing techniques for the semiconductor industry to address other demanding market applications requiring nanoscale control of surface shape and finish, and gain access to a variety of markets that we do not currently serve. One example of this is our July 2006 purchase of substantially all of the assets and assumption of certain liabilities of QED Technologies, Inc. (QED), a company specializing in unique, patented polishing and metrology systems for shaping and polishing of high precision optics.

Revenue for our third fiscal quarter of \$89.0 million was the highest quarterly revenue recorded in our Company's history, and it increased 15.6%, or \$12.0 million, from the previous fiscal quarter. This increase is primarily due to improved semiconductor industry conditions following two quarters of relatively soft industry demand as well as strong performance by QED. During the first half of fiscal 2007, we believe a number of our key customers had reduced production in response to excess inventory of semiconductor devices and this reduced demand for our products. Revenue in our third fiscal quarter was 4.8%, or \$4.1 million, higher than in the three months ended June 30, 2006, which did not include QED.

There are several factors that make it difficult for us to predict future revenue trends for our business, including: the cyclical nature of the semiconductor industry; short order to delivery time for our products and the associated lack of visibility to future customer orders; the effect of competition on pricing; quarter to quarter changes in customer orders regardless of industry strength; and the timing of acquisitions. Some factors that affect demand for our products include customers' production of logic versus memory devices, their transition from 200 mm to 300 mm wafers, customers' specific integration schemes, share gains and losses and pricing changes by us and our competitors.

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Gross profit expressed as a percentage of revenue for our third fiscal quarter was 47.7%, which increased from both the 43.9% reported in the previous fiscal quarter and the 47.6% reported in the third quarter of fiscal 2006. The increase in gross profit as a percentage of revenue over the previous fiscal quarter was primarily driven by higher manufacturing capacity utilization on our higher level of sales, as well as higher manufacturing yields and lower fixed manufacturing costs. We continue to expect our gross profit as a percentage of revenue to be in the range of 46% to 48% for the full fiscal year 2007. We may experience quarterly gross profit above or below this range, as we did in the first two quarters of fiscal 2007, due to a number of factors, including fluctuations in our product mix.

Operating expenses were \$27.9 million in our third quarter of fiscal 2007, compared to \$28.9 million in the previous fiscal quarter of 2007 and \$26.7 million in the third quarter of fiscal 2006. The decrease from the previous fiscal quarter was due to decreased staffing and compensation related expenses and lower depreciation expenses. We continue to expect operating expenses to be in the range of approximately \$27 million to \$30 million in our fourth fiscal quarter of 2007.

Diluted earnings per share for our third fiscal quarter was \$0.42, an increase from the \$0.19 per share reported in the previous fiscal quarter and the \$0.40 per share reported in the same quarter of fiscal 2006. Earnings per share in our third fiscal quarter of 2007 was adversely affected by approximately \$0.06 due to the impairment of our investment in NanoProducts Corporation (NPC), which resulted from our decision to not renew our collaboration agreement with NPC as well as NPC entering into funding arrangements that we believe significantly reduced the likelihood that the Company would recover the value of our investment in NPC.

#### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES AND EFFECTS OF RECENT ACCOUNTING PRONOUNCEMENTS**

We discuss our critical accounting estimates and effects of recent accounting pronouncements in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in Item 7 of Part II of our annual report on Form 10-K for the fiscal year ended September 30, 2006. We believe there have been no material changes in our critical accounting estimates during the first nine months of fiscal 2007.

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115” (SFAS 159). SFAS 159 allows measurement at fair value of eligible financial assets and liabilities that are not otherwise measured at fair value. If the fair value option for an eligible item is elected, unrealized gains and losses for that item shall be reported in current earnings at each subsequent reporting date. This SFAS is effective for fiscal years beginning after November 15, 2007. We do not expect the adoption of SFAS 159 to have a material impact on our consolidated financial position, results of operations or cash flows.



## **RESULTS OF OPERATIONS**

We acquired substantially all of the assets and assumed certain current liabilities of QED in July 2006. Therefore, the prior year comparable periods, the three and nine months ended June 30, 2006, do not include QED results of operations.

### **THREE MONTHS ENDED JUNE 30, 2007, VERSUS THREE MONTHS ENDED JUNE 30, 2006**

#### **REVENUE**

Revenue was \$89.0 million for the three months ended June 30, 2007, which represented an increase of 4.8%, or \$4.1 million, from the three months ended June 30, 2006. Of this increase, \$6.6 million was contributed by QED and \$1.0 million was due to a higher average selling price for our slurry products. These increases were partially offset by a \$3.5 million decrease in sales volume in our core CMP business. The average selling price for our slurry products increased by 1.0% from the third quarter of fiscal 2006, primarily due to a higher-priced product mix.

#### **COST OF GOODS SOLD**

Total cost of goods sold was \$46.6 million for the three months ended June 30, 2007, which represented an increase of 4.6%, or \$2.0 million, from the three months ended June 30, 2006. Of this increase, \$3.3 million was related to QED and \$0.5 million was due to a higher average cost per unit. These increases were partially offset by \$1.8 million related to lower sales volumes in our core CMP business. The higher average unit cost primarily resulted from lower utilization of our manufacturing capacity due to the lower level of sales as well as higher fixed costs.

Fumed metal oxides, such as fumed silica and fumed alumina, are significant raw materials that we use in many of our CMP slurries. In an effort to mitigate our risk to rising raw material costs and to increase supply assurance and quality performance requirements, we have entered into multi-year supply agreements with a number of suppliers. For more financial information about our supply contracts, see "Tabular Disclosure of Contractual Obligations" in this filing as well as in Item 7 of Part II of our annual report on Form 10-K for the fiscal year ended September 30, 2006.

Our need for additional quantities or different kinds of key raw materials has required, and will continue to require, that we enter into new supply arrangements with third parties. Future arrangements may result in costs which are different from those in the existing agreements. In addition, rising energy or other costs may also impact the cost of raw materials, packaging and freight. We expect to continue to invest in our operations excellence initiative to improve product quality, reduce variability and improve product yields in our manufacturing process.

#### **GROSS PROFIT**

Our gross profit as a percentage of revenue was 47.7% for the three months ended June 30, 2007, compared with 47.6% for the three months ended June 30, 2006. The increase resulted primarily from a higher-valued product mix and certain lower variable costs, partially offset by lower utilization of our manufacturing capacity and higher fixed costs. We continue to expect our gross profit as a percentage of revenue to be in the range of 46% to 48% for full fiscal year 2007. Quarterly gross profit may be above or below this range, as demonstrated in the first two quarters of the fiscal year, due to a number of factors, including fluctuations in our product mix.



## **RESEARCH, DEVELOPMENT AND TECHNICAL**

Research, development and technical expenses were \$12.0 million in the three months ended June 30, 2007, which was unchanged from the same period in the previous fiscal year. Our research, development and technical efforts are focused on the following main areas:

- Research related to fundamental CMP technology;
- Development and formulation of new and enhanced CMP slurry and pad products;
- Process development to support rapid and effective commercialization of new products;
  - Evaluation of new polishing applications related to our ESF initiative; and
  - Applications support.

## **SELLING AND MARKETING**

Selling and marketing expenses were \$6.5 million in the three months ended June 30, 2007, which represented an increase of 17.9%, or \$1.0 million, from the three months ended June 30, 2006. Selling and marketing expenses increased primarily due to increased staffing related costs of \$0.8 million.

## **GENERAL AND ADMINISTRATIVE**

General and administrative expenses were \$9.4 million in the three months ended June 30, 2007, which represented an increase of 3.1%, or \$0.3 million, from the three months ended June 30, 2006. The increase resulted primarily from a \$0.6 million increase in professional fees including costs to enforce our intellectual property portfolio, partially offset by a \$0.3 million decrease in depreciation and amortization largely due to certain information technology assets becoming fully depreciated.

## **OTHER INCOME AND EXPENSE, NET**

Other income and expense, net, was \$0.1 million expense in the three months ended June 30, 2007, compared with \$0.8 million income in the three months ended June 30, 2006. The decrease resulted primarily from a \$2.1 million impairment of our investment in NPC as explained in the "Third Quarter of Fiscal 2007 Overview" section above. This was partially offset by foreign exchange gains due to the weakening of the Japanese Yen relative to the U.S. Dollar.

## **PROVISION FOR INCOME TAXES**

Our effective income tax rate was 30.3% for the three months ended June 30, 2007, and 32.7% for the three months ended June 30, 2006. The decrease in the effective tax rate was primarily due to higher tax-exempt interest income and increased research and experimentation tax credits.

## **NET INCOME**

Net income was \$10.1 million for the three months ended June 30, 2007, which represented an increase of 2.9%, or \$0.3 million, from the three months ended June 30, 2006, as a result of the factors discussed above.



**NINE MONTHS ENDED JUNE 30, 2007, VERSUS NINE MONTHS ENDED JUNE 30, 2006**

**REVENUE**

Revenue was \$247.8 million for the nine months ended June 30, 2007, which represented an increase of 6.0%, or \$14.0 million, from the nine months ended June 30, 2006. Of this increase, \$14.2 million was contributed by QED and \$5.8 million was due to a higher average selling price for our slurry products. These increases were partially offset by a \$6.0 million decrease due to reduced sales volume in our core CMP business. The higher average selling price for our slurry products resulted primarily from a higher-priced product mix and higher selling prices. The higher selling prices were mainly attributable to our April 2006 transition to selling directly to customers in Taiwan rather than through a distributor.

**COST OF GOODS SOLD**

Total cost of goods sold was \$132.2 million for the nine months ended June 30, 2007, which represented an increase of 7.1%, or \$8.8 million, from the same period in the previous fiscal year. Of this increase, \$7.6 million was related to QED and \$4.5 million was due to an increase in the average cost per unit. These increases were partially offset by a \$3.2 million decrease in cost of goods sold due to a decrease in sales volume in our core CMP business. The higher average unit cost resulted primarily from lower utilization of our manufacturing capacity due to the lower level of sales and higher fixed costs, partially offset by a lower-cost product mix.

**GROSS PROFIT**

Our gross profit as a percentage of revenue was 46.6% for the nine months ended June 30, 2007, compared with 47.2% for the nine months ended June 30, 2006. The decrease in gross profit expressed as a percentage of revenue resulted primarily from higher fixed costs and a lower utilization of our manufacturing capacity due to the lower level of sales, partially offset by a higher-valued product mix.

**RESEARCH, DEVELOPMENT AND TECHNICAL**

Research, development and technical expenses were \$37.8 million in the nine months ended June 30, 2007, which represented an increase of 7.8%, or \$2.7 million, from the nine months ended June 30, 2006. Research, development and technical expenses increased primarily due to increased staffing related costs of \$1.2 million largely resulting from the inclusion of QED in fiscal 2007, and increased depreciation and amortization costs of \$0.7 million principally related to our data storage laboratory in Singapore and our Asia Pacific technology center in Japan. Higher professional fees of \$0.3 million also contributed to the increase.

**SELLING AND MARKETING**

Selling and marketing expenses were \$17.8 million in the nine months ended June 30, 2007, which represented an increase of 14.1%, or \$2.2 million, from the same period in the previous fiscal year. The single largest factor causing the increase was higher staffing related costs.



## **GENERAL AND ADMINISTRATIVE**

General and administrative expenses were \$28.3 million in the nine months ended June 30, 2007, which represented an increase of 10.0%, or \$2.6 million, from the nine months ended June 30, 2006. The increase resulted primarily from a \$1.7 million increase in staffing related costs, including \$1.3 million in higher share-based compensation expense, and a \$1.0 million increase in professional fees, including costs to enforce our intellectual property.

## **OTHER INCOME AND EXPENSE, NET**

Other income was \$2.3 million in the nine months ended June 30, 2007, compared with \$2.6 million in the nine months ended June 30, 2006. The decrease in other income was primarily due to a \$2.1 million impairment of our investment in NPC, as explained in the "Third Quarter of Fiscal 2007 Overview" section above. This decrease was partially offset by foreign exchange gains due to the weakening of the Japanese Yen relative to the U.S. Dollar.

## **PROVISION FOR INCOME TAXES**

Our effective income tax rate was 30.3% for the nine months ended June 30, 2007, and 32.2% for nine months ended June 30, 2006. The decrease in the effective tax rate was primarily attributable to higher tax-exempt interest income and increased research and experimentation tax credits.

## **NET INCOME**

Net income was \$23.7 million for the nine months ended June 30, 2007, which represented a decrease of 4.5%, or \$1.1 million, from the nine months ended June 30, 2006, as a result of the factors discussed above.

## **LIQUIDITY AND CAPITAL RESOURCES**

We had cash flows from operating activities of \$38.4 million in the nine months ended June 30, 2007, and \$33.1 million in the nine months ended June 30, 2006. Our cash provided by operating activities in the first nine months of fiscal 2007 originated from \$48.6 million of net income adjusted for non-cash items, partially offset by a \$10.2 million net increase in working capital.

In the first nine months of fiscal 2007, cash flows used in investing activities were \$33.9 million, of which \$23.5 million was used for net purchases of short-term investments. Also, \$7.6 million in cash was used for purchases of property, plant and equipment including payments for the expansion of our pad manufacturing capabilities in the U.S. and Taiwan as well as purchases for QED, and \$3.0 million was used to acquire a license of patents. In the first nine months of fiscal 2006, cash flows used in investing activities were \$20.3 million. Purchases of property, plant and equipment of \$19.6 million were made primarily for the construction of our Asia Pacific technology center and for projects in our slurry manufacturing operations. In addition, we used \$5.0 million to acquire patents and associated rights relating to CMP slurry technology and \$2.3 million to acquire substantially all of the assets and assume certain liabilities of Surface Finishes Co., Inc. These cash outflows were partially offset by \$6.6 million received as net proceeds from short-term investments.

In the first nine months of fiscal 2007, cash flows used in financing activities were \$9.6 million, primarily as a result of \$10.0 million in purchases of common stock under our share repurchase program. These cash outflows were partially offset by net proceeds from the issuance of stock, including proceeds received under our employee stock purchase plan, of \$1.1 million. In the first nine months of fiscal 2006, cash flows used in financing activities were \$7.9 million, primarily due to \$8.0 million in purchases of common stock under our share repurchase program. This share repurchase program, which was authorized by our Board of Directors in October 2005 for up to \$40.0 million, had \$14.0 million remaining available for share repurchases at June 30, 2007, although it may be suspended or terminated at any time, at the Company's discretion.

We have an unsecured revolving credit facility of \$50.0 million with an option to increase the facility up to \$80.0 million. This agreement runs through November 2008. Interest accrues on any outstanding balance at either the institution's base rate or the Eurodollar rate plus an applicable margin. We also pay a non-use fee. Loans under this facility are anticipated to be used primarily for general corporate purposes, including working capital and capital expenditures. The credit agreement also contains various covenants. No amounts are currently outstanding under this credit facility and we believe we are currently in compliance with the covenants.

We believe that cash generated by our operations and available borrowings under our revolving credit facility will be sufficient to fund our operations, expected capital expenditures, including limited merger and acquisition activities, and share repurchases for the foreseeable future. However, we plan to expand our business and continue to improve our technology, and to do so may require us to raise additional funds in the future through public or private equity or debt financing, strategic relationships or other arrangements.

#### OFF-BALANCE SHEET ARRANGEMENTS

At June 30, 2007, and September 30, 2006, we did not have any unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which might have been established for the purpose of facilitating off-balance sheet arrangements.

#### TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following summarizes our contractual obligations at June 30, 2007, and the effect such obligations are expected to have on our liquidity and cash flow in future periods.

C O N T R A C T U A L O B L I G A T I O N S (In millions)	Less Than				
	Total	1 Year	1-3 Years	3-5 Years	After 5 Years
Capital lease obligations	\$ 4.9	\$ 1.3	\$ 2.3	\$ 1.3	\$ -
Operating leases	2.0	1.4	0.6	-	-
Purchase obligations	45.9	37.5	6.5	1.9	-
Other long-term liabilities	1.3	-	-	-	1.3
Total contractual obligations	\$ 54.1	\$ 40.2	\$ 9.4	\$ 3.2	\$ 1.3

We operate under a fumed silica supply agreement with Cabot Corporation under which we are obligated to purchase at least 90% of our six-month volume forecast for certain of our slurry products and to pay for the shortfall if we purchase less than that amount. This agreement has an initial six-year term, which expires in December 2009 and will automatically renew unless either party gives certain notice of non-renewal. We currently anticipate meeting



minimum forecasted purchase volume requirements. We also operate under a fumed alumina supply agreement with Cabot Corporation that runs through December 2011, under which we are obligated to pay certain fixed, capital and variable costs. Purchase obligations include an aggregate amount of \$24.8 million of contractual commitments for fumed silica and fumed alumina under these contracts.

In addition to the \$19.0 million in cash that we paid related to our July 2006 QED acquisition, we are obligated to pay another \$2.5 million based on the performance of the QED business in the 12 months following its acquisition, and we may be obligated to pay up to an additional \$2.0 million depending upon the performance of the QED business in the second year following the acquisition. The first-year payment of \$2.5 million is expected to be paid in our fourth quarter of fiscal 2007. Purchase obligations at June 30, 2007, include \$4.5 million related to this agreement, with the conservative assumption that the additional payment will be made in the maximum amount.

Refer to Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of Part II of our annual report on Form 10-K for the fiscal year ended September 30, 2006, for additional information regarding our contractual obligations.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### **EFFECT OF CURRENCY EXCHANGE RATES AND EXCHANGE RATE RISK MANAGEMENT**

We conduct business operations outside of the United States through our foreign operations. Some of our foreign operations maintain their accounting records in their local currencies. Consequently, period to period comparability of results of operations is affected by fluctuations in exchange rates. The primary foreign currencies to which we have exposure are the Japanese Yen and, to a lesser extent, the British Pound and the Euro. From time to time we enter into forward contracts in an effort to manage foreign currency exchange exposure. However, we may be unable to hedge these exposures completely. Approximately 15% of our revenue is transacted in currencies other than the U.S. dollar. We do not currently enter into forward exchange contracts or other derivative instruments for speculative or trading purposes.

#### **MARKET RISK AND SENSITIVITY ANALYSIS RELATED TO FOREIGN EXCHANGE RATE RISK**

We have performed a sensitivity analysis assuming a hypothetical 10% adverse movement in foreign exchange rates. As of June 30, 2007, the analysis demonstrated that such market movements would not have a material adverse effect on our consolidated financial position, results of operations or cash flows over a one-year period. Actual gains and losses in the future may differ materially from this analysis based on changes in the timing and amount of foreign currency rate movements and our actual exposures.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of June 30, 2007.

While we believe the present design of our disclosure controls and procedures is effective enough to make known to our senior management in a timely fashion all material information concerning our business, we intend to continue to improve the design and effectiveness of our disclosure controls and procedures to the extent we believe necessary in the future to provide our senior management with timely access to such material information, and to correct deficiencies that we may discover in the future, as appropriate.

#### **CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### **INHERENT LIMITATIONS ON EFFECTIVENESS OF CONTROLS**

Because of inherent limitations, our disclosure controls or our internal control over financial reporting may not prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must take into account the benefits of controls relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include possible faulty judgment in decision making and breakdowns due to a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

While we are not at present involved in any legal proceedings that we currently believe will have a material impact on our consolidated financial position, results of operations or cash flows, we periodically become a party to legal proceedings in the ordinary course of business. For example, in January 2007, Cabot Microelectronics filed a legal action against DuPont Air Products NanoMaterials LLC (DA Nano), a competitor of ours, in the United States District Court for the District of Arizona, charging that DA Nano's manufacture and marketing of certain CMP slurries infringe five CMP slurry patents that we own. The affected DA Nano products include those used for tungsten CMP. We filed our patent infringement complaint as a counterclaim in response to an action filed by DA Nano in the same court in December 2006 that seeks declaratory relief and alleges non-infringement, invalidity and unenforceability regarding some of the patents at issue in our complaint against DA Nano. DA Nano filed its complaint following our refusal of its request that we license to it our patents raised in its complaint. DA Nano's complaint does not allege any infringement by Cabot Microelectronics' products of intellectual property owned by DA Nano. While the outcome of this and any legal matter cannot be predicted with certainty, we believe that our claims and defenses in the pending action are meritorious, and intend to pursue and defend them vigorously.

### **ITEM 1A. RISK FACTORS**

We do not believe there have been any material changes in our risk factors since the filing of our annual report on Form 10-K for the fiscal year ended September 30, 2006. However, we may update our risk factors in our SEC filings from time to time for clarification purposes or to include additional information, at management's discretion, even when there have been no material changes.

## **RISKS RELATING TO OUR BUSINESS**

### **WE HAVE A NARROW PRODUCT RANGE AND OUR PRODUCTS MAY BECOME OBSOLETE, OR TECHNOLOGICAL CHANGES MAY REDUCE OR LIMIT INCREASES IN CMP CONSUMPTION**

Our business is substantially dependent on a single class of products, CMP slurries, which historically has accounted for almost all of our revenue. Our business would suffer if these products became obsolete or if consumption of these products decreased. Our success depends on our ability to keep pace with technological changes and advances in the semiconductor industry and to adapt, improve and customize our products for advanced IC applications in response to evolving customer needs and industry trends. Since its inception, the semiconductor industry has experienced rapid technological changes and advances in the design, manufacture, performance and application of IC devices, and our customers continually pursue lower cost of ownership of materials consumed in their manufacturing processes, including CMP slurries. We expect these technological changes and advances, and this drive toward lower costs, to continue in the future. Emerging technologies in the semiconductor industry, as well as our customers' efforts to reduce consumption of CMP slurries, could render our products less important to the IC device manufacturing process.

### **A SIGNIFICANT AMOUNT OF OUR BUSINESS COMES FROM A LIMITED NUMBER OF LARGE CUSTOMERS AND OUR REVENUE AND PROFITS COULD DECREASE SIGNIFICANTLY IF WE LOST ONE OR MORE OF THEM AS CUSTOMERS**

Our customer base is concentrated among a limited number of large customers. One or more of these principal customers may stop buying CMP slurries from us or may substantially reduce the quantity of CMP slurries they purchase from us. Our principal customers also hold considerable purchasing power, which can impact the pricing and terms of sale of our products. Any deferral or significant reduction in CMP slurries sold to these principal customers, or a significant number of smaller customers, could seriously harm our business, financial condition and results of operations.

In the nine months ended June 30, 2007, our five largest customers accounted for approximately 42% of our revenue; Taiwan Semiconductor Manufacturing Company (TSMC) was our largest customer, accounting for approximately 17% of our revenue. In fiscal 2006, our five largest customers accounted for approximately 44% of our revenue; Marketech, a distributor, was our largest customer at that time. Effective April 2006, with our transition to direct sales in Taiwan, we began selling directly to TSMC and other customers in Taiwan rather than through Marketech. Due to the timing of this transition, TSMC accounted for approximately 10% of our revenue for the full fiscal year 2006.

### **OUR BUSINESS COULD BE SERIOUSLY HARMED IF OUR EXISTING OR FUTURE COMPETITORS DEVELOP SUPERIOR SLURRY PRODUCTS, OFFER BETTER PRICING TERMS OR SERVICE, OR OBTAIN CERTAIN INTELLECTUAL PROPERTY RIGHTS**

Competition from current CMP slurry manufacturers or new entrants to the CMP slurry market could seriously harm our business and results of operations. Competition from other existing providers of CMP slurries could continue to increase, and opportunities exist for other companies with sufficient financial or technological resources to emerge as potential competitors by developing their own CMP slurry products. Increased competition has and may continue to impact the prices we are able to charge for our slurry products as well as our overall business. In addition, our competitors could have or obtain intellectual property rights which could restrict our ability to market our existing products and/or to innovate and develop new products.



**ANY PROBLEM OR INTERRUPTION IN SUPPLY OF OUR MOST IMPORTANT RAW MATERIALS, INCLUDING FUMED METAL OXIDES, COULD DELAY OUR SLURRY PRODUCTION AND ADVERSELY AFFECT OUR SALES**

Our business would suffer from any problem or interruption in our supply of the key raw materials we use in our CMP slurries, including fumed metal oxides such as fumed alumina and fumed silica. For example, Cabot Corporation continues to be our primary supplier of particular amounts and types of fumed alumina and fumed silica. We believe it would be difficult to promptly secure alternative sources of key raw materials, including fumed metal oxides, in the event one of our suppliers becomes unable to supply us with sufficient quantities of raw materials that meet the quality and technical specifications required by our customers. In addition, contractual amendments to the existing agreements with, or non-performance by, our suppliers could adversely affect us.

Also, if we change the supplier or type of key raw materials we use to make our CMP slurries, or are required to purchase them from a different manufacturer or manufacturing facility or otherwise modify our products, in certain circumstances our customers might have to requalify our CMP slurries for their manufacturing processes and products. The requalification process could take a significant amount of time and expense to complete and could motivate our customers to consider purchasing products from our competitors, possibly interrupting or reducing our sales of CMP slurries to these customers.

**WE ARE SUBJECT TO RISKS ASSOCIATED WITH OUR FOREIGN OPERATIONS**

We currently have operations and a large customer base outside of the United States. Approximately 78% of our revenue was generated by sales to customers outside of the United States for the nine months ended June 30, 2007. Approximately 79% of our revenue was generated by sales to customers outside of the United States for the fiscal year ended September 30, 2006. We encounter risks in doing business in certain foreign countries, including, but not limited to, adverse changes in economic and political conditions, as well as difficulty in enforcing business and customer contracts and agreements, including protection of intellectual property rights.

**BECAUSE WE HAVE LIMITED EXPERIENCE IN BUSINESS AREAS OUTSIDE OF CMP SLURRIES, EXPANSION OF OUR BUSINESS INTO NEW PRODUCTS AND APPLICATIONS MAY NOT BE SUCCESSFUL**

An element of our strategy has been to leverage our current customer relationships and technological expertise to expand our CMP business from CMP slurries into other areas, such as polishing pads. Additionally, under our engineered surface finishes initiative we are actively pursuing a variety of surface modification applications, such as high precision optics. Expanding our business into new product areas could involve technologies, production processes and business models in which we have limited experience, and we may not be able to develop and produce products or provide services that satisfy customers' needs or we may be unable to keep pace with technological or other developments. Also, our competitors may have or obtain intellectual property rights which could restrict our ability to market our existing products and/or to innovate and develop new products.

**BECAUSE WE RELY HEAVILY ON OUR INTELLECTUAL PROPERTY, OUR FAILURE TO ADEQUATELY OBTAIN OR PROTECT IT COULD SERIOUSLY HARM OUR BUSINESS**

Protection of intellectual property is particularly important in our industry because CMP slurry and pad manufacturers develop complex technical formulas for CMP products which are proprietary in nature and differentiate their products from those of competitors. Our intellectual property is important to our success and ability to compete. We attempt to protect our intellectual property rights through a combination of patent, trademark, copyright and trade secret laws, as well as employee and third-party nondisclosure and assignment agreements. Due to our international operations, we pursue protection in different jurisdictions, which may require varying degrees of protection, and we cannot provide assurance that we can obtain adequate protection in each such jurisdiction. Our failure to obtain or maintain adequate protection of our intellectual property rights for any reason, including through the patent prosecution process or in the event of litigation related to such intellectual property, such as the current litigation between us and DA Nano described above, could seriously harm our business. In addition, the costs of obtaining or protecting our intellectual property could negatively affect our operating results.

**WE MAY PURSUE ACQUISITIONS OF, INVESTMENTS IN, AND STRATEGIC ALLIANCES WITH OTHER ENTITIES, WHICH COULD DISRUPT OUR OPERATIONS AND HARM OUR OPERATING RESULTS IF THEY ARE UNSUCCESSFUL**

We expect to continue to make investments in companies, either through acquisitions, investments or alliances, in order to supplement our internal growth and development efforts. Acquisitions and investments involve numerous risks, including the following: difficulties in integrating the operations, technologies, products and personnel of acquired companies; diversion of management's attention from normal daily operations of the business; potential difficulties in entering markets in which we have limited or no direct prior experience and where competitors in such markets have stronger market positions; potential difficulties in operating new businesses with different business models; potential difficulties with regulatory or contract compliance in areas in which we have limited experience; initial dependence on unfamiliar supply chains or relatively small supply partners; insufficient revenues to offset increased expenses associated with acquisitions; potential loss of key employees of the acquired companies; or inability to effectively cooperate and collaborate with our alliance partners.

Further, we may never realize the perceived or anticipated benefits of a business combination or investments in other entities. Acquisitions by us could have negative effects on our results of operations, such as contingent liabilities, gross profit margins, amortization charges related to intangible assets and other effects of accounting for the purchases of other business entities. Investments and acquisitions of technology and development stage companies are inherently risky because these businesses may never develop, and we may incur losses related to these investments. In addition, we may be required to write down the carrying value of these investments to reflect other than temporary declines in their value, which could harm our business and results of operations.

**DEMAND FOR OUR PRODUCTS AND OUR BUSINESS MAY BE ADVERSELY AFFECTED BY WORLDWIDE ECONOMIC AND INDUSTRY CONDITIONS**

Our business is affected by economic and industry conditions, and our revenue is dependent on semiconductor demand. Semiconductor demand, in turn, is impacted by semiconductor industry cycles, and these cycles can dramatically affect our business. During the first two quarters of fiscal 2007, for example, the apparent softening of demand for our products due to excess inventory of semiconductor devices caused our CMP slurry revenue to decrease during the inventory correction. Some additional factors that affect demand for our products include customers' production of logic versus memory devices, their transition from 200 mm to 300 mm wafers, customers'



specific integration schemes, share gains and losses and pricing changes by us and our competitors.

**OUR INABILITY TO ATTRACT AND RETAIN KEY PERSONNEL COULD CAUSE OUR BUSINESS TO SUFFER**

If we fail to attract and retain the necessary managerial, technical and customer support personnel, our business and our ability to maintain existing and obtain new customers, develop new products and provide acceptable levels of customer service could suffer. Competition for qualified personnel, particularly those with significant experience in the semiconductor industry, is intense. The loss of services of key employees could harm our business and results of operations.

**RISKS RELATING TO THE MARKET FOR OUR COMMON STOCK**

**THE MARKET PRICE MAY FLUCTUATE SIGNIFICANTLY AND RAPIDLY**

The market price of our common stock has fluctuated and could continue to fluctuate significantly as a result of factors such as: economic and stock market conditions generally and specifically as they may impact participants in the semiconductor and related industries; changes in financial estimates and recommendations by securities analysts who follow our stock; earnings and other announcements by, and changes in market evaluations of, us or participants in the semiconductor and related industries; changes in business or regulatory conditions affecting us or participants in the semiconductor and related industries; announcements or implementation by us, our competitors, or our customers of technological innovations, new products or different business strategies; and trading volume of our common stock.

**ANTI-TAKEOVER PROVISIONS UNDER OUR CERTIFICATE OF INCORPORATION AND BYLAWS AND OUR RIGHTS PLAN MAY DISCOURAGE THIRD PARTIES FROM MAKING AN UNSOLICITED BID FOR OUR COMPANY**

Our certificate of incorporation, our bylaws, our rights plan and various provisions of the Delaware General Corporation Law may make it more difficult to effect a change in control of our Company. For example, our amended and restated certificate of incorporation authorizes our Board of Directors to issue up to 20 million shares of blank check preferred stock and to attach special rights and preferences to this preferred stock. Also our amended and restated certificate of incorporation provides for the division of our Board of Directors into three classes as nearly equal in size as possible with staggered three-year terms. In addition, the rights issued to our stockholders under our rights plan may make it more difficult or expensive for another person or entity to acquire control of us without the consent of our Board of Directors.

We have adopted change in control arrangements covering our executive officers and other key employees. These arrangements provide for a cash severance payment, continued medical benefits and other ancillary payments and benefits upon termination of service of a covered employee's employment following a change in control.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****ISSUER PURCHASES OF EQUITY SECURITIES**

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands)</b>
Apr. 1 through Apr. 30, 2007	-	-	-	\$ 14,009
May 1 through May 31, 2007	-	-	-	\$ 14,009
Jun. 1 through Jun. 30, 2007	-	-	-	\$ 14,009
<b>Total</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>\$ 14,009</b>

In October 2005, we announced that our Board of Directors had authorized a share repurchase program for up to \$40.0 million of our outstanding common stock. Shares are purchased from time to time, depending on market conditions, in open market transactions, at management's discretion. We fund share purchases from our existing cash balance. The program, which became effective on the authorization date, may be suspended or terminated at any time, at the Company's discretion. We view the program as an effective means to return cash to stockholders.

**ITEM 6. EXHIBITS**

The exhibit numbers in the following list correspond to the number assigned to such exhibits in the Exhibit Table of Item 601 of Regulation S-K:

<b>Exhibit Number</b>	<b>Description</b>
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

C A B O T  
MICROELECTRONICS  
CORPORATION

Date: August 8, 2007 / s / W I L L I A M S .  
JOHNSON  
William S. Johnson  
Vice President and Chief  
Financial Officer  
[Principal Financial  
Officer]

Date: August 8, 2007 / s / T H O M A S S .  
ROMAN  
Thomas S. Roman  
Corporate Controller  
[Principal Accounting  
Officer]