CABOT MICROELECTRONICS CORP
Form 10-Q
February 08, 2010

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

FORM 10-Q

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

For the quarterly period ended

DECEMBER 31, 2009

or

o 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<br>(State of Incorporation) | 36-4324765<br>(I.R.S. Employer Identification No.) |
| 870 NORTH COMMONS DRIVE<br>AURORA, ILLINOIS<br>(Address of principal executive offices) | 60504<br>(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.
YESXNO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES NO

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

| | | | | |
|---|---|---|---|---|
| Large accelerated filer | X | Accelerated filer | Non-accelerated filer | Smaller reporting company |

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

YES NOX

As of January 31, 2010, the Company had 23,574,641 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 December 31, | |
|---|---|---|
| | 2009 | 2008 |
| Revenue | $97,672 | $63,017 |
| Cost of goods sold | 47,264 | 34,311 |
| Gross profit | 50,408 | 28,706 |
| Operating expenses: | | |
| Research, development and technical | 12,581 | 12,114 |
| Selling and marketing | 6,322 | 5,973 |
| General and administrative | 11,245 | 11,326 |
| Total operating expenses | 30,148 | 29,413 |
| Operating income (loss) | 20,260 | (707) |
| Other income, net | 61 | 876 |
| Income before income taxes | 20,321 | 169 |
| Provision for income taxes | 7,197 | 53 |
| Net income | $13,124 | $116 |
| Basic earnings per share | $0.57 | $0.01 |
| Weighted average basic shares outstanding | 23,167 | 23,020 |
| Diluted earnings per share | $0.56 | $0.01 |
| Weighted average diluted shares outstanding | 23,294 | 23,026 |

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

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

| | December 31, 2009 | September 30, 2009 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $224,810 | $199,952 |
| Accounts receivable, less allowance for doubtful accounts of $1,261 at December 31, 2009, and $1,277 at September 30, 2009 | 49,904 | 53,538 |
| Inventories | 43,970 | 44,940 |
| Prepaid expenses and other current assets | 14,301 | 14,428 |
| Deferred income taxes | 3,658 | 3,994 |
| Total current assets | 336,643 | 316,852 |
| | | |
| Property, plant and equipment, net | 116,493 | 122,782 |
| Goodwill | 39,742 | 39,732 |
| Other intangible assets, net | 18,262 | 18,741 |
| Deferred income taxes | 9,399 | 7,953 |
| Other long-term assets | 9,050 | 9,084 |
| Total assets | $529,589 | $515,144 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $12,505 | $15,182 |
| Capital lease obligations | 1,231 | 1,210 |
| Accrued expenses, income taxes payable and other current liabilities | 26,079 | 23,144 |
| Total current liabilities | 39,815 | 39,536 |
| | | |
| Capital lease obligations | 992 | 1,308 |
| Other long-term liabilities | 3,597 | 3,571 |
| Total liabilities | 44,404 | 44,415 |
| | | |
| Commitments and contingencies (Note 9) | | |
| | | |
| Stockholders' equity: | | |
| Common stock: | | |
| Authorized: 200,000,000 shares, $0.001 par value | | |
| Issued: 26,274,001 shares at December 31, 2009, and 26,143,116 shares at September 30, 2009 | 26 | 26 |
| Capital in excess of par value of common stock | 216,441 | 213,031 |
| Retained earnings | 347,433 | 334,309 |
| Accumulated other comprehensive income | 12,363 | 13,690 |
| Treasury stock at cost, 2,722,449 shares at December 31, 2009, and 2,698,234 shares at September 30, 2009 | (91,078) | (90,327) |
| Total stockholders' equity | 485,185 | 470,729 |

| | | |
|---|---|---|
| Total liabilities and stockholders’ equity | $529,589 | $515,144 |

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

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

| | Three Months Ended December 31, 2009 | 2008 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $13,124 | $116 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 6,373 | 6,166 |
| Share-based compensation expense | 3,311 | 4,234 |
| Deferred income tax benefit | (368) | (1,292) |
| Non-cash foreign exchange (gain) loss | 652 | (4,847) |
| Loss on disposal of property, plant and equipment | 52 | 81 |
| Impairment of property, plant and equipment | - | 81 |
| Other | 54 | 515 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 2,818 | 10,547 |
| Inventories | 464 | (7,920) |
| Prepaid expenses and other assets | 90 | 1,150 |
| Accounts payable | (2,644) | (2,956) |
| Accrued expenses, income taxes payable and other liabilities | 3,266 | (8,488) |
| Net cash provided by (used in) operating activities | 27,192 | (2,613) |
| | | |
| Cash flows from investing activities: | | |
| Additions to property, plant and equipment | (833) | (2,341) |
| Purchase of patents | (115) | - |
| Net cash used in investing activities | (948) | (2,341) |
| | | |
| Cash flows from financing activities: | | |
| Repurchases of common stock | (751) | (334) |
| Net proceeds from issuance of stock | 90 | 169 |
| Principal payments under capital lease obligations | (295) | (276) |
| Net cash used in financing activities | (956) | (441) |
| | | |
| Effect of exchange rate changes on cash | (430) | 2,076 |
| Increase (decrease) in cash and cash equivalents | 24,858 | (3,319) |
| Cash and cash equivalents at beginning of period | 199,952 | 221,467 |
| Cash and cash equivalents at end of period | $224,810 | $218,148 |
| | | |
| Supplemental disclosure of non-cash investing and financing activities: | | |
| Purchases of property, plant and equipment in accrued liabilities and accounts payable at the end of the period | $564 | $574 |
| Issuance of restricted stock | 4,478 | 3,727 |

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 and pads 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 deposited upon silicon wafers in the production of advanced ICs. Our products play a critical role in the production of advanced IC devices, thereby enabling our customers to produce smaller, faster and more complex IC devices with fewer defects. We develop, produce and sell CMP slurries for polishing many of the conducting and insulating materials used in IC devices, and also for polishing the disk substrates and magnetic heads used in hard disk drives. We also develop, manufacture and sell CMP polishing pads, which are used in conjunction with slurries in the CMP process. We also continue to pursue our Engineered Surface Finishes (ESF) business where we believe we can leverage our expertise in CMP consumables for the semiconductor industry to develop products for demanding polishing applications in other industries. 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, 2009.

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 December 31, 2009, cash flows for the three months ended December 31, 2009, and December 31, 2008, and results of operations for the three months ended December 31, 2009, and December 31, 2008. The results of operations for the three months ended December 31, 2009 may not be indicative of the results to be expected for future periods, including the fiscal year ending September 30, 2010. 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, 2009. We currently operate predominantly in one industry segment - the development, manufacture and sale of CMP consumables. Certain reclassifications of prior fiscal year amounts have been made to conform to the current period presentation.

The consolidated financial statements include the accounts of Cabot Microelectronics and its subsidiaries. All intercompany transactions and balances between the companies have been eliminated as of December 31, 2009. We performed an evaluation of subsequent events through February 8, 2010, the date the financial statements were issued. There were no subsequent events that required adjustment to or disclosure in our financial statements.

## 2. BUSINESS COMBINATION

On February 27, 2009, we completed the acquisition of Epoch Material Co., Ltd. (Epoch), which previously was a consolidated subsidiary of Eternal Chemical Co., Ltd. (Eternal). Epoch is a Taiwan-based company specializing in the development, manufacture and sale of copper CMP slurries and CMP cleaning solutions to the semiconductor industry, and color filter slurries to the liquid crystal display (LCD) industry. We paid $59,391 to obtain 90% of Epoch’s stock, plus $728 of transaction costs, from our available cash balance. We expect to pay an additional $6,600 to Eternal in August 2010 to acquire the remaining 10% of Epoch’s stock and we have placed $6,600 in an escrow account in Taiwan to be held for this purpose until the payment date. The escrow account is recorded as current restricted cash at December 31, 2009 and is included with prepaid expenses and other current assets on our Consolidated Balance Sheet. During this interim period, Eternal will continue to hold the remaining 10% ownership interest in Epoch. However, Eternal has waived rights to any interest in the earnings of Epoch during the interim period, including any associated dividends. Consequently, we have recorded a $6,600 current liability in accrued expenses and other current liabilities on our Consolidated Balance Sheet at December 31, 2009, rather than recording a noncontrolling interest in Epoch.

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

All business combinations have been accounted for under the purchase method of accounting. Accordingly, the assets and liabilities of the acquired entities are recorded at their estimated fair values at the date of acquisition. Goodwill represents the excess of the purchase price over the fair value of net assets and amounts assigned to identifiable intangible assets. Purchased in-process research and development (IPR&D), for which technological feasibility has not yet been established and no future alternative uses exist, is expensed immediately. In December 2007, the Financial Accounting Standards Board (FASB) issued new standards for the accounting for business combinations. The new standards retain the purchase method of accounting for acquisitions, but require a number of changes, including changes in the way assets and liabilities are recognized in purchase accounting. They also change the recognition of assets acquired and liabilities assumed arising from contingencies, require the capitalization of in-process research and development at fair value, and require acquisition-related costs to be charged to expense as incurred. The new standards were effective for us October 1, 2009 and will apply prospectively to business combinations completed on or after that date.

The purchase price for Epoch was allocated to tangible assets, liabilities assumed, identified intangible assets acquired, as well as IPR&D, based on our preliminary estimation of their fair values. The excess of the purchase price over the aggregate fair values was recorded as goodwill and is generally fully deductible for tax purposes. The following table summarizes the final purchase price allocation.

| | |
|---|---|
| Current assets | $ 11,453 |
| Long-term assets | 13,965 |
| In-process research and development | 1,410 |
| Identified intangible assets | 11,510 |
| Goodwill | 29,877 |
| Total assets acquired | 68,215 |
| Total liabilities assumed | 1,496 |
| Net assets acquired | $ 66,719 |

We have recorded 100% of Epoch's results of operations since February 27, 2009 in our Consolidated Statement of Income.

The following unaudited pro forma consolidated results of operations have been prepared as if the acquisition of Epoch had occurred on October 1, 2008:

| | Three Months Ended December 31, 2008 |
|---|---|
| Revenues | $ 66,997 |
| Net loss | $ (1,444 ) |
| Net loss per share: | |
| Basic | $ (0.06 ) |
| Diluted | $ (0.06 ) |

The unaudited pro forma consolidated results of operations do not purport to be indicative of the results that would have been achieved if the acquisition had actually occurred as of the date indicated, or of those results that may be achieved in the future. The unaudited pro forma consolidated results of operations include adjustments to net income to give effect to: expensing of IPR&D on October 1, 2008; amortization of intangible assets acquired; depreciation of property, plant and equipment acquired; and income taxes.

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

## 3. FAIR VALUE OF FINANCIAL INSTRUMENTS

On October 1, 2008, we adopted various accounting standards issued by the FASB for the fair value measurement of all financial assets and financial liabilities. These standards established a common definition for fair value in generally accepted accounting principles, established a framework for measuring fair value and expanded disclosure about such fair value measurements. These standards also clarified the application of fair value measurement in an inactive market and illustrated how an entity would determine fair value when the market for a financial asset is not active. These standards allow measurement at fair value of eligible financial assets and financial liabilities that are not otherwise measured at fair value on an instrument-by-instrument basis (the "fair value option"). We did not elect the fair value option for any financial assets or financial liabilities that were not previously required to be measured at fair value under other generally accepted accounting principles. On October 1, 2009, we adopted the accounting provisions that relate to non-financial assets and non-financial liabilities. We did not elect the fair value option for any non-financial assets or non-financial liabilities that were not previously required to be measured at fair value under other generally accepted accounting principles. The adoption of these new provisions did not have a material impact on our results of operations, financial position or cash flows.

Fair value is defined as the price that would be received from the sale of an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The FASB established a three-level hierarchy for disclosure based on the extent and level of judgment used to estimate fair value. Level 1 inputs consist of valuations based on quoted market prices in active markets for identical assets or liabilities. Level 2 inputs consist of valuations based on quoted prices for similar assets or liabilities, quoted prices for identical assets or liabilities in an inactive market, or other observable inputs. Level 3 inputs consist of valuations based on unobservable inputs that are supported by little or no market activity. Effective April 1, 2009, we adopted new fair value standards issued by the FASB which require disclosures about fair value of financial instruments in interim reporting periods as well as in annual financial statements and require fair value disclosures in summarized financial information at interim periods.

The following table presents assets that we measured at fair value on a recurring basis at December 31, 2009. As permitted under the relevant standards, we have chosen to not measure any of our liabilities at fair value as we believe our liabilities approximate their fair value due to their short-term, highly liquid characteristics. We have classified the following assets in accordance with the fair value hierarchy set forth in the applicable standards. In instances where the inputs used to measure the fair value of an asset fall into more than one level of the hierarchy, we have classified them based on the lowest level input that is significant to the determination of the fair value.

| | Level 1 | Level 2 | Level 3 | Total Fair Value |
|---|---|---|---|---|
| Cash and cash equivalents | $ 224,810 | $ - | $ - | $ 224,810 |
| Auction rate securities (ARS) | - | - | 8,116 | 8,116 |
| Total | $ 224,810 | $ - | $ 8,116 | $ 232,926 |

Our cash and cash equivalents consist of various bank accounts used to support our operations and investments in institutional money-market funds which are traded in active markets. The recorded amounts of cash, accounts receivable and accounts payable approximate their fair values due to their short-term, highly liquid characteristics. The fair value of our long-term ARS is determined through two discounted cash flow analyses, one using a discount rate based on a market index comprised of tax exempt variable rate demand obligations and one using a discount rate based on the LIBOR swap curve, adding a risk factor to reflect current liquidity issues in the ARS market.

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

Effective April 1, 2009, we adopted accounting standards issued by the FASB regarding the classification and valuation of financial instruments, including the recognition and presentation of other-than-temporary impairments for investment securities we purchase and the determination of fair value of financial instruments when the volume of trading activity significantly decreases. A debt security is considered to be impaired when the fair value of the debt security is less than its amortized cost at the balance sheet date. An other-than-temporary impairment must be recorded when a credit loss exists; that is when the present value of the expected cash flows from a debt security is less than the amortized cost basis of the security. An impairment is considered to be other-than-temporary when: 1) an entity intends to sell a debt security that is impaired; 2) when it is more likely than not that an entity will be required to sell the security before the recovery of its amortized cost basis; or 3) when a credit loss exists. An entity must recognize an impairment related to any of the three of these circumstances currently in earnings.

We applied these new standards to the valuation of our investment in ARS at December 31, 2009. Our ARS investments at December 31, 2009 consisted of two tax exempt municipal debt securities with a total par value of $8,350. The ARS market began to experience illiquidity in early 2008, and this illiquidity continues. Despite this lack of liquidity, there have been no defaults of the underlying securities and interest income on these holdings continues to be received on scheduled interest payment dates. Our ARS, when purchased, were generally issued by A-rated municipalities. Although the credit ratings of both municipalities have been downgraded since our original investment, the ARS are credit enhanced with bond insurance and currently carry a credit rating of AAA.

Since an active market for ARS does not currently exist, we determine the fair value of these investments using a Level 3 discounted cash flow analysis and also consider other factors such as the reduced liquidity in the ARS market and nature of the insurance backing. Key inputs to our discounted cash flow model include projected cash flows from interest and principal payments and the weighted probabilities of improved liquidity or debt refinancing by the issuer. We also incorporate certain Level 2 market indices into the discounted cash flow analysis, including published rates such as the LIBOR rate, the LIBOR swap curve and a municipal swap index published by the Securities Industry and Financial Markets Association.

Based on our fair value assessment, we determined that one ARS continues to be impaired as of December 31, 2009. This security has a fair value of $3,166 (par value $3,400). We assessed the impairment in accordance with the applicable standards and determined that the impairment was due to the lack of liquidity in the ARS market rather than to credit risk. We have maintained the $234 temporary impairment that we first recorded in fiscal 2008. In addition, we believe that this ARS is not permanently impaired because in the event of default by the municipality, the insurance provider would pay interest and principal following the original repayment schedule, and we do not intend to sell the security nor do we believe we will be required to sell the security before the value recovers, which may be at maturity. We determined that the other ARS was not impaired as of December 31, 2009. See Note 6 for more information on these investments.

4. INVENTORIES

Inventories consisted of the following:

| | December 31, | September 30, |
|---|---|---|

| | 2009 | 2009 |
|---|---|---|
| Raw materials | $ 17,901 | $ 20,082 |
| Work in process | 2,880 | 3,080 |
| Finished goods | 23,189 | 21,778 |
| Total | $ 43,970 | $ 44,940 |

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

## 5. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill was $39,742 as of December 31, 2009, and $39,732 as of September 30, 2009. The increase in goodwill was due to foreign exchange fluctuation of the New Taiwan Dollar related to Epoch.

Goodwill and indefinite lived intangible assets are tested for impairment annually in the fourth fiscal quarter or more frequently if indicators of potential impairment exist, using a fair-value-based approach. The recoverability of goodwill is measured at the reporting unit level, which is defined as either an operating segment or one level below an operating segment. We have consistently determined the fair value of our reporting units using a discounted cash flow analysis of our projected future results. The recoverability of indefinite lived intangible assets is measured using the royalty savings method. The use of discounted projected future results is based on assumptions that are consistent with our estimates of future growth within the strategic plan used to manage the underlying business. Factors requiring significant judgment include assumptions related to future growth rates, discount factors, royalty rates and tax rates, among others. Changes in economic and operating conditions that occur after the annual impairment analysis or an interim impairment analysis that impact these assumptions may result in future impairment charges. We completed our annual impairment test during our fourth quarter of fiscal 2009 and concluded that no impairment existed. There were no indicators of potential impairment during the quarter ended December 31, 2009, so we did not perform an impairment review for goodwill and indefinite-lived intangible assets during the quarter.

The components of other intangible assets are as follows:

| | December 31, 2009 | | September 30, 2009 | |
|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Other intangible assets subject to amortization: | | | | |
| Product technology | $8,136 | $ 2,211 | $8,135 | $ 1,978 |
| Acquired patents and licenses | 8,115 | 5,902 | 8,000 | 5,825 |
| Trade secrets and know-how | 2,550 | 2,550 | 2,550 | 2,550 |
| Distribution rights, customer lists and other | 11,290 | 2,356 | 11,287 | 2,068 |
| Total other intangible assets subject to amortization | 30,091 | 13,019 | 29,972 | 12,421 |
| Total other intangible assets not subject to amortization* | 1,190 | | 1,190 | |
| Total other intangible assets | $31,281 | $ 13,019 | $31,162 | $ 12,421 |

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

Amortization expense on our other intangible assets was $594 and $678 for the three months ended December 31, 2009 and 2008, respectively. Estimated future amortization expense for the five succeeding fiscal years is as follows:

Estimated
Amortization

| Fiscal Year | Expense |
|---|---|
| Remainder of 2010 | $ 1,797 |
| 2011 | 2,388 |
| 2012 | 2,388 |
| 2013 | 2,388 |
| 2014 | 2,347 |

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

## 6. OTHER LONG-TERM ASSETS

Other long-term assets consisted of the following:

| | December 31, 2009 | September 30, 2009 |
|---|---|---|
| Long-term investments | $ 8,116 | $ 8,116 |
| Other long-term assets | 934 | 968 |
| Total | $ 9,050 | $ 9,084 |

As discussed in Note 3 of this Form 10-Q, our two ARS that we owned as of December 31, 2009 are classified as long-term investments. The securities are credit enhanced with bond insurance to a AAA credit rating and all interest payments continue to be received on a timely basis. Although we believe these securities will ultimately be collected in full, we believe that it is not likely that we will be able to monetize the securities in our next business cycle (which for us is generally one year). We maintain a $234 pretax reduction ($151 net of tax) in fair value on one of the ARS that we had recognized as of September 30, 2009. We assessed the impairment and determined that the impairment was temporary as it was related to the illiquid ARS market rather than credit risk. In addition, we continue to believe this decline in fair value is temporary based on the nature of the underlying debt, the presence of bond insurance, our expectation that the issuer may refinance its debt, the fact that all interest payments have been received, and our intention not to sell the security nor be required to sell the security until the value recovers, which may be at maturity, given our current cash position, our expected future cash flow, and our unused debt capacity.

## 7. ACCRUED EXPENSES, INCOME TAXES PAYABLE AND OTHER CURRENT LIABILITIES

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

| | December 31, 2009 | September 30, 2009 |
|---|---|---|
| Accrued compensation | $ 9,842 | $ 8,462 |
| Goods and services received, not yet invoiced | 3,479 | 2,806 |
| Warranty accrual | 315 | 360 |
| | 1,741 | 1,175 |

| | | |
|---|---|---|
| Taxes, other than income taxes | | |
| Income taxes payable | 1,491 | - |
| Acquisition related | 6,600 | 6,600 |
| Other | 2,611 | 3,741 |
| Total | $ 26,079 | $ 23,144 |

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

## 8. DERIVATIVE FINANCIAL INSTRUMENTS

On January 1, 2009, we adopted new accounting standards regarding disclosures about derivative instruments and hedging activities. These standards require enhanced disclosures about (a) how and why derivative instruments are used, (b) how derivative instruments and related hedged items are accounted for, and (c) how derivative instruments and related hedged items affect our financial position, financial performance and cash flows.

Periodically we enter into forward foreign exchange contracts in an effort to mitigate the risks associated with currency fluctuations on certain foreign currency balance sheet exposures. Our foreign exchange contracts do not qualify for hedge accounting; therefore, the gains and losses resulting from the impact of currency exchange rate movements on our forward foreign exchange contracts are recognized as other income or expense in the accompanying consolidated income statements in the period in which the exchange rates change. We do not use derivative financial instruments for trading or speculative purposes. In addition, all derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. At December 31, 2009, we had one forward foreign exchange contract to sell Japanese Yen related to intercompany notes with one of our subsidiaries in Japan and for the purpose of hedging the risk associated with a net transactional exposure in Japanese Yen.

The fair value of our derivative instrument included in the Consolidated Balance Sheet was as follows:

| | | Asset Derivatives | | Liability Derivatives | |
|---|---|---|---|---|---|
| | Balance Sheet Location | Fair Value at December 31, 2009 | Fair Value at September 30, 2009 | Fair Value at December 31, 2009 | Fair Value at September 30, 2009 |
| Derivatives not designated as hedging instruments | | | | | |
| Foreign exchange contracts | Prepaid expenses and other current assets | $ 765 | $ - | $ - | $ - |
| | Accrued expenses and other current liabilities | $ - | $ - | $ - | $ 242 |

The following table summarizes the effect of our derivative instrument on our Consolidated Statement of Income for the three months ended December 31:

| | | Gain (Loss) Recognized in Statement of Income Three Months Ended | |
|---|---|---|---|
| | Statement of Income (Loss) Location | December 31, 2009 | December 31, 2008 |
| Derivatives not designated as hedging instruments | | | |
| Foreign exchange contracts | Other income, net | $ 490 | $ (3,710 ) |

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

9. CONTINGENCIES

While we are not involved in any legal proceedings that we 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, we filed a legal action against DuPont Air Products NanoMaterials LLC (DA Nano), a CMP slurry competitor, in the United States District Court for the District of Arizona, charging that DA Nano’s manufacturing and marketing of CMP slurries infringe five CMP slurry patents that we own. The affected DA Nano products include certain products used for tungsten CMP. We filed our 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 our products of intellectual property owned by DA Nano. On July 25, 2008, the District Court issued its patent claim construction, or “Markman” Order (“Markman Order”) in the litigation. In a Markman ruling, a district court hearing a patent infringement case interprets and rules on the scope and meaning of disputed patent claim language regarding the patents in suit. We believe that a Markman decision is often a significant factor in the progress and outcome of patent infringement litigation. In the Markman Order, the District Court adopted interpretations that we believe are favorable to Cabot Microelectronics on all claim terms that were in dispute in the litigation. On January 27, 2009, we filed a motion for summary judgment on DA Nano’s infringement of certain of the patents at issue in the suit, and on that same date, DA Nano filed a motion for summary judgment on non-infringement and invalidity of certain of the patents at issue in the suit. On November 16, 2009, the District Court issued its ruling on all of these respective summary judgment motions. In its summary judgment ruling, the District Court denied a motion filed by DA Nano for summary judgment of invalidity of three of our patents at issue in the case, which are fundamental patents in the field of tungsten CMP. The District Court also denied DA Nano’s motion for summary judgment of non-infringement of these patents. In addition, the District Court denied DA Nano’s motion for summary judgment of non-infringement of another one of our patents at issue in the suit that is considered to be a foundational CMP patent. The District Court also denied Cabot Microelectronics’ motion for summary judgment of infringement of the tungsten patents, stating that despite the weight of the record on DA Nano’s infringement, summary judgment is not the forum to decide issues of fact that remain. We believe that the summary judgment ruling supports our position on the merits of the case with regard to the evidence of DA Nano’s infringement of our tungsten patents and the lack of evidence of invalidity of these patents. Although no trial date has yet been set, the parties submitted pretrial filings on January 15, 2010, and as a result of this and the ruling on the summary judgment motions, we now expect the case to proceed in a timely manner, with trial possibly scheduled for the first half of calendar 2010. While the outcome of this and any legal matter cannot be predicted with certainty, we continue to believe that our claims and defenses in the pending action are meritorious, and we intend to continue to pursue and defend them vigorously.

Refer to Note 17 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, 2009, for additional information regarding commitments and contingencies.

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

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. Additions and deductions to the warranty reserve are recorded in cost of goods sold. Our warranty reserve requirements changed during the first three months of fiscal 2010 as follows:

| | |
|---|---|
| Balance as of September 30, 2009 | $360 |
| Reserve for product warranty during the reporting period | 274 |
| Settlement of warranty | (319) |
| Balance as of December 31, 2009 | $315 |

10. SHARE-BASED COMPENSATION PLANS

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 23, 2008 ("2000 Equity Incentive Plan"); our Cabot Microelectronics Corporation Employee Stock Purchase Plan (ESPP), which was amended to become the Cabot Microelectronics Corporation 2007 Employee Stock Purchase Plan, as Amended and Restated January 1, 2010, and, pursuant to our 2000 Equity Incentive Plan, our Directors' Deferred Compensation Plan, as amended September 23, 2008 and our 2001 Executive Officer Deposit Share Program. For additional information regarding these programs, refer to Note 12 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, 2009. In conjunction with certain cost reduction initiatives we implemented in the second quarter of fiscal 2009, the ESPP was amended as of January 19, 2009 to suspend the 15% discount from the fair market value of our stock that employees previously received on their ESPP purchases. Pursuant to the amended ESPP, effective with the six-month period beginning January 1, 2009, the ESPP shares were purchased at a price equal to the lower of the closing price at the beginning or end of each semi-annual offering period. In light of improved economic and industry conditions, the ESPP was amended again as of January 1, 2010 to reinstate the 15% discount effective January 1, 2010.

We record share-based compensation expense for all share-based awards, including stock option grants, restricted stock and restricted stock unit awards and employee stock purchases. We calculate share-based compensation expense using the straight-line approach based on awards ultimately expected to vest, which requires the use of an estimated forfeiture rate. Our estimated forfeiture rate is primarily based on historical experience, but may be revised in future periods if actual forfeitures differ from the estimate. We use the Black-Scholes model to estimate the grant date fair value of our stock options and employee stock purchases. This model requires the input of highly subjective assumptions, including the price volatility of the underlying stock, the expected term of our stock options and the risk-free interest rate. We estimate the expected volatility of our stock options based on a combination of our stock's historical volatility and the implied volatilities from actively-traded options on our stock. We calculate the expected term of our stock options using the simplified method, due to our limited amount of historical option exercise data, and we add a slight premium to this expected term for employees who meet the definition of retirement eligible pursuant to their grants during the contractual term of the grant.  The simplified method uses an average of the vesting term and the contractual term of the option to calculate the expected term.  The risk-free rate is derived from the U.S. Treasury yield curve in effect at the time of grant.

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

Share-based compensation expense for the three months ended December 31, 2009, and 2008, was as follows:

| Income statement classifications: | Three Months Ended December 31, 2009 | 2008 |
|---|---|---|
| Cost of goods sold | $ 248 | $ 346 |
| Research, development and technical | 242 | 388 |
| Selling and marketing | 301 | 419 |
| General and administrative | 2,520 | 3,081 |
| Total share-based compensation expense | 3,311 | 4,234 |
| Tax benefit | 1,179 | 1,513 |
| Total share-based compensation expense, net of tax | $ 2,132 | $ 2,721 |

For additional information regarding the estimation of fair value, refer to Note 12 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, 2009.

## 11. OTHER INCOME, NET

Other income, net, consisted of the following:

| | Three Months Ended December 31, 2009 | 2008 |
|---|---|---|
| Interest income | $ 44 | $ 734 |
| Interest expense | (71 ) | (101 ) |

| | | |
|---|---|---|
| Other income (expense) | 88 | 243 |
| Total other income, net | $ 61 | $ 876 |

The decrease in interest income during the three months ended December 31, 2009 was primarily due to lower interest rates earned on our cash balances compared to the same period in fiscal 2009.

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

## 12. COMPREHENSIVE INCOME

The components of comprehensive income were as follows:

| | Three Months Ended December 31, 2009 | Three Months Ended December 31, 2008 |
|---|---|---|
| Net income | $ 13,124 | $ 116 |
| Other comprehensive income: | | |
| Foreign currency translation adjustment | (1,334 ) | 5,450 |
| Minimum pension liability adjustment | 7 | 1 |
| Total comprehensive income | $ 11,797 | $ 5,567 |

The foreign currency translation adjustments during the three months ended December 31, 2009 and 2008 resulted primarily from the changes in the exchange rates of the U.S. dollar relative to the Japanese Yen.

## 13. INCOME TAXES

Our effective income tax rate was 35.4% for the three months ended December 31, 2009 compared to an effective income tax rate of 31.4% for the three months ended December 31, 2008. The increase in the effective tax rate during the first quarter of fiscal 2010 is primarily due to the expiration of the research and experimentation tax credit as of December 31, 2009 and a decrease in tax-exempt interest income, partially offset by a reduction in tax expense related to share-based compensation. There were no material changes to our liability for uncertain tax positions during the three months ended December 31, 2009.

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

## 14. EARNINGS PER SHARE

The standards of accounting for earnings per share require 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 December 31, 2009 | Three Months Ended December 31, 2008 |
|---|---|---|
| Numerator: | | |
| Earnings available to common shares | $ 13,124 | $ 116 |
| | | |
| Denominator: | | |
| Weighted average common shares | 23,167,213 | 23,019,620 |
| (Denominator for basic calculation) | | |
| | | |
| Weighted average effect of dilutive securities: | | |
| Share-based compensation | 126,677 | 6,469 |
| Diluted weighted average common shares | 23,293,890 | 23,026,089 |
| (Denominator for diluted calculation) | | |
| | | |
| Earnings per share: | | |
| Basic | $ 0.57 | $ 0.01 |
| | | |
| Diluted | $ 0.56 | $ 0.01 |

For the three months ended December 31, 2009 and 2008, approximately 2.7 million and 4.1 million shares, respectively, attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because the exercise price of the options was greater than the average market price of our common stock and, therefore, their inclusion would have been anti-dilutive.

## 15. NEW ACCOUNTING PRONOUNCEMENTS

On October 1, 2009, we adopted new accounting standards for the accounting and reporting of minority equity interests in subsidiaries. Minority interests are characterized as noncontrolling interests and are reported as a component of equity separate from the parent's equity, and purchases or sales of equity interests that do not result in a change of control are accounted for as equity transactions. In addition, net income attributable to the noncontrolling interest is included in consolidated net income on the face of the statement of income and, upon loss of control, the interest sold, as well as any interest retained, is recorded at fair value with any gain or loss recognized in earnings. The new standards apply prospectively, except for the presentation and disclosure requirements, which apply retrospectively. The adoption of these standards had no effect on our results of operations, financial position or cash flows as we currently have no minority interests in any of our subsidiaries.

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

In June 2009, the FASB issued new standards prescribing the information that a reporting entity must provide in its financial reports about the transfer of financial assets. The new standards amend previous guidance by removing the concept of a qualifying special-purpose entity and removing the exception from applying the provisions of accounting for variable interest entities that are qualifying special-purpose entities. The new standards are effective for transfers of financial assets occurring on or after January 1, 2010. We do not believe the adoption of these new standards will have a material impact on our results of operations, financial position or cash flows.

In June 2009, the FASB issued new standards regarding the recognition of a controlling financial interest in a variable interest entity (VIE). The primary beneficiary of a VIE is defined as the enterprise that has both: 1) the power to direct the activities of a VIE that most significantly impact the entity's economic performance; and 2) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. The new standards also require ongoing reassessments of whether an enterprise is the primary beneficiary of a VIE. The new standards are effective for annual reporting periods beginning after November 15, 2009 and for interim reporting periods within the first annual reporting period. We do not believe the adoption of these new standards will have a material impact on our results of operations, financial position or cash flows. We do not currently have any interest or arrangements that are considered variable interest entities.

In October 2009, the FASB issued ASU No. 2009-13, "Revenue Recognition (Topic 605) – Multiple-Deliverable Revenue Arrangements" (ASU 2009-13), a consensus of the FASB Emerging Issues Task Force. The guidance in ASU 2009-13 modifies the fair value requirements regarding the recognition of revenue under multiple element arrangements by allowing the use of the best estimate of selling price in addition to vendor-specific objective evidence (VSOE) and third-party evidence (TPE) for determining the selling price of a deliverable. A vendor is now required to use its best estimate of the selling price when VSOE or TPE of the selling price cannot be determined. In addition, the residual method of allocating arrangement consideration is no longer permitted. ASU 2009-13 is effective prospectively for revenue arrangements entered into or modified in fiscal years beginning on or after June 15, 2010. We are currently assessing the potential impact that the adoption of this new standards update will have on our results of operations, financial position or cash flows.

In October 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-14, "Software (Topic 985) – Certain Revenue Arrangements That Include Software Elements" (ASU 2009-14), a consensus of the FASB Emerging Issues Task Force. The guidance in ASU 2009-14 modifies the existing accounting rules regarding the recognition of revenue from the sale of software to exclude: (a) non-software components of tangible products; and (b) software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product's essential functionality. ASU 2009-14 is effective prospectively for revenue arrangements entered into or modified in fiscal years beginning on or after June 15, 2010. We are currently assessing the potential impact that the adoption of this new standards update will have on our results of operations, financial position or cash flows.

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## 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, contraction or trends; growth or contraction of the markets in which the Company participates; international events or various economic factors; 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; uses and investment of the Company's cash balance; the construction of 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, 2009, including the consolidated financial statements and related notes thereto.

## FIRST QUARTER OF FISCAL 2010 OVERVIEW

The global economic recession had a significant impact on our business in the first half of fiscal 2009 as semiconductor customers reduced their production and, as a result, demand for our CMP consumables products dramatically decreased. We believe a combination of improved underlying demand and semiconductor inventory replenishment positively impacted demand for our products in the second half of fiscal 2009 as our revenues improved significantly, and this positive impact continued in the first quarter of fiscal 2010. We believe that current semiconductor inventories are at relatively low levels, and we have seen stability across the foundry, logic and memory segments of the semiconductor industry. Further, we expect that the positive trends will continue into calendar 2010 based on reported forecasts from our customers. We also continue to see the positive impact on our business of our fiscal 2009 acquisition of Epoch Material Co., Ltd. (Epoch) and continued growth in our polishing pad business. There are many factors, however, that make it difficult for us to predict future revenue trends for our business, including: the pace, timing and sustainability of the ongoing economic recovery; the cyclical nature of the semiconductor industry; the short order to delivery time for our products and the associated lack of visibility to future customer orders; quarter to quarter changes in customer orders regardless of industry strength; and potential future acquisitions by us.

Revenue for our first quarter of fiscal 2010 was $97.7 million, which represented an increase of 55.0%, or $34.7 million, from the first quarter of fiscal 2009 and an increase of 1.2%, or $1.2 million, from the previous fiscal quarter. The increase in revenue from the first quarter of fiscal 2009 was primarily due to increased sales volume due to improved economic and semiconductor industry conditions as well as contributions from Epoch. The increase in revenue from our prior fiscal quarter was primarily due to increased demand from memory device manufacturers. We may experience a slight decrease in revenue during our second quarter of fiscal 2010 based on typical seasonal patterns for the semiconductor industry and for our Company.

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Gross profit expressed as a percentage of revenue for our first quarter of fiscal 2010 was 51.6%. Our gross profit percentage increased from 45.6% reported in the first quarter of fiscal 2009 and from 48.4% in our prior fiscal quarter. The increase in gross profit percentage from the first quarter of fiscal 2009 was primarily due to the significant increase in sales volume and the related benefits of increased utilization of our manufacturing capacity. The increase in gross profit percentage from the prior fiscal quarter was primarily due to a higher-valued product mix and the positive effect of a $1.6 million raw material supplier credit related to the Company achieving a certain volume threshold. We believe there have been two structural changes that have positively impacted our gross profit percentage: 1) our acquisition of the Epoch business and the related logistics, purchasing and other synergies we have achieved; and 2) the continued increase in the volume of pad sales and the related improvement in the manufacturing yields on pads. In past fiscal years, we had provided full year gross profit margin guidance in the range of 46% to 48%. We suspended this guidance in April 2009 due to the uncertainty in the global economic and industry environments caused by the economic recession. In light of the stabilizing industry environment and resulting increased visibility, we are providing gross profit percentage guidance in the range of 46% to 50% for the full fiscal year 2010. However, we may continue to experience fluctuations in our gross profit due to a number of factors, including the extent to which we utilize our manufacturing capacity and fluctuations in our product mix, which may cause our quarterly gross profit to be above or below this new guidance range.

Operating expenses were $30.1 million in our first quarter of fiscal 2010, compared to $29.4 million in the first quarter of fiscal 2009 and $28.0 million in the previous fiscal quarter. The increase in operating expenses from both the comparable quarter of fiscal 2009 and from the prior fiscal quarter was primarily due to increased staffing-related costs, including costs associated with our annual incentive bonus program. We continue to expect full year fiscal 2010 operating expenses to be in the range of $120 million to $125 million, which will include a full year of Epoch expenses, the reestablishment of certain employee benefits and the relaxation of certain other temporary cost saving initiatives we implemented in fiscal 2009.

Diluted earnings per share for our first fiscal quarter was $0.56, an increase from diluted earnings per share of $0.01 reported in the first quarter of fiscal 2009 and the $0.52 reported in the previous fiscal quarter as a result of the factors discussed above.

## 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, 2009. We believe there have been no material changes in our critical accounting estimates during the first three months of fiscal 2010. See Notes 3, 8 and 15 of the Notes to the Consolidated Financial Statements for a discussion of new accounting pronouncements.

## RESULTS OF OPERATIONS

### THREE MONTHS ENDED DECEMBER 31, 2009, VERSUS THREE MONTHS ENDED DECEMBER 31, 2008

### REVENUE

Revenue was $97.7 million for the three months ended December 31, 2009, which represented a 55.0%, or $34.7 million, increase from the three months ended December 31, 2008. The increase in revenue was driven by a $35.4 million increase in sales volume (including $5.5 million in sales of Epoch products) and a $2.5 million revenue increase due to the effect of foreign exchange rate changes, primarily related to the Japanese Yen. These increases were partially offset by a decrease in revenue of $3.1 million due to a lower weighted average selling price of for our CMP slurries. We experienced significant demand increases across all product lines. We believe the semiconductor industry is demonstrating stability across the foundry, logic and memory segments and we expect that the positive trends will continue into calendar 2010. However, revenue in the second quarter of fiscal 2010 may decrease slightly from the first quarter of fiscal 2010 based on typical seasonal patterns for the semiconductor industry and for our Company.

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## COST OF GOODS SOLD

Total cost of goods sold was $47.3 million for the three months ended December 31, 2009, which represented an increase of 37.8%, or $13.0 million, from the three months ended December 31, 2008. The increase in cost of goods sold was primarily due to $15.2 million from increased sales volume due to the increased demand for our products associated with the economic and industry recovery, a $1.9 million increase due to the effect of foreign exchange rate changes, primarily related to the Japanese Yen, and a $1.1 million increase due to certain production variances, partially offset by a $5.2 million decrease in cost of goods sold due to higher utilization of our manufacturing capacity on the increased sales volume.

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 Quarterly Report on Form 10-Q as well as in Item 7 of Part II of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

Our need for additional quantities or different kinds of key raw materials in the future 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, a number of factors could impact the future cost of raw materials, packaging, freight and labor. We also 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 51.6% for the three months ended December 31, 2009, as compared to 45.6% for the three months ended December 31, 2008. The increase in gross profit as a percentage of revenue was primarily due to the significant increase in sales volume and the related increased utilization of our manufacturing capacity, partially offset by a slight decrease in the weighted average selling price of our CMP slurries. Our gross profit percentage in the first quarter of 2010 was positively impacted by a $1.6 million raw material supplier credit related to the Company achieving a certain volume threshold.

## RESEARCH, DEVELOPMENT AND TECHNICAL

Total research, development and technical expenses were $12.6 million for the three months ended December 31, 2009, which represented an increase of 3.9%, or $0.5 million, from the three months ended December 31, 2008. The increase was primarily due to $0.6 million in higher staffing-related costs.

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 consumable products, including collaborating on joint development projects with our customers;
- Process development to support rapid and effective commercialization of new products;

- Technical support of CMP products in our customers' manufacturing facilities; and
- Evaluation of new polishing and metrology applications outside of the semiconductor industry.

SELLING AND MARKETING

Selling and marketing expenses were $6.3 million for the three months ended December 31, 2009, which represented an increase of 5.8%, or $0.3 million, from the three months ended December 31, 2008. The increase was primarily due to $0.3 million in higher staffing-related costs and $0.3 million in higher depreciation expense, partially offset by a $0.1 million decrease in professional fees and $0.2 million in other miscellaneous expenses.

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## GENERAL AND ADMINISTRATIVE

General and administrative expenses were $11.2 million for the three months ended December 31, 2009, which represented a decrease of 0.7%, or $0.1 million, from the three months ended December 31, 2008. The decrease was primarily due to a $1.0 million decrease in professional fees, including costs to enforce our intellectual property, partially offset by $0.6 million in higher staffing-related costs, primarily related to our annual incentive bonus program, and $0.1 million in higher information technology expenses.

## OTHER INCOME, NET

Other income was $0.1 million for the three months ended December 31, 2009 compared to $0.9 million during the three months ended December 31, 2008. The decrease in other income was primarily due to a decrease in interest income due to lower interest rates earned on our cash balances compared to the same period in fiscal 2009.

## PROVISION FOR INCOME TAXES

Our effective income tax rate was 35.4% for the three months ended December 31, 2009 compared to a 31.4% effective income tax rate for the three months ended December 31, 2008. The increase in the effective tax rate during the first quarter of fiscal 2010 is primarily due to the expiration of the research and experimentation tax credit as of December 31, 2009 and a decrease in tax-exempt interest income, partially offset by a reduction in tax expense related to share-based compensation.

## NET INCOME

Net income was $13.1 million for the three months ended December 31, 2009 compared to $0.1 million during the three months ended December 31, 2008. The significant increase in net income was a result of the factors discussed above.

## LIQUIDITY AND CAPITAL RESOURCES

We generated $27.2 million in cash flows from operating activities in the first three months of fiscal 2010, compared to using $2.6 million in cash from operating activities in the first three months of fiscal 2009. Our cash provided by operating activities in the first three months of fiscal 2010 originated from $13.1 million in net income, $10.1 million in non-cash items and a $4.0 million increase in cash flow due to a net decrease in working capital. The increase in cash from operations compared to the first three months of fiscal 2009 was primarily due to increased net income in the period, the timing of accounts payable and accrued liability payments, including the payment made in the first quarter of fiscal 2009 for our annual incentive bonus related to fiscal 2008, and changes in accounts receivable and inventory balances due to the significant increase in sales in fiscal 2010.

In the first three months of fiscal 2010, cash flows used in investing activities were $0.9 million, representing $0.8 million in purchases of property, plant and equipment and $0.1 million in other investing activities. In the first three months of fiscal 2009, cash flows used in investing activities were $2.3 million, representing purchases of property, plant and equipment. We estimate that our total capital expenditures in fiscal 2010 will be approximately $13 million.

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In the first three months of fiscal 2010, cash flows used in financing activities were $1.0 million, representing $0.8 million in repurchases of common stock pursuant to the terms of our Second Amended and Restated Cabot Microelectronics Corporation 2000 Equity Incentive Plan (EIP) for shares withheld from employees and purchased by the Company to cover payroll taxes on the vesting of restricted stock granted under the EIP and $0.3 million in principal payments under capital lease obligations, partially offset by $0.1 million received from the issuance of common stock under our EIP. In the first three months of fiscal 2009, cash flows used in financing activities were $0.4 million, representing $0.3 million in repurchases of common stock pursuant to the terms of our EIP for shares withheld to cover payroll taxes on the vesting of restricted stock granted under the EIP and $0.3 million in principal payments under capital lease obligations, partially offset by $0.2 million received from the issuance of common stock under our EIP.

In January 2008, our Board of Directors authorized a share repurchase program for up to $75.0 million of our outstanding common stock. Share repurchases are made from time to time, depending on market conditions, at management's discretion. No shares were repurchased under this program during the first three months of fiscal 2010 or fiscal 2009. As of December 31, 2009, we have $50.0 million remaining on this share repurchase program. We fund share purchases under this program from our available cash balance.

We have an unsecured revolving credit facility of $50.0 million with an option to increase the facility to $80.0 million. Pursuant to an amendment we entered into in October 2008, the agreement extends to November 2011, with an option to renew for two additional one-year terms. The amendment did not include any other material changes to the terms of the credit agreement. Under this agreement, interest accrues on any outstanding balance at either the lending institution's base rate or the Eurodollar rate plus an applicable margin. We also pay a non-use fee. Loans under this facility are intended primarily for general corporate purposes, including financing working capital, capital expenditures and acquisitions. 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 our current balance of cash and long-term investments, cash generated by our operations and available borrowings under our revolving credit facility will be sufficient to fund our operations, expected capital expenditures, merger and acquisition activities, and share repurchases for the foreseeable future. However, we plan to further expand our business; therefore, we may need to raise additional funds in the future through equity or debt financing, strategic relationships or other arrangements. The current uncertainty in the capital and credit markets may hinder our ability to secure additional financing in the type or amount necessary to pursue these objectives.

## OFF-BALANCE SHEET ARRANGEMENTS

At December 31, 2009, and September 30, 2009, 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.

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TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following summarizes our contractual obligations at December 31, 2009, and the effect such obligations are expected to have on our liquidity and cash flow in future periods.

| CONTRACTUAL OBLIGATIONS (In millions) | Total | Less Than 1 Year | 1-3 Years | 3-5 Years | After 5 Years |
|---|---|---|---|---|---|
| Purchase obligations | $37.6 | $35.9 | $0.6 | $0.3 | $0.8 |
| Acquisition related | 6.6 | 6.6 | - | - | - |
| Capital lease obligations | 2.2 | 1.2 | 1.0 | - | - |
| Operating leases | 6.1 | 2.3 | 2.7 | 0.7 | 0.4 |
| Other long-term liabilities | 3.6 | - | - | - | 3.6 |
| Total contractual obligations | $56.1 | $46.0 | $4.3 | $1.0 | $4.8 |

We operate under a fumed silica supply agreement with Cabot Corporation under which we are generally obligated to purchase at least 90% of our six-month volume forecast for certain of our slurry products, to purchase certain non-material minimum quantities every six months, and to pay for the shortfall if we purchase less than these amounts. This agreement was amended in April 2008 to extend the termination date to December 2012 and to change the pricing and some other non-material terms of the agreement. The agreement will automatically renew unless either party gives certain notice of non-renewal. We currently anticipate we will not have to pay any shortfall under this agreement. 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 $17.9 million of contractual commitments for fumed silica and fumed alumina under these contracts.

As discussed in Note 2 of the Notes to the Consolidated Financial Statements, we completed the first closing of the acquisition of Epoch during the second quarter of fiscal 2009. Under the share purchase agreement, we paid $59.4 million to obtain 90% of Epoch's stock. We expect to pay an additional $6.6 million to Eternal on the second closing date to purchase the remaining 10% ownership interest, in August 2010, and we have placed the $6.6 million in an escrow account for this purpose to be held until then. The escrow account is recorded as short-term restricted cash at December 31, 2009 and is included with prepaid expenses and other current assets on our Consolidated Balance Sheet. During this interim period, Eternal will continue to hold the remaining 10% ownership interest in Epoch; however, Eternal has waived rights to any interest in Epoch earnings during the interim period, including any associated dividends. Consequently, we have recorded a $6.6 million current liability on our Consolidated Balance Sheet at December 31, 2009 in accrued expenses and other current liabilities rather than recording a noncontrolling interest in Epoch.

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, 2009, for additional information regarding our contractual obligations.

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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 currencies to which we have exposure are the Japanese Yen and the New Taiwan Dollar 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 are unlikely to be able to hedge these exposures completely. During the three months ended December 31, 2009, we recorded $1.3 million in currency translation losses, net of tax, that are included in other comprehensive income on our Consolidated Balance Sheet. These losses primarily relate to the general strengthening of the U.S. dollar relative to the Japanese Yen. Approximately 24% of our revenue is transacted in currencies other than the U.S. dollar. However, we also incur expenses in foreign countries that are transacted in currencies other than the U.S. dollar, so the net exposure on the Consolidated Statement of Income is limited. 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 December 31, 2009, 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.

MARKET RISK RELATED TO INVESTMENTS IN AUCTION RATE SECURITIES

At December 31, 2009, we owned two auction rate securities (ARS) with a total estimated fair value of $8.1 million ($8.3 million par value) which were classified as other long-term assets on our Consolidated Balance Sheet. Beginning in 2008, general uncertainties in the global credit markets significantly reduced liquidity in the ARS market, and this illiquidity continues. For more information on our ARS, see Notes 3 and 7 of the Notes to the Consolidated Financial Statements and the "Risk Factors" set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q.

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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 December 31, 2009.

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.

We acquired Epoch Material Co., Ltd. (Epoch) in a business combination on February 27, 2009, midway through our fiscal year 2009. Subsequent to the acquisition, we applied certain corporate-level controls to elements of Epoch's internal control over financial reporting. Management has excluded from its assessment of internal control over financial reporting those elements that were not subject to our internal controls. For additional information, refer to Item 9A, "Controls and Procedures", in our Annual Report on Form 10-K for the fiscal year ended September 30, 2009. We will report on our assessment of our combined operations within one year, as permitted by the Sarbanes-Oxley Act of 2002 and the applicable SEC rules and regulations concerning business combinations.

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.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

While we are not involved in any legal proceedings that we 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, we filed a legal action against DuPont Air Products NanoMaterials LLC (DA Nano), a CMP slurry competitor, in the United States District Court for the District of Arizona, charging that DA Nano's manufacturing and marketing of CMP slurries infringe five CMP slurry patents that we own. The affected DA Nano products include certain products used for tungsten CMP. We filed our 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 our products of intellectual property owned by DA Nano. On July 25, 2008, the District Court issued its patent claim construction, or "Markman" Order ("Markman Order") in the litigation. In a Markman ruling, a district court hearing a patent infringement case interprets and rules on the scope and meaning of disputed patent claim language regarding the patents in suit. We believe that a Markman decision is often a significant factor in the progress and outcome of patent infringement litigation. In the Markman Order, the District Court adopted interpretations that we believe are favorable to Cabot Microelectronics on all claim terms that were in dispute in the litigation. On January 27, 2009, we filed a motion for summary judgment on DA Nano's infringement of certain of the patents at issue in the suit, and on that same date, DA Nano filed a motion for summary judgment on non-infringement and invalidity of certain of the patents at issue in the suit. On November 16, 2009, the District Court issued its ruling on all of these respective summary judgment motions. In its summary judgment ruling, the District Court denied a motion filed by DA Nano for summary judgment of invalidity of three of our patents at issue in the case, which are fundamental patents in the field of tungsten CMP. The District Court also denied DA Nano's motion for summary judgment of non-infringement of these patents. In addition, the District Court denied DA Nano's motion for summary judgment of non-infringement of another one of our patents at issue in the suit that is considered to be a foundational CMP patent. The District Court also denied Cabot Microelectronics' motion for summary judgment of infringement of the tungsten patents, stating that despite the weight of the record on DA Nano's infringement, summary judgment is not the forum to decide issues of fact that remain. We believe that the summary judgment ruling supports our position on the merits of the case with regard to the evidence of DA Nano's infringement of our tungsten patents and the lack of evidence of invalidity of these patents. Although no trial date has yet been set, the parties submitted pretrial filings on January 15, 2010, and as a result of this and the ruling on the summary judgment motions, we now expect the case to proceed in a timely manner, with trial possibly scheduled for the first half of calendar 2010. While the outcome of this and any legal matter cannot be predicted with certainty, we continue to believe that our claims and defenses in the pending action are meritorious, and we intend to continue to pursue and defend them vigorously.

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## 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, 2009. 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

#### DEMAND FOR OUR PRODUCTS FLUCTUATES 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 upon semiconductor demand. Semiconductor demand, in turn, is impacted by semiconductor industry cycles, and these cycles can dramatically affect our business. These cycles may be characterized by rapid decreases or increases in product demand, excess or low customer inventories, and rapid swings in prices of semiconductor devices. In the first half of fiscal 2009, our business was significantly impacted by the global economic recession. We first began to see significant adverse effects of this in our fourth quarter of fiscal 2008 as the reduction in end user demand for IC devices caused semiconductor manufacturers to reduce their production, which reduced the demand for our CMP consumables products. Weakness in the U.S. and global economy and stress in the financial markets caused a significant decrease in demand for our products during the first half of fiscal 2009, and our revenue decreased dramatically from revenue earned in the first half of fiscal 2008. Although demand for our products increased significantly during the second half of fiscal 2009 and this strength in demand continued during the first quarter of fiscal 2010, it is uncertain if this increase in demand will continue into the future. If the global economic recovery falters and conditions begin to deteriorate again, we could experience material adverse impacts on our results of operations and financial condition.

Adverse global economic conditions may have other negative effects on our Company such as:

- The ability of our customers to pay their obligations to us may be adversely affected causing a negative impact on our cash flows and our results of operations as evidenced by the bankruptcy filing of a small number of our customers in fiscal 2009.
- The carrying value of our goodwill and other intangible assets may decline in value, which could harm our financial position and results of operations.
- Our suppliers may not be able to fulfill their obligations to us, which could harm our production process and our business.

Some additional factors that affect demand for our products include customers’ production of logic versus memory devices, customers’ specific integration schemes, share gains and losses and pricing changes by us and our competitors.

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

Our business is substantially dependent on a single class of products, CMP slurries, which account for the majority of our revenue. Our business in CMP pads is also developing and growing. 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 and pads. We expect these technological changes and advances, and this drive toward lower costs, will continue in the future. Potential technology developments in the semiconductor industry, as well as our customers' efforts to reduce consumption of CMP slurries and pads and possibly reuse or recycle 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 THESE CUSTOMERS

Our customer base is concentrated among a limited number of large customers. One or more of these principal customers could stop buying CMP consumables from us or could substantially reduce the quantity of CMP consumables 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 consumables sold to these principal customers, or a significant number of smaller customers, could seriously harm our business, financial condition and results of operations.

During the three months ended December 31, 2009 and 2008, our five largest customers accounted for approximately 46% and 38% of our revenue; respectively. Taiwan Semiconductor Manufacturing Company (TSMC) was our largest customer during each of these periods, accounting for approximately 18% and 15% of our revenue for the three months ended December 31, 2009 and 2008, respectively. During the full year fiscal 2009, our five largest customers accounted for approximately 42% of our revenue; with TSMC accounting for approximately 17% of our revenue.

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

Competition from other CMP slurry manufacturers could seriously harm our business and results of operations. Competition from other providers of CMP slurries could continue to increase, and opportunities exist for other companies 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 DISRUPTION IN OUR SUPPLY CHAIN, INCLUDING SUPPLY OF OUR MOST IMPORTANT RAW MATERIALS, OR IN OUR ABILITY TO MANUFACTURE AND DELIVER OUR PRODUCTS TO OUR CUSTOMERS, COULD ADVERSELY AFFECT OUR RESULTS OF OPERATIONS

We depend on our supply chain to enable us to meet the demands of our customers. Our supply chain includes the raw materials we use to manufacture our products, our production operations, and the means by which we deliver our products to our customers. Our business could be adversely affected by any problem or interruption in our supply of the key raw materials we use in our CMP slurries and pads, including fumed silica, which we use for certain of our slurries, or any problem or interruption that may occur during production or delivery of our products, such as weather-related problems or natural disasters.

For instance, Cabot Corporation continues to be our primary supplier of particular amounts and types of fumed silica. We believe it would be difficult to promptly secure alternative sources of key raw materials, including fumed silica, 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, including any significant financial distress our suppliers may suffer, could adversely affect us. Also, if we change the supplier or type of key raw materials we use to make our CMP slurries or pads, 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 and pads 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 consumables to these customers.

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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 86% and 84% of our revenue was generated by sales to customers outside of the United States for the three months ended December 31, 2009, and the fiscal year ended September 30, 2009, respectively. We encounter risks in doing business in certain foreign countries, including, but not limited to, adverse changes in economic and political conditions, fluctuation in exchange rates, compliance with a variety of foreign laws and regulations, as well as difficulty in enforcing business and customer contracts and agreements, including protection of intellectual property rights.

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, including our acquisition of Epoch Material Co., Ltd., a Taiwan-based company, the first closing of which we completed in the fiscal quarter ended March 31, 2009, 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; increased risk associated with foreign operations; 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, in areas 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 in and acquisitions of technology-related 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 acquisition or investments to reflect other than temporary declines in their value, which could harm our business and results of operations.

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 CMP polishing pads. Additionally, pursuant to our Engineered Surface Finishes business, we are pursuing a number 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.

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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 we develop complex technical formulas for CMP products that are proprietary in nature and differentiate our products from those of our 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 provide 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 DuPont Air Products Nanomaterials described in “Legal Proceedings” in this Quarterly Report on Form 10-Q, could seriously harm our business. In addition, the costs of obtaining or protecting our intellectual property could negatively affect our operating results.

WE MAY NOT BE ABLE TO MONETIZE OUR INVESTMENTS IN AUCTION RATE SECURITIES IN THE SHORT TERM AND WE COULD EXPERIENCE A DECLINE IN THEIR MARKET VALUE, WHICH COULD ADVERSELY AFFECT OUR FINANCIAL RESULTS

We owned auction rate securities (ARS) with an estimated fair value of $8.1 million ($8.3 million par value) at December 31, 2009, which were classified as Other Long-Term Assets on our Consolidated Balance Sheet. If current illiquidity in the ARS market does not lessen, if issuers of our ARS are unable to refinance the underlying securities, if issuers are unable to pay debt obligations and related bond insurance fails, or if credit ratings decline or other adverse developments occur in the credit markets, then we may not be able to monetize these securities in the foreseeable future. We may also be required to further adjust the carrying value of these instruments through an impairment charge that may be deemed other-than-temporary which would adversely affect our financial results.

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. We compete with other industry participants for qualified personnel, particularly those with significant experience in the semiconductor industry. 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.

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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, which 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. 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.

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, which may make it more expensive to acquire our Company.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

ISSUER PURCHASES OF EQUITY SECURITIES

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands) |
|---|---|---|---|---|
| Oct. 1 through Oct. 31, 2009 | - | - | - | $50,003 |
| Nov. 1 through Nov. 30, 2009 | 6,612 | $30.59 | - | $50,003 |
| Dec. 1 through Dec. 31, 2009 | 17,603 | $31.13 | - | $50,003 |
| Total | 24,215 | $30.99 | - | $50,003 |

In January 2008, we announced that the Board of Directors had authorized a share repurchase program for up to $75.0 million of our outstanding common stock. Shares are repurchased from time to time, depending on market conditions, in open market transactions, at management's discretion. We fund share repurchases 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. No shares were repurchased under this program during the fiscal quarter ended December 31, 2009.

Separate from this share repurchase program, the shares purchased during the first quarter of fiscal 2010 were purchased pursuant to the terms of our Second Amended and Restated Cabot Microelectronics Corporation 2000 Equity Incentive Plan as shares withheld from award recipients and purchased by the Company to cover payroll taxes on the vesting of shares of restricted stock granted under the Equity Incentive Plan.

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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:

| Exhibit Number | Description |
|---|---|
| 10.15 | Cabot Microelectronics Corporation 2007 Employee Stock Purchase Plan, as Amended and Restated January 1, 2010. |
| 10.22 | Cabot Microelectronics Corporation 401(k) Plan, as amended. |
| 10.57 | Adoption Agreement, as amended January 1, 2010, of Cabot Microelectronics Corporation 401(k) Plan. |
| 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. |

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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.

| | |
|---|---|
| | CABOT MICROELECTRONICS CORPORATION |
| Date: February 8, 2010 | /s/ WILLIAM S. JOHNSON<br>William S. Johnson<br>Vice President and Chief Financial Officer<br>[Principal Financial Officer] |
| Date: February 8, 2010 | /s/ THOMAS S. ROMAN<br>Thomas S. Roman<br>Corporate Controller<br>[Principal Accounting Officer] |