

MKS INSTRUMENTS INC

Form 10-Q

November 07, 2008

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q**

(MARK ONE)

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

For the quarterly period ended September 30, 2008

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 0-23621
MKS INSTRUMENTS, INC.**

(Exact name of registrant as specified in its charter)

Massachusetts

04-2277512

*(State or other jurisdiction
of incorporation or organization)*

*(I.R.S. Employer
Identification No.)*

2 Tech Drive, Suite 201, Andover, Massachusetts

01810

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code (978) 645-5500

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, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a 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

Number of shares outstanding of the issuer's common stock as of October 31, 2008: 49,140,353

MKS INSTRUMENTS, INC.
FORM 10-Q
INDEX

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

Consolidated Balance Sheets September 30, 2008 and December 31, 2007 3

Consolidated Statements of Operations Three and nine months ended September 30, 2008 and 2007 4

Consolidated Statements of Cash Flows Nine months ended September 30, 2008 and 2007 5

Notes to Unaudited Consolidated Financial Statements 6

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. 14

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK. 20

ITEM 4. CONTROLS AND PROCEDURES. 21

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS. 21

ITEM 1A. RISK FACTORS. 21

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS. 22

ITEM 6. EXHIBITS. 22

SIGNATURES

EXHIBIT INDEX

EX-31.1 SECTION 302 CERTIFICATION OF THE CEO

EX-31.2 SECTION 302 CERTIFICATION OF THE CFO

EX-32.1 SECTION 906 CERTIFICATION OF THE CEO & CFO

Table of ContentsPART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS.MKS INSTRUMENTS, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

| | September 30, 2008 (unaudited) | December 31, 2007 |
|---|--------------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 145,432 | \$ 223,968 |
| Short-term investments | 111,780 | 99,797 |
| Trade accounts receivable, net | 104,558 | 107,504 |
| Inventories | 142,680 | 150,731 |
| Deferred income taxes | 16,489 | 17,984 |
| Other current assets | 19,379 | 9,996 |
| Total current assets | 540,318 | 609,980 |
| Property, plant and equipment, net | 79,760 | 81,365 |
| Goodwill | 337,765 | 337,473 |
| Acquired intangible assets, net | 29,089 | 36,141 |
| Other assets | 9,768 | 11,301 |
| Total assets | \$ 996,700 | \$ 1,076,260 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Short-term borrowings | \$ 17,321 | \$ 18,967 |
| Current portion of capital lease obligations | 989 | 1,236 |
| Accounts payable | 25,405 | 28,683 |
| Accrued compensation | 12,969 | 17,842 |
| Other accrued expenses | 29,764 | 29,017 |
| Total current liabilities | 86,448 | 95,745 |
| Long-term debt | | 5,000 |
| Long-term portion of capital lease obligations | 540 | 871 |
| Other liabilities | 21,459 | 20,635 |
| Commitments and contingencies (Note 8) | | |
| Stockholders equity: | | |
| Preferred Stock, \$0.01 par value, 2,000,000 shares authorized; none issued and outstanding | 113 | 113 |

Edgar Filing: MKS INSTRUMENTS INC - Form 10-Q

Common Stock, no par value, 200,000,000 shares authorized;
49,130,826 and 54,261,947 shares issued and outstanding at
September 30, 2008 and December 31, 2007, respectively

| | | |
|--|------------|--------------|
| Additional paid-in capital | 632,428 | 685,465 |
| Retained earnings | 247,718 | 255,244 |
| Accumulated other comprehensive income | 7,994 | 13,187 |
| Total stockholders' equity | 888,253 | 954,009 |
| Total liabilities and stockholders' equity | \$ 996,700 | \$ 1,076,260 |

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

3

Table of Contents

MKS INSTRUMENTS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|------------|
| | 2008 | 2007 | 2008 | 2007 |
| Net Revenues | | | | |
| Products | \$ 135,890 | \$ 164,694 | \$ 455,732 | \$ 544,170 |
| Services | 21,474 | 16,320 | 66,082 | 52,254 |
| Total net revenues | 157,364 | 181,014 | 521,814 | 596,424 |
| Cost of revenues | | | | |
| Cost of products | 81,027 | 93,660 | 264,341 | 306,881 |
| Cost of services | 13,398 | 10,756 | 42,139 | 34,053 |
| Total cost of revenues | 94,425 | 104,416 | 306,480 | 340,934 |
| Gross profit | 62,939 | 76,598 | 215,334 | 255,490 |
| Research and development | 19,528 | 17,159 | 59,263 | 53,809 |
| Selling, general and administrative | 33,460 | 32,494 | 100,282 | 102,998 |
| Amortization of acquired intangible assets | 1,963 | 3,877 | 7,052 | 12,092 |
| Income from operations | 7,988 | 23,068 | 48,737 | 86,591 |
| Interest expense | 86 | 192 | 608 | 625 |
| Interest income | 1,412 | 4,202 | 5,746 | 11,521 |
| Gain (net of impairment) of investments | 506 | | (906) | |
| Income before income taxes | 9,820 | 27,078 | 52,969 | 97,487 |
| Provision for income taxes | 3,029 | 5,696 | 16,562 | 26,288 |
| Net income | \$ 6,791 | \$ 21,382 | \$ 36,407 | \$ 71,199 |
| Net income per share: | | | | |
| Basic | \$ 0.14 | \$ 0.38 | \$ 0.73 | \$ 1.26 |
| Diluted | \$ 0.14 | \$ 0.37 | \$ 0.71 | \$ 1.24 |
| Weighted average common shares outstanding: | | | | |
| Basic | 48,730 | 56,809 | 50,051 | 56,661 |
| Diluted | 49,898 | 57,482 | 51,112 | 57,582 |

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

Table of Contents

MKS INSTRUMENTS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

| | Nine Months Ended September 30, | |
|--|------------------------------------|-----------|
| | 2008 | 2007 |
| Cash flows from operating activities: | | |
| Net income | \$ 36,407 | \$ 71,199 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 17,803 | 22,798 |
| Stock-based compensation | 11,758 | 9,294 |
| Tax expense (benefit) from stock-based compensation | (12) | 3,485 |
| Excess tax benefit from stock-based compensation | (2,202) | (1,511) |
| Deferred income taxes | 1,731 | (5,092) |
| Gain (net of impairment) of investments | 906 | |
| Other | 211 | (97) |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable | 1,022 | 9,970 |
| Inventories | 6,076 | (7,668) |
| Other current assets | (6,408) | (5,220) |
| Accrued expenses and other current liabilities | 268 | (3,656) |
| Accounts payable | (2,985) | (9,486) |
| Income taxes payable | (3,236) | 1,046 |
| Net cash provided by operating activities | 61,339 | 85,062 |
| Cash flows from investing activities: | | |
| Purchases of short-term and long-term available for sale investments | (221,361) | (159,916) |
| Maturities, sales and settlements of short-term and long-term available for sale investments | 208,209 | 104,363 |
| Purchases of property, plant and equipment | (8,413) | (11,519) |
| Other | (59) | 987 |
| Net cash used in investing activities | (21,624) | (66,085) |
| Cash flows from financing activities: | | |
| Proceeds from short-term borrowings | 106,094 | 98,733 |
| Payments on short-term borrowings | (108,768) | (98,505) |
| Repurchases of common stock | (115,723) | (48,970) |
| Principal payments on long-term debt and capital lease obligations | (6,021) | (1,026) |
| Proceeds from exercise of stock options and employee stock purchase plan | 7,020 | 43,301 |
| Excess tax benefit from stock-based compensation | 2,202 | 1,511 |
| Net cash used in financing activities | (115,196) | (4,956) |

| | | |
|--|------------|------------|
| Effect of exchange rate changes on cash and cash equivalents | (3,055) | 1,039 |
| Increase (decrease) in cash and cash equivalents | (78,536) | 15,060 |
| Cash and cash equivalents at beginning of period | 223,968 | 215,208 |
| Cash and cash equivalents at end of period | \$ 145,432 | \$ 230,268 |

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

Table of Contents

MKS INSTRUMENTS, INC.
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 (Tables in thousands, except share and per share data)

1) Basis of Presentation

The terms MKS and the Company refer to MKS Instruments, Inc. and its subsidiaries. The interim financial data as of September 30, 2008 and for the three and nine months ended September 30, 2008 and 2007 is unaudited; however, in the opinion of MKS, the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods. The unaudited consolidated financial statements presented herein have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and note disclosures required by United States generally accepted accounting principles. The consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the MKS Annual Report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission on February 28, 2008. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments, including those related to revenue recognition, stock-based compensation, inventory, intangible assets, goodwill and other long-lived assets, in-process research and development expenses, merger expenses, income taxes and investments. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

2) Goodwill and Intangible AssetsIntangible Assets

Acquired amortizable intangible assets consisted of the following as of September 30, 2008:

| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
|---|-----------------------------|-----------------------------|---------------------------|
| Completed technology | \$ 93,204 | \$ (79,701) | \$ 13,503 |
| Customer relationships | 23,542 | (11,543) | 11,999 |
| Patents, trademarks, tradenames and other | 29,729 | (26,142) | 3,587 |
| | \$ 146,475 | \$ (117,386) | \$ 29,089 |

Acquired amortizable intangible assets consisted of the following as of December 31, 2007:

| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
|---|-----------------------------|-----------------------------|---------------------------|
| Completed technology | \$ 93,204 | \$ (75,681) | \$ 17,523 |
| Customer relationships | 23,542 | (9,644) | 13,898 |
| Patents, trademarks, tradenames and other | 29,729 | (25,009) | 4,720 |
| | \$ 146,475 | \$ (110,334) | \$ 36,141 |

Table of Contents

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Tables in thousands, except share and per share data)

Aggregate amortization expense related to acquired intangibles for the three and nine months ended September 30, 2008 was \$1,963,000 and \$7,052,000, respectively. Aggregate amortization expense related to acquired intangibles for the three and nine months ended September 30, 2007 was \$3,877,000 and \$12,092,000, respectively. Estimated amortization expense for each of the five succeeding fiscal years is as follows:

| Year | Amount |
|------------------|---------|
| 2008 (remaining) | \$1,949 |
| 2009 | 7,751 |
| 2010 | 6,309 |
| 2011 | 5,764 |
| 2012 | 3,488 |
| 2013 | 3,270 |

Goodwill

The changes in the carrying amount of goodwill during the three and nine months ended September 30, 2008 were not material.

3) **Net Income Per Share**

The following table sets forth the computation of basic and diluted net income per share:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-----------|------------------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Numerator: | | | | |
| Net income | \$ 6,791 | \$ 21,382 | \$ 36,407 | \$ 71,199 |
| Denominator: | | | | |
| Shares used in net income per common share basic | 48,730 | 56,809 | 50,051 | 56,661 |
| Effect of dilutive securities: | | | | |
| Stock options, restricted stock and employee stock purchase plan | 1,168 | 673 | 1,061 | 921 |
| Shares used in net income per common share diluted | 49,898 | 57,482 | 51,112 | 57,582 |
| Net income per common share: | | | | |
| Basic | \$ 0.14 | \$ 0.38 | \$ 0.73 | \$ 1.26 |
| Diluted | \$ 0.14 | \$ 0.37 | \$ 0.71 | \$ 1.24 |

The computation of diluted net income per common share excludes the effect of the potential exercise of options to purchase approximately 3,117,040 and 3,172,652 shares for the three and nine months ended September 30, 2008 and approximately 4,447,436 and 3,312,073 shares for the three and nine months ended September 30, 2007, respectively, because the option exercise price was greater than the average market price of our common shares and the effect of including these options would have been anti-dilutive.

4) **Inventories**

Inventories consist of the following:

Edgar Filing: MKS INSTRUMENTS INC - Form 10-Q

| | September 30, 2008 | December 31, 2007 |
|-----------------|--------------------------|-------------------------|
| Raw material | \$ 67,927 | \$ 73,529 |
| Work in process | 24,761 | 26,171 |
| Finished goods | 49,992 | 51,031 |
| | \$ 142,680 | \$ 150,731 |

Table of Contents

MKS INSTRUMENTS, INC.
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)
 (Tables in thousands, except share and per share data)

5) Stockholders EquityComprehensive Income

Components of comprehensive income were as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Net income | \$ 6,791 | \$ 21,382 | \$ 36,407 | \$ 71,199 |
| Other comprehensive income (loss): | | | | |
| Changes in value of financial instruments designated as cash flow hedges (net of tax) | 1,137 | (761) | 1,911 | (915) |
| Foreign currency translation adjustment | (6,350) | 2,997 | (6,951) | 3,252 |
| Unrealized gain (loss) on investments (net of tax) | (35) | 21 | (153) | 92 |
| Other comprehensive income (loss) | (5,248) | 2,257 | (5,193) | 2,429 |
| Total comprehensive income | \$ 1,543 | \$ 23,639 | \$ 31,214 | \$ 73,628 |

Stock Repurchase Program

On February 12, 2007, MKS Board of Directors approved a share repurchase program (the Program) for the repurchase of up to \$300.0 million of its outstanding stock over the subsequent two years. The repurchases may be made from time to time on the open market or through privately negotiated transactions. The timing and amount of any shares repurchased under the Program will depend on a variety of factors, including the price of our common stock, corporate and regulatory requirements, capital availability, and other market conditions. The Program may be discontinued at any time at the discretion of the Company and its Board of Directors. During the three months ended September 30, 2008, we repurchased 616,000 shares of common stock for \$13,785,000 for an average price of \$22.36 per share and during the nine months ended September 30, 2008, we repurchased 5,667,000 shares of common stock for \$115,723,000 for an average price of \$20.42 per share. During the three months ended September 30, 2007, we repurchased 748,000 shares of common stock for \$17,251,000 for an average price of \$23.06 per share and during the nine months ended September 30, 2007, we repurchased 1,949,000 shares of common stock for \$48,970,000 for an average price of \$25.13 per share. As of September 30, 2008, the Company has repurchased an aggregate of 10,446,000 shares of its common stock for \$216,880,000 for an average price of \$20.76 per share since the Program's inception on February 12, 2007.

6) Income Taxes

The Company adopted FASB Interpretation 48, Accounting for Uncertainty in Income Taxes (FIN 48) in 2007. At December 31, 2007, the total amount of gross unrecognized tax benefits, which excludes interest and penalties discussed below, was approximately \$16,100,000. If these benefits were recognized in a future period, the timing of which is not estimable, the net unrecognized tax benefit of approximately \$13,200,000 would impact the Company's effective tax rate. The total amount of gross unrecognized tax benefits at September 30, 2008 was approximately \$15,400,000. The net decrease from January 1, 2008 was primarily attributable to the close of the statute of limitation on the 2004 tax year.

Edgar Filing: MKS INSTRUMENTS INC - Form 10-Q

MKS and its subsidiaries are subject to U.S. federal income tax as well as the income tax of multiple state and foreign jurisdictions. The Company has concluded all U.S. federal income tax matters for years through 2002. While the U.S. 2004 federal tax year is closed, the 2003 federal tax year remains open to the extent of the loss carryforward to 2005. Currently, the Company is under a federal audit for the 2005 tax year. As of September 30, 2008, there were ongoing audits in various other tax jurisdictions.

Within the next 12 months, it is reasonably possible that the Company may recognize \$4,500,000 to \$5,000,000 of previously unrecognized tax benefits related to various federal, state, and foreign tax positions as a result of the conclusion of various audits and the expiration of the statute of limitations. The following tax years, in the major tax jurisdictions noted, are open for assessment or refund: U.S. Federal: 2003, 2005 to 2007, Germany: 2001 to 2007, Korea: 2004 to 2007, Japan: 2001 to 2007, and the United Kingdom: 2006 and 2007.

Table of Contents

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Tables in thousands, except share and per share data)

The Company accrues interest and, if applicable, penalties, for any uncertain tax positions. This interest and penalty expense is a component of income tax expense. At September 30, 2008 and December 31, 2007, the Company had approximately \$1,600,000 and \$1,500,000, respectively, accrued for interest on unrecognized tax benefits.