

CABOT MICROELECTRONICS CORP
Form 10-Q
February 08, 2007

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

FORM 10-Q

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

For the quarterly period ended

DECEMBER 31, 2006

or

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

For the transition period from _____ to _____

Commission File Number 000-30205

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

DELAWARE
(State of Incorporation)

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

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

60504
(Zip Code)

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

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

YES NO

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

X

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

YES NO

As of January 31, 2007, the Company had 23,907,594 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,	
	2006	2005
Revenue	\$ 81,816	\$ 81,488
Cost of goods sold	42,501	43,051
Gross profit	39,315	38,437
Operating expenses:		
Research, development and technical	12,247	11,659
Selling and marketing	5,476	5,026
General and administrative	9,425	8,414
Total operating expenses	27,148	25,099
Operating income	12,167	13,338
Other income, net	1,174	716
Income before income taxes	13,341	14,054
Provision for income taxes	4,216	4,483
Net income	\$ 9,125	\$ 9,571
Basic earnings per share	\$ 0.38	\$ 0.39
Weighted average basic shares outstanding	23,839	24,363
Diluted earnings per share	\$ 0.38	\$ 0.39
Weighted average diluted shares outstanding	23,841	24,363

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, 2006	September 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 54,130	\$ 54,965
Short-term investments	106,265	110,965
Accounts receivable, less allowance for doubtful accounts of \$536 at December 31, 2006, and \$551 at September 30, 2006	47,808	48,028
Inventories	41,951	40,326
Prepaid expenses and other current assets	4,946	4,785
Deferred income taxes	2,454	2,436
Total current assets	257,554	261,505
Property, plant and equipment, net	127,719	130,176
Goodwill	4,569	4,565
Other intangible assets, net	13,802	11,447
Deferred income taxes	3,060	1,365
Other long-term assets	2,860	3,075
Total assets	\$ 409,564	\$ 412,133
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 11,105	\$ 15,104
Capital lease obligations	1,275	1,254
Accrued expenses, income taxes payable and other current liabilities	18,106	22,475
Total current liabilities	30,486	38,833
Capital lease obligations	4,155	4,420
Other long-term liabilities	1,155	1,109
Total liabilities	35,796	44,362
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Common stock:		
Authorized: 200,000,000 shares, \$0.001 par value		
Issued: 25,375,040 shares at December 31, 2006, and 25,254,719 shares at September 30, 2006	24	24
Capital in excess of par value of common stock	160,573	157,463
Retained earnings	260,132	251,007
Accumulated other comprehensive income	30	272
Treasury stock at cost, 1,497,641 shares at December 31, 2006, and 1,297,167 shares at September 30, 2006	(46,991)	(40,995)
Total stockholders' equity	373,768	367,771
Total liabilities and stockholders' equity	\$ 409,564	\$ 412,133

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,	
	2006	2005
Cash flows from operating activities:		
Net income	\$ 9,125	\$ 9,571
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,109	4,832
Loss on equity investment	-	566
Share-based compensation expense	2,925	2,494
Deferred income tax benefit	(1,719)	(840)
Non-cash foreign exchange (gain) loss	(59)	973
Other	203	(50)
Changes in operating assets and liabilities:		
Accounts receivable	211	(6,392)
Inventories	(1,668)	3,872
Prepaid expenses and other assets	62	1,356
Accounts payable	(3,668)	1,192
Accrued expenses, income taxes payable and other liabilities	(4,621)	2,042
Net cash provided by operating activities	6,900	19,616
Cash flows from investing activities:		
Additions to property, plant and equipment	(3,476)	(5,408)
Proceeds from the sale of property, plant and equipment	100	11
Acquisition of business	-	(2,282)
Acquisition of patent license	(3,000)	-
Purchases of short-term investments	(29,100)	(33,830)
Proceeds from the sale of short-term investments	33,800	34,110
Net cash used in investing activities	(1,676)	(7,399)
Cash flows from financing activities:		
Repurchases of common stock	(5,996)	(3,998)
Net proceeds from issuance of stock	176	137
Principal payments under capital lease obligations	(243)	(227)
Net cash used in financing activities	(6,063)	(4,088)
Effect of exchange rate changes on cash	4	(275)
Increase (decrease) in cash	(835)	7,854
Cash and cash equivalents at beginning of period	54,965	44,436
Cash and cash equivalents at end of period	\$ 54,130	\$ 52,290
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	\$ 864	\$ 6,233
Issuance of restricted stock	4,097	68

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 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 developing and 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 December 31, 2006, cash flows for the three months ended December 31, 2006, and December 31, 2005, and results of operations for the three months ended December 31, 2006, and December 31, 2005. The results of operations for the three months ended December 31, 2006, 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.

We discuss the effects of recent accounting pronouncements in Note 2 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. We do not believe there have been any significant new accounting pronouncements issued during the first three months of fiscal 2007 that are applicable to our business.

2. INVENTORIES

Inventories consisted of the following:

December 31,	September 30,
2006	2006

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Raw materials	\$	20,147	\$	18,623
Work in process		1,440		1,805
Finished goods		20,364		19,898
Total	\$	41,951	\$	40,326

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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 December 31, 2006, and September 30, 2006, respectively.

The components of other intangible assets are as follows:

	December 31, 2006		September 30, 2006	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<u>Other intangible assets subject to amortization:</u>				
Product technology	\$ 5,380	\$ 269	\$ 5,380	\$ 135
Acquired patents and licenses *	8,000	943	5,000	479
Trade secrets and know-how	2,550	2,550	2,550	2,550
Distribution rights, customer lists and other	1,457	1,106	1,457	1,059
Total other intangible assets subject to amortization	17,387	4,868	14,387	4,223
Total other intangible assets not subject to amortization **	1,283		1,283	
Total other intangible assets	\$ 18,670	\$ 4,868	\$ 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 \$645 and \$4 for the three months ended December 31, 2006 and 2005, respectively. Estimated future amortization expense for the five succeeding fiscal years is as follows:

Fiscal Year	Estimated amortization expense
	\$2,160

Remainder of 2007	
2008	2,838
2009	1,663
2010	854
2011	847

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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:

	December 31, 2006	September 30, 2006
Accrued compensation	\$ 8,496	\$ 12,948
Raw materials accrual	1,617	3,088
Warranty accrual	515	924
Income taxes payable	3,027	764
Taxes, other than income taxes	1,755	2,270
Other	2,696	2,481
Total	\$ 18,106	\$ 22,475

5. CONTINGENCIES

We periodically become a party to legal proceedings in the ordinary course of business. We are not 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.

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 first quarter of fiscal 2007 as follows:

Balance as of September 30, 2006	\$ 924
Additions charged to expense	-
Deductions	(409)
Balance as of December 31, 2006	\$ 515

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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 SFAS 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. 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 had 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.

Share-based compensation expense under SFAS 123R for the three months ended December 31, 2006, and December 31, 2005, was as follows:

	Three Months Ended	
	December 31,	
	2006	2005
Cost of goods sold	\$ 187	\$ 150
Research, development and technical	290	233
Selling and marketing	309	245
General and administrative	2,139	1,866
Total share-based compensation expense	2,925	2,494
Tax benefit	1,045	923
Total share-based compensation expense, net of tax	\$ 1,880	\$ 1,571

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.

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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	
	December 31,	
	2006	2005
Interest income	\$ 1,453	\$ 1,211
Interest expense	(124)	(138)
Other income (expense)	(155)	(357)
Total other income, net	\$ 1,174	\$ 716

8. COMPREHENSIVE INCOME

The components of comprehensive income were as follows:

	Three Months Ended	
	December 31,	
	2006	2005
Net income	\$ 9,125	\$ 9,571
Other comprehensive income:		
Net unrealized gain on derivative instruments	9	9
Foreign currency translation adjustment	(251)	(1,895)
Total comprehensive income	\$ 8,883	\$ 7,685

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

9. EARNINGS PER SHARE

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

	Three Months Ended	
	December 31,	
	2006	2005
Numerator:		
Earnings available to common shares	\$ 9,125	\$ 9,571
Denominator:		
Weighted average common shares	23,838,984	24,363,269
(Denominator for basic calculation)		
Weighted average effect of dilutive securities:		
Share-based compensation	2,511	-
Diluted weighted average common shares	23,841,495	24,363,269
(Denominator for diluted calculation)		
Earnings per share:		
Basic	\$ 0.38	\$ 0.39
Diluted	\$ 0.38	\$ 0.39

For the three months ended December 31, 2006 and 2005, approximately 4.4 million and 3.9 million shares, respectively, attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive.

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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 and trends; growth of the markets in which the Company participates; international events; product performance; the generation, protection and acquisition of intellectual property, and litigation related to such intellectual property; new product introductions; development of new products, technologies and markets; the acquisition of or investment in other entities; the construction of new or refurbishment of existing facilities by the Company; and statements preceded by, followed by or that include the words "intends", "estimates", "plans", "believes", "expects", "anticipates", "should", "could" or similar expressions, are forward-looking statements. Forward-looking statements reflect our current expectations and are inherently uncertain. Our actual results may differ significantly from our expectations. We assume no obligation to update this forward-looking information. The section entitled "Risk Factors" describes some, but not all, of the factors that could cause these differences.

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

FIRST QUARTER OF FISCAL 2007 OVERVIEW

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

In addition to strengthening and growing our core CMP business, through our Engineered Surface Finishes (ESF) growth initiative we are exploring a variety of surface modification applications where we believe our technical ability to shape, enable and enhance the performance of surfaces at an atomic level may provide previously unseen surface performance or improved productivity. By supplementing our internal development efforts with some externally acquired technologies and businesses, we seek to leverage our expertise in CMP formulation, materials and polishing techniques for the semiconductor industry to address other demanding market applications requiring nanoscale control of surface shape and finish, and gain access to a variety of markets that we do not currently serve.

Revenue for our first fiscal quarter was \$81.8 million, which represented a decrease of 5.9%, or \$5.2 million, from the previous fiscal quarter and an increase of 0.4%, or \$0.3 million, from the three months ended December 31, 2005, which did not include QED Technologies, Inc. (QED), a business we acquired in July 2006. We believe the decrease in our revenue from the previous fiscal quarter is primarily indicative of an apparent softening of demand due to an

inventory correction in the semiconductor industry. Despite this apparent softening, our long-term goal continues to be 15% annual revenue growth to be achieved through a combination of organic growth along with growth through acquisition. However, there are several factors that make it difficult for us to predict future revenue trends for our business, including: the cyclical nature of the semiconductor industry; short order to delivery time for our products and the associated lack of visibility to future customer orders; the effect of competition on pricing; quarter to quarter changes in customer orders regardless of industry strength; and the timing of acquisitions.

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Gross profit expressed as a percentage of revenue for our first fiscal quarter was 48.1%, an increase from both the 44.4% reported in the previous fiscal quarter and the 47.2% reported in the first quarter of fiscal 2006. The increase in gross profit as a percentage of revenue over the previous fiscal quarter was primarily driven by