

CABOT MICROELECTRONICS CORP
Form 10-Q
August 06, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended

June 30, 2018
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 36-4324765
(State of Incorporation) (I.R.S. Employer Identification No.)

870 NORTH COMMONS DRIVE 60504
AURORA, ILLINOIS (Zip Code)
(Address of principal executive offices)

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).

YESXNO

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

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Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company	Emerging growth company
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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

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 July 31, 2018, the Company had 25,551,252 shares of Common Stock, par value \$0.001 per share, outstanding.

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 June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Revenue	\$150,437	\$127,957	\$433,394	\$370,395
Cost of goods sold	69,737	65,414	203,635	186,316
Gross profit	80,700	62,543	229,759	184,079
Operating expenses:				
Research, development and technical	13,059	14,333	38,578	41,819
Selling and marketing	6,207	7,346	18,833	22,166
General and administrative	19,504	13,953	56,218	41,148
Total operating expenses	38,770	35,632	113,629	105,133
Operating income	41,930	26,911	116,130	78,946
Interest expense	513	1,117	2,803	3,402
Other income (expense), net	1,627	(115)	3,361	1,115
Income before income taxes	43,044	25,679	116,688	76,659
Provision for income taxes	7,873	5,740	54,863	16,209
Net income	\$35,171	\$19,939	\$61,825	\$60,450
Basic earnings per share (in dollars per share)	\$1.37	\$0.79	\$2.42	\$2.42
Weighted average basic shares outstanding (in shares)	25,612	25,228	25,479	24,941
Diluted earnings per share (in dollars per share)	\$1.34	\$0.77	\$2.35	\$2.37
Weighted average diluted shares outstanding (in shares)	26,319	25,721	26,222	25,450
Dividends per share (in dollars per share)	\$0.40	\$0.20	\$1.00	\$0.58

The accompanying notes are an integral part of these Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited and in thousands)

	Three Months		Nine Months	
	Ended June 30,		Ended June 30,	
	2018	2017	2018	2017
Net income	\$35,171	\$19,939	\$61,825	\$60,450
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(8,829)	(2,635)	2,276	(6,326)
Net unrealized gain (loss) on available-for-sale securities	(48)	-	(48)	-
Net unrealized gain (loss) on cash flow hedges	(210)	1	(63)	819
Other comprehensive income (loss), net of tax	(9,087)	(2,634)	2,165	(5,507)
Comprehensive income	\$26,084	\$17,305	\$63,990	\$54,943

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)

	June 30, 2018	September 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 186,124	\$ 397,890
Available-for-sale securities	124,455	-
Accounts receivable, less allowance for doubtful accounts of \$1,817 at June 30, 2018, and \$1,747 at September 30, 2017	74,017	64,793
Inventories	77,302	71,873
Prepaid expenses and other current assets	29,008	16,426
Total current assets	490,906	550,982
Property, plant and equipment, net	108,569	106,361
Goodwill	101,059	101,932
Other intangible assets, net	36,982	42,710
Deferred income taxes	13,067	21,598
Other long-term assets	8,899	10,517
Total assets	\$ 759,482	\$ 834,100
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 18,290	\$ 17,624
Current portion of long-term debt	-	10,938
Accrued expenses, income taxes payable and other current liabilities	72,009	62,651
Total current liabilities	90,299	91,213
Long-term debt, net of current portion, less prepaid debt issuance cost of \$441 at September 30, 2017	-	132,997
Deferred income taxes	62	63
Other long-term liabilities	34,940	14,790
Total liabilities	125,301	239,063
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Common Stock: Authorized: 200,000,000 shares, \$0.001 par value; Issued: 35,806,136 shares at June 30, 2018, and 35,230,742 shares at September 30, 2017	36	35
Capital in excess of par value of common stock	615,543	580,938
Retained earnings	433,818	397,881
Accumulated other comprehensive income	6,114	3,949
Treasury stock at cost, 10,262,236 shares at June 30, 2018, and 9,948,190 shares at September 30, 2017	(421,330)	(387,766)
Total stockholders' equity	634,181	595,037
Total liabilities and stockholders' equity	\$ 759,482	\$ 834,100

The accompanying notes are an integral part of these Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited and amounts in thousands)

	Nine Months Ended	
	June 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$61,825	\$60,450
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	19,527	19,530
Provision for doubtful accounts	80	25
Share-based compensation expense	14,269	9,716
Deemed repatriation transition tax	24,641	-
Deferred income tax expense	9,280	2,081
Non-cash foreign exchange (gain)	(1,340)	470
Loss (gain) on disposal of property, plant and equipment	45	(621)
Impairment of assets	-	860
Realized loss on the sale of available-for-sale securities	117	-
(Gain) on sale of assets	(956)	-
Other	4,030	(323)
Changes in operating assets and liabilities:		
Accounts receivable	(9,612)	(5,638)
Inventories	(5,526)	(247)
Prepaid expenses and other assets	(12,482)	(3,405)
Accounts payable	473	(1,186)
Accrued expenses, income taxes payable and other liabilities	(375)	8,304
Net cash provided by operating activities	103,996	90,016
Cash flows from investing activities:		
Additions to property, plant and equipment	(15,245)	(15,901)
Proceeds from the sale of property, plant and equipment	-	637
Proceeds from the sale of assets	3,027	-
Purchases of available-for-sale securities	(178,412)	-
Proceeds from the sale and maturities of available-for-sale securities	55,194	175
Settlement of net investment hedge	(9,882)	-
Net cash used in investing activities	(145,318)	(15,089)
Cash flows from financing activities:		
Repayment of long-term debt	(144,375)	(7,656)
Repurchases of common stock	(33,072)	(5,882)
Proceeds from issuance of stock	20,297	27,561
Dividends paid	(20,507)	(13,977)
Tax benefits associated with share-based compensation expense	-	5,826
Net cash provided by (used in) financing activities	(177,657)	5,872
Effect of exchange rate changes on cash	7,213	(4,376)
(Decrease) increase in cash and cash equivalents	(211,766)	76,423
Cash and cash equivalents at beginning of period	397,890	287,479
Cash and cash equivalents at end of period	\$ 186,124	\$ 363,902

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	\$ 1,588	\$ 2,018
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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 polishes surfaces at an atomic level, thereby helping to enable IC device manufacturers 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. We develop, manufacture and sell CMP polishing pads, which are used in conjunction with slurries in the CMP process. We also develop and provide products for demanding surface modification applications in other industries through our Engineered Surface Finishes (ESF) business. 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, 2017.

The unaudited Consolidated Financial Statements have been prepared by Cabot Microelectronics pursuant to the rules of the Securities and Exchange Commission (SEC) and accounting principles generally accepted in the United States of America (U.S. GAAP). In the opinion of management, these unaudited Consolidated Financial Statements include all adjustments, consisting of normal recurring adjustments, necessary for the fair statement of Cabot Microelectronics' financial position as of June 30, 2018, cash flows for the nine months ended June 30, 2018 and June 30, 2017, and results of operations for the three and nine months ended June 30, 2018 and June 30, 2017. The Consolidated Balance Sheets as of September 30, 2017 were derived from audited financial statements. The results of operations for the three and nine months ended June 30, 2018 may not be indicative of results to be expected for future periods, including the fiscal year ending September 30, 2018. This Report on Form 10-Q does not contain all of the footnote disclosures from the annual financial statements and 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, 2017.

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 June 30, 2018.

USE OF ESTIMATES

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires management to make judgments, assumptions and estimates that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. The accounting estimates that require management's most difficult and subjective judgments include, but are not limited to, those estimates related to bad debt expense, inventory valuation, valuation and classification of auction rate securities, impairment of long-lived assets and investments, business combinations, goodwill, other intangible assets, interest rate swaps, share-based compensation, income taxes and contingencies. We base our estimates on historical experience, current conditions and on various other assumptions that we believe are reasonable under the circumstances. However, future events are subject to change and estimates and judgments routinely require adjustment. Actual results may differ from these estimates under different assumptions or conditions.

The results of operations for the quarter ended December 31, 2017 and nine months ended June 30, 2018 include a correction to prior period amounts, which we determined to be immaterial to the prior periods to which they relate and are expected to be immaterial to our fiscal 2018 results. The adjustments, relating primarily to accumulated earnings

taxes of a foreign operation, increased the income tax expense for the first quarter of fiscal 2018 by \$2,071. Separately, in Note 14 of this Report on Form 10-Q, we discuss the effects of the Tax Cuts and Jobs Act ("Tax Act") on our financial statements.

2. AVAILABLE-FOR-SALE SECURITIES

The Company has a managed investment arrangement with a third party to invest in fixed income securities. These assets were classified as available-for-sale securities and were recorded at fair value. We have presented these securities on the Consolidated Balance Sheets as of June 30, 2018 as a current asset due to management's intent to use these funds for current business requirements. Unrealized gains and losses, net of the related tax effect, are recorded within other comprehensive income. Realized gains and losses, interest and dividends are recorded in the other income (expense), net line item of the Consolidated Statements of Income. Cash flows from purchases, sales and maturities of these securities are presented as investing activities on the Consolidated Statements of Cash Flows.

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Available-for-sale securities consist of the following as of June 30, 2018:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Asset backed securities	\$ 13,900	\$ 1	\$ -	\$ 13,901
Certificates of deposit	2,439	3	-	2,442
Commercial paper	7,756	-	(2)	7,754
Corporate debt securities	75,312	-	(52)	75,260
U.S. Treasuries	25,094	4	-	25,098
Total available-for-sale securities	\$ 124,501	8	\$ (54)	\$ 124,455

Available-for-sale securities, by contractual maturity, as of June 30, 2018 are as follows:

	Amortized Cost	Estimated Fair Value
Mature in one year or less	\$ 79,397	\$ 79,373
Mature after one year through four years	45,104	45,082
	\$ 124,501	\$ 124,455

3. FAIR VALUE OF FINANCIAL INSTRUMENTS

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 Financial Accounting Standards Board ("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.

The following table presents financial instruments, other than long-term debt, that we measured at fair value on a recurring basis at June 30, 2018 and September 30, 2017. See Note 8 for a detailed discussion of our long-term debt. We have classified the following assets and liabilities 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.

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June 30, 2018	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Cash and cash equivalents	\$ 174,089	\$ 12,035	\$ -	\$ 186,124
Other long-term investments	1,089	-	-	1,089
Available-for-sale securities:				
Asset Backed Securities		13,901		13,901
Certificates of Deposit		2,442		2,442
Commercial Paper		7,754		7,754
Corporate debt securities		75,260		75,260
U.S. Treasuries		25,098		25,098
Derivative financial instruments	-	8	-	8
Total assets	\$ 175,178	\$ 136,498	\$ -	\$ 311,676
Liabilities:				
Derivative financial instruments	-	44	-	44
Total liabilities	\$-	\$44	\$ -	\$44

September 30, 2017	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Cash and cash equivalents	\$ 397,890	\$-	\$ -	\$ 397,890
Other long-term investments	929	-	-	929
Derivative financial instruments	-	263	-	263
Total assets	\$ 398,819	\$ 263	\$ -	\$ 399,082
Liabilities:				
Derivative financial instruments	-	1,881	-	1,881
Total liabilities	\$-	\$ 1,881	\$ -	\$ 1,881

Our cash and cash equivalents consist of various bank accounts used to support our operations and investments in institutional money-market funds that are traded in active markets. We are invested exclusively in AAA-rated, prime institutional money market funds, comprised of high quality, fixed income securities. Our other long-term investments represent the fair value of investments under the Cabot Microelectronics Supplemental Employee Retirement Plan (SERP), which is a nonqualified supplemental savings plan. The fair value of the investments is determined through quoted market prices within actively traded markets. Although the investments are allocated to individual participants and investment decisions are made solely by those participants, the SERP is a nonqualified plan. Consequently, the Company owns the assets and the related offsetting liability for disbursement until a participant makes a qualifying withdrawal. The long-term investment was adjusted to \$1,089 in the third quarter of fiscal 2018 to reflect its fair value as of June 30, 2018.

We use an investment pricing valuation methodology of a third-party service provider to determine fair values of our available-for-sale securities, consisting of fixed income securities that are under our managed investment arrangement; these are listed in Note 2 of this report on Form 10-Q. Our available-for-sale securities are valued using a market-based valuation methodology at the end of each reporting period. Market-based valuation is determined on the basis of the last reported sale price or market quotation, typically obtained from the third-party service provider. Market quotations may also include exchange trades and publicly-available bid/offer data from established market

makers or quotation systems. All available-for-sale securities are classified as Level 2 based upon inputs other than quoted prices with observable market data.

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The fair value of our derivative instruments is estimated using standard valuation models and market-based observable inputs over the contractual term, including one-month LIBOR-based yield curves for interest rate swaps, and forward rates and/or the Overnight Index Swap (OIS) curve for forward foreign exchange contracts, among others. We consider the risk of nonperformance, including counterparty credit risk, in the calculation of the fair value of derivative financial instruments. Our derivative financial instruments include forward foreign exchange contracts and interest rate swaps. We terminated our interest rate swap agreements during the quarter, in connection with the extinguishment of debt. In the fourth quarter of fiscal 2017, we entered into forward foreign exchange contracts in an effort to protect our net investment in a foreign operation against potential adverse changes resulting from foreign currency fluctuation. This net investment hedge was terminated during the quarter driven by a significant repatriation of funds from this foreign operation. See Note 9 of this Report on Form 10-Q for more information on our use of derivative financial instruments.

4. INVENTORIES

Inventories consisted of the following:

	June 30, 2018	September 30, 2017
Raw materials	\$40,255	\$ 36,415
Work in process	8,036	7,365
Finished goods	29,011	28,093
Total	\$	