CABOT MICROELECTRONICS CORP
Form 10-Q
August 08, 2014
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, 2014

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.
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 X 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 July 31, 2014, the Company had 23,778,720 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 June 30,		Nine Months Ended June 30,	
	2014	2013	2014	2013
Revenue	$108,358	$109,968	$308,329	$316,865
Cost of goods sold	56,632	55,359	162,364	163,872
Gross profit	51,726	54,609	145,965	152,993
Operating expenses:				
Research, development and technical	15,368	15,149	44,303	45,538
Selling and marketing	6,489	6,470	19,667	20,625
General and administrative	11,380	10,776	33,182	34,017
Total operating expenses	33,237	32,395	97,152	100,180
Operating income	18,489	22,214	48,813	52,813
Interest expense	832	907	2,547	2,732
Other income (expense), net	(132)	248	588	1,565
Income before income taxes	17,525	21,555	46,854	51,646
Provision for income taxes	4,223	5,261	12,149	14,543
Net income	$13,302	$16,294	$34,705	$37,103
Basic earnings per share	$0.55	$0.70	$1.45	$1.60
Weighted average basic shares outstanding	23,753	22,951	23,769	22,897
Diluted earnings per share	$0.53	$0.68	$1.39	$1.55
Weighted average diluted shares outstanding	24,613	23,739	24,704	23,697

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

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CABOT MICROELECTRONICS CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited and in thousands)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2014	2013	2014	2013
Net income	$13,302	$16,294	$34,705	$37,103
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	3,644	(4,077)	(1,568)	(15,828)
Unrealized gain on investments	-	-	151	-
Other comprehensive income (loss), net of tax	3,644	(4,077)	(1,417)	(15,828)
Comprehensive income	$16,946	$12,217	$33,288	$21,275

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, 2014	September 30, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$265,515	$226,029
Accounts receivable, less allowance for doubtful accounts of $1,422 at June 30, 2014, and $1,532 at September 30, 2013	55,375	54,640
Inventories	70,904	63,786
Prepaid expenses and other current assets	12,917	10,684
Deferred income taxes	8,120	7,659
Total current assets	412,831	362,798
Property, plant and equipment, net	105,944	111,985
Goodwill	43,882	44,306
Other intangible assets, net	7,849	9,785
Deferred income taxes	8,784	10,291
Other long-term assets	10,688	12,427
Total assets	$589,978	$551,592
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$12,428	$16,663
Accrued expenses, income taxes payable and other current liabilities	27,465	40,620
Current portion of long-term debt	8,750	10,938
Total current liabilities	48,643	68,221
Long-term debt, net of current portion	166,250	150,937
Deferred income taxes	1,018	1,559
Other long-term liabilities	9,525	7,433
Total liabilities	225,436	228,150
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Common Stock: Authorized: 200,000,000 shares, $0.001 par value; Issued: 31,889,633 shares at June 30, 2014, and 30,213,577 shares at September 30, 2013	32	30
Capital in excess of par value of common stock	432,671	376,206
Retained earnings	211,896	177,191
Accumulated other comprehensive income	16,019	17,436
Treasury stock at cost, 7,997,555 shares at June 30, 2014, and 6,866,675 shares at September 30, 2013	(296,076)	(247,421)
Total stockholders' equity	364,542	323,442
Total liabilities and stockholders' equity	$589,978	$551,592

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)

	Nine Months Ended June 30, 2014	2013
Cash flows from operating activities:		
Net income	$ 34,705	$ 37,103
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,937	15,576
Provision for doubtful accounts	(216)	213
Share-based compensation expense	10,897	10,317
Deferred income tax expense (benefit)	641	(774)
Non-cash foreign exchange (gain)/loss	(191)	4,817
(Gain)/loss on disposal of property, plant and equipment	(43)	513
Impairment of property plant and equipment	2,293	38
Other	(253)	(2,023)
Changes in operating assets and liabilities:		
Accounts receivable	(889)	(7,932)
Inventories	(7,492)	(2,882)
Prepaid expenses and other assets	(1,250)	(2,771)
Accounts payable	(3,839)	(2,799)
Accrued expenses, income taxes payable and other liabilities	(12,564)	4,055
Net cash provided by operating activities	36,736	53,451
Cash flows from investing activities:		
Additions to property, plant and equipment	(10,242)	(10,209)

Proceeds from the sale of property, plant and equipment		190		16
Proceeds from the sale of investments		2,305		25
Other investing activities		1,062		-
Net cash used in investing activities		(6,685)		(10,168)
Cash flows from financing activities:				
Issuance of long-term debt		17,500		-
Repayment of long-term debt		(4,375)		(6,563)
Repurchases of common stock		(47,709)		(31,293)
Net proceeds from issuance of stock		41,661		21,065
Tax benefits associated with share-based compensation expense		2,788		733
Debt issuance costs		(550)		-
Principal payments under capital lease obligations		-		(21)
Net cash provided by (used in) financing activities		9,315		(16,079)
Effect of exchange rate changes on cash		120		(4,052)
Increase in cash and cash equivalents		39,486		23,152
Cash and cash equivalents at beginning of period		226,029		178,459
Cash and cash equivalents at end of period	$	265,515	$	201,611

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	$945	$663
Issuance of restricted stock	7,785	5,926

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 pursue other demanding surface modification applications through 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, 2013.

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 June 30, 2014, cash flows for the nine months ended June 30, 2014, and June 30, 2013, and results of operations for the three and nine months ended June 30, 2014, and June 30, 2013. The results of operations for the three and nine months ended June 30, 2014 may not be indicative of results to be expected for future periods, including the fiscal year ending September 30, 2014. 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, 2013.

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, 2014.

Revision of Prior Period Amounts

In the third quarter of fiscal 2014, the Company recorded adjustments to prior periods to correct certain items of income tax accounting, which related to fiscal years 2011 through 2013. The adjustments, totaling $3,635, related to the accounting for intercompany profit in inventory at our foreign branch locations and the accounting for annual incentive costs and related fringe benefits, and are reflected in the Consolidated Balance Sheet table below as of September 30, 2013. In evaluating the cumulative materiality of the corrections, we considered guidance in Accounting Standard Codification (ASC) Topic 250, "Accounting Changes and Error Corrections", and its subtopics, ASC 250-10-S99-1, "Assessing Materiality" and ASC 250-10-S99-2, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements". We concluded that the cumulative effect of correcting these prior period amounts was not material individually or in the aggregate to any of the prior reporting periods. We also evaluated the effect that these adjustments would have had on our consolidated financial statements as of and for the three and nine months ended June 30, 2014, and concluded these adjustments would have had a material impact. As such, we concluded that revision of prior periods for the cumulative effect of these adjustments was appropriate. Since the cumulative impact of the adjustments is not material to prior periods, we have not amended previously filed reports. As part of this revision, we also corrected previously disclosed out-of-period adjustments, which were immaterial to their respective prior periods.

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The correction of out-of-period adjustments is reflected in the comparative results for the three and nine months ended June 30, 2013 included in this Form 10-Q. We intend to present the annual effect of the cumulative corrections to fiscal years 2012 and 2013 in our Annual Report on Form 10-K for the fiscal year ended September 30, 2014 and in any other future filings containing such financial information.

The following tables summarize the effects of the revisions to the financial statements for the comparative periods of fiscal 2013 (in thousands, except per share data):

CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended June 30, 2013		
	As Originally Reported	Adjustment	As Revised
Income before income taxes	$21,555	$ -	$21,555
Provision for income taxes	6,062	(801)	5,261
Net income	15,493	801	16,294
Basic earnings per share	$0.68	$ 0.02	$0.70
Weighted average diluted shares outstanding	23,776	(37)	23,739
Diluted earnings per share	$0.65	$ 0.03	$0.68

	Nine Months Ended June 30, 2013		
	As Originally Reported	Adjustment	As Revised
Income before income taxes	$51,646	$ -	$51,646
Provision for income taxes	17,030	(2,487)	14,543
Net income	34,616	2,487	37,103
Basic earnings per share	$1.51	$ 0.09	$1.60
Weighted average diluted shares outstanding	23,729	(32)	23,697
Diluted earnings per share	$1.46	$ 0.09	$1.55

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended June 30, 2013		
	As Originally Reported	Adjustment	As Revised
Net income	$15,493	$ 801	$16,294
Other comprehensive income (loss), net of tax	(4,077)	-	(4,077)
Comprehensive income	$11,416	$ 801	$12,217

	Nine Months Ended June 30, 2013		
	As Originally Reported	Adjustment	As Revised
Net income	$34,616	$ 2,487	$37,103
Other comprehensive income (loss), net of tax	(15,828)	-	(15,828)
Comprehensive income	$18,788	$ 2,487	$21,275

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CONSOLIDATED BALANCE SHEET

	September 30, 2013		
	As Originally Reported	Adjustment	As Revised
Prepaid expenses and other current assets	$13,598	$ (2,914)	$10,684
Total current assets	365,712	(2,914)	362,798
Total assets	554,506	(2,914)	551,592
Accrued expenses, income taxes payable and other current liabilities	39,899	721	40,620
Total current liabilities	67,500	721	68,221
Total liabilities	227,429	721	228,150
Retained earnings	180,826	(3,635)	177,191
Total stockholders' equity	327,077	(3,635)	323,442
Total liabilities and stockholders' equity	$554,506	$ (2,914)	$551,592

CONSOLIDATED STATEMENT OF CASH FLOWS

	Nine Months Ended June 30, 2013		
	As Originally Reported	Adjustment	As Revised
Net income	$34,616	$ 2,487	$37,103
Deferred income tax expense (benefit)	912	(1,686)	(774)
Change in accrued expenses, income taxes payable and other current liabilities	4,856	(801)	4,055
Net cash provided by operating activities	$53,451	$ -	$53,451

Results of Operations

The results of operations for the nine months ended June 30, 2014 include an asset impairment charge of $2,111 ($1,475 net of tax) related to certain manufacturing assets recorded in the quarter ended March 31, 2014. This asset impairment charge included in cost of goods sold reduced our gross profit percentage by 210 basis points during the second quarter of fiscal 2014 and by 70 basis points on a year-to-date basis. The impairment charge reduced diluted earnings per share by approximately $0.06 on a year-to-date basis.

2. 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 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.

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The following table presents financial instruments, other than long-term debt, that we measured at fair value on a recurring basis at June 30, 2014 and September 30, 2013. See Note 7 for a detailed discussion of our long-term debt. We have chosen to not measure any of our other financial instruments at fair value as we believe their carrying value approximates their fair value. 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.

June 30, 2014	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents	$265,515	$ -	$-	$265,515
Auction rate securities (ARS)	-	-	5,895	5,895
Other long-term investments	1,701	-	-	1,701
Total	$267,216	$ -	$5,895	$273,111

September 30, 2013	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents	$226,029	$ -	$-	$226,029
Auction rate securities (ARS)	-	-	7,966	7,966
Other long-term investments	1,375	-	-	1,375
Total	$227,404	$ -	$7,966	$235,370

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 ARS and other long-term investments are included in other long-term assets on our Consolidated Balance Sheet. 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. 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 such time a participant makes a qualifying withdrawal. The long-term asset was adjusted to $1,701 in the third quarter of fiscal 2014 to reflect its fair value as of June 30, 2014.

We applied accounting standards regarding the classification and valuation of financial instruments to the valuation of our investment in ARS at June 30, 2014. Our ARS investments at June 30, 2014 consisted of two tax exempt municipal debt securities with a total par value of $5,895. The ARS market began to experience illiquidity in early 2008, and this illiquidity continues. Despite this lack of liquidity, there have been no defaults in payment 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, one of the ARS is credit enhanced with bond insurance, and the other, as discussed below in this footnote, has become an obligation of the bond insurer. Both ARS currently carry a credit rating of AA- by Standard & Poor's.

Since an active market for ARS does not currently exist, we classify these investments as held-to-maturity and we determine the fair value of these investments using a Level 3 discounted cash flow analysis and also consider other factors such as the reduced liquidity in the ARS market and nature of the insurance backing. Key inputs to our discounted cash flow model include projected cash flows from interest and principal payments and the weighted probabilities of improved liquidity or debt refinancing by the issuer. We also incorporate certain Level 2 market indices into the discounted cash flow analysis, including published rates such as the LIBOR rate, the LIBOR swap curve and a municipal swap index published by the Securities Industry and Financial Markets Association. The following table presents a reconciliation of the activity in fiscal 2014 for fair value measurements using level 3 inputs:

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Balance as of October 1, 2013	$7,966
Net sales of ARS	(2,305)
Reversal of temporary impairment	234
Balance as of June 30, 2014	$5,895

Based on our fair value assessment, we determined that one ARS continued to be impaired as of September 30, 2013. In November 2011, the municipality that issued our impaired ARS filed for bankruptcy protection. As a result of the approval of the municipality's reorganization plan, and our voting elections, we received 65 % of the par value outstanding, or $2,113, during the quarter ended December 31, 2013, and we reversed the $234 temporary impairment that we previously recorded. We believe that this ARS is no longer impaired as of June 30, 2014 based on: (1) the successful monetization of $2,130 of the par value of the security in accordance with a bankruptcy plan during the nine months ended June 30, 2014; (2) the fact that the bond insurer is now responsible for servicing all future interest and principal payments; (3) the fact that all interest payments have been received; and (4) our intention not to sell the security or be required to sell it until the value is collected in full, which may be at maturity. As of June 30, 2014, this security has a fair value equal to its par value of $1,120. We determined that the fair value of the other ARS was not impaired as of June 30, 2014. See Note 5 for more information on these investments.

3. INVENTORIES

Inventories consisted of the following:

	June 30, 2014	September 30, 2013
Raw materials	$42,258	$ 38,004
Work in process	4,463	5,001
Finished goods	24,183	20,781
Total	$70,904	$ 63,786

The increase in raw material and finished goods inventory is primarily due to higher raw material costs incurred and greater volume levels of certain raw materials maintained in fiscal 2014 in conjunction with certain Company sourcing initiatives.

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4. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill was $43,882 as of June 30, 2014, and $44,306 as of September 30, 2013. The decrease in goodwill was due to foreign exchange fluctuations of the New Taiwan dollar.

The components of other intangible assets are as follows:

	June 30, 2014		September 30, 2013	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Other intangible assets subject to amortization:				
Product technology	$8,332	$ 6,554	$8,362	$ 5,853
Acquired patents and licenses	8,270	7,456	8,270	7,196
Trade secrets and know-how	2,550	2,550	2,550	2,550
Distribution rights, customer lists and other	12,389	8,322	12,496	7,484
Total other intangible assets subject to amortization	31,541	24,882	31,678	23,083
Total other intangible assets not subject to amortization*	1,190		1,190	
Total other intangible assets	$32,731	$ 24,882	$32,868	$ 23,083

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

Amortization expense on our other intangible assets was $601 and $1,870 for the three and nine months ended June 30, 2014, respectively. Amortization expense on our other intangible assets was $654 and $1,973 for the three and nine months ended June 30, 2013, respectively. Estimated future amortization expense for the five succeeding fiscal years is as follows:

Fiscal Year	Estimated Amortization Expense
Remainder of 2014	$ 605
2015	2,413
2016	1,996
2017	1,166
2018	461

Goodwill and indefinite-lived intangible assets are tested for impairment annually in the fourth quarter of the fiscal year 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. An entity has the option to assess the fair value of a reporting unit either using a qualitative analysis ("step zero") or a discounted cash flow analysis ("step one"). Similarly, an entity has the option to use a step zero or a step one approach to determine the recoverability of indefinite-lived intangible assets. In fiscal 2013, we chose to refresh our step one analysis for both goodwill impairment and for indefinite-lived intangible asset impairment. 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 2013 and concluded that no impairment existed. There were no indicators of potential impairment during the nine months ended June 30, 2014, so it was not necessary to perform an impairment review for goodwill and indefinite-lived intangible assets during the first nine months of fiscal year 2014. There have been no cumulative impairment charges recorded on the goodwill for any of our reporting units.

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5. OTHER LONG-TERM ASSETS

Other long-term assets consisted of the following:

	June 30, 2014	September 30, 2013
Auction rate securities	$5,895	$ 7,966
Other long-term assets	3,092	3,086
Other long-term investments	1,701	1,375
Total	$10,688	$ 12,427

As discussed in Note 2 of this Form 10-Q, the two ARS that we owned as of June 30, 2014 are classified as long-term investments. One of the securities is credit enhanced with bond insurance and the other is now an obligation of the bond insurer, and all interest payments continue to be received on a timely basis. Although we believe these securities will ultimately be collected in full, we believe that it is not likely that we will be able to monetize the securities in our next business cycle (which for us is generally one year). As discussed in Note 2, we received 65 % of the par value outstanding of one of the ARS, or $2,113, during the quarter ended December 31, 2013, and we reversed the $234 pretax reduction ($151 net of tax) in fair value on that ARS that we first recognized in fiscal 2008. We believe this security is no longer impaired based on: (1) the successful monetization of 65% of the par value of the security in accordance with a bankruptcy plan during the quarter ended December 31, 2013; (2) the fact that the bond insurer is now responsible for servicing all future interest and principal payments; (3) the fact that all interest payments have been received; and (4) our intention not to sell the security nor be required to sell the security until the value is collected in full, which may be at maturity.

As discussed in Note 2 of this Form 10-Q, we recorded a long-term asset and a corresponding long-term liability of $1,701 representing the fair value of our SERP investments as of June 30, 2014.

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

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

	June 30, 2014	September 30, 2013
Accrued compensation	$14,231	$ 24,601
Goods and services received, not yet invoiced	4,067	4,681
Deferred revenue and customer advances	483	458
Warranty accrual	240	324
Income taxes payable	2,773	7,652
Taxes, other than income taxes	1,164	951

Other	4,507	1,953
Total	$27,465	$ 40,620

The decrease in accrued compensation was primarily due to the payment of our annual incentive bonus program earned in fiscal 2013, partially offset by nine months of accrual under our annual incentive bonus program related to fiscal 2014. The decrease in income taxes payable was primarily due to tax payments made in foreign jurisdictions.
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7. DEBT

On February 13, 2012, we entered into a credit agreement (the "Credit Agreement") among the Company, as Borrower, Bank of America, N.A., as administrative agent, swing line lender and an L/C issuer, Bank of America Merrill Lynch and J.P. Morgan Securities LLC, as joint lead arrangers and joint book managers, JPMorgan Chase Bank, N.A., as syndication agent, and Wells Fargo Bank, N.A. as documentation agent. The Credit Agreement provided us with a $175,000 term loan (the "Term Loan"), which we drew on February 27, 2012 to fund approximately half of the special cash dividend we paid to our stockholders on March 1, 2012, and a $100,000 revolving credit facility (the "Revolving Credit Facility"), which remains undrawn, with sub-limits for multicurrency borrowings, letters of credit and swing-line loans. The Term Loan and the Revolving Credit Facility are referred to as the "Credit Facilities." On June 27, 2014, we entered into an amendment (the "Amendment") to the Credit Agreement, which (i) increased term loan commitments by $17,500, from $157,500 to $175,000, the same level as the original amount under the Credit Agreement at its inception in 2012; (ii) increased the uncommitted accordion feature on the Revolving Credit Facility from $75,000 to $100,000; (iii) extended the expiration date of the Credit Facilities from February 13, 2017 to June 27, 2019; (iv) relaxed the consolidated leverage ratio financial covenant; and (v) revised certain pricing terms and other terms within the Credit Agreement. On June 27, 2014, we drew the $17,500 of increased term loan commitments, bringing the total outstanding commitments under the Term Loan to $175,000.

Borrowings under the amended Credit Facilities (other than in respect of swing-line loans) bear interest at a rate per annum equal to the "Applicable Rate" (as defined below) plus, at our option, either (1) a LIBOR rate determined by reference to the cost of funds for deposits in the relevant currency for the interest period relevant to such borrowing or (2) the "Base Rate", which is the highest of (x) the prime rate of Bank of America, N.A., (y) the federal funds rate plus 1/2 of 1.00% and (z) the one-month LIBOR rate plus 1.00%. The current Applicable Rate for borrowings under the Credit Facilities is 1.50%, as amended, with respect to LIBOR borrowings and 0.25% with respect to Base Rate borrowings, with such Applicable Rate subject to adjustment based on our consolidated leverage ratio. Swing-line loans bear interest at the Base Rate plus the Applicable Rate for Base Rate loans under the Revolving Credit Facility. In addition to paying interest on outstanding principal under the Credit Agreement, we pay a commitment fee to the lenders under the Revolving Credit Facility in respect of the unutilized commitments thereunder. As amended, the fee ranges from 0.20% to 0.30%, based on our consolidated leverage ratio. Interest expense and commitment fees are paid according to the relevant interest period and no less frequently than at the end of each calendar quarter. We paid $2,658 in arrangement fees, upfront fees and administration fees in February 2012 and we paid an additional $550 in upfront fees and arrangement fees in June 2014, of which $417 and $1,564 remains in prepaid expenses and other current assets and other long-term assets, respectively, on our Consolidated Balance Sheet as of June 30, 2014. We must also pay letter of credit fees as necessary. The Term Loan has periodic scheduled repayments; however, we may voluntarily prepay the Credit Facilities without premium or penalty, subject to customary "breakage" fees and reemployment costs in the case of LIBOR borrowings. All obligations under the Credit Agreement are guaranteed by certain of our existing and future direct and indirect domestic subsidiaries. The obligations under the Credit Agreement and guarantees of those obligations are secured, subject to certain exceptions, by first priority liens and security interests in the assets of the Company and its domestic subsidiaries.

The Credit Agreement contains covenants that restrict the ability of the Company and its subsidiaries to take certain actions, including, among other things and subject to certain significant exceptions: creating liens, incurring indebtedness, making investments, engaging in mergers, selling property, paying dividends or amending organizational documents. The Credit Agreement requires us to comply with certain financial ratio maintenance covenants. As amended, these include a maximum consolidated leverage ratio of 3.00 to 1.00 through December 31, 2015 and a minimum consolidated fixed charge coverage ratio of 1.25 to 1.00. As amended, the maximum consolidated leverage ratio will decrease to 2.75 to 1.00 from January 1, 2016 through the termination of the Credit Agreement. As of June 30, 2014, our consolidated leverage ratio was 1.69 to 1.00 and our consolidated fixed charge coverage ratio was 4.81 to 1.00. The Credit Agreement also contains customary affirmative covenants and events of default. We believe we are in compliance with these covenants.

At June 30, 2014, the fair value of the Term Loan, using level 2 inputs, approximates its carrying value of $175,000 as the loan bears a floating market rate of interest. As of June 30, 2014, $8,750 of the debt outstanding is classified as short-term.

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Principal repayments of the Term Loan are generally made on the last calendar day of each quarter if that day is considered to be a business day. As of June 30, 2014, scheduled principal repayments of the Term Loan were as follows:

Fiscal Year	Principal Repayments
Remainder of 2014	$ 2,188
2015	8,750
2016	8,750
2017	7,656
2018	14,219
2019	133,437
Total	$ 175,000

8. DERIVATIVE FINANCIAL INSTRUMENTS

Periodically we enter into forward foreign exchange contracts in an effort to mitigate the risks associated with currency fluctuations on certain foreign currency balance sheet exposures. Our foreign exchange contracts do not qualify for hedge accounting; therefore, the gains and losses resulting from the impact of currency exchange rate movements on our forward foreign exchange contracts are recognized as other income or expense in the accompanying consolidated income statements in the period in which the exchange rates change. We do not use derivative financial instruments for trading or speculative purposes. In addition, all derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. At June 30, 2014, we had forward foreign exchange contracts to either buy or sell Japanese yen and British pound for the purpose of hedging the risk associated with a net transactional exposure in those currencies.

The fair value of our derivative instruments included in the Consolidated Balance Sheet, which was determined using level 2 inputs, was as follows:

		Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value at June 30, 2014	Fair Value at September 30, 2013	Fair Value at June 30, 2014	Fair Value at September 30, 2013
Derivatives not designated as hedging instruments					
Foreign exchange contracts	Prepaid expenses and other current assets	$ 172	$ 60	$ 47	$ -
	Accrued expenses and other current liabilities	$ -	$ -	$ -	$ -

The following table summarizes the effect of our derivative instruments on our Consolidated Statement of Income for the three and six months ended March 31:

		Gain (Loss) Recognized in Statement of Income			
		Three Months Ended		Nine Months Ended	
	Statement of Income Location	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Derivatives not designated as hedging instruments					
Foreign exchange contracts	Other income, net	$230	$ (1)	$(107)	$322

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9. COMMITMENTS AND CONTINGENCIES

LEGAL PROCEEDINGS

While we are not involved in any legal proceedings that we believe will have a material impact on our consolidated financial position, results of operations or cash flows, we periodically become a party to legal proceedings in the ordinary course of business.

Refer to Note 16 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, 2013, 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 our specifications and customers' performance requirements, and costs related to such replacement. The warranty reserve is based upon a historical product replacement rate, adjusted for any specific known conditions or circumstances. Additions and deductions to the warranty reserve are recorded in cost of goods sold. Our warranty reserve activity during the first nine months of fiscal 2014 was as follows:

Balance as of September 30, 2013	$324
Reserve for product warranty during the reporting period	555
Settlement of warranty	(639)
Balance as of June 30, 2014	$240

PURCHASE OBLIGATIONS

Purchase obligations include our take-or-pay arrangements with suppliers, and purchase orders and other obligations entered into in the normal course of business regarding the purchase of goods and services. We operate under a fumed silica supply agreement with Cabot Corporation, our former parent Company, which is not a related party, which requires us to purchase certain minimum quantities of fumed silica each year of the agreement, and to pay a shortfall if we purchase less than the minimum. The agreement became effective as of January 1, 2013 and has an initial term of four years. Purchase obligations as of June 30, 2014 include $81,742 of contractual commitments related to our Cabot Corporation agreement for fumed silica.

POSTRETIREMENT OBLIGATIONS IN FOREIGN JURISDICTIONS

As required by local law, we have defined benefit plans covering employees in certain foreign jurisdictions, which are unfunded. Benefit costs, consisting primarily of service costs, are recorded as fringe benefit expense under cost of goods sold and operating expenses in our Consolidated Statements of Income. The projected benefit obligations and accumulated benefit obligations under all such unfunded plans are updated annually during the fourth quarter of the fiscal year. Benefit payments under all such unfunded plans to be paid over the next 10 years are expected to be immaterial. For more information regarding these plans, refer to Note 16 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, 2013.

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10. SHARE-BASED COMPENSATION PLANS

We issue share-based awards under the following programs: our Cabot Microelectronics Corporation 2012 Omnibus Incentive Plan (OIP), our Cabot Microelectronics Corporation 2007 Employee Stock Purchase Plan, as Amended and Restated January 1, 2010 (ESPP), and, pursuant to the OIP, our Directors' Deferred Compensation Plan, as amended September 23, 2008 (DDCP), and our 2001 Executive Officer Deposit Share Program (DSP). Prior to March 2012, when our stockholders approved the OIP, we issued share-based payments under our Second Amended and Restated Cabot Microelectronics Corporation 2000 Equity Incentive Plan, as amended and restated September 23, 2008 (EIP); our ESPP, and, pursuant to the EIP, the DDCP and DSP. For additional information regarding these programs, refer to Note 11 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, 2013. Other than the ESPP, all share-based payments granted beginning March 6, 2012 are made from the OIP, and the EIP is no longer available for any awards.

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

Share-based compensation expense for the three and nine months ended June 30, 2014, and 2013, was as follows:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2014	2013	2014	2013
Cost of goods sold	$462	$385	$1,391	$1,300
Research, development and technical	378	313	1,096	989
Selling and marketing	318	326	978	1,036
General and administrative	1,948	1,990	7,432	6,992
Total share-based compensation expense	3,106	3,014	10,897	10,317
Tax benefit	(1,009)	(1,010)	(3,694)	(3,541)
Total share-based compensation expense, net of tax	$2,097	$2,004	$7,203	$6,776

Our non-employee directors received annual equity awards in March 2014, pursuant to the OIP. The award agreements provide for immediate vesting of the award at the time of termination of service for any reason other than by reason of Cause, Death, Disability or a Change in Control, as defined in the OIP, if at such time the non-employee director has completed an equivalent of at least two full terms as a director of the Company, as defined in the

Company's bylaws. Seven of the Company's eight non-employee directors had completed at least two full terms of service as of the date of the March 2014 award. Consequently, the requisite service period for the award has already been satisfied and we recorded the fair value of $1,325 of the awards to these seven directors to share-based compensation expense in the fiscal quarter ended March 31, 2014 rather than recording that expense over the one-year vesting period stated in the award agreement, as is done for the other non-employee director.

For additional information regarding the estimation of fair value, refer to Note 11 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, 2013.

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11. OTHER INCOME (EXPENSE), NET

Other income (expense), net, consisted of the following:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2014	2013	2014	2013
Interest income	$91	$44	$170	$122
Other income (expense)	(223)	204	418	1,443
Total other income (expense), net	$(132)	$248	$588	$1,565

Other income (expense) primarily represents the gains and losses recorded on transactions denominated in foreign currencies. The decrease in other income was primarily due to the impact of foreign currency fluctuations on monetary assets and liabilities denominated in currencies other than the functional currency, net of the gains and losses incurred on forward foreign exchange contracts discussed in Note 8 of this Form 10-Q.

12. INCOME TAXES

Our effective income tax rate was 24.1 % and 25.9 % for the three and nine months ended June 30, 2014 compared to a 24.4 % and 28.2 % effective income tax rate for the three and nine months ended June 30, 2013. The effective income tax rate for the comparable periods of fiscal 2013 has been revised downward from 28.1% and 33.0%, as originally presented, to reflect the correction on non-material period period adjustments discussed in Note 1 under the heading "Revision of Prior Period Amounts". The decrease in the effective tax rate during the first nine months of fiscal 2014 was primarily due to lower income tax expense on foreign earnings resulting from our election to permanently reinvest the earnings of our foreign subsidiaries. The Company was awarded a tax holiday in South Korea in conjunction with our investment in research, development and manufacturing facilities there. Subject to certain conditions, which we believe we have met, this arrangement allows for a 0 % tax rate in fiscal years 2013, 2014 and 2015, and a tax at 50 % of the local statutory rate in effect for fiscal years 2016 and 2017. This tax holiday reduced our income tax provision by approximately $2,857 in the first nine months of fiscal 2014.

13. EARNINGS PER SHARE

Basic earnings per share (EPS) is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period, excluding the effects of unvested restricted stock awards with a right to receive non-forfeitable dividends, which are considered participating securities as prescribed by the two-class method under ASC 260. Diluted EPS is calculated in a similar manner, but the weighted-average number of common shares outstanding during the period is increased to include the weighted-average dilutive effect of "in-the-money" stock options and unvested restricted stock shares using the treasury stock method.

The standards of accounting for earnings per share require companies to provide a reconciliation of the numerator and denominator of the basic and diluted earnings per share computations. Basic and diluted earnings per share were calculated as follows:

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	Three Months Ended June 30,		Nine Months Ended June 30,	
	2014	2013	2014	2013
Numerator:				
Net income	$13,302	$16,294	$34,705	$37,103
Less: income attributable to participating securities	(176)	(216)	(311)	(365)
Earnings available to common shares	$13,126	$16,078	$34,394	$36,738
Denominator:				
Weighted average common shares (Denominator for basic calculation)	23,752,770	22,951,408	23,768,858	22,897,320
Weighted average effect of dilutive securities:				
Share-based compensation	860,722	787,951	935,511	799,909
Diluted weighted average common shares (Denominator for diluted calculation)	24,613,492	23,739,359	24,704,369	23,697,229
Earnings per share:				
Basic	$0.55	$0.70	$1.45	$1.60
Diluted	$0.53	$0.68	$1.39	$1.55

For the three months ended June 30, 2014 and 2013, approximately 0.5 million and 1.5 million shares, respectively, attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because the exercise price of the options was greater than the average market price of our common stock and, therefore, their inclusion would have been anti-dilutive.

For the nine months ended June 30, 2014 and 2013, approximately 0.5 million and 1.6 million shares, respectively, attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because the exercise price of the options was greater than the average market price of our common stock and, therefore, their inclusion would have been anti-dilutive.

14. FINANCIAL INFORMATION BY INDUSTRY SEGMENT AND PRODUCT LINE

We operate predominantly in one industry segment – the development, manufacture, and sale of CMP consumables.

Revenue generated by product line for the three and nine months ended June 30, 2014, and 2013, was as follows:

	Three Months Ended June 30,		Nine Months Ended June 30,	
Revenue:	2014	2013	2014	2013

Tungsten slurries	$42,170	$38,634	$117,098	$116,159
Dielectric slurries	29,651	30,581	88,718	90,673
Other Metals slurries	19,641	20,106	54,782	55,147
Polishing pads	8,764	8,451		