CABOT CORP
Form 10-Q
May 10, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2011

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 1-5667

Cabot Corporation

(Exact name of registrant as specified in its charter)

Delaware	**04-2271897**
(State of Incorporation)	**(I.R.S. Employer Identification No.)**

Two Seaport Lane

Boston, Massachusetts	**02210-2019**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (617) 345-0100

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 (§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 (Do not check if smaller reporting company) ¨ 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

Indicate the number of shares outstanding of each of the issuer s classes of Common Stock, as of the latest practicable date.

As of April 29, 2011 the Company had 65,571,648 shares of Common Stock, par value $1 per share, outstanding.

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Part I. Financial Information

Item 1. Financial Statements

CABOT CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

UNAUDITED

	Three Months Ended March 31		Six Months Ended March 31	
	2011	2010	2011	2010
	(In millions, except per share amounts)			
Net sales and other operating revenues	$ 791	$ 712	$ 1,544	$ 1,391
Cost of sales	630	572	1,225	1,115
Gross profit	161	140	319	276
Selling and administrative expenses	64	61	128	128
Research and technical expenses	19	19	36	37
Income from operations	78	60	155	111
Interest and dividend income			1	
Interest expense	(10)	(11)	(20)	(20)
Other income (expense)	4	(4)	6	(4)
Income from continuing operations before income taxes and equity in net income of affiliated companies	72	45	142	87
(Provision) benefit for income taxes	(17)	1	(11)	(10)
Equity in net income of affiliated companies	1	1	4	4
Net income from continuing operations	56	47	135	81
Income from discontinued operations, net of tax			1	
Net income	56	47	136	81
Net income attributable to noncontrolling interests	5	4	10	9
Net income attributable to Cabot Corporation	$ 51	$ 43	$ 126	$ 72
Weighted-average common shares outstanding, in millions:				
Basic	64	64	64	64
Diluted	65	64	65	64
Income per common share:				
Basic:				
Income from continuing operations attributable to Cabot Corporation	$ 0.77	$ 0.66	$ 1.89	$ 1.10
Income from discontinued operations			0.02	
Net income attributable to Cabot Corporation	$ 0.77	$ 0.66	$ 1.91	$ 1.10

Diluted:				
Income from continuing operations attributable to Cabot Corporation	$ 0.76	$ 0.65	$ 1.87	$ 1.09
Income from discontinued operations			0.02	
Net income attributable to Cabot Corporation	$ 0.76	$ 0.65	$ 1.89	$ 1.09
Dividends per common share	$ 0.18	$ 0.18	$ 0.36	$ 0.36

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

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CABOT CORPORATION

CONSOLIDATED BALANCE SHEETS

ASSETS

UNAUDITED

	March 31, 2011	September 30, 2010
	(In millions)	
Current assets:		
Cash and cash equivalents	$ 366	$ 387
Accounts and notes receivable, net of reserve for doubtful accounts of $5 and $4	621	576
Inventories:		
Raw materials	151	121
Work in process	10	38
Finished goods	229	178
Other	37	36
Total inventories	427	373
Prepaid expenses and other current assets	83	72
Deferred income taxes	33	30
Total current assets	1,530	1,438
Property, plant and equipment	3,054	2,943
Accumulated depreciation and amortization	(2,060)	(1,968)
Net property, plant and equipment	994	975
Goodwill	39	39
Equity affiliates	57	61
Intangible assets, net of accumulated amortization of $12 and $12	4	4
Assets held for rent	42	40
Deferred income taxes	258	245
Other assets	90	84
Total assets	$ 3,014	$ 2,886

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

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CABOT CORPORATION

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS EQUITY

UNAUDITED

	March 31, 2011	September 30, 2010
	(In millions, except share and per share amounts)	
Current liabilities:		
Notes payable to banks	$ 57	$ 29
Accounts payable and accrued liabilities	413	447
Income taxes payable	27	34
Deferred income taxes	6	6
Current portion of long-term debt	17	23
Total current liabilities	520	539
Long-term debt	588	600
Deferred income taxes	6	6
Other liabilities	333	324
Commitments and contingencies (Note E)		
Stockholders equity:		
Preferred stock:		
Authorized: 2,000,000 shares of $1 par value		
Issued and Outstanding : None and none		
Common stock:		
Authorized: 200,000,000 shares of $1 par value		
Issued: 65,595,421 and 65,429,916 shares		
Outstanding: 65,561,751 and 65,370,220 shares	66	65
Less cost of 33,670 and 59,696 shares of common treasury stock	(1)	(2)
Additional paid-in capital	60	46
Retained earnings	1,227	1,125
Deferred employee benefits	(17)	(20)
Accumulated other comprehensive income	108	88
Total Cabot Corporation stockholders equity	1,443	1,302
Noncontrolling interests	124	115
Total stockholders equity	1,567	1,417
Total liabilities and stockholders equity	$ 3,014	$ 2,886

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

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CABOT CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

	Six Months Ended March 31	
	2011	2010
	(In millions)	
Cash Flows from Operating Activities:		
Net income	$ 136	$ 81
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	70	67
Deferred tax provision	(18)	(2)
Impairment charges		2
Loss on sale of property, plant and equipment	1	5
Equity in net income of affiliated companies	(4)	(4)
Non-cash compensation	12	16
Other non-cash items, net	4	(1)
Changes in assets and liabilities:		
Accounts and notes receivable	(32)	(89)
Inventories	(46)	(22)
Prepaid expenses and other current assets	(12)	(14)
Accounts payable and accrued liabilities	(46)	(32)
Income taxes payable	(5)	(7)
Other liabilities	(5)	2
Cash dividends received from equity affiliates	3	6
Other		4
Cash provided by operating activities	58	12
Cash Flows from Investing Activities:		
Additions to property, plant and equipment	(72)	(31)
Proceeds from sales of property, plant and equipment		3
(Increase) decrease in assets held for rent	(1)	1
Settlement of derivatives		(7)
Cash used in investing activities	(73)	(34)
Cash Flows from Financing Activities:		
Borrowings under financing arrangements	31	3
Repayments under financing arrangements	(14)	
Repayments of long-term debt	(17)	(5)
Increase in notes payable to banks, net	10	5
Purchases of common stock		(2)
Proceeds from sales of common stock	3	
Cash dividends paid to noncontrolling interests	(3)	(5)
Cash dividends paid to common stockholders	(24)	(23)
Cash used in financing activities	(14)	(27)
Effect of exchange rate changes on cash	8	(7)

Decrease in cash and cash equivalents	(21)	(56)
Cash and cash equivalents at beginning of period	387	304
Cash and cash equivalents at end of period	$ 366	$ 248

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

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CABOT CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

Six Months Ended March 31, 2010

(In millions, except shares in thousands)

UNAUDITED

	Common Stock, Net of Treasury Stock		Additional		Deferred	Accumulated Other	Cabot Corporation	Non-	Total	Total
	Shares	Cost	Paid-in Capital	Retained Earnings	Employee Benefits	Comprehensive Income	Stockholders Equity	controlling Interests	Stockholders Equity	Comprehensive Income
Balance at September 30, 2009	65,309	$ 63	$ 18	$ 1,018	$ (25)	$ 60	$ 1,134	$ 103	$ 1,237	
Net income attributable to Cabot Corporation				72						$ 72
Foreign currency translation adjustment						(6)				(6)
Change in employee benefit plans						1				1
Total other comprehensive loss										(5)
Comprehensive income attributable to Cabot Corporation, net of tax							67			$ 67
Net income attributable to noncontrolling interests, net of tax								9		$ 9
Noncontrolling interest foreign currency adjustment								(1)		(1)
Comprehensive income attributable to noncontrolling interests										8
Comprehensive income(1)									75	$ 75
Noncontrolling interests - dividends paid								(5)	(5)	
Cash dividends paid to common stockholders				(23)			(23)		(23)	
Issuance of stock under employee compensation plans, net of forfeitures	131	1	4				5		5	
Amortization of share-based compensation			11				11		11	
Purchase and retirement of common and treasury stock	(88)	(1)	(1)				(2)		(2)	
Principal payment by Employee Stock					3		3		3	

Ownership Plan under guaranteed loan									
Balance at March 31, 2010	65,352	$ 63	$ 32	$ 1,067	$ (22)	$ 55	$ 1,195	$ 106	$ 1,301

(1) Comprehensive income for the three months ended March 31, 2010 was $47 million.

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

CABOT CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

Six Months Ended March 31, 2011

(In millions, except shares in thousands)

UNAUDITED

	Common Stock, Net of Treasury Stock		Additional		Deferred	Accumulated Other	Cabot Corporation	Non-	Total	Total
	Shares	Cost	Paid-in Capital	Retained Earnings	Employee Benefits	Comprehensive Income	Stockholders Equity	controlling Interests	Stockholders Equity	Comprehensive Income
Balance at September 30, 2010	65,370	$ 63	$ 46	$ 1,125	$ (20)	$ 88	$ 1,302	$ 115	$ 1,417	
Net income attributable to Cabot Corporation				126						$ 126
Foreign currency translation adjustment						20				20
Total other comprehensive income										20
Comprehensive income attributable to Cabot Corporation, net of tax							146			$ 146
Net income attributable to noncontrolling interests, net of tax								10		$ 10
Noncontrolling interest foreign currency adjustment								3		3
Comprehensive income attributable to noncontrolling interests										13
Comprehensive income[1]									159	$ 159
Noncontrolling interest - dividends								(4)	(4)	
Cash dividends paid to common stockholders				(24)			(24)		(24)	
Issuance of stock under employee compensation plans, net of forfeitures	218	2	5				7		7	
Amortization of share-based compensation			9				9		9	
Purchase and retirement of common and treasury stock	(26)									
Principal payment by Employee Stock Ownership Plan under guaranteed loan					3		3		3	

Balance at March 31, 2011	65,562	$ 65	$ 60	$ 1,227	$ (17)	$ 108	$ 1,443	$ 124	$ 1,567

(1) Comprehensive income for the three months ended March 31, 2011 was $71 million.

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

CABOT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2011

UNAUDITED

A. Basis of Presentation

The consolidated financial statements include the accounts of Cabot Corporation (Cabot or the Company) and its wholly owned subsidiaries and majority-owned and controlled U.S. and non-U.S. subsidiaries. Additionally, Cabot considers consolidation of entities over which control is achieved through means other than voting rights, of which there were none in the periods presented. Intercompany transactions have been eliminated in consolidation.

The unaudited consolidated financial statements have been prepared in accordance with the requirements of Form 10-Q and consequently do not include all disclosures required by Form 10-K. Additional information may be obtained by referring to Cabot s Annual Report on Form 10-K for the fiscal year ended September 30, 2010 (2010 10-K).

The financial information submitted herewith is unaudited and reflects all adjustments which are, in the opinion of management, necessary to provide a fair statement of the results for the interim periods ended March 31, 2011 and 2010. All such adjustments are of a normal recurring nature. The results for interim periods are not necessarily indicative of the results to be expected for the fiscal year.

The amount included in the caption Income from discontinued operations, net of tax in the consolidated statements of operations represents a tax settlement in connection with the Company s discontinued operations. The settlement amount was a benefit of approximately $1 million for the six months ended March 31, 2011.

B. Significant Accounting Policies

Revenue Recognition and Accounts Receivable

Cabot recognizes revenue when persuasive evidence of a sales arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectability is probable. Cabot generally is able to ensure that products meet customer specifications prior to shipment. If the Company is unable to determine that the product has met the specified objective criteria prior to shipment or if title has not transferred because of sales terms, the revenue is considered unearned and is deferred until the revenue recognition criteria are met.

Shipping and handling charges related to sales transactions are recorded as sales revenue when billed to customers or included in the sales price. Shipping and handling costs are included in cost of sales.

The following table shows the relative size of the revenue recognized in each of the Company s reportable segments.

	Three months ended March 31		Six months ended March 31	
	2011	2010 (1)	2011	2010 (1)
Core Segment				
Rubber Blacks Business	59%	60%	60%	60%
Supermetals Business	7%	5%	7%	6%
Performance Segment	29%	30%	28%	29%
New Business Segment	3%	3%	3%	3%
Specialty Fluids Segment	2%	2%	2%	2%

(1) As discussed in Note M Financial Information by Segment , 2010 business segment revenues have been recast to exclude the adjustment for unearned revenue.

Cabot derives the substantial majority of its revenues from the sale of products in the Core and Performance Segments. Revenue from these products is typically recognized when the product is shipped and title and risk of loss have passed to the customer. The Company offers certain of its customers cash discounts and volume rebates as sales incentives. The discounts and volume rebates are recorded as a reduction in sales at the time revenue is recognized and are estimated based on historical experience and contractual obligations. Cabot periodically reviews the assumptions underlying its estimates of discounts and volume rebates and adjusts its revenues accordingly.

CABOT CORPORATION

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Revenue in the New Business Segment is typically recognized when the product is shipped and title and risk of loss have passed to the customer. Depending on the nature of the contract with the customer, a portion of the segment s revenue may be recognized using proportional performance.

The majority of the revenue in the Specialty Fluids Segment arises from the rental of cesium formate. This revenue is recognized throughout the rental period based on the contracted rental terms. Customers are also billed and revenue is recognized, typically at the end of the job, for cesium formate product that is not returned. On occasion the Company also makes sales of cesium formate outside of a rental process and revenue is recognized upon delivery of the fluid.

Cabot maintains allowances for doubtful accounts based on an assessment of the collectibility of specific customer accounts, the aging of accounts receivable and other economic information on both an historical and prospective basis. Customer account balances are charged against the allowance when it is probable the receivable will not be recovered. Changes in the allowance during the first six months of fiscal 2011 and 2010 were not material. There is no off-balance sheet credit exposure related to customer receivable balances.

Goodwill and Long-Lived Assets

Goodwill is comprised of the cost of business acquisitions in excess of the fair value assigned to the net tangible and identifiable intangible assets acquired. Goodwill is not amortized but is reviewed for impairment at least annually. The annual review consists of the comparison of each reporting unit s carrying value to its fair value, which is performed as of March 31. Certain circumstances may give rise to an impairment assessment at a date other than the annual assessment date.

The fair value of a reporting unit is primarily based on discounted estimated future cash flows. The assumptions used to estimate fair value include management s best estimates of future growth rates, operating cash flows, capital expenditures, discount rates and market conditions over an estimate of the remaining operating period at the reporting unit level. If an impairment exists, a loss is recorded to write-down the value of goodwill to its implied fair value.

Cabot s long-lived assets primarily include property, plant and equipment, long-term investments, assets held for rent and intangible assets. The carrying values of long-lived assets are reviewed for impairment whenever events or changes in business circumstances indicate that the carrying amount of an asset may not be recoverable.

Financial Instruments

Cabot s financial instruments consist primarily of cash and cash equivalents, accounts and notes receivable, accounts payable and accrued liabilities, short-term and long-term debt, and derivative instruments. The carrying values of Cabot s financial instruments approximate fair value with the exception of long-term debt that has not been designated as part of a fair value hedge. The non-hedged long-term debt is recorded at amortized cost. The fair values of the Company s financial instruments are based on quoted market prices, if such prices are available. In situations where quoted market prices are not available, the Company relies on valuation models to derive fair value. Such valuation takes into account the ability of the financial counterparty to perform. Cabot uses derivative financial instruments primarily for purposes of hedging exposures to fluctuations in interest rates and foreign currency exchange rates, which exist as part of its on-going business operations. Cabot does not enter into contracts for speculative purposes, nor does it hold or issue any financial instruments for trading purposes. All financial instruments are recognized on the consolidated balance sheets at fair value. Where Cabot has a legally enforceable master netting agreement with a counterparty, financial instruments with that counterparty are presented on a net basis. The changes in the fair value of derivatives are recorded in either earnings or accumulated other comprehensive income, depending on whether or not the instrument is designated as part of a hedge transaction and, if designated as part of a hedge transaction, the type of hedge transaction. The gains or losses on derivative instruments reported in accumulated other comprehensive income are reclassified to earnings in the period in which earnings are affected by the underlying hedged item. The ineffective portion of all hedges is recognized in earnings during the period in which the ineffectiveness occurs.

In accordance with Cabot s risk management strategy, the Company may enter into certain derivative instruments that may not be designated as hedges for hedge accounting purposes. Although these derivatives are not designated as hedges, the Company believes that such instruments are closely correlated with the underlying exposure, thus managing the associated risk. The Company records in earnings the gains or losses from changes in the fair value of derivative instruments that are not designated as hedges. Cash movements associated with these instruments are presented in the consolidated statement of cash flows as cash flows from operating activities because the derivatives are designed to mitigate risk to the Company s cash flow from operations.

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Income Tax in Interim Periods

The Company records its tax provision or benefit on an interim basis using an estimated annual effective tax rate. This rate is applied to the current period ordinary income or loss to determine the income tax provision or benefit allocated to the interim period. Losses from jurisdictions for which no benefit can be recognized and the income tax effects of unusual or infrequent items are excluded from the estimated annual effective tax rate and are recognized in the impacted interim period as discrete items. During the six months ended March 31, 2011, the Company recognized as a discrete item net tax benefits of $26 million principally from the repatriation of high tax dividends in response to changes in U.S. tax legislation.

Valuation allowances are provided against the future tax benefits that arise from the losses in jurisdictions for which no benefit can be recognized. The estimated annual effective tax rate may be significantly impacted by nondeductible expenses and the Company s projected earnings mix by tax jurisdiction. Adjustments to the estimated annual effective income tax rate are recognized in the period when such estimates are revised.

Inventory Valuation

The cost of most raw materials, work in process and finished goods inventories in the U.S. is determined by the last-in, first-out (LIFO) method. Had the Company used the first-in, first-out (FIFO) method instead of the LIFO method for such inventories, the value of those inventories would have been $100 million higher as of March 31, 2011 and $98 million higher as of September 30, 2010. The cost of other U.S. and all non-U.S. inventories is determined using the average cost method or the FIFO method.

During the three and six months ended March 31, 2011 and 2010, inventory quantities were reduced at the Company s U.S. Supermetals site. These reductions had the following effects on cost of sales and net income:

	Three months ended March 31		Six months ended March 31	
	2011	2010	2011	2010
	(Dollars in millions, except per share amounts)			
Decrease in cost of sales	$ 8	$ 4	$ 14	$ 7
Increase in net income	$ 5	$ 2	$ 9	$ 5
Increase in net income per diluted common share	$ 0.08	$ 0.04	$ 0.14	$ 0.07

Cabot reviews inventory for both potential obsolescence and potential declines in anticipated selling prices. In this review, the Company makes assumptions about the future demand for and market value of the inventory, and based on these assumptions estimates the amount of any obsolete, unmarketable, slow moving or overvalued inventory. Cabot writes down the value of these inventories by an amount equal to the difference between the cost of the inventory and its estimated market value. There were no significant write-downs in either the three and six months ended March 31, 2011 or 2010.

C. Goodwill and Other Intangible Assets

The carrying amount of goodwill attributable to each reporting unit with goodwill balances for the periods ended March 31, 2011 and September 30, 2010, are as follows:

	Rubber Blacks Business	Fumed Metal Oxides Business	New Business Segment	Total
		(Dollars in millions)		
Goodwill	$ 27	$ 11	$ 1	$ 39

Impairment tests are performed at least annually. The Company performed its annual impairment assessment as of March 31, 2011 and determined that there was no impairment.

Cabot does not have any indefinite-lived intangible assets. As of both March 31, 2011 and September 30, 2010, Cabot had $4 million of finite-lived intangible assets. Intangible assets are amortized over their estimated useful lives, which range from six to fourteen years, with a weighted average period of ten years. Amortization relative to these intangible assets is expected to aggregate to less than $1 million per year over the next five years.

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D. Employee Benefit Plans

Curtailment of employee benefit plan

During the first six months of fiscal 2011, the Company incurred a curtailment in one of its foreign employee benefit plans as a result of the action taken in the 2009 Global Restructuring Plan. Associated with this curtailment, the Company recognized a $1 million benefit in the first six months of fiscal 2011.

Net periodic defined benefit pension and other postretirement benefit costs

Net periodic defined benefit pension and other postretirement benefit costs include the following:

	Three Months Ended March 31							
	2011		2010		2011		2010	
	Pension Benefits				Postretirement Benefits			
	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign
	(Dollars in millions)							
Service cost	$ 1	$ 2	$ 1	$ 2	$ 1	$	$	$
Interest cost	2	2	2	3	1		1	
Expected return on plan assets	(2)	(3)	(2)	(3)				
Amortization of prior service credit					(1)		(1)	
Amortization of actuarial loss		1						
Net periodic benefit cost	$ 1	$ 2	$ 1	$ 2	$ 1	$	$	$

	Six Months Ended March 31							
	2011		2010		2011		2010	
	Pension Benefits				Postretirement Benefits			
	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign
	(Dollars in millions)							
Service cost	$ 2	$ 3	$ 2	$ 3	$ 1	$	$	$
Interest cost	4	4	4	5	2		2	
Expected return on plan assets	(4)	(6)	(4)	(6)				
Amortization of prior service credit					(2)		(2)	
Amortization of actuarial loss		2		1				
Curtailment income		(1)						
Net periodic benefit cost	$ 2	$ 2	$ 2	$ 3	$ 1	$	$	$

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CABOT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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E. Commitments and Contingencies

Purchase Commitments

Cabot has entered into long-term purchase agreements primarily for the purchase of raw materials and natural gas. Under certain of these agreements, the quantity of material being purchased is fixed, but the price paid changes as market prices change. For those commitments, the amounts included in the table below are based on market prices at March 31, 2011.

	Payments Due by Fiscal Year						
	Remainder of fiscal 2011	2012	2013	2014	2015	Thereafter	Total
	(Dollars in millions)						
Core Segment:							
Rubber Blacks Business	$ 166	$ 236	$ 206	$ 160	$ 157	$ 1,298	$ 2,223
Supermetals Business	12	15	13	5			45
Performance Segment	12	22	20	21	21	189	285
New Business Segment		1	1				2
Corporate and other	2						2
Total	$ 192	$ 274	$ 240	$ 186	$ 178	$ 1,487	$ 2,557

Guarantee Agreements

Cabot has provided certain indemnities pursuant to which it may be required to make payments to an indemnified party in connection with certain transactions and agreements. In connection with certain acquisitions and divestitures, Cabot has provided routine indemnities with respect to such matters as environmental, tax, insurance, product and employee liabilities. In connection with various other agreements, including service and supply agreements, Cabot may provide routine indemnities for certain contingencies and routine warranties. Cabot is unable to estimate the maximum potential liability for these types of indemnities as a maximum obligation is not explicitly stated in most cases and the amounts, if any, are dependent upon the outcome of future contingent events, the nature and likelihood of which cannot be reasonably estimated. The duration of the indemnities vary, and in many cases are indefinite. Cabot has not recorded any liability for these indemnities in the consolidated financial statements, except as otherwise disclosed.

Contingencies

Cabot is a defendant, or potentially responsible party, in various lawsuits and environmental proceedings wherein substantial amounts are claimed or at issue.

Environmental Matters

As of March 31, 2011 and September 30, 2010, Cabot had $6 million on a discounted basis ($7 million on an undiscounted basis) and $7 million, on a discounted and undiscounted basis, respectively, reserved for environmental matters primarily related to divested businesses. These amounts represent Cabot s best estimates of its share of costs likely to be incurred at those sites where costs are reasonably estimable based on its analysis of the extent of clean up required, alternative clean up methods available, abilities of other responsible parties to contribute and its interpretation of laws and regulations applicable to each site. Cabot reviews the adequacy of this reserve as circumstances change at individual sites. Cash payments related to these environmental matters were $1 million and less than $1 million in the first six months of fiscal 2011 and 2010, respectively.

Other Matters

Respirator Liabilities

Cabot has exposure in connection with a safety respiratory products business that a subsidiary acquired from American Optical Corporation (AO) in an April 1990 asset purchase transaction. The subsidiary manufactured respirators under the AO brand and disposed of that business in July 1995. In connection with its acquisition of the business, the subsidiary agreed, in certain circumstances, to assume a portion of AO s liabilities, including costs of legal fees together with amounts paid in settlements and judgments, allocable to AO respiratory products used prior to the 1990 purchase by the Cabot subsidiary. As more fully described in the 2010 10-K, the Company s respirator liabilities involve claims for personal injury, including asbestosis, silicosis and coal worker s

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March 31, 2011

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pneumoconiosis, allegedly resulting from the use of AO respirators that are alleged to have been negligently designed or labeled.

As of March 31, 2011 and September 30, 2010, there were approximately 43,000 and 45,000 claimants, respectively, in pending cases asserting claims against AO in connection with respiratory products. Cabot has a reserve to cover its expected share of liability for existing and future respirator liability claims. The book value of the reserve is being accreted up to the undiscounted liability through interest expense over the expected cash flow period, which is through 2062. At March 31, 2011 and September 30, 2010, the reserve was $13 million and $15 million, respectively, on a discounted basis ($18 million and $20 million on an undiscounted basis, respectively). Cash payments related to this liability were approximately $3 million and $1 million in the first six months of fiscal 2011 and 2010, respectively.

Other

During the three and six months ended March 31, 2011, the Company recognized a benefit of approximately $9 million related to a legal judgment associated with a feedstock pipeline breakage that occurred in a prior period. This benefit was recorded within cost of sales and other income (expense) in the consolidated statements of operations.

The Company has various other lawsuits, claims and contingent liabilities arising in the ordinary course of its business and with respect to the Company s divested businesses. In the opinion of the Company, although final disposition of some or all of these other suits and claims may impact the Company s financial statements in a particular period, they should not, in the aggregate, have a material adverse effect on the Company s financial position.

F. Income Tax Uncertainties

As of March 31, 2011, the total amount of unrecognized tax benefits was $46 million. In addition, accruals of $5 million and $14 million have been recorded for penalties and interest, respectively, as of March 31, 2011.

A reconciliation of the beginning and ending amount of unrecognized tax benefits for the six months ended March 31, 2011 and 2010 is as follows:

	Six months ended March 31	
	2011	2010
	(Dollars in millions)	
Balance at beginning of the period	$ 75	$ 81
Additions based on tax positions related to the current year	2	3
Additions based on tax positions of prior years	1	
Reduction for tax positions of prior years	(6)	(11)
Balance at end of the period	$ 72	$ 73

If the unrecognized tax benefits of $72 million were recognized at a given point in time, there would be approximately a $35 million favorable impact on the Company s tax provision as a portion of the amount recognized would create a deferred tax asset which would attract a full valuation allowance.

During the first six months of fiscal 2011, the balance of unrecognized tax positions was reduced by $6 million primarily due to the settlement of audits in a number of tax jurisdictions including a $1 million settlement classified as discontinued operations. Certain Cabot subsidiaries are under audit in jurisdictions outside of the U.S. In addition, certain statutes of limitations are scheduled to expire in the near future. It is reasonably possible that a further change in the unrecognized tax benefits may occur within the next twelve months related to the settlement of one or more of these audits or the lapse of applicable statutes of limitations; however, an estimated range of the impact on the unrecognized tax benefits cannot be quantified at this time.

Cabot files U.S. federal and state and non-U.S. income tax returns in jurisdictions with varying statutes of limitations. The 2007 through 2011 tax years generally remain subject to examination by the IRS and the 2004 through 2011 tax years remain subject to examination by most state tax authorities. In significant non-U.S. jurisdictions, the 2002 through 2011 tax years generally remain subject to examination by their respective tax authorities. Cabot s significant non-U.S. jurisdictions include Argentina, Brazil, Canada, China, Germany, Japan, the Netherlands, and the United Kingdom.

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G. Earnings Per Share

The following tables summarize the components of the basic and diluted earnings per common share computations:

	Three Months Ended March 31		Six Months Ended March 31	
	2011	2010	2011	2010
	(Dollars in millions, except per share amounts)			
Basic EPS:				
Net income attributable to Cabot Corporation	$ 51	$ 43	$ 126	$ 72
Less: Dividends and dividend equivalents to participating securities	1	1	1	1
Less: Undistributed earnings allocated to participating securities[1]	1		2	1
Earnings allocated to common shareholders (numerator)	$ 49	$ 42	$ 123	$ 70
Weighted average common shares outstanding	65	65	65	65
Less: Participating securities[1]	1	1	1	1
Adjusted weighted average common shares (denominator)	64	64	64	64
Basic EPS	$ 0.77	$ 0.66	$ 1.91	$ 1.10
Diluted EPS:				
Earnings allocated to common shareholders	$ 49	$ 42	$ 123	$ 70
Plus: Earnings allocated to participating securities	2	1	3	2
Less: Adjusted earnings allocated to participating securities[2]	(2)	(1)	(3)	(2)
Income available to common shares (numerator)	$ 49	$ 42	$ 123	$ 70
Adjusted weighted average common shares outstanding	64	64	64	64
Effect of dilutive securities:				
Common shares issuable[3]	1		1	
Adjusted weighted average common shares (denominator)	65	64	65	64
Diluted EPS	$ 0.76	$ 0.65	$ 1.89	$ 1.09

(1) Participating securities consist of shares of unvested restricted stock, vested restricted stock awards held by employees in which Cabot has a security interest, and unvested time-based restricted stock units. For both the three and six months ended March 31, 2011 and 2010, participating securities amounted to approximately 1 million shares and units issued under Cabot s equity incentive plans.

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Undistributed earnings are the earnings which remain after dividends declared during the period are assumed to be distributed to the common and participating shareholders. Undistributed earnings are allocated to common and participating shareholders on the same basis as dividend distributions. The calculation of undistributed earnings is as follows:

	Three Months Ended March 31		Six Months Ended March 31	
	2011	2010	2011	2010
	(Dollars in millions)			
Calculation of undistributed earnings:				
Net income attributable to Cabot Corporation	$ 51	$ 43	$ 126	$ 72
Less: Dividends declared on common stock	11	10	23	22
Less: Dividends declared on participating securities	1	1	1	1
Undistributed earnings	$ 39	$ 32	$ 102	$ 49
Allocation of undistributed earnings:				
Undistributed earnings allocated to common shareholders	$ 38	$ 32	$ 100	$ 48
Undistributed earnings allocated to participating shareholders	1		2	1
Undistributed earnings	$ 39	$ 32	$ 102	$ 49

(2) Undistributed earnings are adjusted for the assumed distribution of dividends to the dilutive securities, which are described in (3) below, and then reallocated to participating securities.

(3) Represents incremental shares of common stock from the (i) assumed exercise of stock options issued under Cabot s equity incentive plans; (ii) assumed issuance of shares to employees pursuant to the Company s Supplemental Retirement Savings Plan; and (iii) assumed issuance of shares under outstanding performance-based stock unit awards issued under Cabot s equity incentive plans. For both the three and six months ended March 31, 2011, 23,000 incremental shares of common stock were not included in the calculation of diluted earnings per share because the options exercise prices were greater than the average market price of Cabot common stock for the relevant period. For the three and six months ended March 31, 2010, 600,400 and 268,000 incremental shares of common stock, respectively, were not included in the calculation of diluted earnings per share because the options exercise prices were greater than the average market price of Cabot common stock for the relevant period.

H. Restructuring

Cabot s restructuring activities were recorded in the consolidated statements of operations as follows:

Three Months Ended March 31		Six Months Ended March 31	
2011	2010	2011	2010
(Dollars in millions)			

Cost of sales	$ 7	$ 5	$ 10	$ 11
Selling and administrative expenses		4	1	13
Research and technical expenses				
Total	$ 7	$ 9	$ 11	$ 24

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Details of these restructuring activities and the related reserves during the three months ended March 31, 2011 is as follows:

	Severance and Employee Benefits	Environmental Remediation	Asset Impairment and Accelerated Depreciation	Other	Total
			(Dollars in millions)		
Reserve at December 31, 2010	$ 14	$ 1	$	$	$ 15
Charges	2	1	1	3	7
Costs charged against assets			(1)		(1)
Cash paid	(3)			(2)	(5)
Foreign currency translation adjustment	1				1