

MKS INSTRUMENTS INC

Form 10-Q

November 04, 2011

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, 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 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 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 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

As of October 31, 2011 the registrant had 52,443,278 shares of common stock outstanding.

MKS INSTRUMENTS, INC.
FORM 10-Q
INDEX

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (Unaudited).

Consolidated Balance Sheets – September 30, 2011 and December 31, 2010 3

Consolidated Statements of Operations – Three and nine months ended September 30, 2011 and 2010 4

Consolidated Statements of Cash Flows – Nine months ended September 30, 2011 and 2010 5

Notes to Unaudited Consolidated Financial Statements 6

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. 18

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK. 24

ITEM 4. CONTROLS AND PROCEDURES. 25

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS. 25

ITEM 1A. RISK FACTORS. 25

ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS. 26

ITEM 6. EXHIBITS. 26

SIGNATURES 27

EXHIBIT INDEX

EX-31.1

EX-31.2

EX-32.1

EX-101 INSTANCE DOCUMENT

EX-101 SCHEMA DOCUMENT

EX-101 CALCULATION LINKBASE DOCUMENT

EX-101 LABELS LINKBASE DOCUMENT

EX-101 PRESENTATION LINKBASE DOCUMENT

EX-101 DEFINITION LINKBASE DOCUMENT

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

MKS INSTRUMENTS, INC.
 CONSOLIDATED BALANCE SHEETS
 (in thousands, except share and per share data)
 (Unaudited)

	September 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 216,111	\$ 162,476
Short-term investments	309,728	269,457
Trade accounts receivable, net	125,517	138,181
Inventories	161,059	156,429
Deferred income taxes	10,371	13,775
Other current assets	27,542	12,577
Total current assets	850,328	752,895
Property, plant and equipment, net	69,891	68,976
Long-term marketable securities	9,260	
Goodwill	140,084	140,020
Intangible assets, net	1,307	1,743
Other assets	16,842	18,779
Total assets	\$1,087,712	\$ 982,413
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term borrowings	\$ 1,302	\$
Accounts payable	22,572	36,427
Accrued compensation	24,519	29,944
Other current liabilities	34,538	43,315
Total current liabilities	82,931	109,686
Other liabilities	32,169	25,688
Commitments and contingencies (Note 15)		
Stockholders equity:		
Preferred Stock, \$0.01 par value, 2,000,000 shares authorized; none issued and outstanding		
Common Stock, no par value, 200,000,000 shares authorized; 52,444,933 and 50,648,601 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively	113	113

Edgar Filing: MKS INSTRUMENTS INC - Form 10-Q

Additional paid-in capital	703,405	663,792
Retained earnings	254,701	171,356
Accumulated other comprehensive income	14,393	11,778
Total stockholders' equity	972,612	847,039
Total liabilities and stockholders' equity	\$1,087,712	\$ 982,413

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,	
	2011	2010	2011	2010
Net revenues				
Products	\$ 167,145	\$ 199,376	\$ 573,329	\$ 569,377
Services	27,363	21,947	77,517	64,759
Total net revenues	194,508	221,323	650,846	634,136
Cost of revenues				
Cost of products	90,785	110,418	307,087	315,674
Cost of services	16,045	12,402	44,732	37,145
Total cost of revenues	106,830	122,820	351,819	352,819
Gross profit	87,678	98,503	299,027	281,317
Research and development	14,331	15,070	46,809	46,899
Selling, general and administrative	31,984	28,247	96,542	86,961
Amortization of intangible assets	251	250	751	1,033
Gain on sale of asset				(682)
Income from operations	41,112	54,936	154,925	147,106
Interest income	284	67	869	698
Interest expense	12	32	17	84
Income from continuing operations before income taxes	41,384	54,971	155,777	147,720
Provision for income taxes	11,011	18,370	48,760	48,977
Income from continuing operations	30,373	36,601	107,017	98,743
Income from discontinued operations, net of taxes		2,035		7,895
Net income	\$ 30,373	\$ 38,636	\$ 107,017	\$ 106,638
Basic income per share:				
Continuing operations	\$ 0.58	\$ 0.73	\$ 2.06	\$ 1.98
Discontinued operations		0.04		0.16
Net income	\$ 0.58	\$ 0.77	\$ 2.06	\$ 2.13

Edgar Filing: MKS INSTRUMENTS INC - Form 10-Q

Diluted income per share:				
Continuing operations	\$ 0.57	\$ 0.72	\$ 2.03	\$ 1.94
Discontinued operations		0.04		0.16
Net income	\$ 0.57	\$ 0.76	\$ 2.03	\$ 2.10
Cash dividends per common share	\$ 0.15	\$	\$ 0.45	\$
Weighted average common shares outstanding:				
Basic	52,456	50,226	52,070	49,965
Diluted	52,992	50,994	52,761	50,821

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

4

Table of Contents

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

	Nine Months Ended September 30,	
	2011	2010
Cash flows from operating activities:		
Net income	\$ 107,017	\$ 106,638
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,641	10,619
Stock-based compensation	8,597	6,714
Provision for excess and obsolete inventory	10,924	8,804
Gain on disposal of discontinued operations		(4,431)
Deferred income taxes	3,084	11,715
Excess tax benefits from stock-based compensation	(5,282)	(1,830)
Other	503	(620)
Changes in operating assets and liabilities:		
Trade accounts receivable	13,511	(60,374)
Inventories	(14,856)	(44,414)
Income taxes	(3,295)	(897)
Other current assets	(9,816)	(1,753)
Accrued expenses and other current liabilities	(1,422)	33,849
Accounts payable	(13,962)	12,232
Net cash provided by operating activities	104,644	76,252
Cash flows from investing activities:		
Purchases of short-term and long-term investments	(359,857)	(237,025)
Maturities, sales and settlements of short-term and long-term investments	311,419	176,093
Purchases of property, plant and equipment	(9,691)	(11,430)
Proceeds from sale of assets	7	2,148
Net proceeds from sales of discontinued operations		15,581
Other	(473)	(1,061)
Net cash used in investing activities	(58,595)	(55,694)
Cash flows from financing activities:		
Proceeds from short-term borrowings	27,340	111,383
Payments on short-term borrowings	(26,094)	(115,836)
Repurchase of common stock	(475)	
Net proceeds related to employee stock-based compensation	26,327	1,409
Dividend payments to common stockholders	(23,498)	
Excess tax benefits from stock-based compensation	5,282	1,830
Net cash provided by (used in) financing activities	8,882	(1,214)

Edgar Filing: MKS INSTRUMENTS INC - Form 10-Q

Effect of exchange rate changes on cash and cash equivalents	(1,296)	(362)
Increase in cash and cash equivalents	53,635	18,982
Cash and cash equivalents at beginning of period	162,476	111,009
Cash and cash equivalents at end of period	\$ 216,111	\$ 129,991

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

5

Table of Contents

MKS INSTRUMENTS, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(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, 2011 and for the three and nine months ended September 30, 2011 and 2010 are 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 consolidated balance sheet presented as of December 31, 2010 has been derived from the audited consolidated financial statements as of that date. 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 (U.S. GAAP). 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, 2010 filed with the Securities and Exchange Commission on February 25, 2011.

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, acquisition 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) **Recently Issued Accounting Pronouncements**

In September 2011, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) which simplifies how companies test goodwill for impairment. The amendments permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in the goodwill accounting standard. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Company does not expect the new ASU to have a material effect on its financial position, results of operations or cash flows.

In June 2011, the FASB issued an ASU which eliminates the option to present the components of other comprehensive income as part of the statement of equity and requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments are effective retrospectively for fiscal years, and interim periods within those years, beginning after December 15, 2011. The ASU requires changes in presentation only and the Company does not expect it will have a material effect on its consolidated financial statements.

In May 2011, the FASB issued an ASU which applies to all reporting entities that are required or permitted to measure or disclose the fair value of an asset, a liability, or an instrument classified in a reporting entity's shareholders' equity in the financial statements. The amendments do not extend the use of fair value accounting, but provide guidance on how it should be applied where its use is already required or permitted by other standards within U.S. GAAP. The amendments change the wording used to describe many requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Additionally, the ASU clarifies the FASB's intent about the application of existing fair value measurements. The amendments in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods

beginning after December 15, 2011. Early application by public entities is not permitted. The Company does not expect the new ASU to have a material effect on its financial position, results of operations or cash flows. In October 2009, the FASB issued an ASU that established new accounting and reporting provisions for arrangements including multiple revenue-generating activities. This ASU provides amendments to the criteria for separating deliverables, measuring and allocating arrangement consideration to one or more units of accounting. The amendments in this ASU also established a selling price hierarchy for determining the selling price of a deliverable. Significantly enhanced disclosures are also required to provide information about a vendor's multiple-deliverable revenue arrangements, including information about the nature and terms,

Table of Contents

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

significant deliverables, and its performance within arrangements. The amendments also require providing information about the significant judgments made and changes to those judgments and about how the application of the relative selling-price method affects the timing or amount of revenue recognition. The amendments in this ASU were effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. The Company adopted the new ASU in the first quarter of 2011, and the adoption did not have a material impact on the Company's financial position, results of operations or cash flows. In October 2009, the FASB issued an ASU that changed the accounting model for revenue arrangements that include both tangible products and software elements that are essential to the functionality, and scoped these products out of current software revenue guidance. The new ASU includes factors to help companies determine what software elements are considered essential to the functionality. The amendments now subject software-enabled products to other revenue guidance and disclosure requirements, such as guidance surrounding revenue arrangements with multiple-deliverables. The amendments in this ASU were effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. The Company adopted the new ASU in the first quarter of 2011, and the adoption did not have a material impact on the Company's financial position, results of operations or cash flows.

3) Cash and Cash Equivalents and Investments

The fair value of short-term available-for-sale investments with maturities or estimated lives of less than one year consists of the following:

	September 30, 2011	December 31, 2010
Time deposits and drafts	\$ 1,351	\$ 15,716
U.S. treasury and agency obligations	307,764	253,250
	\$309,115	\$ 268,966

The fair value of short-term trading investments with maturities or estimated lives of less than one year consists of the following:

	September 30, 2011	December 31, 2010
Equity mutual funds	\$613	\$ 491

The changes in the net unrealized holding loss on short-term trading investments have been included in earnings and were immaterial for the three and nine months ended September 30, 2011 and 2010, respectively.

The fair value of long-term available-for-sale investments with maturities or estimated lives of more than one year consists of the following:

	September 30, 2011	December 31, 2010
U.S. treasury and agency obligations	\$9,260	\$

The following table shows the gross unrealized gains and (losses) aggregated by investment category for available-for-sale securities:

Edgar Filing: MKS INSTRUMENTS INC - Form 10-Q

	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
As of September 30, 2011:				
Money market funds	\$ 75,794	\$	\$	\$ 75,794
Time deposits and drafts	32,239			32,239
U.S. treasury and agency obligations	318,748	44	(17)	318,775
	\$426,781	\$ 44	\$(17)	\$ 426,808
Reported as follows:				
Cash and cash equivalents ⁽¹⁾	\$108,433	\$	\$	\$ 108,433
Short-term investments ⁽²⁾	309,086	43	(14)	309,115
Long-term marketable securities	9,262	1	(3)	9,260
	\$426,781	\$ 44	\$(17)	\$ 426,808

7

Table of Contents

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

	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
As of December 31, 2010:				
Money market funds	\$ 7,032	\$	\$	\$ 7,032
Time deposits and drafts	18,554			18,554
U.S. treasury and agency obligations	298,034	42	(35)	298,041
	\$ 323,620	\$ 42	\$ (35)	\$ 323,627
Reported as follows:				
Cash and cash equivalents ⁽¹⁾	\$ 54,664	\$	\$ (3)	\$ 54,661
Short-term investments ⁽²⁾	268,956	42	(32)	268,966
	\$ 323,620	\$ 42	\$ (35)	\$ 323,627

(1) The cash and cash equivalent amounts presented in the tables above do not include cash amounts of \$107,678 and \$107,815 as of September 30, 2011 and December 31, 2010, respectively.

(2) The short-term investment amounts presented in the tables above do not include \$613 and \$491 of short-term trading investments as of September 30, 2011 and December 31, 2010, respectively.

Interest income is accrued as earned. Dividend income is recognized as income on the date the stock trades ex-dividend. The cost of marketable securities sold is determined by the specific identification method and realized gains or losses are reflected in income and were not material for the three and nine months ended September 30, 2011 and 2010.

4) Fair Value Measurements

In accordance with the provisions of fair value accounting, a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability and defines fair value based upon an exit price model.

The fair value measurement guidance establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

- Level 1 Quoted prices in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 assets and liabilities include money market funds and debt and equity securities.
- Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing

model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain time deposits, time drafts and non-exchange traded derivative contracts.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Table of Contents

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

The following tables provide a summary of assets and liabilities of the Company measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010:

Description	September 30, 2011	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available-for-sale securities:				
Money market funds	\$ 75,794	\$ 75,794	\$	\$
Time deposits and drafts	32,239		32,239	
U.S. treasury and agency obligations	318,775	318,775		
Trading securities:				
Equity mutual funds	613	613		
Derivatives - currency forward contracts	909		909	
Total assets	\$428,330	\$395,182	\$ 33,148	\$
Liabilities:				
Derivatives - currency forward contracts	\$ 2,074	\$	\$ 2,074	\$

Description	September 30, 2011	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Reported as follows:				
Assets:				
Cash and cash equivalents				