

CABOT MICROELECTRONICS CORP
Form 10-Q
May 09, 2007

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

FORM 10-Q

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

For the quarterly period ended

MARCH 31, 2007

or

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

For the transition period from _____ to _____

Commission File Number 000-30205

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

DELAWARE
(State of Incorporation)

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

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

60504
(Zip Code)

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

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

YES NO

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

Edgar Filing: CABOT MICROELECTRONICS CORP - Form 10-Q

Large accelerated filer	<input checked="" type="checkbox"/> Accelerated filer	<input type="checkbox"/> Non-accelerated filer
-------------------------	---	--

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

YES NO

As of April 30, 2007, the Company had 23,793,510 shares of Common Stock, par value \$0.001 per share, outstanding.

1

CABOT MICROELECTRONICS CORPORATION

INDEX

Part I. Financial Information	Page	
Item 1.	Financial Statements	
	<u>Consolidated Statements of Income</u>	
	Three and Six Months Ended March 31, 2007 and 2006	3
	<u>Consolidated Balance Sheets</u>	
	March 31, 2007, and September 30, 2006	4
	<u>Consolidated Statements of Cash Flows</u>	
	Six Months Ended March 31, 2007 and 2006	5
	<u>Notes to the Consolidated Financial Statements</u>	6
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	12
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	18
Item 4.	<u>Controls and Procedures</u>	19
Part II. Other Information		
Item 1.	<u>Legal Proceedings</u>	19
Item 1A.	<u>Risk Factors</u>	20
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	23
Item 4.	<u>Submission of Matters to a Vote of Security Holders</u>	24
Item 6.	<u>Exhibits</u>	24
	<u>Signatures</u>	25

PART I. FINANCIAL INFORMATION
ITEM 1.

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2007	2006	2007	2006
Revenue	\$ 76,987	\$ 67,389	\$ 158,803	\$ 148,877
Cost of goods sold	43,188	35,855	85,689	78,906
Gross profit	33,799	31,534	73,114	69,971
Operating expenses:				
Research, development and technical	13,481	11,321	25,728	22,980
Selling and marketing	5,847	5,075	11,323	10,101
General and administrative	9,537	8,244	18,962	16,658
Total operating expenses	28,865	24,640	56,013	49,739
Operating income	4,934	6,894	17,101	20,232
Other income, net	1,260	1,090	2,434	1,806
Income before income taxes	6,194	7,984	19,535	22,038
Provision for income taxes	1,703	2,547	5,919	7,030
Net income	\$ 4,491	\$ 5,437	\$ 13,616	\$ 15,008
Basic earnings per share	\$ 0.19	\$ 0.22	\$ 0.57	\$ 0.62
Weighted average basic shares outstanding	23,708	24,233	23,774	24,299
Diluted earnings per share	\$ 0.19	\$ 0.22	\$ 0.57	\$ 0.62
Weighted average diluted shares outstanding	23,718	24,233	23,777	24,299

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

Index

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

	March 31, 2007	September 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 57,818	\$ 54,965
Short-term investments	105,750	110,965
Accounts receivable, less allowance for doubtful accounts of \$530 at March 31, 2007, and \$551 at September 30, 2006	47,563	48,028
Inventories	42,102	40,326
Prepaid expenses and other current assets	9,315	4,785
Deferred income taxes	2,540	2,436
Total current assets	265,088	261,505
Property, plant and equipment, net	123,839	130,176
Goodwill	4,569	4,565
Other intangible assets, net	13,082	11,447
Deferred income taxes	4,166	1,365
Other long-term assets	2,756	3,075
Total assets	\$ 413,500	\$ 412,133
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 9,330	\$ 15,104
Capital lease obligations	1,297	1,254
Accrued expenses, income taxes payable and other current liabilities	18,710	22,475
Total current liabilities	29,337	38,833
Capital lease obligations	3,885	4,420
Other long-term liabilities	1,263	1,109
Total liabilities	34,485	44,362
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Common stock:		
Authorized: 200,000,000 shares, \$0.001 par value		
Issued: 25,418,250 shares at March 31, 2007, and 25,254,719 shares at September 30, 2006	24	24
Capital in excess of par value of common stock	164,708	157,463
Retained earnings	264,623	251,007
Accumulated other comprehensive income	651	272
Treasury stock at cost, 1,627,337 shares at March 31, 2007, and 1,297,167 shares at September 30, 2006	(50,991)	(40,995)
Total stockholders' equity	379,015	367,771
Total liabilities and stockholders' equity	\$ 413,500	\$ 412,133

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

Index

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

	Six Months Ended	
	March 31,	
	2007	2006
Cash flows from operating activities:		
Net income	\$ 13,616	\$ 15,008
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12,229	9,800
Loss on equity investment	-	566
Share-based compensation expense	6,257	5,145
Deferred income tax benefit	(2,903)	(2,902)
Non-cash foreign exchange (gain) loss	(127)	889
Other	655	297
Changes in operating assets and liabilities:		
Accounts receivable	648	2,046
Inventories	(1,660)	(4,526)
Prepaid expenses and other assets	(4,201)	3,227
Accounts payable	(5,253)	1,341
Accrued expenses, income taxes payable and other liabilities	(3,823)	(2,684)
Net cash provided by operating activities	15,438	28,207
Cash flows from investing activities:		
Additions to property, plant and equipment	(5,605)	(15,460)
Proceeds from the sale of property, plant and equipment	172	17
Acquisition of business	-	(2,282)
Acquisition of patent license	(3,000)	-
Purchases of short-term investments	(62,375)	(81,655)
Proceeds from the sale of short-term investments	67,590	82,242
Net cash used in investing activities	(3,218)	(17,138)
Cash flows from financing activities:		
Repurchases of common stock	(9,995)	(7,995)
Net proceeds from issuance of stock	988	789
Principal payments under capital lease obligations	(491)	(460)
Net cash used in financing activities	(9,498)	(7,666)
Effect of exchange rate changes on cash	131	(242)
Increase in cash	2,853	3,161
Cash and cash equivalents at beginning of period	54,965	44,436
Cash and cash equivalents at end of period	\$ 57,818	\$ 47,597
Supplemental disclosure of noncash investing and financing activities:		
Purchases of property, plant and equipment in accrued liabilities and accounts payable at the end of the period	\$ 502	\$ 1,498
Issuance of restricted stock	4,487	68

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

Index

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

1. BACKGROUND AND BASIS OF PRESENTATION

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

The unaudited consolidated financial statements have been prepared by Cabot Microelectronics Corporation pursuant to the rules of the Securities and Exchange Commission (SEC) and accounting principles generally accepted in the United States of America. In the opinion of management, these unaudited consolidated financial statements include all normal recurring adjustments necessary for the fair presentation of Cabot Microelectronics' financial position as of March 31, 2007, cash flows for the six months ended March 31, 2007, and March 31, 2006, and results of operations for the three and six months ended March 31, 2007, and March 31, 2006. The results of operations for the three and six months ended March 31, 2007, may not be indicative of the results to be expected for future periods, including the fiscal year ending September 30, 2007. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in Cabot Microelectronics' annual report on Form 10-K for the fiscal year ended September 30, 2006. We currently operate predominantly in one industry segment - the development, manufacture and sale of CMP slurries.

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

2. INVENTORIES

Inventories consisted of the following:

	March 31, 2007	September 30, 2006
Raw materials	\$ 21,658	\$ 18,623
Work in process	1,537	1,805
Finished goods	18,907	19,898
Total	\$ 42,102	\$ 40,326

Index

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

3. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill was \$4,569 and \$4,565 as of March 31, 2007, and September 30, 2006, respectively.

The components of other intangible assets were as follows:

	March 31, 2007		September 30, 2006	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<u>Other intangible assets</u>				
<u>subject to amortization:</u>				
Product technology	\$ 5,380	\$ 404	\$ 5,380	\$ 135
Acquired patents and licenses *	8,000	1,482	5,000	479
Trade secrets and know-how	2,550	2,550	2,550	2,550
Distribution rights, customer lists and other	1,457	1,152	1,457	1,059
Total other intangible assets subject to amortization	17,387	5,588	14,387	4,223
Total other intangible assets not subject to amortization **	1,283		1,283	
Total other intangible assets	\$ 18,670	\$ 5,588	\$ 15,670	\$ 4,223

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

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

Amortization expense was \$720 and \$1,365 for the three and six months ended March 31, 2007, respectively. Amortization expense for the three and six months ended March 31, 2006, was \$4 and \$8, respectively. Estimated future amortization expense for the five succeeding fiscal years is as follows:

Fiscal Year	Estimated amortization expense
Remainder of 2007	\$1,440

2008	2,838
2009	1,663
2010	854
2011	847
2012	847

7

Index

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

4. ACCRUED EXPENSES, INCOME TAXES PAYABLE AND OTHER CURRENT LIABILITIES

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

	March 31,	September
	2007	30,
		2006
Accrued compensation	\$ 8,751	\$ 12,948
Goods and services received, not yet invoiced	4,342	3,088
Warranty accrual	435	924
Income taxes payable	-	764
Taxes, other than income taxes	1,938	2,270
Other	3,244	2,481
Total	\$ 18,710	\$ 22,475

5. CONTINGENCIES

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

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

PRODUCT WARRANTIES

We maintain a warranty reserve that reflects management's best estimate of the cost to replace product that does not meet customers' specifications and performance requirements, and costs related to such replacement. The warranty

reserve is based upon a historical product replacement rate, adjusted for any specific known conditions or circumstances. Adjustments to the warranty reserve are recorded in cost of goods sold. Our warranty reserve requirements changed during our second quarter of fiscal 2007 as follows:

Balance as	
o f	
September	\$
30, 2006	924
Additions	
charged to	
expense	-
Deductions	(489)
Balance as	
of March	\$
31, 2007	435

Index

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

6. SHARE-BASED COMPENSATION PLANS

Effective October 1, 2005, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment” (SFAS 123R), which requires all share-based payments, including stock option grants, restricted stock and employee stock purchases, to be recognized in the income statement based on their fair values. We currently issue share-based payments under the following programs: our Second Amended and Restated Cabot Microelectronics Corporation 2000 Equity Incentive Plan, as amended and restated September 26, 2006 (“2000 Equity Incentive Plan”); our Directors’ Deferred Compensation Plan, as amended September 26, 2006; our 2001 Executive Officer Deposit Share Program; and our Cabot Microelectronics Corporation Employee Stock Purchase Plan, as amended (“Employee Stock Purchase Plan”). For additional information regarding these programs, refer to Note 10 of “Notes to the Consolidated Financial Statements” included in Item 8 of Part II of our annual report on Form 10-K for the fiscal year ended September 30, 2006.

Prior to December 1, 2006, awards and grants made as part of our annual equity incentive award program under our 2000 Equity Incentive Plan consisted solely of non-qualified stock option grants. As permitted by the 2000 Equity Incentive Plan, on December 1, 2006, our compensation committee decided to award a blend of non-qualified stock option grants and restricted stock awards (restricted stock units for our non-United States employees) to all employees who were receiving awards on December 1, 2006, according to an approximate three-to-one ratio of non-qualified stock options granted to shares of restricted stock awarded. Our compensation committee made this decision primarily to address the financial impact of the expensing of equity-based compensation now required pursuant to SFAS 123R, as well as to provide a more competitive balance of equity incentives being awarded to our employees under the 2000 Equity Incentive Plan.

Prior to March 6, 2007, initial and annual equity grants made to non-employee directors under our 2000 Equity Incentive Plan as part of our non-employee directors’ compensation program consisted solely of non-qualified stock option grants. In order to align the Company’s equity grants and awards for non-employee directors with the Company’s revised equity grants and awards for employees including executive officers, as described above, on March 5, 2007, our Board of Directors approved revisions to the equity incentive elements of the non-employee directors’ compensation program effective as of March 6, 2007, the date of our annual meeting of stockholders. As with the revisions to the methodology for awards and grants made to employees, these revisions have resulted in annual grants/awards to non-employee directors consisting of a blend of non-qualified stock option grants and restricted stock awards according to an approximate three-to-one ratio, respectively.

Share-based compensation expense under SFAS 123R for the three and six months ended March 31, 2007, and March 31, 2006, was as follows:

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2007	2006	2007	2006
Cost of goods sold	\$ 196	\$ 163	\$ 383	\$ 313
Research, development and technical	281	243	571	476
Selling and marketing	321	259	630	504

Edgar Filing: CABOT MICROELECTRONICS CORP - Form 10-Q

General and administrative	2,534	1,986	4,673	3,852
Total share-based compensation expense	3,332	2,651	6,257	5,145
Tax benefit	1,190	981	2,235	1,903
Total share-based compensation expense, net of tax	\$ 2,142	\$ 1,670	\$ 4,022	\$ 3,242

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

Index

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

7. OTHER INCOME, NET

Other income, net, consisted of the following:

Three Months Ended		Six Months Ended
March 31,		March 31,
2007	2006	