CABOT MICROELECTRONICS CORP
Form 10-Q
May 07, 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

MARCH 31, 2010

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 (State of Incorporation)	36-4324765 (I.R.S. Employer Identification No.)
870 NORTH COMMONS DRIVE AURORA, ILLINOIS (Address of principal executive offices)	60504 (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES X NO

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 NO X

As of April 30, 2010, the Company had 23,633,635 shares of Common Stock, par value $0.001 per share, outstanding.

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PART I. FINANCIAL INFORMATION
ITEM 1.

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2010	2009	2010	2009
Revenue	$98,556	$45,399	$196,228	$108,416
Cost of goods sold	49,091	32,689	96,355	67,000
Gross profit	49,465	12,710	99,873	41,416
Operating expenses:				
Research, development and technical	12,908	12,621	25,489	24,735
Selling and marketing	6,530	5,261	12,852	11,234
General and administrative	12,699	10,590	23,944	21,916
Purchased in-process research and development	-	1,500	-	1,500
Total operating expenses	32,137	29,972	62,285	59,385
Operating income (loss)	17,328	(17,262)	37,588	(17,969)
Other income (expense), net	(440)	477	(379)	1,353
Income (loss) before income taxes	16,888	(16,785)	37,209	(16,616)
Provision (benefit) for income taxes	5,941	(6,672)	13,138	(6,619)
Net income (loss)	$10,947	$(10,113)	$24,071	$(9,997)
Basic earnings (loss) per share	$0.47	$(0.44)	$1.04	$(0.43)
Weighted average basic shares outstanding	23,263	23,107	23,205	23,053
Diluted earnings (loss) per share	$0.47	$(0.44)	$1.03	$(0.43)
Weighted average diluted shares outstanding	23,485	23,107	23,367	23,053

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)

	March 31, 2010	September 30, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$241,715	$199,952
Accounts receivable, less allowance for doubtful accounts of $1,145 at March 31, 2010, and $1,277 at September 30, 2009	54,828	53,538
Inventories	47,323	44,940
Prepaid expenses and other current assets	14,959	14,428
Deferred income taxes	3,907	3,994
Total current assets	362,732	316,852
Property, plant and equipment, net	115,480	122,782
Goodwill	39,994	39,732
Other intangible assets, net	17,747	18,741
Deferred income taxes	8,963	7,953
Other long-term assets	8,903	9,084
Total assets	$553,819	$515,144
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$16,538	$15,182
Capital lease obligations	1,252	1,210
Accrued expenses and other current liabilities	31,028	23,144
Total current liabilities	48,818	39,536
Capital lease obligations	671	1,308
Other long-term liabilities	3,711	3,571
Total liabilities	53,200	44,415
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Common stock:		
Authorized: 200,000,000 shares, $0.001 par value		
Issued: 26,321,880 shares at March 31, 2010, and 26,143,116 shares at September 30, 2009	26	26
Capital in excess of par value of common stock	220,817	213,031
Retained earnings	358,380	334,309
Accumulated other comprehensive income	12,474	13,690
Treasury stock at cost, 2,722,449 shares at March 31, 2010, and 2,698,234 shares at September 30, 2009	(91,078)	(90,327)
Total stockholders' equity	500,619	470,729

Total liabilities and stockholders' equity	$553,819	$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)

	Six Months Ended March 31,	
	2010	2009
Cash flows from operating activities:		
Net income (loss)	$24,071	$(9,997)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	12,642	12,268
Share-based compensation expense	6,395	7,130
Deferred income tax benefit	(249)	(2,481)
Provision for doubtful accounts	(117)	816
Non-cash foreign exchange (gain) loss	1,127	(2,174)
Loss on disposal of property, plant and equipment	68	88
Impairment of property, plant and equipment	-	1,243
Purchased in-process research and development	-	1,500
Other	27	1,130
Changes in operating assets and liabilities:		
Accounts receivable	(2,285)	14,805
Inventories	(3,161)	(1,593)
Prepaid expenses and other assets	(537)	(3,891)
Accounts payable	1,232	(6,081)
Accrued expenses, income taxes payable and other liabilities	8,408	(11,140)
Net cash provided by operating activities	47,621	1,623
Cash flows from investing activities:		
Additions to property, plant and equipment	(5,338)	(4,652)
Acquisition of business, net of cash acquired	-	(60,491)
Purchase of patents	(115)	-
Proceeds from the sale of investments	50	50
Net cash used in investing activities	(5,403)	(65,093)
Cash flows from financing activities:		
Repurchases of common stock	(751)	(334)
Net proceeds from issuance of stock	1,391	1,091
Principal payments under capital lease obligations	(595)	(555)
Net cash provided by financing activities	45	202
Effect of exchange rate changes on cash	(500)	772
Increase (decrease) in cash and cash equivalents	41,763	(62,496)
Cash and cash equivalents at beginning of period	199,952	221,467
Cash and cash equivalents at end of period	$241,715	$158,971
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	$790	$562

Issuance of restricted stock	4,985	4,209

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

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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 March 31, 2010, cash flows for the six months ended March 31, 2010, and March 31, 2009, and results of operations for the three and six months ended March 31, 2010, and March 31, 2009. The results of operations for the three and six months ended March 31, 2010 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 March 31, 2010.

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 March 31, 2010 and is included with prepaid expenses and other current assets on our Consolidated

Balance Sheet. During this interim period, Eternal continues 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 March 31, 2010, 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 March 31, 2009	Six Months Ended March 31, 2009
Revenues	$ 46,168	$ 113,164
Net loss	$ (9,473)	$ (10,917)
Net loss per share:		
Basic	$ (0.41)	$ (0.47)
Diluted	$ (0.41)	$ (0.47)

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 March 31, 2010. 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	$ 241,715	$ -	$ -	$ 241,715
Auction rate securities (ARS)	-	-	8,066	8,066
Total	$ 241,715	$ -	$ 8,066	$ 249,781

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.

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 own 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 as of March 31, 2010. Our ARS investments at March 31, 2010 consisted of two tax exempt municipal debt securities with a total par value of $8,300. 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 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 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 March 31, 2010. This security has a fair value of $3,116 (par value $3,350). We assessed the impairment in accordance with 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. We believe that this ARS is not permanently impaired because in the event of default by the municipality, we expect the insurance provider would pay interest and principal following the original repayment schedule, we were able to successfully monetize at par value $50 of this security during our fiscal quarter ended March 31, 2010, 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 March 31, 2010. See Note 6 for more information on these investments.

4. INVENTORIES

Inventories consisted of the following:

	March 31, 2010	September 30, 2009
Raw materials	$ 20,061	$ 20,082
Work in process	3,326	3,080
Finished goods	23,936	21,778
Total	$ 47,323	$ 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 $39,994 as of March 31, 2010, and $39,732 as of September 30, 2009. The increase in goodwill was due to foreign exchange fluctuation of the New Taiwan Dollar related goodwill associated with the Epoch acquisition.

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 six months ended March 31, 2010, so we did not perform an impairment review for goodwill and indefinite-lived intangible assets during the quarter. There have been no cumulative impairment charges recorded on the goodwill of any of our reporting units.

The components of other intangible assets are as follows:

	March 31, 2010		September 30, 2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Other intangible assets subject to amortization:				
Product technology	$8,157	$ 2,447	$8,135	$ 1,978
Acquired patents and licenses	8,115	5,980	8,000	5,825
Trade secrets and know-how	2,550	2,550	2,550	2,550
Distribution rights, customer lists and other	11,366	2,654	11,287	2,068
Total other intangible assets subject to amortization	30,188	13,631	29,972	12,421
Total other intangible assets not subject to amortization*	1,190			