

CABOT CORP
Form 10-Q
May 10, 2006

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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
March 31, 2006

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

(State of Incorporation)

04-2271897

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

Two Seaport Lane
Boston, Massachusetts

(Address of principal executive offices)

02210-2019

(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, 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

As of May 3, 2006 the Company had 63,421,612 shares of Common
Stock, par value \$1 per share, outstanding.

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CABOT CORPORATION
 CONSOLIDATED STATEMENTS OF OPERATIONS
 Three and Six Months Ended March 31, 2006 and 2005
 (In millions, except per share amounts)
 UNAUDITED

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2006	2005	2006	2005
Net sales and other operating revenues	\$ 627	\$ 527	\$ 1,214	\$ 1,022
Cost of sales	542	397	1,023	775
Gross profit	85	130	191	247
Selling and administrative expenses	59	56	117	110
Research and technical expense	14	15	27	30
Goodwill asset impairment		90		90
Income (loss) from operations	12	(31)	47	17
Interest and dividend income	1	1	3	3
Interest expense	(7)	(8)	(13)	(16)
Other income	6	3	2	5
Income (loss) from continuing operations before income taxes	12	(35)	39	9
Provision for income taxes	(1)	(13)	(5)	(22)
Equity in net income of affiliated companies, net of tax	4	2	7	4
Minority interest in net income, net of tax	(3)	(4)	(7)	(6)
Income (loss) from continuing operations	12	(50)	34	(15)
Cumulative effect of an accounting change, net of tax			2	
Net income (loss)	12	(50)	36	(15)
Dividends on preferred stock, net of tax benefit			(1)	(1)
Net income (loss) available to common shares	\$ 12	\$ (50)	\$ 35	\$ (16)

Weighted-average common shares outstanding:

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Basic	60	60	60	60
Diluted	69	60	69	60
Income (loss) per common share:				
Basic:				
Continuing operations	\$ 0.19	\$ (0.84)	\$ 0.54	\$ (0.26)
Cumulative effect of an accounting change			0.04	
Net income (loss) per share basic	\$ 0.19	\$ (0.84)	0.58	\$ (0.26)
Diluted:				
Continuing operations	\$ 0.17	\$ (0.84)	\$ 0.48	\$ (0.26)
Cumulative effect of an accounting change			0.04	
Net income (loss) per share diluted	\$ 0.17	\$ (0.84)	\$ 0.52	\$ (0.26)
Dividends per common share	\$ 0.16	\$ 0.16	\$ 0.32	\$ 0.32

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

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CABOT CORPORATION
CONSOLIDATED BALANCE SHEETS
March 31, 2006 and September 30, 2005

(In millions)

ASSETS
UNAUDITED

	March 31, 2006	September 30, 2005
Current assets:		
Cash and cash equivalents	\$ 103	\$ 181
Short-term marketable securities investments		30
Accounts and notes receivable, net of reserve for doubtful accounts of \$6 and \$4	511	430
Inventories:		
Raw materials	167	169
Work in process	117	134
Finished goods	171	151
Other	40	39
Total inventories	495	493
Prepaid expenses and other current assets	91	66
Assets held for sale		5
Deferred income taxes	42	41
Total current assets	1,242	1,246
Investments:		
Equity affiliates	55	63
Long-term marketable securities and cost investments	4	6
Total investments	59	69
Property, plant and equipment	2,393	2,264
Accumulated depreciation and amortization	(1,468)	(1,430)
Net property, plant and equipment	925	834
Other assets:		
Goodwill	36	25
Intangible assets, net of accumulated amortization of \$9 and \$9	5	6
Assets held for rent	38	37
Deferred income taxes	116	108
Other assets	35	49

Total other assets	230	225
Total assets	\$ 2,456	\$ 2,374

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

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CABOT CORPORATION
CONSOLIDATED BALANCE SHEETS
March 31, 2006 and September 30, 2005
(In millions, except for share and per share amounts)
LIABILITIES & STOCKHOLDERS EQUITY
UNAUDITED

	March 31, 2006	September 30, 2005
Current liabilities:		
Notes payable to banks	\$ 56	\$ 34
Accounts payable and accrued liabilities	340	321
Income taxes payable	59	30
Deferred income taxes	1	1
Current portion of long-term debt	54	47
Total current liabilities	510	433
Long-term debt	451	463
Deferred income taxes	14	15
Other liabilities	281	307
Commitments and contingencies (Note I)		
Minority interest	62	57
Stockholders' equity:		
Preferred stock:		
Authorized: 2,000,000 shares of \$1 par value Series B ESOP Convertible Preferred Stock 7.75% Cumulative issued: 75,336 shares; outstanding: 57,844 and 61,068 shares (aggregate per share Redemption value of \$41 and \$44)	58	61
Less cost of shares of preferred treasury stock	(38)	(38)
Common stock:		
Authorized: 200,000,000 shares of \$1 par value Issued and outstanding: 63,531,605 and 62,971,872 shares	63	63
Less cost of shares of common treasury stock	(5)	(5)
Additional paid-in capital	20	32
Retained earnings	1,130	1,127
Unearned compensation		(41)
Deferred employee benefits	(40)	(42)
Notes receivable for restricted stock	(18)	(19)
Accumulated other comprehensive loss	(32)	(39)
Total stockholders' equity	1,138	1,099

Total liabilities and stockholders' equity	\$ 2,456	\$ 2,374
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The accompanying notes are an integral part of these financial statements

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CABOT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Six Months Ended March 31, 2006 and 2005
(In millions)
UNAUDITED

	March 31,	
	2006	2005
Cash Flows from Operating Activities:		
Net income (loss)	\$ 36	\$ (15)
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:		
Depreciation and amortization	61	70
Deferred tax provision	(5)	1
Cumulative effect of an accounting change	(2)	
Equity in income of affiliated companies	(4)	(4)
Goodwill asset impairment		90
Non-cash compensation	15	15
Other non-cash charges, net	12	10
Changes in assets and liabilities (net of effect of acquisition):		
Accounts and notes receivable	(42)	(24)
Inventory	1	(53)
Prepayments and other current assets	4	5
Accounts payable and accrued liabilities	(21)	(7)
Income taxes payable	(11)	(3)
Other liabilities	(17)	(13)
Other, net	(3)	1
Cash provided by operating activities	24	73
Cash Flows from Investing Activities:		
Additions to property, plant and equipment	(101)	(69)
Cash paid for acquisition of affiliate, net of cash acquired	(19)	
Proceeds from sales of property, plant and equipment	6	1
Increase in assets held for rent	(1)	(3)
Purchase of marketable securities investments	(20)	(55)
Proceeds from sale and maturity of marketable securities investments	57	90
Cash used in investing activities	(78)	(36)
Cash Flows from Financing Activities:		
Repayments of long-term debt	(31)	
Proceeds from issuance of long-term debt	26	

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Proceeds from issuance of notes payable	23	
Repayments of debt related to Cabot Japan KK	(18)	
Purchases of common stock		(11)
Proceeds from sales of common stock	6	1
Cash dividends paid to stockholders	(21)	(21)
Cash dividends paid to minority interest stockholders	(5)	(8)
Cash used in financing activities	(20)	(39)
Effect of exchange rate changes on cash	(4)	(1)
Decrease in cash and cash equivalents	(78)	(3)
Cash and cash equivalents at beginning of period	181	159
Cash and cash equivalents at end of period	\$ 103	\$ 156

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

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CABOT CORPORATION
 CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
 Six Months Ended March 31, 2006
 (In millions, except shares in thousands)
 UNAUDITED

	Preferred Stock, net of Treasury Stock		Common Stock, net of Treasury Stock		Additional Paid-in Capital	Retained Earnings	Unearned Compensation	Employee Benefits	Notes Receivable		Accumulated Other Comprehensive Income	Total Stockholders' Equity	
	Shares	Cost	Shares	Cost					Deferred from	Other			
(Dollars in millions)													
2006													
Balance at September 30, 2005	44	\$ 23	62,820	\$ 58	\$ 32	\$ 1,127	\$ (41)	\$ (42)	\$ (19)	\$ (39)	\$ 1,099		
Net income						36						\$ 36	
Foreign currency translation adjustment										2		2	
Unrealized gain on derivative instruments										5		5	
Total comprehensive income												7	
Comprehensive income												43	\$ 43
Common dividends paid							(20)					(20)	
Issuance of stock under employee compensation plans, net of actual forfeitures			252		18							18	
Preferred stock conversion	(3)	(3)	472		3								
Purchase and retirement, common and treasury stock			(161)										
Preferred dividends paid to Employee Stock Ownership Plan, net of tax						(1)						(1)	

benefit													
Principal payment by													
Employee Stock													
Ownership Plan													
under guaranteed													
loan									2			2	
Reversal of unearned													
compensation due to													
FAS 123 (R)													
implementation				(29)		(12)		41					
Cumulative effect of													
change in accounting													
principle				(4)								(4)	
Notes receivable for													
restricted stock													
repayments and													
forfeitures										1		1	
Balance at March 31,													
2006	41	\$ 20	63,383	\$ 58	\$ 20	\$ 1,130	\$	\$ (40)	\$ (18)	\$ (32)	\$ 1,138		

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

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CABOT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2006
Unaudited

A. Basis of Presentation

The consolidated financial statements include the accounts of Cabot Corporation and its majority-owned and controlled U.S. and non-U.S. subsidiaries (Cabot or the Company). Intercompany transactions have been eliminated.

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, 2005 (2005 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, 2006 and 2005. 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.

Certain amounts in fiscal 2005 have been reclassified to conform to the fiscal 2006 presentation.

B. Significant Accounting Policies

Revenue Recognition

Cabot derives most of its revenues from the sale of rubber blacks, performance products, inkjet colorants, fumed metal oxides and tantalum and related products and from the rental and sale of cesium formate. Revenue from product sales is typically recognized when the product is shipped and title and risk of loss have passed to the customer. Revenue from the rental of cesium formate is recognized throughout the rental period based on the contracted rental amount. Customers are also billed and revenue is recognized, typically at the end of the job, for cesium formate product that is not returned. Other operating revenues, which represent less than ten percent of total revenues, include tolling, servicing and royalties for licensed technology.

Cabot's revenue recognition policies are in compliance with Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition, which establishes criteria that must be satisfied before revenue is realized or realizable and earned. Cabot recognizes revenue when persuasive evidence of a sales arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility is probable. Cabot generally is able to ensure that products meet customer specifications prior to shipment. If we are unable to determine that the product has met the specified objective criteria prior to shipment, the revenue is deferred until product acceptance has occurred.

Certain customer contracts contain price protection clauses that provide for the potential reduction in past or future sales prices. Cabot analyzes these contract provisions to determine if an obligation related to these clauses exists and records revenue net of any estimated price protection commitments.

Under certain multi-year supply contracts with declining prices and minimum volumes, Cabot recognizes revenue based on the estimated average selling price over the contract lives. At March 31, 2006 and September 30, 2005, Cabot had less than a million and \$1 million, respectively, of revenue deferred related to certain supply agreements representing the difference between the billed price and the estimated average selling price. The

revenue deferred will be recognized as customers purchase the contracted minimum volumes through 2006.

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 of sales at the time revenue is recognized based on historical experience. Rebates are estimated and recorded based primarily on historical experience and contractual obligations. Cabot's estimates for discounts and volume rebates are made quarterly and the assumptions underlying the estimates are updated for changes in facts and circumstances as appropriate.

Accounts and notes receivable as of March 31, 2006 and September 30, 2005 primarily include trade accounts receivable, which arise in the normal course of business, income tax receivables of \$25 million and \$23 million, respectively, and the current portion of notes receivable of \$7 million and \$6 million, respectively.

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CABOT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
March 31, 2006
Unaudited

Trade receivables are recorded at the invoiced amount and do not bear interest. Cabot sells a portion of its notes receivables from customers related to one of its subsidiaries at a discount. These transactions are accounted for as a sale under the provisions of FAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. The difference between the proceeds from the sale and the carrying value of the receivables is recognized as a loss on the sale of receivables and is included in other expense in the accompanying statements of operations. The Company recorded less than a million dollars of losses related to sales of receivables during the periods ended March 31, 2006 and 2005.

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 a historical and prospective basis. Customer account balances are charged against the allowance for doubtful accounts when Cabot determines it is probable the receivable will not be recovered. The activity in the allowance was not material during the second fiscal quarters of 2006 or 2005.

Shipping and handling charges related to sales transactions are recorded as sales revenue when billed to customers or included in the sales price in accordance with Emerging Issues Task Force (EITF) 00-10, Accounting for Shipping and Handling Fees and Costs. Shipping and handling costs are included in cost of sales.

Assets Held for Sale

Cabot classifies its long-lived assets as held for sale when management commits to a plan to sell the assets, the assets are ready for immediate sale in their present condition, an active program to locate buyers has been initiated, the sale of the assets is probable and expected to be completed within one year, the assets are marketed at reasonable prices in relation to their fair value and it is unlikely that significant changes will be made to the plan to sell the assets. The Company measures long-lived assets to be disposed of by sale at the lower of the carrying amount and fair value, less cost to sell.

During the second quarter of fiscal 2006, Cabot sold the property, plant and equipment assets related to Supermetal's direct finished tantalum sputtering target business to Tosoh SMD, a division of Tosoh Corporation. These assets were recorded at their fair value and classified as assets held for sale at December 31, 2005. There was no gain or loss recognized in connection with the sale.

Asset Retirement Obligations

Cabot accounts for asset retirement obligations in accordance with Statement of Financial Accounting Standards (FAS) No. 143, Accounting for Asset Retirement Obligations. Cabot has determined that certain legal obligations exist primarily related to site restoration activities required upon the closing of certain facilities. However, until a closure date is determined for a facility, these facilities and the associated legal obligations have been determined to have an indeterminate life. Accordingly, the fair value of the liability cannot be reasonably estimated and an asset retirement obligation has not been recognized. Cabot had \$3 million and \$5 million of asset retirement obligations at March 31, 2006 and September 30, 2005, respectively, related to the closure of the Company's carbon black manufacturing facilities in Zierbena, Spain and Altona, Australia (as further discussed in the restructuring footnote at Note G). Cabot also had a \$3 million reserve at both March 31, 2006 and September 30, 2005 related to the decommissioning of storage bins used in the Supermetals Business that cannot be closed without governmental approval. There was no activity in this reserve balance during the three or six months ending March 31, 2006. Cabot expects the liability related to the Supermetals Business to be paid over the next

twenty-four to thirty-six months.

C. Stock-Based Compensation

Cabot established the 2006 Long-Term Incentive Plan (the 2006 Plan) in order to provide equity-based compensation to the Company s key employees, advisors or consultants. The 2006 Plan was approved by Cabot s stockholders on March 9, 2006 and replaces the 1996 Equity Incentive Plan and the 1999 Equity Incentive Plan. Although the 2006 Plan allows Cabot to issue various forms of equity, Cabot expects to use the 2006 Plan primarily to issue shares of restricted stock and stock options under its long-term incentive compensation program. The terms of awards made under this program are determined generally by the Compensation Committee of the Board of Directors. As the program has been administered since 1992, participants are granted a specific number of shares of common stock (the Grant Number) that the participant may then elect either (i) to purchase as shares of restricted

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CABOT CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
 March 31, 2006
 Unaudited

elect either (i) to purchase as shares of restricted stock at a percentage of the market price of such stock on the date of grant (which in the last six years has been 30%) or (ii) to receive as non-qualified stock options for a number of shares of common stock equal to two times the Grant Number, exercisable at 100% of the market price of such stock on the date of grant. Both the purchase restricted stock and the stock options granted under the program are subject to a three-year vesting period. Stock options granted under the program expire five years from the date of grant. Variations of the stock options and restricted stock are made to international employees in order to provide benefits comparable to U.S. employees. No awards have been granted under the 2006 Plan and there are 4.5 million shares available for future grants at March 31, 2006 under the 2006 Plan. No new awards may be granted under either the 1996 Equity Incentive Plan or the 1999 Equity Incentive Plan although there remain outstanding certain awards previously granted under these plans.

Through fiscal year 2005, Cabot followed Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees , and related interpretations, which resulted in the accounting for grants of awards to employees at their intrinsic value in the consolidated financial statements. On October 1, 2005, Cabot adopted FAS No. 123(R), Accounting for Stock-Based Compensation, using the modified prospective method, which permits the provisions of FAS 123(R) to be applied to the consolidated financial statements on a going-forward basis. Prior periods have not been restated. FAS 123(R) requires companies to recognize share-based payments to employees as compensation expense on a fair value method. Under the fair value recognition provisions of FAS 123(R), stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the service period, which generally represents the vesting period. The fair value of stock options is calculated using the Black-Scholes option-pricing model and the fair value of restricted stock is based on intrinsic value. The expense recognized over the service period is required to include an estimate of the awards that will be forfeited. Previously under APB 25, Cabot recorded the impact of forfeitures as they occurred. In connection with the adoption of FAS 123(R) during the first quarter of fiscal year 2006, Cabot recorded a \$2 million gain (after-tax) from the cumulative effect of the change from recording forfeitures as they occur to estimating forfeitures during the service period. In addition, the previously recorded unearned compensation balance of \$41 million, as of the date of adoption, which was included as a component of stockholders' equity, was reclassified to additional paid-in capital and retained earnings.

Stock-based Compensation

Prior to the adoption of FAS No. 123(R), Cabot included in its financial statements the stock-based compensation disclosure requirements of FAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure . The following table illustrates the effect the fair value recognition provisions of FAS No. 123 would have had on net loss and earnings per share for the three and six months ended March 31, 2005.

(in millions, except for per share amounts)	Three Months Ended March 31, 2005	Six Months Ended March 31, 2005
Net loss, as reported	\$ (50)	\$ (15)
Add: Stock-based compensation expense included in reported net income, net of related tax effects	5	10
Deduct: Stock-based compensation using fair value method for all awards, net of related tax effects	(5)	(11)

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Pro forma net loss	\$	(50)	\$	(16)
Net loss per common share:				
Basic, pro forma	(\$	0.84)	(\$	0.28)
Basic, as reported	(\$	0.84)	(\$	0.26)
Diluted, pro forma	(\$	0.84)	(\$	0.28)
Diluted, as reported	(\$	0.84)	(\$	0.26)

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CABOT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
March 31, 2006
Unaudited

Stock-based employee compensation expense was \$4 million and \$8 million after tax for the three and six months ending March 31, 2006, respectively. The Company recognized the full impact of its stock-based employee compensation in the consolidated statements of operations for the six months ended March 31, 2006 under FAS 123(R) and did not capitalize any such costs on the consolidated balance sheets, as such costs that qualified for capitalization were not material. The following table presents stock-based compensation expenses included in the Company's consolidated statement of operations:

(Dollars in millions)	Three Months Ended March 31, 2006	Six Months Ended March 31, 2006
Cost of sales	\$ 3	\$ 5
Selling and administrative	4	7
Research and technical		1
Stock-based compensation expense before tax	7	13
Income tax benefit	(3)	(5)
Net stock-based compensation expense	\$ 4	\$ 8

Stock Options- As of March 31, 2006, there was \$2 million of total unrecognized compensation cost related to non-vested options granted under the Company's equity incentive plans. That cost is expected to be recognized over a weighted-average period of 3.08 years.

Restricted Stock- As of March 31, 2006, there was \$26 million of total unrecognized compensation cost related to non-vested restricted stock granted under the Company's equity incentive plans. That cost is expected to be recognized over a weighted-average period of 1.15 years.

Equity Incentive Plan Activity

The following table summarizes the total stock option, non-vested stock option activity and the restricted stock activity in the equity incentive plans for the three and six months ended March 31, 2006:

	Three Months Ended March 31, 2006					
	Stock Options			Restricted Stock		
(Shares in thousands)	Total	Weighted Average Exercise Price	Non- Vested Shares	Weighted Average Exercise Price	Restricted Shares	Weighted Average Fair Value
Outstanding at December 31, 2005	795	\$29.56	432	\$29.82	3,006	\$30.28
Granted					3	37.24
Exercised/Vested	(147)	30.73			(22)	31.19
Cancelled/Forfeited	(1)	28.00	(1)	28.00	(69)	30.76
Outstanding at March 31, 2006	647	29.31	431	29.83	2,918	30.27

Exercisable at March 31,
2006

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28.27

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CABOT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
March 31, 2006
Unaudited

	Six Months Ended March 31, 2006				Restricted Stock	
		Stock Options				
(Shares in thousands)	Total	Weighted Average Exercise Price	Non- Vested Shares	Weighted Average Exercise Price	Restricted Shares	Weighted Average Fair Value
Outstanding at September 30, 2005	866	\$29.42	450	\$29.79	3,092	\$30.29
Granted					6	34.58
Exercised/Vested	(204)	29.80	(4)	28.00	(27)	30.53
Cancelled/Forfeited	(15)	29.22	(15)	29.22	(153)	32.01
Outstanding at March 31, 2006	647	29.31	431	29.83	2,918	30.27
Exercisable at March 31, 2006	216	28.27				

Stock Options

The following table summarizes information related to the outstanding and vested options on March 31, 2006:

	Options Outstanding	Vested Options
Aggregate Intrinsic Value (dollars in millions)	\$ 3	\$ 1
Weighted Average Remaining Contractual Term (in years)	2	1

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value, based on the Company's closing common stock price of \$33.99 on March 31, 2006, which would have been received by the option holders had all option holders exercised their options on that date.

The following table summarizes information related to the total intrinsic value of options exercised during the three and six months ended March 31, 2006:

	Three Months Ended March 31, 2006	Six Months Ended March 31, 2006
(Dollars in millions)		
Intrinsic Value	\$ 1	\$ 2
Cash Received	5	6
Tax Benefit	< 1	< 1

The Company settles employee stock option exercises with newly issued common shares. The total fair value of the shares vested during the three and six months ended March 31, 2006 was less than a million dollars.

The Company uses the Black-Scholes option-pricing model to estimate the fair value of the options at the grant date. There were no option grants during the three or six months ended March 31, 2006. The fair values of options outstanding on March 31, 2006 were calculated using the following weighted-average assumptions:

	Years Ended September 30,		
	2005	2004	2003
Expected stock price volatility	42%	44%	46%
Risk free interest rate	3.8%	3.7%	2.2%
Expected life of options (years)	4	4	4
Expected annual dividends per share	\$0.64	\$0.60	\$0.52

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CABOT CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
 March 31, 2006
 Unaudited

The expected stock price volatility assumption was determined using the historical volatility of the Company's common stock over the expected life of the option.

D. Acquisitions

Cabot had a 50:50 joint venture arrangement with Showa Denko K.K. in an entity called Showa Cabot K.K. (SCK). On November 8, 2005, Cabot purchased Showa Denko K.K.'s 50% joint venture interest in SCK for \$19 million and renamed the entity Cabot Japan K.K. (CJKK). In addition, as part of the acquisition, Cabot assumed approximately \$26 million of SCK's debt obligations and approximately \$10 million of unfunded pension liabilities.

Prior to the acquisition, Cabot's investment in SCK was accounted for as an equity method investment. Included in Cabot's consolidated results for the period ended March 31, 2006 are 50% of the operating results of SCK from October 1, 2005 through November 7, 2005 and 100% of the operating results of SCK from November 8, 2005 through March 31, 2006.

The fair value of the assets acquired and liabilities and debt assumed represents the 50% of SCK that was purchased. A preliminary allocation of the purchase price is as follows:

(Dollars in millions)

Cash paid	\$ 19
Accounts receivable	\$ 20
Inventories	3
Deferred income taxes	7
Investments in marketable securities	1
Property, plant and equipment	26
Total assets acquired	\$ 57
Accounts payable and accrued expenses	27
Notes payable	12
Pension obligation	10
Total liabilities assumed	\$ 49
Net assets acquired	\$ 8
Excess purchase price	\$ 11

At March 31, 2006, the excess purchase price related to the acquisition of SCK has been included as a component of goodwill in the accompanying consolidated balance sheets.

The allocation of the purchase price is based on estimates of the fair value of the net assets acquired, and is subject to adjustment. The allocation is not yet finalized as management is still in the process of performing the valuation of tangible and intangible assets and pension obligations. As a result, preliminary estimates and assumptions are subject to change. The allocation will be finalized during fiscal 2006.

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The following unaudited pro forma financial information reflects the consolidated results of operations of Cabot for the three and six months ended March 31, 2006 and 2005 as though the acquisition of SCK had occurred on the first day of the respective period. The pro forma operating results are presented for comparative purposes only and do not purport to present Cabot's actual operating results for these periods or results that may occur in the future:

	Three Months Ended March 31, 2006		Six Months Ended March 31, 2006	
	2006	2005	2006	2005
(In millions, except per share amounts)				
Total revenues	\$ 627	\$ 561	\$ 1,226	\$ 1,088
Net income (loss)	\$ 12	\$ (50)	\$ 36	\$ (14)
Net income (loss) per share:				
Basic	\$ 0.19	\$ (0.82)	\$ 0.58	\$ (0.22)
Diluted	\$ 0.17	\$ (0.82)	\$ 0.52	\$ (0.22)

E. Goodwill and Other Intangible Assets

The carrying amount of goodwill attributable to each reportable segment with goodwill balances and the changes in those balances during the six months ended March 31, 2006 are as follows:

(Dollars in millions)	Carbon Black Business	Metal Oxides Business	Total
Balance at September 30, 2005	\$ 15	\$ 10	\$ 25
Increase for Acquisition of CJKK	11		11
Balance at March 31, 2006	\$ 26	\$ 10	\$ 36

Cabot does not have any indefinite-lived intangible assets. At March 31, 2006 and September 30, 2005, Cabot had \$5 million of finite-lived intangible assets. These intangible assets are comprised of \$12 million for patents, \$1 million for other intellectual property and \$1 million of pension intangible assets related to minimum pension liabilities recorded in fiscal year 2005, less related accumulated amortization of \$8 million for patents and \$1 million for other intellectual property at both March 31, 2006 and September 30, 2005. Intangible assets are amortized over their estimated useful lives, which range from two to fifteen years, with a weighted average amortization period of ten years. Amortization expense is estimated to be approximately \$1 million in each of the next five years.

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F. Employee Benefit Plans

Net periodic defined benefit pension and other postretirement benefit costs include the following components for the three months ended March 31, 2006 and 2005:

(Dollars in millions)	Three Months Ended March 31,							
	2006		2005		2006		2005	
	Pension Benefits				Postretirement Benefits			
	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign
Service cost	\$ 1	\$ 2	\$ 1	\$ 1	\$ 1		\$	\$
Interest cost	1	3	2	3	2		2	
Expected gain on plan assets	(2)	(3)	(3)	(3)				
Recognized loss		1		1			1	
Amortization of prior service cost							(1)	
Net periodic benefit cost	\$	\$ 3	\$	\$ 2	\$ 3	\$	\$ 2	\$

Net periodic defined benefit pension and other postretirement benefit costs include the following components for the six months ended March 31, 2006 and 2005:

(Dollars in millions)	Six Months Ended March 31,							
	2006		2005		2006		2005	
	Pension Benefits				Postretirement Benefits			
	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign
Service cost	\$ 3	\$ 3	\$ 2	\$ 3	\$ 2		\$ 1	\$
Interest cost	3	5	3	6	3		3	
Expected gain on plan assets	(5)	(5)	(5)	(6)				
Recognized loss		2		2	1		1	
Amortization of prior service cost							(1)	
Net periodic benefit cost	\$ 1	\$ 5	\$	\$ 5	\$ 6	\$	\$ 4	\$

In connection with the Altona plant closure and subsequent windup of the related employee benefit plans, during the first quarter of 2006 the Company recognized \$1 million of previously unrecognized actuarial gains. This has been included as a component of the Altona restructuring charges.

G. Restructuring***Altona Restructuring***

In October 2004, Cabot initiated a plan to shut down its Altona, Australia carbon black manufacturing facility due to an indication by Cabot's raw materials supplier that it would cease supply in September 2005, as well as the decline of the carbon black business in Australia. Production at this facility ceased on October 3, 2005. As of March 31, 2006, Cabot expects the shutdown plan to result in a pre-tax charge to earnings of approximately \$25 million, which is expected to be partly offset by gains on the sale of the land on which the facility is located. These gains are estimated to be between approximately \$7 million and \$10 million (net of transaction costs). The \$25 million of estimated charges includes approximately \$7 million for severance and employee benefits, \$6 million for accelerated depreciation of the facility assets, \$3 million for the demolition of the facility, \$2 million for asset retirement obligations related to site remediation and restoration and \$7 million for the realization of foreign currency translation adjustments. All charges associated with this restructuring initiative are related to the Carbon Black Business. Cabot has recorded \$17 million of these charges in the consolidated statements of operations since October 2004 and anticipates that the remaining \$8 million of charges, including the foreign currency translation adjustment, will be incurred over the next six months in connection with the closure, demolition, remediation and restoration of the property.

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Details of the Altona restructuring activity and changes in the reserve during the three months ended March 31, 2006 are as follows:

(Dollars in millions)	Severance and Employee Benefits	Asset Retirement Obligation	Total
Reserve at December 31, 2005	\$ 2	\$ 2	