

RARE ELEMENT RESOURCES LTD
Form 10-Q
November 06, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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**QUARTERLY REPORT PURSUANT TO SECTION 13 OR
15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2012

OR

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**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: 001-34852

RARE ELEMENT RESOURCES LTD.

(Exact Name of Registrant as Specified in its Charter)

BRITISH COLUMBIA
(State of other jurisdiction of incorporation or
organization)

N/A
(I.R.S. Employer Identification No.)

225 Union Blvd., Suite 250
Lakewood, Colorado
(Address of Principal Executive Offices)

80228
(Zip Code)

(720) 278-2460

(Registrant's Telephone Number, including Area Code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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 (as defined in Rule 12b-2 of the Exchange Act)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes No

Number of shares of issuer's common stock outstanding as of November 8, 2012: 44,824,245

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Reporting Currency, Financial and Other Information

All amounts in this report are expressed in United States (U.S.) dollars, unless otherwise indicated.

Financial information is presented in accordance with accounting principles generally accepted in the United States (U.S. GAAP).

References to Rare Element, the Company, we, our, and us mean Rare Element Resources Ltd., its predecessors, consolidated subsidiaries, or any one or more of them, as the context requires.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking information within the meaning of Canadian securities legislation and forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995 (collectively, forward-looking statements). Such forward-looking statements concern our anticipated results and developments in our operation in future periods, planned exploration and development of our properties, timing for completion of a definitive feasibility study for the Bear Lodge Rare Earth Element (REE) Project, our future capital needs and our ability to meet these needs, our ability to obtain additional financing and plans related to our business and other matters that may occur in the future. These statements relate to analyses and other information that are based on forecasts of future results, estimates of amounts not yet determinable and the reasonable assumptions of management.

Any statements that express or involve discussions with respect to predictions, expectations, beliefs, plans, projections, objectives, assumptions or future events or performance (often, but not always, using words or phrases such as expects or does not expect , is expected , anticipates or does not anticipate , plans , estimates or stating that certain actions, events or results may , could , would , might or will be taken, occur or be achieved) statements of historical fact and may be forward-looking statements.

Forward-looking statements are subject to a variety of known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from our expectations and include, among others, the factors referenced in the Risk Factors section of our Annual Report on Form 10-K for the fiscal year ended June 30, 2012, including, without limitation, risks associated with:

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our history of losses and need for additional financing;

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our lack of history of producing metals from our mineral properties;

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numerous uncertainties that could affect the profitability or feasibility of the Bear Lodge REE Project;

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the exploration, development, permitting and operations of our Bear Lodge REE Project;

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increased costs affecting financial condition;

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fluctuations in demand for, and price of, rare earth products;

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an extremely volatile rare earth industry;

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an increase in global supply or predatory pricing and dumping by our competitors;

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the establishment of new uses and markets of rare earth products;

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a shortage of equipment and supplies;

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mining and resource exploration being an inherently dangerous activity;

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operating in the resource industry, which is highly speculative;

resource estimates;

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our lack of insurance for our operations;

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mineral operations being subject to market forces outside of our control;

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the permitting, licensing and approval processes for our operations;

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the governmental and environmental regulations;

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future legislation regarding the mining industry and climate change;

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our land reclamation requirements;

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proposed legislation;

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competition in the mining and rare earth elements industries;

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foreign currency fluctuations;

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our dependence on key personnel;

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the potential difficulty of attracting and retaining qualified personnel;

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our executive officers and directors being engaged in other businesses;

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title in our properties;

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enforcement of civil liabilities in the United States;

our securities; and

tax consequences to U.S. shareholders.

This list is not exhaustive of the factors that may affect our forward-looking statements. Although we have attempted to identify important factors that could cause actual results to differ materially from those described in forward-looking statements, there may be other factors that cause results not to be as anticipated, estimated or intended. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, believed, estimated or expected. We caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Except as required by law, we disclaim any obligation to revise or update any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. **We qualify all the forward-looking statements contained in this Quarterly Report by the foregoing cautionary statements.** We advise you to carefully review the reports and documents we file from time to time with the United States Securities and Exchange Commission (the SEC), particularly our Annual Report on Form 10-K. The reports and documents filed by us with the SEC are available at www.sec.gov.

PART I FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****RARE ELEMENT RESOURCES LTD.
(an exploration stage company)
CONSOLIDATED BALANCE SHEETS**

(Expressed in thousands of U.S. dollars, except shares outstanding)

September 30, 2012**June 30, 2012****ASSETS:****CURRENT ASSETS**

Cash and cash equivalents	\$	32,069	\$	37,030
Short-term investments		15,254		14,633
Interest receivable		230		175
Prepaid expenses		202		240
Marketable securities		34		74
Accounts receivable		271		23
Total Current Assets		48,060		52,175

Equipment		551		608
Mineral properties		27		27
Restricted cash		-		422
Total assets	\$	48,638	\$	53,232

LIABILITIES:**CURRENT LIABILITIES**

Accounts payable and accrued liabilities	\$	1,967	\$	2,055
Total Current Liabilities		1,967		2,055

Asset retirement obligation		435		435
Total liabilities		2,402		2,490

Commitments and contingencies**SHAREHOLDERS' EQUITY:**

Common shares, no par value - unlimited shares authorized; shares outstanding				
September 30, 2012 - 44,769,245, June 30, 2012 - 44,364,245		93,142		92,500
Additional paid in capital		20,759		20,052
Accumulated other comprehensive loss		(42)		(45)
Accumulated deficit during exploration stage		(67,623)		(61,765)
Total shareholders' equity		46,236		50,742

Total liabilities and shareholders' equity	\$	48,638	\$	53,232
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See accompanying notes to consolidated interim financial statements

RARE ELEMENT RESOURCES LTD.
(an exploration stage company)
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(Expressed in thousands of U.S. dollars, except share and per share amounts)

	For the three month periods ended September 30,		Cumulative during exploration stage
	2012	2011	
Operating income and (expenses):			
Exploration	\$ (5,382)	\$ (3,847)	\$ (33,522)
Corporate administration	(2,393)	(3,942)	(33,821)
Depreciation	(46)	(20)	(218)
Gain/(loss) on currency translation	1,802	(3,497)	1,975
Write-down of mineral property	-	-	(2,924)
Total operating expenses	(6,019)	(11,306)	(68,510)
Non-operating income and (expenses):			
Interest income	168	286	1,843
Other income	-	-	10
Loss on sale of marketable securities	(7)	-	(18)
Unrealized gain/(loss) on derivatives	-	86	(948)
Total non-operating income	161	372	887
Net loss	\$ (5,858)	\$ (10,934)	\$ (67,623)
Other comprehensive loss			
Realized loss on available-for-sale securities	\$ 7	\$ -	\$ 18
Unrealized loss on available-for-sale securities	(4)	(96)	(60)
COMPREHENSIVE LOSS	\$ (5,855)	\$ (11,030)	\$ (67,665)
LOSS PER SHARE - BASIC AND DILUTED	\$ (0.13)	\$ (0.25)	
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	44,391,636	44,096,015	

See accompanying notes to consolidated interim financial statements

RARE ELEMENT RESOURCES LTD.
(an exploration stage company)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in thousands of U.S. dollars)

	For the three month periods ended September 30,		Cumulative during exploration stage
	2012	2011	
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss for the period	\$ (5,858)	\$ (10,934)	\$ (67,623)
Adjustments to reconcile loss for the period to net cash and cash equivalents used in operations:			
Depreciation	46	20	218
Asset retirement obligation	-	-	435
Fair value of warrants received pursuant to the sale of mineral properties	-	-	(15)
Unrealized (gain)/loss on derivatives	-	(86)	948
Write-down of mineral property	-	-	1,891
Loss on currency translation	7	9	(26)
Loss on disposal of marketable securities	7	-	18
Loss on disposal of equipment	(3)	-	(3)
Stock-based compensation	984	3,312	20,890
Changes in non-cash working capital			
Accounts receivable	21	(104)	(143)
Interest receivable	(55)	(129)	(238)
Prepaid expenses	38	(49)	(214)
Accounts payable and accrued liabilities	(88)	3	1,748
Due to related party	-	(31)	(28)
Net cash and cash equivalents used in operating activities	(4,901)	(7,989)	(42,142)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of marketable securities	-	-	(207)
Purchases of short-term investments	(621)	-	(15,254)
Additions to mineral properties, net of cost recoveries	-	-	(29)
Release of restricted cash	422	-	-
Purchases of equipment	-	(208)	(769)
Proceeds from the sale of equipment	14	-	14
	36	-	150

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Proceeds from sale of marketable securities			
Payments received for sale/option of mineral properties	-	-	279
Net cash and cash equivalents used in investing activities	(149)	(208)	(15,816)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Advance of promissory note	-	-	111
Repayment of promissory note	-	-	(129)
Cash received for common shares, net of share issuance costs	89	55	94,615
Shares subscribed	-	-	(4,788)
Net cash and cash equivalents provided by financing activities	89	55	89,808
Cash acquired in capital transaction	-		
Cash provided by (used in) operating activities	287		(10)
Cash Flows from Investing Activities:			
Additions to property, plant and equipment	(53)		(72)
Proceeds from sales of property, plant and equipment			18
Increase in assets held for rent	(4)		(3)
Investment in equity affiliate	(3)		
Cash used in investing activities	(60)		(57)
Cash Flows from Financing Activities:			
Borrowings under financing arrangements	25		84
Repayments under financing arrangements	(54)		(54)
Repayments of long-term debt	(47)		(10)
(Decrease) increase in notes payable to banks, net	(25)		45
Proceeds from sales of common stock			1
Purchases of common stock			(24)
Proceeds from cash contribution received from minority interest shareholders			8
Cash dividends paid to minority interest stockholders	(1)		(13)
Cash dividends paid to stockholders	(24)		(23)
(Increase) in shareholder note receivable	(1)		
Cash (used in) provided by financing activities	(127)		14
Effect of exchange rate changes on cash	(9)		10
Increase (decrease) in cash and cash equivalents	91		(43)
Cash and cash equivalents at beginning of period	129		154
Cash and cash equivalents at end of period	\$ 220	\$	111

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

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Six Months Ended March 31, 2009

(In millions, except shares in thousands)

UNAUDITED

	Common Stock, Net of Treasury Stock		Additional Paid-in Capital	Retained Earnings	Deferred Employee Benefits	Notes	Accumulated Other Comprehensive Income	Total Stockholders' Equity	Total Comprehensive Loss
	Shares	Cost				for Restricted Stock			
Balance at September 30, 2008	65,278	\$ 61	\$ 21	\$ 1,143	\$ (30)	\$ (21)	\$ 75	\$ 1,249	
Net income				(54)					\$ (54)
Foreign currency translation adjustment							(44)		(44)
Change in unrealized gain on derivative instruments							(1)		(1)
Other comprehensive loss									(45)
Comprehensive loss								(99)	\$ (99)
Common dividends paid				(24)				(24)	
Issuance of stock under employee compensation plans, net of forfeitures	11	1	1					2	
Amortization of share-based compensation			11					11	
Purchase and retirement of common and treasury stock	(18)		(1)					(1)	
Principal payment by Employee Stock Ownership Plan under guaranteed loan					3			3	
Notes receivable for restricted stock payments and forfeitures						1		1	
Balance at March 31, 2009	65,271	\$ 62	\$ 32	\$ 1,065	\$ (27)	\$ (20)	\$ 30	\$ 1,142	

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

Table of Contents**CABOT CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****March 31, 2009****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, 2008 (2008 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, 2009 and 2008. 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.

As of September 30, 2008, the Company classified \$7 million of land acquired in connection with the purchase of Showa Cabot K.K. as held for sale in current assets on the consolidated balance sheet. As of March 31, 2009, the Company has determined that this land, while not impaired, is unlikely to be sold within the next twelve months and, therefore, has reclassified the balance from assets held for sale in current assets to other assets in non-current assets in the consolidated balance sheet.

B. Significant Accounting Policies***Revenue Recognition and Accounts Receivable***

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 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, the revenue is deferred until product acceptance has occurred.

The following table shows the relative size of the revenue recognized in each of the Company's reportable segments. Other operating revenues, which are included in the percentages below, represent less than two percent of total revenues and include tolling, servicing and royalties for licensed technology.

	Three months ended		Six months ended	
	2009	2008	2009	2008
Core Segment				
Rubber Blacks Business	60%	59%	62%	58%
Supermetals Business	5%	7%	6%	8%
Performance Segment	29%	30%	27%	30%
New Business Segment	4%	2%	3%	2%
Specialty Fluids Segment	2%	2%	2%	2%

As indicated above, Cabot derives a substantial majority of its revenues from the sale of products in the Rubber Blacks Business and Performance Segment. Revenue from these products is typically recognized when the product is shipped and title and risk of loss have passed to

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

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CABOT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

UNAUDITED

Supermetals revenues also are generally recognized when the product is shipped and title and risk of loss have passed to the customer.

The majority of the revenue in the Specialty Fluids Business 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.

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.

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 were not material to any period presented. There is no off-balance sheet credit exposure related to customer receivable balances.

Goodwill

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. The fair value of a reporting unit is 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. If an impairment exists, a loss is recorded to write-down the value of goodwill to its implied fair value.

Financial Instruments

Cabot's financial instruments consist primarily of cash and cash equivalents, short-term and long-term debt, and derivative instruments. The carrying values of Cabot's financial instruments approximate fair value with the exception of certain long-term debt that has not been designated with a fair value hedge. This portion of long-term debt is recorded at face value. The fair values of the Company's derivative 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 derivatives are recognized on the consolidated balance sheets at fair value. The changes in the fair value of derivatives are recorded in either earnings or 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 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.

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.

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The Company carries a variety of different cash and cash equivalents on its consolidated balance sheets. Cabot continually assesses the liquidity of cash and cash equivalents and, as of March 31, 2009, has determined that they are readily convertible to cash.

Income Tax in Interim Periods

The Company records its tax (benefit) provision on an interim basis using the 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 realized and the income tax effects of unusual and infrequent items are excluded from the estimated annual effective tax rate. Valuation allowances are provided against the future tax benefits that arise from the losses in jurisdictions for which no benefit can be realized. In addition, the effects of the unusual and infrequent items are recognized in the impacted interim period as discrete items. 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.

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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 \$111 million and \$140 million higher as of March 31, 2009 and September 30, 2008, respectively. 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, 2009, inventory quantities were reduced in the Company's U.S. Rubber Blacks and Performance Products Businesses. This reduction led to a liquidation of LIFO inventory quantities carried at lower costs that were prevailing in prior years, as compared with the cost of purchases made in the current fiscal year through March 31, 2009. This resulted in a decrease of cost of goods sold of approximately \$3 million and an increase of net income by approximately \$2 million, or \$0.03 per share, for the three and six months ended March 31, 2009.

During the three and six months ended March 31, 2008, inventory quantities were reduced at the Company's U.S. Supermetals site, leading to a liquidation of LIFO inventory quantities. This resulted in a decrease of cost of goods sold of \$3 million and \$4 million, respectively, and an increase of net income by approximately \$2 million and \$3 million, or \$0.03 and \$0.04 per share, respectively, for the three and six months ended March 31, 2008.

Cabot reviews inventory for potential obsolescence periodically. 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 or slow moving inventory. Cabot writes down the value of these obsolete, unmarketable or slow moving inventories by an amount equal to the difference between the cost of the inventory and its estimated market value.

C. Accounting Pronouncements

New and Adopted

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (FAS) No. 157, Fair Value Measurements (FAS 157). FAS 157 (i) provides guidance for using fair value to measure assets and liabilities; and (ii) requires additional disclosure about the use of fair value measures, the information used to measure fair value, and the effect fair-value measurements have on earnings. The primary areas in which Cabot utilizes fair value measures are in valuing pension plan assets and liabilities, valuing hedge-related derivative financial instruments, allocating purchase price to the assets and liabilities of acquired companies, and evaluating long-term assets for potential impairment. FAS 157 does not require any new fair value measurements. In February 2008, the FASB issued FASB Staff Position FAS 157-2, which defers the effective date of FAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years beginning after November 15, 2008. Effective October 1, 2008, Cabot adopted the portion of FAS 157 that was not deferred, which includes the disclosures in Note J, and applied the provisions of the statement prospectively to assets and liabilities measured and disclosed at fair value. The adoption of the deferred portion of FAS 157 on October 1, 2009 is not expected to have a material impact on the Company's consolidated financial statements.

In March 2008, the FASB issued FAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (FAS 161). FAS 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance and cash flows. Effective January 1, 2009 Cabot adopted FAS 161, which includes the disclosures in Note K, and applied the provisions of the statement prospectively.

Not Yet Adopted

In December 2007, the FASB issued FAS No. 141 (Revised 2007), Business Combinations (FAS 141(R)). FAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of business combinations. FAS 141(R) is effective on a prospective basis for financial statements issued for fiscal years beginning after December 15, 2008. Accordingly, any business combination Cabot enters into after September 30, 2009 will be subject to this new standard.

Table of Contents**CABOT CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****March 31, 2009****UNAUDITED**

In December 2007, the FASB issued FAS No. 160, Noncontrolling Interests in Consolidated Financial Statements—An Amendment of ARB No. 51 (FAS 160). FAS 160 establishes accounting and reporting standards for the ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in the parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. FAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. FAS 160 will be effective for Cabot for the first quarter of fiscal 2010, beginning October 1, 2009. The Company is evaluating the impact of FAS 160 on its consolidated financial statements.

D. 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, 2009 are as follows:

	Rubber Blacks Business	Performance Segment (Dollars in millions)	Total
Balance at September 30, 2008	\$ 23	\$ 11	\$ 34
Foreign currency translation adjustment	(1)		(1)
Balance at March 31, 2009	\$ 22	\$ 11	\$ 33

As required by FAS No. 142, Goodwill and Other Intangibles, (FAS 142) impairment tests are performed at least annually. The Company performed its annual FAS 142 impairment assessment as of March 31, 2009 and determined that there was no impairment.

Cabot does not have any indefinite-lived intangible assets. As of March 31, 2009 and September 30, 2008, Cabot had \$3 million of finite-lived intangible assets. Intangible assets are amortized over their estimated useful lives, which range from ten 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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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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UNAUDITED

E. Employee Benefit Plans

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

	Three Months Ended March 31							
	2009		2008		2009		2008	
	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign
	Pension Benefits				Postretirement Benefits			
	(Dollars in millions)							
Service cost	\$ 1	\$ 1	\$ 1	\$ 2	\$ 1	\$	\$	\$
Interest cost	2	3	2	3	2		2	
Expected return on plan assets	(3)	(3)	(2)	(4)				
Amortization of prior service cost					(1)		(1)	
Amortization of actuarial loss								
Net periodic benefit cost	\$	\$ 1	\$ 1	\$ 1	\$ 2	\$	\$ 1	\$

	Six Months Ended March 31							
	2009		2008		2009		2008	
	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign
	Pension Benefits				Postretirement Benefits			
	(Dollars in millions)							
Service cost	\$ 2	\$ 2	\$ 2	\$ 3	\$ 1	\$	\$ 1	\$
Interest cost	4	6	4	6	3		3	
Expected return on plan assets	(5)	(6)	(4)	(7)				
Amortization of prior service cost					(1)		(1)	
Amortization of actuarial loss				1				
Net periodic benefit cost	\$ 1	\$ 2	\$ 2	\$ 3	\$ 3	\$	\$ 3	\$

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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. The commitments in the table below are quantified on the basis of market prices at March 31, 2009.

	Remainder of fiscal 2009	Payments Due by Fiscal Year					Total
		2010	2011	2012	2013	Thereafter	
(Dollars in millions)							
Core Segment							
Rubber Blacks Business	\$ 74	\$ 171	\$ 148	\$ 129	\$ 122	\$ 932	\$ 1,576
Supermetals Business	16	15	16	17	6	1	71
Performance Segment	32	24	15	15	15	128	229
Total	\$ 122	\$ 210	\$ 179	\$ 161	\$ 143	\$ 1,061	\$ 1,876

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 durations 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, 2009 and September 30, 2008, Cabot had \$7 million on a discounted basis (\$9 million on an undiscounted basis) and \$9 million on a discounted basis (\$10 million on an 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

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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 approximately \$2 million in the first six months of both fiscal 2009 and fiscal 2008.

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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 2008 10-K, the Company s respirator liabilities involve claims for personal injury, including asbestosis, silicosis and coal worker s pneumoconiosis, allegedly resulting from the use of AO respirators that are alleged to have been negligently designed or labeled.

As of March 31, 2009, there were approximately 54,000 claimants 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 2052, and, at March 31, 2009, is approximately \$13 million on a discounted basis (or approximately \$23 million on an undiscounted basis). Cash payments related to this liability have been approximately \$1 million in the first six months of both fiscal 2009 and fiscal 2008.

Beryllium Claims

Cabot is a party to several pending actions in connection with its discontinued beryllium operations in Reading, Pennsylvania. Cabot entered the beryllium industry through an acquisition in 1978. The Company ceased manufacturing beryllium products at one of the acquired facilities in 1979, and the balance of its former beryllium business was sold to NGK Metals, Inc. (NGK) in 1986. As more fully described in the 2008 10-K, the actions are pending in several state and federal courts, and involve claims for personal injury and medical monitoring relating to alleged contact with beryllium in various ways. Cabot believes it has valid defenses to all of the beryllium actions against it and will assert them vigorously in the various venues in which claims have been asserted. In addition, there is a contractual indemnification obligation running from NGK to Cabot in connection with many of these matters. While the outcome of litigation is uncertain, the Company does not believe that the ultimate disposition of these matters will have a material adverse effect on the Company s consolidated financial position.

AVX Contract Dispute

On March 8, 2004, AVX Corporation (AVX) filed an action against the Company in the United States District Court for the District of Massachusetts. The complaint alleges that Cabot violated the federal antitrust laws in connection with the parties January 1, 2001 tantalum supply agreement (the Supply Agreement) by purportedly tying AVX s purchases of Cabot s flake tantalum powder to its purchases of Cabot s nodular tantalum powder. In February 2009, the court granted the Company s motion for summary judgment and dismissed the case against Cabot. AVX has appealed the court s order.

On September 6, 2005, AVX filed an action in the Superior Court of Massachusetts for Suffolk County, which, in November 2005, was moved to the Business Litigation Section of the Superior Court of Massachusetts. The action alleges that Cabot improperly administered the parties Supply Agreement for the years 2003 through 2005. In particular, AVX claims that Cabot has not provided all of the price relief due to AVX under the most favored customer (MFC) provisions of the Supply Agreement. AVX seeks a judicial declaration of the rights of the parties to the Supply Agreement, an accounting of monies paid, due or owing under the MFC provisions, and an award of any sums not paid that should have been. Cabot filed an answer and counterclaims against AVX asserting that AVX actually underpaid for tantalum products in the period 2003 through 2005. On December 31, 2007, the court issued an order allowing AVX s motion for partial summary judgment on one significant legal issue involving interpretation of the Supply Agreement, but denied AVX s motion and Cabot s cross-motion in all other respects, including AVX s motion to dismiss Cabot s affirmative defenses that would negate AVX s claims. Prior to July 2008, AVX had indicated that it believed it is owed additional MFC benefits of approximately \$24 million, which Cabot disputes. In July 2008, AVX attempted to assert new legal theories that increased its damage claim for additional MFC benefits to approximately \$96 million. Cabot subsequently filed a motion to strike AVX s revised

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claim for MFC benefits and in November 2008, the court granted Cabot's motion and denied AVX's additional damage claim for MFC benefits of \$72 million, thereby, Cabot believes, limiting AVX's claim to the previously stated \$24 million. Despite this ruling, AVX has most recently filed a new damage report seeking damages in excess of \$24 million. Cabot has filed a new motion to strike this report based on the court's prior ruling. This motion has not yet been decided. In March 2009, the court established a trial date of October 16, 2009 for this matter. Cabot believes that it has valid defenses to all of AVX's claims, including the one on which partial summary judgment was granted, and will continue to assert these defenses and its counterclaims vigorously. In addition, if necessary, Cabot has the right to appeal the court's order allowing AVX's motion for partial summary judgment. While the outcome of litigation is uncertain, the Company does not believe that the ultimate disposition of these matters will have a material adverse effect on the Company's consolidated financial position.

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The Company has various other lawsuits, claims and contingent liabilities arising in the ordinary course of its business and in respect of 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 consolidated financial position.

G. Income Tax Uncertainties

As of March 31, 2009, the total amount of unrecognized tax benefits was \$72 million. In addition, accruals of \$4 million and \$11 million have been recorded for penalties and interest, respectively. If the unrecognized tax benefits were recognized at a given point in time, there would be approximately a \$68 million favorable impact on the Company's tax provision.

A reconciliation of the beginning and ending amount of unrecognized tax benefits for the six months ended March 31, 2009 is as follows:

	(Dollars in millions)
Balance at September 30, 2008	\$ 80
Additions based on tax positions related to the current year	2
Additions for tax positions of prior years	1
Reductions for tax positions of prior years	(11)
Balance at March 31, 2009	\$ 72

During the second quarter of fiscal 2009, the Company settled the U.S. Internal Revenue Service (IRS) audit for the 2003 and 2004 tax years. The U.S. and non-U.S. settlements, statute of limitation lapses, and translation of non-U.S. balances resulted in a reduction in the amount of uncertain tax positions of approximately \$11 million for the six months ended March 31, 2009. The IRS is currently auditing the tax years 2005 and 2006 and certain Cabot subsidiaries are under audit in a number of 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 2005 through 2008 tax years generally remain subject to examination by federal tax authorities and the 2003 through 2008 tax years remain subject to examination by most state tax authorities. In significant non-U.S. jurisdictions, the 2001 through 2008 tax years generally remain subject to examination by their respective tax authorities. Cabot's significant non-U.S. jurisdictions include the United Kingdom, Germany, Japan, Canada, China, Argentina, Brazil and the Netherlands.

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H. Earnings Per Share

Basic and diluted earnings per share (EPS) were calculated as follows:

	Three Months Ended March 31		Six Months Ended March 31	
	2009	2008	2009	2008
	(Dollars in millions, except per share amounts)			
Basic EPS:				
(Loss) income available to common shares (numerator)	\$ (58)	\$ 11	\$ (54)	\$ 47
Weighted average common shares outstanding	65	65	65	65
Less: contingently issuable shares ⁽¹⁾	(2)	(3)	(2)	(3)
Adjusted weighted average common shares (denominator)	63	62	63	62
Basic (loss) earnings per share	\$ (0.92)	\$ 0.18	\$ (0.85)	\$ 0.74
Diluted EPS:				
(Loss) income available to common shares (numerator)	\$ (58)	\$ 11	\$ (54)	\$ 47
Adjusted weighted average common shares outstanding	63	62	63	62
Effect of dilutive securities:				
Common shares issuable ⁽²⁾		2		2
Adjusted weighted average shares (denominator)	63	64	63	64
Diluted (loss) earnings per share	\$ (0.92)	\$ 0.17	\$ (0.85)	\$ 0.73

⁽¹⁾ Represents outstanding unvested restricted stock issued under Cabot's equity incentive plans.⁽²⁾ Represents incremental shares for the (i) assumed exercise of stock options; (ii) assumed issuance of shares pursuant to the Company's SERP obligation to employees; and (iii) outstanding unvested restricted stock issued under Cabot's equity incentive plans, net of assumed share repurchases. For the three and six months ended March 31, 2009, 1,586,100 and 1,503,100 of these incremental shares, respectively, were excluded from the calculation of diluted earnings per share as those shares would have been anti-dilutive due to the Company's net loss position. For the three and six months ended March 31, 2008, options to purchase approximately 221,900 shares of common stock were not included in the calculation of diluted earnings per share because those options' exercise prices were greater than the average market price of Cabot common stock during both periods.**I. Restructuring**

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

	Three months ended		Six months ended	
	March 31		March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Cost of sales	\$ 40	\$ 8	\$ 41	\$ (3)
Selling and administrative expenses	3		4	
Research and technical expenses	2		2	
 Total	 \$ 45	 \$ 8	 \$ 47	 \$ (3)

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Details of these restructuring activities and the reserves for these plans during the three months ended March 31, 2009 are as follows:

	Severance and Employee Benefits	Environmental Remediation	Asset Impairment and Accelerated Depreciation	Total
	(Dollars in millions)			
Reserve at December 31, 2008	\$ 3	\$ 1	\$	\$ 4
Charges	29	1	15	45
Cost charged against assets			(15)	(15)
Cash paid	(7)	(2)		(9)
Foreign currency translation adjustment	1			1
Reserve at March 31, 2009	\$ 26	\$	\$	\$ 26

Details of these restructuring activities and the reserves for these plans during the six months ended March 31, 2009 are as follows:

	Severance and Employee Benefits	Environmental Remediation	Asset Impairment and Accelerated Depreciation	Total
	(Dollars in millions)			
Reserve at September 30, 2008	\$ 2	\$ 1	\$	\$ 3
Charges	31	2	14	47
Cost charged against assets			(14)	(14)
Cash paid	(8)	(3)		(11)
Foreign currency translation adjustment	1			1
Reserve at March 31, 2009	\$ 26	\$	\$	\$ 26

As of March 31, 2009, the reserve balances for the 2009 Global Restructuring Plan (which is described below) and the 2008 Global Restructuring plan (which included a workforce reduction and the termination of underperforming projects in the New Business Segment undertaken when Cabot reorganized its business and regional structure in fiscal 2008) are included in accrued expenses in the consolidated balance sheet. As of March 31, 2009, there were no reserves associated with other previously disclosed restructuring activities.

2009 Global Restructuring

In response to a significant reduction in global demand, Cabot committed to a broad-based restructuring of its operations. Over the course of calendar year 2009, Cabot plans to: (i) close its manufacturing operations located in Berre, France, in Stanlow and Dukinfield, U.K., close its

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tantalum powder operations in Boyertown, Pennsylvania, and suspend its tantalum mining operations in Lac du Bonnet, Manitoba; (ii) close its regional office in Kuala Lumpur, Malaysia; (iii) mothball assets at its manufacturing operations in Merak, Indonesia; Sarnia, Ontario; and Tuscola, Illinois; (iv) implement short worktime at its manufacturing operations in Rheinfelden, Germany; and (v) incur workforce reductions across a variety of its other operations.

The Company expects this restructuring will result in a cumulative pre-tax charge to earnings of approximately \$140 million, with approximately \$90 million of this amount expected to be recorded during fiscal year 2009. Estimates of the total amount the Company expects to incur for each major type of cost associated with the restructuring plan are: (i) severance and employee benefits of \$70 million for approximately 400 employees, (ii) accelerated depreciation and impairment of facility assets of \$40 million, (iii) demolition and site clearing costs of \$20 million, and (iv) product requalification and other restructuring related costs of \$10 million. The total after-tax charge is estimated to be approximately \$120 million.

Net cash outlays related to these actions are expected to be \$80 million, approximately \$35 million of which is expected to be paid during fiscal 2009.

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The segments impacted by this restructuring are presented in the table below.

Location	Core Segment		Performance Segment
	Rubber		
	Blacks Business	Supermetals Business	
Berre, France	X		X
Stanlow, U.K.	X		X
Dukinfield, U.K.			X
Boyertown, PA		X	
Lac du Bonnet, Manitoba		X	
Merak, Indonesia	X		
Sarnia, Ontario	X		X
Rheinfelden, Germany			X
Tuscola, IL			X

Through March 31, 2009, Cabot has recorded \$45 million of charges associated with this restructuring, comprised of \$16 million for accelerated depreciation and asset impairments and \$29 million for severance and employee benefits. Net cash outlays related to these actions were \$5 million during the second quarter of fiscal 2009 for severance and employee benefits.

Other Restructuring

In addition to the 2009 Global Restructuring, for the three months ended March 31, 2009, Cabot had \$1 million of restructuring charges related to previously disclosed plans, offset by \$1 million of benefit received from the sale of assets previously written down. During the six months ended March 31, 2009, other restructuring activities included \$4 million of costs associated with the closure of Cabot's Waverly, West Virginia plant and the 2008 Global Restructuring plan, partially offset by a \$1 million benefit related to the previous closure of the Company's facility in Zierbena, Spain and the \$1 million benefit from the asset sale noted above.

Restructuring activity for the three months ended March 31, 2008 includes the cost associated with the Waverly, West Virginia plant closure, global cost reduction initiatives and the closure of the Company's Altona, Australia plant. For the six months ended March 31, 2008, restructuring activities also included a \$1 million write-down of the value of a former carbon black manufacturing facility in Hanau, Germany.

J. Fair Value Measurements

Effective October 1, 2008, Cabot implemented FAS 157 for financial assets and financial liabilities reported or disclosed at fair value. As permitted by FASB Staff Position No. FAS 157-2, the Company elected to defer implementation of the provisions of FAS 157 for nonfinancial assets and nonfinancial liabilities until October 1, 2009, except for nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. FAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The disclosures focus on the inputs used to measure fair value. FAS 157 establishes the following hierarchy for categorizing these inputs:

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Level 1	Quoted market prices in active markets for identical assets or liabilities
Level 2	Significant other observable inputs (e.g., quoted prices for similar items in active markets, quoted prices for identical or similar items in markets that are not active, inputs other than quoted prices that are observable such as interest rate and yield curves, and market-corroborated inputs)
Level 3	Significant unobservable inputs

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The following table presents information about the Company's financial assets and liabilities measured at fair value on a recurring basis as of March 31, 2009:

	March 31, 2009		
	Level 1 Inputs	Level 2 Inputs	Total
	(Dollars in Millions)		
Assets at fair value:			
Equity securities ⁽¹⁾	\$ 1	\$	\$ 1
Derivatives relating to:			
Interest rates ⁽²⁾		4	4
Foreign currency ⁽²⁾		1	1
Commodities ⁽²⁾		1	1
Total assets at fair value	\$ 1	\$ 6	\$ 7
Liabilities at fair value:			
Derivatives relating to:			
Foreign currency ⁽²⁾	\$	\$ 41	\$ 41
Total liabilities at fair value	\$	\$ 41	\$ 41

(1) The Company's investments in equity securities are included in Short-term marketable securities and Long-term marketable securities and cost investments in the consolidated balance sheets.

(2) The Company's derivatives are included in Other assets and Other liabilities in the consolidated balance sheets.

K. Financial Instruments**Risk Management**

Cabot's business operations are exposed to changes in interest rates, foreign currency exchange rates and commodity prices because Cabot finances certain operations through long- and short-term borrowings, denominates transactions in a variety of foreign currencies and purchases certain commoditized raw materials. Changes in these rates and prices may have an impact on future cash flows and earnings. The Company manages these risks through normal operating and financing activities and, when deemed appropriate, through the use of derivative financial instruments.

The Company has policies governing the use of derivative instruments and does not enter into financial instruments for trading or speculative purposes. All of the derivative instruments Cabot enters into are reviewed and approved by the Financial Risk Management Committee, an internal management committee responsible for overseeing Cabot's financial risk management policy.

By using derivative instruments, Cabot is subject to credit and market risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, Cabot's credit risk will equal the fair value of the derivative. Generally, when the fair value of a derivative contract is positive, the counterparty owes Cabot, thus creating a payment risk for Cabot. The Company minimizes counterparty credit (or repayment) risk

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by entering into transactions with major financial institutions of investment grade credit rating. As of March 31, 2009, the counterparties that the Company has executed derivatives with were rated between AA and A, inclusive, by Standard and Poor's. Cabot's exposure to market risk is not hedged in a manner that completely eliminates the effects of changing market conditions on earnings or cash flow. No significant concentration of credit risk existed at March 31, 2009.

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Cabot's objective is to maintain a certain range of fixed-to-floating interest rate mix on the Company's debt portfolio. Cabot enters into interest rate swaps as a hedge of the underlying debt instruments to effectively change the characteristics of the interest rate without changing the debt instrument. The following table provides details of the derivatives held as of March 31, 2009 used to manage interest rate risk.

			FAS 133 Hedge
Description	Borrowing	Notional Amount	Designation
Interest Rate Swaps Variable to Fixed	Revolving Credit Facility	JPY 9.3 billion	Cash Flow
Interest Rate Swaps Fixed to Variable	Medium Term Notes	USD 8 million	Fair Value
Interest Rate Swaps Fixed to Variable	Eurobond (20% of \$175 million)	USD 35 million	Fair Value

Foreign Currency Risk Management

Cabot's international operations are subject to certain risks, including currency exchange rate fluctuations and government actions. Cabot endeavors to match the currency in which debt is issued to the currency of the Company's major, stable cash receipts. In some situations Cabot has issued debt denominated in U.S. dollars and then entered into cross currency swaps that exchange the dollar principal and interest payments into a currency where the Company expects long-term, stable cash receipts.

Additionally, the Company has foreign currency exposure arising from its net investments in foreign operations. Cabot enters into cross-currency swaps to mitigate the impact of currency rate changes on the Company's net investments.

The Company also has foreign currency exposure arising from the denomination of current assets and current liabilities in foreign currencies other than the functional currency of a given subsidiary as well as the risk that currency fluctuations could affect the dollar value of future cash flows generated in foreign currencies. Accordingly, Cabot uses short-term forward contracts to minimize the exposure to foreign currency risk. These forward contracts typically have a duration of 30 days.

In certain situations where the Company has forecasted purchases under a long-term commitment denominated in a foreign currency, Cabot may enter into appropriate financial instruments in accordance with the Company's risk management policy to hedge future cash flow exposures. The following table provides details of the derivatives held as of March 31, 2009 used to manage foreign currency risk.

			FAS 133 Hedge
Description	Borrowing	Notional Amount	Designation

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Cross Currency Swap	Eurobond (80% of \$175 million)	USD 140 million swapped to EUR 124 million	No designation
Cross Currency Swap	Eurobond (20% of \$175 million)	USD 35 million swapped to EUR 31 million	No designation
Cross Currency Swap	N/A	USD 20 million swapped to JPY 2.5 Billion	Net investment hedge
Forward Foreign Currency Contracts	N/A	(a)	No designation

^(a) Cabot's forward foreign exchange contracts are denominated primarily in the Japanese yen, British pound sterling, euro, Canadian dollar and Australian dollar. The duration of these forwards is generally 30 days. The total net notional dollar value of these forward contracts at March 31, 2009 was \$30 million.

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Five of Cabot's carbon black plants in Europe are subject to mandatory greenhouse gas emission trading schemes. Cabot's objective is to ensure compliance with the European Union (EU) Emission Trading Scheme, which is based upon a Cap-and-Trade system that establishes a maximum allowable emission credit for each ton of CO₂ emitted. European Union Allowances (EUAs) originate from the individual EU state's country allocation process and are issued by that country's government. A company that has an excess of EUAs based on the CO₂ emissions limits may sell EUAs in the Emission Trading Scheme and if they have a shortfall, a company can buy EUAs or Certified Emission Reduction (CER) units to comply.

In order to limit the variability in cost to Cabot's European operations, the Company committed to current prices by entering into agreements which run from calendar years 2008 to 2012 to purchase CERs and to sell EUAs. The following table provides details of the derivatives held as of March 31, 2009 used to manage commodity risk.

	Notional Amount	Buyer/ Seller	FAS 133 Hedge Designation
CERs	EUR 14 million	Buyer	No designation
EUAs	EUR 17 million	Seller	No designation

The Company also has exposure to the prices of commodities in its procurement of certain raw materials. In order to manage the price volatility associated with forecasted inventory purchases, Cabot may enter into swap trades to buy such commodities. At March 31, 2009, the Company did not have any open contracts outstanding.

Accounting for Derivative Instruments and Hedging Activities

The Company calculates the fair value of financial instruments using quoted market prices whenever available. When quoted market prices are not available for various types of financial instruments (such as forwards, options and swaps), the Company uses standard models with market-based inputs, which take into account the present value of estimated future cash flows and the ability of the financial counterparty to perform.

Fair Value Hedge

For derivative instruments that are designated and qualify as fair value hedges, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current period earnings.

Cash Flow Hedge

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is recorded in other comprehensive income and reclassified to earnings in the same period or periods that the

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hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current period earnings. At March 31, 2009, open contracts hedge forecasted transactions until August 2010.

Net Investment Hedge

For net investment hedges, changes in the fair value of the effective portion of the derivatives gains or losses are reported as foreign currency translation gains or losses in other comprehensive income while changes in the ineffective portion are reported in earnings. The gains or losses on derivative instruments reported in other comprehensive income are reclassified to earnings in the period in which earnings are affected by the underlying item. At March 31, 2009 the Company had outstanding foreign currency denominated debt of \$96 million designated as a nonderivative net foreign investment hedge. During the three and six months ended March 31, 2009, the (loss) gain recorded in other comprehensive income was \$(7) million and \$9 million, respectively.

Other Derivative Instruments

From time to time, the Company may enter into certain derivative instruments that may not be designated as hedges under FAS 133. Although these derivatives do not qualify for hedge accounting, Cabot believes that such instruments are closely correlated with the underlying exposure, thus managing the associated risk. The gains or losses from changes in the fair value of derivative instruments that are not accounted for as hedges are recognized in current period earnings.

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The following table provides the fair value and gross consolidated balance sheet presentations of derivative instruments:

	Consolidated Balance Sheet Caption (Dollars in millions)	March 31, 2009
Fair Value of Derivative Instruments		
Asset Derivatives		
Derivatives designated as hedges		
Interest rate ⁽¹⁾	Noncurrent other assets	\$ 4
Total derivatives designated as hedges		\$ 4
Derivatives not designated as hedges		
Foreign currency	Other assets	\$ 1
Commodity contracts	Other assets & noncurrent other assets	3
Total derivatives not designated as hedges		\$ 4
Total Asset Derivatives		\$ 8
Liability Derivatives		
Derivatives designated as hedges		
Interest rate	Noncurrent other liabilities	\$
Foreign currency	Other liabilities	5
Total derivatives designated as hedges		\$ 5
Derivatives not designated as hedges		
Foreign currency	Other liabilities	\$ 36
Commodity contracts ⁽²⁾	Other assets & noncurrent other assets	2
Total derivatives not designated as hedges		\$ 38
Total Liability Derivatives		\$ 43

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- (1) Interest rate contracts of \$3 million presented on a gross basis in this table have the legal right to offset against other types of contracts and, therefore, are presented on a net basis in Noncurrent other liabilities on the consolidated balance sheet.
- (2) Commodity contracts presented on a gross basis in this table have the legal right to offset, therefore are presented on a net basis in Other assets and Noncurrent other assets in the consolidated balance sheet.

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UNAUDITED

The following table provides detail on the impact of the derivative instruments on the consolidated statement of operations for the three months ended March 31, 2009:

	Change in Unrealized Gain (Loss) in Accumulated Statement of Other Comprehensive Operations Income (Loss) (AOCI ⁽¹⁾⁽²⁾)	Consolidated Statement of Operations Caption	Gain / (Loss) Reclassified from AOCI to earnings ⁽³⁾	Additional Gain / (Loss) Recognized in earnings ⁽³⁾⁽⁴⁾
(Dollars in millions)				
Derivatives designated as hedges:				
Fair value:				
Interest rates	\$	Interest expense		\$ (1)
Cash flow:				
Interest rates	\$	Interest expense		
Foreign currency		Cost of sales	\$	
Commodities		Cost of sales	(1)	
Net foreign investment:				
Foreign currency	\$ 2	N/A		
Total derivatives designated as hedges	\$ 2		\$ (1)	\$ (1)
Derivatives not designated as hedges:				
Foreign currency		Other expense		5
Commodities		Cost of sales		
Total derivatives not designated as hedges				5
Total Derivatives	\$ 2		\$ (1)	\$ 4

- (1) Net unrealized gains/losses from interest rate hedges are included in Change in unrealized gain on derivative instruments in the consolidated statement of changes in stockholders equity.
- (2) Net unrealized gains/losses from foreign currency hedges (net of tax) are included in Foreign currency translation adjustment in the consolidated statement of changes in stockholders equity.
- (3) Pre-tax amounts.
- (4) Includes immaterial amounts of hedge ineffectiveness.

See Note J Fair Value Measurements for classification of derivatives by input level as required by FAS 157.

The net after-tax amounts to be reclassified from accumulated other comprehensive income to earnings within the next 12 months are expected to be immaterial.

Table of Contents**CABOT CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****March 31, 2009****UNAUDITED****L. Financial Information by Segment**

Cabot is organized into four business segments: the Core Segment, which is further disaggregated for financial reporting purposes into the Rubber Blacks and Supermetals Businesses, the Performance Segment, the New Business Segment and the Specialty Fluids Segment. During the first quarter of fiscal 2009, management changed the allocation method of its corporate costs to its segments. Under this new method, costs that are not controlled by the segments and which primarily benefit corporate interests are not allocated to the segments and are included under the caption "Unallocated and Other" in the table below. The presentation of prior period results conforms to the new allocation method.

While the Chief Operating Decision Maker uses a number of performance measures to manage the performance of the segments and allocate resources to them, (loss) income from operations before taxes is the measure that is most consistently used and is, therefore, the measure presented in the table below.

	Core Segment		Performance Segment	New Business Segment	Specialty Fluids Segment	Segment Total	Unallocated and Other ⁽¹⁾	Consolidated Total
	Rubber Blacks Business	Supermetals Business						
(Dollars in millions)								
Three months ended March 31, 2009								
Net sales and other operating revenues ⁽²⁾	\$ 272	\$ 23	\$ 132	\$ 16	\$ 11	\$ 454	\$ 16	\$ 470
(Loss) income before taxes ⁽³⁾	\$ (17)	\$ (7)	\$ (1)	\$ (1)	\$ 4	\$ (22)	\$ (69)	\$ (91)
Three months ended March 31, 2008								
Net sales and other operating revenues ⁽²⁾	\$ 454	\$ 57	\$ 236	\$ 14	\$ 16	\$ 777	\$ 9	\$ 786
Income (loss) before taxes ⁽³⁾	\$ 28	\$ 1	\$ 32	\$ (9)	\$ 5	\$ 57	\$ (34)	\$ 23
Six months ended March 31, 2009								
Net sales and other operating revenues ⁽²⁾	\$ 671	\$ 68	\$ 289	\$ 34	\$ 26	\$ 1,088	\$ 34	\$ 1,122
Income (loss) before taxes ⁽³⁾	\$ 7	\$ (4)	\$ 2	\$ (4)	\$ 8	\$ 9	\$ (99)	\$ (90)
Six months ended March 31, 2008								
Net sales and other operating revenues ⁽²⁾	\$ 864	\$ 110	\$ 447	\$ 24	\$ 32	\$ 1,477	\$ 20	\$ 1,497
Income (loss) before taxes ⁽³⁾	\$ 44	\$ 4	\$ 63	\$ (21)	\$ 12	\$ 102	\$ (46)	\$ 56

⁽¹⁾ Unallocated and Other includes costs that are not controlled by the segments and which primarily benefit corporate interests, certain items and eliminations that are not allocated to the operating segments. Management does not consider these items necessary for an

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understanding of the operating results of the segments and such amounts are excluded in the segment reporting to the Chief Operating Decision Maker.

⁽²⁾ During the third quarter of fiscal 2008, the Company purchased additional shares of one of its Rubber Blacks equity affiliates which resulted in the consolidation of its operating results in the Company's consolidated financial statements beginning

Table of Contents**CABOT CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****March 31, 2009****UNAUDITED**

April 1, 2008. In the first quarter of fiscal 2008 (prior to the consolidation), segment sales included 100% of the sales of this equity affiliate at market-based prices. Unallocated and other reflects an elimination for sales of this equity affiliate for this period, offset by royalties paid by other equity affiliates, other operating revenues and external shipping and handling fees.

⁽³⁾ Income (loss) before taxes for Unallocated and Other includes:

	Three Months Ended March 31		Six Months Ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Interest expense	\$ (8)	\$ (9)	\$ (17)	\$ (18)
Certain items ^(a)	(46)	(12)	(48)	(2)
Equity in net income of affiliated companies ^(b)		(2)	(2)	(4)
Unallocated corporate costs ^(c)	(8)	(10)	(15)	(17)
Other expense, net and foreign currency transaction losses ^(d)	(7)	(1)	(17)	(5)
Total	\$ (69)	\$ (34)	\$ (99)	\$ (46)

^(a) Certain items consist of amounts that are not included in segment profit before taxes (PBT). Certain items for the three months ended March 31, 2009 include charges of \$45 million for 2009 restructuring activities plus \$1 million for the write-down of impaired investments, and \$1 million related to the previously announced closure of the Waverly, WV plant, offset by a benefit of \$1 million related to 2008 restructuring activities. Certain items for the first six months of fiscal 2009 include charges of \$45 million for 2009 restructuring activities plus \$1 million for the write-down of impaired investments, \$2 million related to the previously announced closure of the Waverly, WV plant, and \$1 million related to 2008 restructuring activities, offset by a benefit of \$1 million from a former carbon black facility. Certain items for the three months ended March 31, 2008 include \$7 million for restructuring charges, \$1 million of charges related to a former carbon black facility, and \$4 million for costs associated with the transition of the Company's CEO. Certain items for the first six months of fiscal 2008 include a gain of \$18 million from the sale of land in Altona, Australia, offset by charges of \$14 million for restructuring initiatives, \$1 million of charges related to a former carbon black facility, \$4 million for costs associated with the transition of the Company's CEO, and \$1 million for environmental reserves and legal settlements.

^(b) Equity in net income of affiliated companies is included in segment PBT and is removed from Unallocated and Other to reconcile back to income (loss) from operations before taxes.

^(c) During the first quarter of fiscal 2009, management changed the allocation method of its corporate costs to its segments. The Company has recast prior periods to conform to the new allocation method. Under this new method, costs that are not controlled by the segments and which primarily benefit corporate interests are not allocated to the segments.

^(d) Other expense, net and foreign currency transaction losses consists of investment income that is not included in segment PBT and foreign currency transaction losses net of other foreign currency risk management activities.

The Performance Segment is comprised of the Performance Products and Fumed Metal Oxides Businesses. The net sales from each of these businesses for the three and six months ended March 31, 2009 and 2008 are as follows:

	Three months ended March 31	Six months ended March 31
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	2009	2008	2009	2008
	(Dollars in millions)			
Performance Products	\$ 90	\$ 164	\$ 195	\$ 305
Fumed Metal Oxides	42	72	94	142
Total Performance Segment Sales	\$ 132	\$ 236	\$ 289	\$ 447

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The New Business Segment is comprised of the Inkjet Colorants and the Aerogel Businesses and the business development activities of Cabot Superior MicroPowders (CSMP). The net sales from each of these businesses for the three and six months ended March 31, 2009 and 2008 are as follows:

	Three months ended March 31		Six months ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Inkjet Colorants	\$ 9	\$ 11	\$ 22	\$ 19
Aerogel	5	2	9	3
CSMP	2	1	3	2
Total New Business Segment Sales	\$ 16	\$ 14	\$ 34	\$ 24

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****I. Critical Accounting Policies and Estimates**

The preparation of our financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses and related disclosure of contingent assets and liabilities. We consider an accounting estimate to be critical to the financial statements if 1) the estimate is complex in nature or requires a high degree of judgment and 2) different estimates and assumptions were used, the results could have a material impact on the consolidated financial statements. On an ongoing basis, we evaluate our policies and estimates. We base our estimates on historical experience, current conditions and on various other assumptions that we believe are 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. The estimates that we believe are critical to the preparation of the Consolidated Financial Statements as of March 31, 2009 and for the three months then ended are presented below. We have other critical accounting policies that are discussed under the **Critical Accounting Policies** heading in management's discussion and analysis in our Fiscal 2008 Annual Report on Form 10-K ([2008 10-K](#)).

Revenue Recognition and Accounts Receivable

Our 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. We recognize revenue when persuasive evidence of a sales arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectability is probable. We generally are 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.

The following table shows the relative size of the revenue recognized in each of our reportable segments. Other operating revenues, which are included in the percentages below, represent less than two percent of total revenues and include tolling, servicing and royalties for licensed technology:

	Three months ended		Six Months Ended	
	March 31		March 31	
	2009	2008	2009	2008
Core Segment				
Rubber Blacks Business	60%	59%	62%	58%
Supermetals Business	5%	7%	6%	8%
Performance Segment	29%	30%	27%	30%
New Business Segment	4%	2%	3%	2%
Specialty Fluids Segment	2%	2%	2%	2%

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As indicated above, we derive a substantial majority of revenues from the sale of products in our Rubber Blacks Business and Performance Segment. Revenue from these products is typically recognized when the product is shipped and title and risk of loss have passed to the customer. We offer certain 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. We periodically review the assumptions underlying the estimates of discounts and volume rebates and adjust revenues accordingly. Certain Rubber Blacks Business and Performance Segment customer contracts contain price protection clauses that provide for the potential reduction in past or future sales prices under specific circumstances. We analyze these contract provisions to determine if an obligation related to these clauses exists and record revenue net of any estimated protection commitments.

Supermetals revenues also are generally recognized when the product is shipped and title and risk of loss have passed to the customer.

The majority of the revenue in the Specialty Fluids Business 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.

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.

We maintain 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. In the current economic environment there could be significant changes in the allowance due to events such as customer liquidity matters or customer bankruptcies. Such changes could impact our results of operations and cash flows. Changes in the allowance were not material to any period presented.

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 we used the first-in, first-out (FIFO) method instead of the LIFO method for such inventories, the value of those inventories would have been \$111 million and \$140 million higher as of March 31, 2009 and September 30, 2008, respectively. The cost of other U.S. and all non-U.S. inventories is determined using the average cost method or the FIFO method. In periods of rapidly rising or declining raw material costs, the inventory method we employ can have a significant impact on our profitability. Under our current LIFO method, when raw material costs are rising, our most recent higher priced purchases are the first to be charged to cost of sales. If, however, we were using a FIFO method, our purchases from earlier periods, which were at lower prices, would instead be the first charged to cost of sales.

At certain times, we may decrease inventory levels to the point where layers of inventory recorded under the LIFO method that were purchased in preceding years are liquidated. The inventory in these layers may be valued at an amount that is different than our current costs. If there is a liquidation of an inventory layer, there may be an impact to our cost of sales and net income for that period. If the liquidated inventory is at a cost lower than our current cost, there would be a reduction in our cost of sales and an increase to our net income during the period. Conversely, if the liquidated inventory is at a cost higher than our current cost, there would be an increase in our cost of sales and a reduction to our net income during the period.

We review inventory for potential obsolescence periodically. In this review, we make assumptions about the future demand for and market value of the inventory and based on these assumptions estimate the amount of any obsolete, unmarketable or slow moving inventory. We write down the value of these obsolete, unmarketable or slow moving inventories by an amount equal to the difference between the cost of the inventory and its estimated market value.

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Goodwill

We account for goodwill and other intangible assets in accordance with FAS No. 142, Goodwill and Other Intangible Assets, (FAS 142). We perform an impairment test for goodwill at least annually and when events or changes in business circumstances indicate that the carrying value may not be recoverable. To test whether an impairment exists, the fair value of the applicable reporting unit is estimated based on discounted future cash flows. The calculation of fair value is sensitive to both the estimated future cash flows and the discount rate applied to those cash flows. The assumptions used to estimate the discounted cash flows are based on management's best estimates about selling prices, production and sales volumes, costs, future growth rates, capital expenditures and market conditions over an estimate of the remaining operating period at the reporting unit. The discount rate is based on the weighted average cost of capital that is determined by evaluating the risk-free rate of return, cost of debt and expected equity premiums. If an impairment exists, a loss to write down the value of goodwill to its implied fair value is recorded. While this would have no direct impact on our cash flows, it would reduce our earnings. We performed our annual impairment test as of March 31, 2009 and determined that no impairment existed.

Financial Instruments

Our financial instruments consist primarily of cash and cash equivalents, short-term and long-term debt, and derivative instruments. The carrying values of our financial instruments approximate fair value with the exception of certain long-term debt that has not been designated with a fair value hedge. This portion of long-term debt is recorded at face value. The fair values of our derivative instruments are based on quoted market prices, if such prices are available. In situations where quoted market prices are not available, we rely on valuation models to derive fair value. Such valuation takes into account the ability of the financial counterparties to perform. We use derivative financial instruments primarily for purposes of hedging exposures to fluctuations in interest rates and foreign currency exchange rates, which exist as part of our on-going business operations. We do not enter into contracts for speculative purposes, nor do we hold or issue any financial instruments for trading purposes.

All derivatives are recognized on the consolidated balance sheets at fair value. The changes in the fair value of derivatives are recorded in either earnings or 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 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.

In accordance with our risk management strategy, we 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, we believe that such instruments are closely correlated with the underlying exposure, thus managing the associated risk. We record in earnings the gains or losses from changes in the fair value of derivative instruments that are not designated as hedges.

We carry a variety of different cash and cash equivalents on our consolidated balance sheets. We continually assess the liquidity of cash and cash equivalents and as of March 31, 2009, we have determined that they are readily convertible to cash.

Assets and liabilities measured at fair value are classified in the fair value hierarchy based on the inputs used for valuation. Assets that are traded on an exchange with a quoted price are classified as Level 1. Assets and liabilities that are valued based on quoted prices for similar assets or liabilities in active markets, or standard pricing models using observable inputs are classified as Level 2. As of March 31, 2009, we have no assets or liabilities that are valued using unobservable inputs and, therefore, no assets or liabilities that are classified as Level 3. The sensitivity of fair value estimates is immaterial relative to the assets and liabilities measured at fair value, as well as to our total equity, as of March 31, 2009.

Litigation and Contingencies

We are involved in litigation in the ordinary course of business, including personal injury and environmental litigation. After consultation with counsel, as appropriate, we accrue a liability for litigation when it is probable that a liability has been incurred and the amount can be reasonably estimated. The estimated reserves are recorded based on our best estimate of the liability associated with such matters or the low end of the estimated range of liability if we are unable to identify a better estimate within that range. Our best estimate is determined through the evaluation of various information, including claims, settlement offers, demands by government agencies, estimates performed by independent third parties, identification of other responsible parties and an assessment of their ability to contribute, and our prior experience. Litigation is highly uncertain and there is always the possibility of an unusual result in any particular case that may reduce our earnings and cash flows.

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The most significant reserves that we have established are for environmental remediation and respirator litigation claims. The amount accrued for environmental matters reflects our assumptions about remediation requirements at the contaminated sites, the nature of the remedies, the outcome of discussions with regulatory agencies and other potentially responsible parties at multi-party sites, and the number and financial viability of other potentially responsible parties. A portion of the reserve for environmental matters is recognized on a discounted basis, which requires the use of an estimated discount rate and estimates of future cash flows associated with the liability. These liabilities can be affected by the availability of new information, changes in the assumptions on which the accruals are based, unanticipated government enforcement action or changes in applicable government laws and regulations, which could result in higher or lower costs.

Our current estimate of the cost of our share of existing and future respirator liability claims is based on facts and circumstances existing at this time. Developments that could affect our estimate include, but are not limited to, (i) significant changes in the number of future claims, (ii) changes in the rate of dismissals without payment of pending silica and non-malignant asbestos claims, (iii) significant changes in the average cost of resolving claims, (iv) significant changes in the legal costs of defending these claims, (v) changes in the nature of claims received, (vi) changes in the law and procedure applicable to these claims, (vii) the financial viability of other parties which contribute to the settlement of respirator claims, (viii) a change in the availability of insurance coverage maintained by the entity from which we acquired the safety respiration products business, (ix) changes in the allocation of costs among the various parties paying legal and settlement costs and (x) a determination that our interpretation of the contractual obligations on which we have estimated our share of liability is inaccurate. We cannot determine the impact of these potential developments on our current estimate of our share of liability for these existing and future claims. Accordingly, the actual amount of these liabilities for existing and future claims could be different than the reserved amount. Further, if the timing of our actual payments made for respirator claims differs significantly from our estimated payment schedule, and we could no longer reasonably predict the timing of such payments, we could then be required to record the reserve amount on an undiscounted basis on our consolidated balance sheets, causing an immediate impact to earnings.

Income Taxes

Our business operations are global in nature, and we are subject to taxes in numerous jurisdictions. Tax laws and tax rates vary substantially in these jurisdictions and are subject to change given the political and economic climate in those countries. We file our tax returns in accordance with our interpretations of each jurisdiction's tax laws.

Significant judgment is required in determining our worldwide provision for income taxes and recording the related tax assets and liabilities. In the ordinary course of our business, there are operational decisions, transactions, facts and circumstances, and calculations which make the ultimate tax determination uncertain. Furthermore, our tax positions are periodically subject to challenge by taxing authorities throughout the world. We have recorded reserves for taxes and associated interest and penalties that may become payable in future years as a result of audits by tax authorities. Any significant impact as a result of changes in underlying facts, law, tax rates, tax audit, or review could lead to adjustments to our income tax expense, our effective tax rate, and/or our cash flow.

We record our tax (benefit) provision on an interim basis using the 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 realized and the income tax effects of unusual and infrequent items are excluded from the estimated annual effective tax rate. Valuation allowances are provided against the future tax benefits that arise from the losses in jurisdictions for which no benefit can be realized. In addition, the effects of the unusual and infrequent items are recognized in the impacted interim period as discrete items. The estimated annual effective tax rate may be significantly impacted by nondeductible expenses and our projected earnings mix by tax jurisdiction. Adjustments to the estimated annual effective income tax rate are recognized in the period that such estimates are revised.

Additionally, we have established valuation allowances against a variety of deferred tax assets, including net operating loss carry-forwards, foreign tax credits, and other income tax credits. Valuation allowances take into consideration our ability to use these deferred tax assets and reduce the value of such items to the amount that is deemed more likely than not to be recoverable. Our ability to utilize these deferred tax assets is dependent on achieving our forecast of future taxable operating income over an extended period of time. We review our forecast in relation to actual results and expected trends on a quarterly basis. Failure to achieve our operating income targets may change our assessment regarding the recoverability of our net deferred tax assets and such change could result in a valuation allowance being recorded against some or all of our net deferred tax assets. An increase in a valuation allowance would result in additional income tax expense, lower stockholders' equity and could have a significant impact on our earnings in future periods. The release of valuation allowances in periods when these tax attributes become realizable would reduce our effective tax rate.

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Restructuring Activities

Our consolidated financial statements detail specific charges relating to restructuring activities as well as the actual spending that has occurred against the resulting accruals. Our restructuring charges are estimates based on our preliminary assessments of (i) severance and other employee benefits to be granted to employees, which are based on known benefit formulas and identified job grades, (ii) costs to vacate certain facilities and (iii) asset impairments. Because these accruals are estimates, they are subject to change as a result of deviations from initial restructuring plans or subsequent information that may come to our attention. These deviations may lead to changes in estimates, which would then be reflected in our consolidated financial statements.

II. Results of Operations

Overview

In the second quarter and first six months of fiscal 2009, operating results decreased compared to the same periods of fiscal 2008. Ongoing global weakness in the tire, automotive, construction and electronics markets led to significantly lower volumes in our key businesses. In the second quarter of fiscal 2009, performance was also unfavorably affected by \$42 million from compressed unit margins in our carbon black related businesses as prices have declined as a result of lower commodity costs and difficult market conditions while weak demand has resulted in older, higher cost inventories being reflected in our results. These factors more than offset lower operating expenses from cost reduction activities, improved performance in our New Business Segment, a \$9 million favorable impact from the time lag of pricing adjustments in our Rubber Blacks Business contracts and a \$9 million benefit in our Rubber Blacks and Performance Products Businesses from our LIFO accounting methodology.

During the second quarter of fiscal 2009, volumes in our Rubber Blacks Business decreased by 28% due to weakness in the tire and automotive markets. Compressed unit margins in the business unfavorably affected results by \$31 million, more than offsetting contract lag and LIFO benefits and the effect of lower operating expenses.

In the Supermetals Business, second quarter fiscal 2009 volumes decreased significantly due to weakness in the electronics industry, which more than offset the benefits of higher selling prices and a favorable product mix. During the quarter, we announced our intention to suspend tantalum mining and processing activities at our operations in Manitoba, Canada due to global market conditions for tantalum.

In the Performance Segment, volumes in the second quarter of fiscal 2009 decreased by 36% in Performance Products and by 44% in Fumed Metal Oxides due to weakness in the automotive, construction and electronics industries. Compressed unit margins in Performance Products unfavorably affected results by \$11 million, more than offsetting a \$6 million LIFO benefit and the positive effect of lower operating expenses from cost reduction efforts.

Profitability in the Specialty Fluids Segment declined slightly in the second quarter of fiscal 2009 due to a slowdown of drilling activity in the North Sea that more than offset revenues from regions outside the North Sea and lower operating costs.

Increased revenues and lower costs in the New Business segment led to improved performance.

During the first six months of fiscal 2009, our cash flow from operations was \$287 million and we reduced working capital by \$294 million.

The restructuring of our operations that we announced in January 2009 is proceeding as anticipated and is expected to result in fixed cost savings of at least \$80 million in fiscal 2010.

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Second Quarter and First Six Months Fiscal 2009 versus Second Quarter and First Six Months Fiscal 2008 Consolidated

Net Sales and Gross Profit

	Three months ended March 31		Six months ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Net sales and other operating revenues	\$ 470	\$ 786	\$ 1,122	\$ 1,497
Gross profit	\$ (5)	\$ 118	\$ 87	\$ 234

The \$316 million decrease in net sales from the second quarter of fiscal 2008 to the second quarter of fiscal 2009 was due primarily to lower volumes (\$261 million) from ongoing weakness in the tire, automotive, construction and electronics markets, the impact of lower selling prices (\$39 million), principally in our carbon black related businesses, and the unfavorable effect of foreign currency translation (\$26 million). For the first six months of fiscal 2009, the \$375 million decrease in sales when compared to the first six months of fiscal 2008 was principally due to lower volumes (\$508 million) from global weakness in our key end markets and the unfavorable impact of foreign currency translation (\$34 million), partially offset by higher selling prices (\$138 million).

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Gross profit decreased by \$123 million in the second quarter of fiscal 2009, when compared to the second quarter of fiscal 2008, due principally to lower volumes from weakness in the tire, automotive, construction and electronics markets and lower unit margins as older, higher cost inventories affected our results. These factors offset the benefit of lower operating expenses from cost reduction actions, contract lag and LIFO benefits (as described below) in our Rubber Blacks and Performance Products Businesses and improvement in the performance of our New Business Segment. For the first six months of fiscal 2009, the \$147 million decline in gross profit when compared to the first six months of fiscal 2008 was principally due to lower volumes from the global weakness in our end markets, partially offset by contract lag and LIFO benefits in our carbon black related businesses and lower operating expenses.

During the second quarter and first six months of fiscal 2009 we recorded \$40 million and \$41 million, respectively, of pre-tax restructuring related charges as cost of sales in our consolidated statement of operations. In the second quarter and first six months of fiscal 2008, we recorded restructuring related charges of \$8 million and restructuring related income of \$3 million, respectively. In the first six months of fiscal 2008, the benefit included an \$18 million pre-tax benefit from the sale of land at our former carbon black facility in Altona, Australia.

Selling and Administrative Expenses

	Three months ended March 31		Six months ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Selling and administrative expenses	\$ 54	\$ 66	\$ 110	\$ 123

Selling and administrative expenses decreased by \$12 million and \$13 million in the second quarter and first six months of fiscal 2009, respectively, when compared to the same periods in fiscal 2008. Lower expenses from cost reduction efforts were the principal driver of the decrease.

We recorded \$4 million and \$5 million of pre-tax charges, principally related to restructuring activities, as selling and administrative expenses in the second quarter and first six months of fiscal 2009, respectively. In the same periods of 2008, we recorded \$4 million and \$5 million, respectively, of pre-tax charges, principally related to CEO transition costs, in our consolidated statement of operations as selling and administrative expenses.

Research and Technical Expenses

	Three months ended March 31		Six months ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Research and technical expenses	\$ 19	\$ 19	\$ 37	\$ 35

Research and technical expenses were flat in the second quarter of fiscal 2009 when compared to the second quarter of fiscal 2008 as we continue to invest in our business and product development activities. In the first six months of fiscal 2009, research and technical expenses increased by \$2 million when compared to the first six months of fiscal 2008, principally associated with ongoing development work related to our Cabot Elastomer Composite technology.

Interest Expense

	Three months ended March 31		Six months ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Interest expense	\$ 8	\$ 9	\$ 17	\$ 18

Interest expense decreased by \$1 million in both the second quarter and first six months of fiscal 2009 when compared to the same periods of fiscal 2008, due principally to the effect of lower interest rates as well as lower debt balances.

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	Three months ended March 31		Six months ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Other expense	\$ 6	\$ 2	\$ 15	\$ 4

The \$4 million increase in other expense in the second quarter of fiscal 2009 compared to the second quarter of fiscal 2008 was due principally to losses on transactional hedging contracts. For the first six months of fiscal 2009, other expense increased by \$11 million when compared to the first six months of fiscal 2008. The increase is primarily attributable to losses on foreign currency transactions, including an intercompany loan in Brazil denominated in U.S. dollars and charges related to the repatriation of a portion of our Bolivars held in Venezuela.

Effective Tax Rate

We recorded an income tax benefit in the second quarter of fiscal 2009 of \$31 million, which represents an effective tax rate benefit for net income from continuing operations of 34%. This amount includes \$5 million of net tax benefits from the settlement of the IRS audit of tax years 2003 and 2004 and certain non-U.S. audits. It also includes a benefit of \$19 million (net \$15 million year to date) from the application of FIN 18 interim financial reporting rules. The \$15 million year to date benefit will reverse during the last six months of fiscal 2009. This compares to an income tax provision recorded in the second quarter of fiscal 2008 of \$11 million, which represented an effective tax rate for net income from continuing operations of 48%. The tax rate for the second quarter of fiscal 2008 included a \$5 million charge for the reversal of Chinese tax credits during the quarter that had been recorded in the first quarter of fiscal 2008.

The Company is currently under audit by the IRS for tax years 2005 and 2006 and is under audit in a number of jurisdictions outside of the U.S. It is possible that some of these audits will be resolved in fiscal 2009, which may impact our effective tax rate going forward.

Minority Interest in Net Loss (Income), net of tax

	Three months ended March 31		Six months ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Minority interest in net loss (income), net of tax	\$ 2	\$ (3)	\$ 4	\$ (8)

Minority interest in net loss (income), net of tax is the means by which the minority shareholders' portion of the income or loss in our consolidated joint ventures is removed from our consolidated statement of operations. In the second quarter and first six months of fiscal 2009, in total, these joint ventures experienced losses, primarily driven by lower volumes and compressed unit margins. This, in turn, led to our minority shareholders in these ventures absorbing a portion of these losses, resulting in a benefit to our consolidated statement of operations. In the second quarter and first six months of fiscal 2008, our consolidated joint ventures were profitable in total. Accordingly, our joint venture partners shared partially in these profits, and we removed their portion of this income from our consolidated results through minority interest in net loss (income).

Net (Loss) Income

We reported a net loss for the second quarter of fiscal 2009 of \$58 million (a loss of \$0.92 per diluted common share after-tax) compared to net income of \$11 million (\$0.17 per diluted common share after-tax) in the same period of fiscal 2008. For the first six months of fiscal 2009, we reported a net loss of \$54 million (a loss of \$0.85 per diluted common share) compared to net income of \$47 million (\$0.73 per diluted common share) for the first six months of fiscal 2008.

Table of Contents**Second Quarter and First Six Months Fiscal 2009 versus Second Quarter and First Six Months Fiscal 2008 By Business Segment**

The following discussion of results includes information on our reportable segment sales and segment (or business) operating profit (loss) before tax (PBT). Segment PBT is a non-GAAP financial measure and is not intended to replace income (loss) from operations before taxes, the most directly comparable GAAP financial measure. In calculating segment PBT we exclude certain items, meaning items that are significant and unusual or infrequent, as these amounts are not believed to reflect the true underlying business performance. In addition, in calculating segment PBT we include equity in net income of affiliated companies, royalties paid by equity affiliates and minority interest but exclude interest expense, foreign currency transaction gains and losses, interest income and dividend income. Further, beginning in the first quarter of fiscal 2009, we exclude certain corporate costs that are not controlled by the Segments and which primarily benefit corporate interests. Our Chief Operating Decision-Maker uses segment PBT to evaluate changes in the operating results of each segment before non-operating factors and before certain items and to allocate resources to the segments. We believe that this non-GAAP measure also assists our investors in evaluating the changes in our results and performance. A reconciliation of segment PBT and income (loss) from operations is set forth below.

When discussing our business activities we use several terms. The term *fixed costs* means fixed manufacturing costs, including utilities. The term *LIFO benefit* includes two factors: (i) the impact of current inventory costs being recognized immediately in cost of goods sold (COGS) under a last-in first-out method, compared to the older costs that would have been included in COGS under a first-in first-out method (COGS impact); and (ii) the impact of reductions in inventory quantities, causing historical inventory costs to flow through COGS (liquidation impact). The LIFO impact on PBT in the second quarter of fiscal 2009 is comprised of \$6 million of COGS impact and \$3 million of liquidation impact . The term *contract lag* refers to the time lag of the price adjustments in certain of our rubber blacks supply contracts to account for changes in feedstock costs and, in some cases, changes in other relevant costs.

Total segment PBT, certain items, other unallocated items (which includes unallocated corporate costs), and income (loss) from operations before income taxes for the three and six months ended March 31, 2009 and 2008 are set forth in the table below. The details of certain items and other unallocated items are shown below.

	Three months ended March 31		Six months ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Total segment PBT	\$ (22)	\$ 57	\$ 9	\$ 102
Certain items	(46)	(12)	(48)	(2)
Other unallocated items	(23)	(22)	(51)	(44)
(Loss) income from operations before income taxes	\$ (91)	\$ 23	\$ (90)	\$ 56

Total segment PBT decreased by \$79 million in the second quarter of fiscal 2009 when compared to the same period of fiscal 2008. The decrease was driven principally by lower volumes (\$99 million) from weakness in the tire, automotive, construction and electronics markets and lower unit margins from older, higher cost inventories (\$42 million). These factors were partially offset by lower operating expenses from cost reduction efforts (\$19 million), contract lag and LIFO benefits in our carbon black related businesses (\$18 million) and the favorable impact of foreign currency translation (\$14 million). In the first six months of fiscal 2009, total segment PBT decreased by \$93 million when compared to the first six months of fiscal 2008. The decrease was principally due to lower volumes from global weakness in our key end markets (\$178 million), partially offset by contract lag and LIFO benefits in our Rubber Blacks and Performance Products Businesses (\$60 million), the positive impact of foreign currency translation (\$19 million) and lower operating expenses (\$15 million).

Table of Contents*Certain Items:*

Details of the certain items for the second quarter and first six months of fiscal 2009 and 2008 are as follows:

	Three months ended March 31		Six months ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Environmental reserves and legal settlements	\$	\$	\$	\$ (1)
CEO Transition Costs		(4)		(4)
Write-down of impaired investments	(1)		(1)	
Restructuring initiatives:				
Fiscal 2009 Global	(45)		(45)	
Fiscal 2008 Global	1		(1)	
Altona, Australia				18
North America	(1)	(7)	(2)	(13)
Europe		(1)	1	(2)
Total certain items, pre-tax	\$ (46)	\$ (12)	\$ (48)	\$ (2)

In the second quarter and first six months of fiscal 2009, \$46 million and \$48 million, respectively, pre-tax, of charges principally related to restructuring initiatives were recorded as certain items. In the same periods of fiscal 2008, \$12 million and \$2 million, respectively, pre-tax, of charges principally from restructuring activities and CEO transition costs were recorded as certain items, which included an \$18 million gain from the sale of land at our former carbon black facility in Altona, Australia in the first six months of fiscal 2008.

Other Unallocated Items:

	Three months ended March 31		Six months ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Interest expense	\$ (8)	\$ (9)	\$ (17)	\$ (18)
Equity in net income of affiliated companies		(2)	(2)	(4)
Unallocated corporate costs	(8)	(10)	(15)	(17)
Other expense, net and foreign currency transaction losses	(7)	(1)	(17)	(5)
Total	\$ (23)	\$ (22)	\$ (51)	\$ (44)

Core Segment

Sales and PBT for the Rubber Blacks and Supermetals Businesses, which together comprise the Core Segment, for the second quarter and first six months of fiscal 2009 and 2008 are as follows:

	Three months ended March 31		Six months ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Rubber Blacks Business Sales	\$ 272	\$ 454	\$ 671	\$ 864
Supermetals Business Sales	23	57	68	110

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Segment Sales	\$ 295	\$ 511	\$ 739	\$ 974
Rubber Blacks Business PBT	\$ (17)	\$ 28	\$ 7	\$ 44
Supermetals Business PBT	(7)	1	(4)	4
Segment PBT	\$ (24)	\$ 29	\$ 3	\$ 48

Table of Contents*Rubber Blacks Business*

Sales in the Rubber Blacks Business decreased by \$182 million in the second quarter of fiscal 2009 and by \$193 million in the first six months of fiscal 2009 when compared to the same periods of fiscal 2008. In the second quarter of fiscal 2009, the results were driven by lower volumes (\$127 million) from ongoing weakness in the global tire and automotive markets, lower pricing (\$41 million) in both the contract and non-contract business and the unfavorable impact of foreign currency translation (\$17 million). For the first six months of fiscal 2009, lower volumes (\$245 million) and an unfavorable foreign currency translation (\$23 million) were partially offset by higher pricing (\$67 million).

Rubber Blacks PBT decreased by \$45 million and \$37 million in the second quarter and first six months of fiscal 2009, respectively, when compared to the same periods of fiscal 2008. In the second quarter of fiscal 2009, the decrease was principally driven by the impact of 28% lower volumes from weakness in our key end markets (\$36 million) and lower unit margins (\$31 million) as contract and non-contract prices adjusted downward as a result of lower feedstock costs and difficult market conditions while weak demand resulted in older, higher cost inventories being reflected in our results. These unfavorable factors more than offset a contract lag benefit of \$9 million, a LIFO benefit of \$3 million and the impact of lower operating expenses from cost reduction efforts. For the first six months of fiscal 2009 lower volumes from weakness in the global tire and automotive markets affected the Rubber Blacks Business by \$71 million. This impact more than offset a \$31 million favorable contract lag and a \$13 million LIFO benefit as well as the benefit of lower operating expenses. For the second quarter and first six months of fiscal 2008, the contract lag impact was an unfavorable \$17 million and \$26 million, respectively. The LIFO impact was a benefit of \$2 million in the second quarter of fiscal 2008 and an unfavorable impact of \$5 million in the first six months of fiscal 2008.

Historically, our rubber blacks supply contracts have provided for a price adjustment on the first day of each quarter to account for changes in feedstock costs and, in some cases, changes in other relevant costs. The feedstock adjustments are based upon the average of a relevant index over a three-month period. Because of the need to communicate these adjustments to our customers in a timely manner, the contracts typically provide for the adjustments to be calculated in the month preceding the quarter. Accordingly, the calculation has been typically based upon the average of the three months preceding the month in which the calculation is made. In periods of rapidly changing feedstock costs this time lag can have a significant impact on the results of the Rubber Blacks Business. For example, the contract price adjustment applicable to sales made in the quarter ended March 31, 2009 was calculated using the relevant index average during the months of September, October and November while actual raw material costs were lower. We have been reducing this time delay in our contracts and, while approximately 50% of the total volume of our Rubber Blacks Business continues to be sold under contract, only half of these contracted volumes are now sold under agreements containing a four month lag in the time when prices are adjusted for feedstock costs.

Supermetals Business

Sales in the Supermetals Business decreased by \$34 million in the second quarter of fiscal 2009 when compared to the second quarter of fiscal 2008. The decrease was driven principally by lower volumes (\$40 million) from weakness in the electronics industry, partially offset by higher prices and a favorable product mix (\$5 million). For the first six months of fiscal 2009, sales decreased by \$42 million as lower volumes (\$56 million) from weakness in the electronics market more than offset higher prices and a favorable product mix (\$11 million) and the benefit of foreign currency translation (\$3 million).

PBT in the Supermetals Business in the second quarter and first six months of fiscal 2009 decreased by \$8 million when compared to the same periods of fiscal 2008. For both periods, the impact of lower volumes (\$14 million in the second quarter and \$21 million in the first six months) more than offset the favorable effect of higher prices and a favorable product mix (\$5 million in the second quarter and \$11 million in the first six months) and lower operating expenses. Despite recording negative PBT, the Supermetals Business generated \$8 million and \$20 million in cash during the second quarter and first six months of fiscal 2009, respectively, on a constant currency basis, principally from a reduction in working capital.

During the quarter we announced our intention to suspend tantalum mining and processing activities at our operations in Manitoba, Canada. These actions are in response to the global market conditions for tantalum and to reduce fixed costs in the Supermetals Business. Even with these suspended operations, we have sufficient sources and supplies of raw material to meet our needs.

Table of Contents**Performance Segment**

Sales and PBT for the Performance Segment for the second quarter and first six months of fiscal 2009 and 2008 are as follows:

	Three months ended		Six months ended	
	March 31		March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Performance Products Business Sales	\$ 90	\$ 164	\$ 195	\$ 305
Fumed Metal Oxides Business Sales	42	72	94	142
Segment Sales	\$ 132	\$ 236	\$ 289	\$ 447
Segment PBT	\$ (1)	\$ 32	\$ 2	\$ 63

Sales in the Performance Segment decreased by \$104 million in the second quarter of fiscal 2009 when compared to the second quarter of fiscal 2008. The decrease was driven principally by lower volumes (\$90 million) from ongoing global weakness in the automotive, construction and electronics industries, the unfavorable impact of foreign currency translation (\$10 million) and lower prices (\$4 million). For the first six months of fiscal 2009, the \$158 million decrease in sales when compared to the same period of fiscal 2008 was due principally to lower volumes (\$207 million) from weakness in our key end markets and the unfavorable impact of foreign currency translation (\$15 million), partially offset by higher pricing (\$58 million).

PBT in the Performance Segment in the second quarter of fiscal 2009 was \$33 million lower when compared to the second quarter of fiscal 2008. Volumes in the Performance Products and Fumed Metal Oxides Businesses decreased by 36% and 44% in the second quarter of fiscal 2009, respectively, when compared to the same period of fiscal 2008. These lower volumes from ongoing weakness in the global automotive, construction and electronics markets unfavorably affected PBT by \$45 million. Older, higher cost inventories compressed unit margins in the Performance Products Business during the quarter, negatively affecting PBT by \$11 million. These unfavorable factors more than offset a \$6 million LIFO benefit, lower operating expenses from cost reduction efforts and the favorable impact of foreign currency translation. For the first six months of fiscal 2009, PBT decreased by \$61 million. The decrease was driven by lower volumes from weakness in our key end markets (\$82 million) partially offset by higher pricing (\$19 million).

New Business Segment

Sales and PBT for the New Business Segment for the second quarter and first six months of fiscal 2009 and 2008 are as follows:

	Three months ended		Six months ended	
	March 31		March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Inkjet Colorants Business Sales	\$ 9	\$ 11	\$ 22	\$ 19
Aerogel Business Sales	5	2	9	3
Superior MicroPowders Sales	2	1	3	2
Segment Sales	\$ 16	\$ 14	\$ 34	\$ 24
Segment PBT	\$ (1)	\$ (9)	\$ (4)	\$ (21)

Sales in the New Business Segment increased by \$2 million and \$10 million in the second quarter and first six months of fiscal 2009, respectively, when compared to the same periods of fiscal 2008. In the second quarter of fiscal 2009, the improvement in revenues was driven by increased orders in the Aerogel Business and higher commercial revenue in Superior MicroPowders, which partially offset declines in Inkjet Colorants volumes from weakness in the consumer electronics industry. For the first six months of fiscal 2009, the improved sales performance came from all businesses within the segment.

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The loss in the New Business Segment for the second quarter of fiscal 2009 was \$1 million, which is an \$8 million improvement from the second quarter of fiscal 2008. For the first six months of fiscal 2009, the improvement in performance was \$17 million over the first six months of fiscal 2008. The improvement was driven by increased sales as well as lower expenses and the improved efficiency of our business development process.

Table of Contents***Specialty Fluids Segment***

Sales and PBT for the Specialty Fluids Segment for the second quarter and first six months of fiscal 2009 and 2008 are as follows:

	Three months ended March 31		Six months ended March 31	
	2009	2008	2009	2008
	(Dollars in millions)			
Segment Sales	\$ 11	\$ 16	\$ 26	\$ 32
Segment PBT	\$ 4	\$ 5	\$ 8	\$ 12

Sales in the Specialty Fluids Segment decreased by \$5 million in the second quarter and by \$6 million in the first six months of fiscal 2009 when compared to the same periods of fiscal 2008. These decreases were due to a slowdown in drilling activity in the North Sea that was not offset by revenues from other regions.

In the second quarter and first six months of fiscal 2009 PBT decreased by \$1 million and \$4 million, respectively, compared to the second quarter and first six months of fiscal 2008. Lower drilling activity in the North Sea, affecting both rental revenue and volume of fluid sold, more than offset revenues from regions outside the North Sea and lower operating costs. For the first six months of fiscal 2009, the percentage of revenue from drilling activity outside of the North Sea increased when compared to the first six months of fiscal 2008.

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III. Cash Flow and Liquidity

Overview

Our liquidity position improved during the quarter and first six months of fiscal 2009 primarily driven by decreasing carbon black feedstock costs which resulted in reduced working capital requirements. At March 31, 2009, we had cash and cash equivalents of \$220 million, and current availability under our revolving and other credit facilities of approximately \$170 million. While the availability of our credit facilities is dependent upon the financial viability of our lenders, we have no reason to believe that such liquidity will be unavailable or decreased. Our revolving credit facility contains financial covenants relating to our debt to total capitalization ratio and the level of subsidiary debt. At March 31, 2009 we were in compliance with these covenants and expect to remain so. All available cash is on deposit with banking institutions or money market funds that we continue to believe are financially sound.

We expect cash on hand, cash from operations and present financing arrangements, including our unused lines of credit, to be sufficient to meet our cash requirements for the foreseeable future. This includes our anticipated debt repayments, capital expenditures and cash restructuring costs to be made during the next twelve months.

Cash Flows from Operating Activities

Cash generated by operating activities, which consists of net (loss) income adjusted for the various non-cash items included in earnings, changes in working capital and changes in certain other balance sheet accounts, totaled \$287 million in the first six months of fiscal 2009 compared to a use of cash from operating activities of \$10 million during the first six months of fiscal 2008. The principal drivers of the cash generated from operations in the first six months of fiscal 2009 were a \$238 million decrease in receivables due to lower pricing as a result of lower carbon black feedstock costs, lower sales volumes, receivables collections and a \$163 million decrease in inventories due to reductions in inventory levels and declines in carbon black feedstock costs. These sources of cash were partially offset by the use of cash for accounts payable and accrued liabilities due to the timing of certain payments. In the first six months of fiscal 2008 there was a \$30 million and a \$39 million increase in receivables and inventories, respectively, principally due to rising carbon black feedstock costs. These uses of cash were partially offset by stronger net income from operations in that period.

Restructurings

A significant portion of the restructuring charges we have or will incur are non-cash in nature. Specifically, of the anticipated \$140 million charge for the 2009 Global Restructuring, only \$80 million is expected to require a cash outlay. As of March 31, 2009, we had \$26 million of total restructuring costs in accrued liabilities in the consolidated balance sheet related to the fiscal 2009 global restructuring plan and our 2008 global restructuring plan. We have made cash payments of \$11 million during fiscal 2009 related to restructuring costs. We expect to make additional cash payments related to these restructuring activities of \$31 million during the remainder of fiscal 2009 and \$45 million in 2010 and thereafter.

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Repatriation of Foreign Currency

Beginning in fiscal 2007, we began repatriating portions of our cash balance in Venezuela denominated in Bolivars. During the first six months of fiscal 2009, we recognized a foreign exchange loss as a result of this repatriation. As of March 31, 2009, we had cash denominated in Bolivars of approximately \$10 million in Venezuela, which has been translated at the official exchange rate. We continue to be concerned about the amount that we will be able to receive when we repatriate some or all of this cash as we have not received approval to exchange the Bolivars at the official rate. If we are unable to repatriate this cash at the official exchange rate or if the official exchange rate devalues, we may incur additional reductions to our earnings and translated cash balances would be reduced.

Environmental and Litigation

We have recorded a \$7 million reserve on a discounted basis (\$9 million on an undiscounted basis) as of March 31, 2009, for environmental remediation costs at various sites. These sites are primarily associated with businesses divested in prior years. Additionally, as of March 31, 2009, we have recorded a \$13 million reserve on a discounted basis (approximately \$23 million on an undiscounted basis) for respirator claims. We anticipate that these expenditures will be made over a number of years, and will not be concentrated in any one year. We also have other litigation costs associated with lawsuits arising in the ordinary course of business including claims filed against us in connection with certain discontinued operations.

Cash Flows from Investing Activities

Cash flows from investing activities consumed \$60 million of cash in the first six months of fiscal 2009 compared to \$57 million in the first six months of fiscal 2008. During the first six months of fiscal 2009, capital expenditures of \$56 million included residual spending to complete rubber blacks capacity expansion at an existing facility in China and energy centers at other rubber blacks facilities and an investment of \$3 million in a carbon black joint venture located in China. In fiscal 2008 capital expenditures of \$72 million were partially offset by the proceeds of \$18 million received from the sale of the land on which our Altona, Australia carbon black plant was located.

Cash Flows from Financing Activities

Financing activities used \$127 million of cash during the first six months of fiscal 2009 compared to \$14 million of cash provided during the same period of fiscal 2008. In the first six months of fiscal 2009 financing cash flows were primarily driven by the net reduction in debt of \$101 million and dividend payments of \$24 million to stockholders. In the first six months of fiscal 2008, we drew down a net \$30 million from our uncommitted working capital facilities in China, and \$40 million from a revolving credit facility in North America. These sources of cash were partially offset by dividend payments of \$23 million to stockholders and open market repurchases of common stock for \$24 million.

Table of Contents**Contractual Obligations****Purchase Commitments**

We have 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 we pay changes as market prices change. The commitments in the table below are quantified on the basis of market prices at March 31, 2009.

	Remainder of fiscal 2009	Payments Due by Fiscal Year					Total
		2010	2011	2012	2013	Thereafter	
(Dollars in millions)							
Core Segment							
Rubber Blacks Business	\$ 74	\$ 171	\$ 148	\$ 129	\$ 122	\$ 932	\$ 1,576
Supermetal Business	16	15	16	17	6	1	71
Performance Segment	32	24	15	15	15	128	229
Total	\$ 122	\$ 210	\$ 179	\$ 161	\$ 143	\$ 1,061	\$ 1,876

Off-balance sheet arrangements

Cabot has no material transactions that meet the definition of an off-balance sheet arrangement.

Forward-Looking Information

This report on Form 10-Q contains forward-looking statements under the Federal securities laws. These forward-looking statements address expectations or projections about the future, including our expectations concerning the amount and timing of the charge to earnings we will record and the cash outlays we will make in connection with, and the annualized fixed cost savings we expect to realize from, our recent restructuring initiative; the adequacy of our sources and supply of tantalum ore for the near term; our expected tax rate for fiscal 2009; the amount and timing of charges and payments associated with restructurings and cost reduction initiatives we have previously undertaken; the expected impact of our derivative instruments on our consolidated statement of operations; the amount and timing of payments associated with environmental remediation and respirator claims; the outcome of pending litigation; capital expenditures for fiscal 2009; cash requirements and uses of available cash; our ability to remain in compliance with the financial covenants in our revolving credit facility; and our ability to meet cash requirements for the foreseeable future.

Forward-looking statements are based on our current expectations, assumptions, estimates and projections about Cabot's businesses and strategies, market trends and conditions, economic conditions and other factors. These statements are not guarantees of future performance and are subject to risks, uncertainties, potentially inaccurate assumptions, and other factors, some of which are beyond our control or difficult to predict. If known or unknown risks materialize, or should underlying assumptions prove inaccurate, our actual results could differ materially from those expressed in the forward-looking statements.

In addition to factors described elsewhere in this report, the following are some of the factors that could cause our actual results to differ materially from those expressed in the forward-looking statements: changes in raw material costs; lower than expected demand for our products; fluctuations in currency exchange rates; patent rights of others; stock and credit market conditions; the timely commercialization of products under development (which may be disrupted or delayed by technical difficulties, market acceptance, competitors' new products, as well as difficulties in moving from the experimental stage to the production stage); our ability to successfully implement our cost reduction initiatives and organizational restructurings; demand for our customers' products; competitors' reactions to market conditions; the accuracy of the assumptions we used in establishing a reserve for our share of liability for respirator claims; and the outcome of pending litigation. Other factors and risks are discussed in our 2008 10-K.

We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. Investors are advised, however, to consult any further disclosures we make on related subjects in future 10-K, 10-Q

and 8-K reports filed with the Securities and Exchange Commission.

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IV. Recently Issued Accounting Pronouncements Not Yet Adopted

In December 2007, the FASB issued FAS No. 141 (Revised 2007), *Business Combinations* (FAS 141(R)). FAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of business combinations. FAS 141(R) is effective on a prospective basis for financial statements issued for fiscal years beginning after December 15, 2008. Accordingly, any business combination we enter into after September 30, 2009 will be subject to this new standard.

In December 2007, the FASB issued FAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51* (FAS 160). FAS 160 establishes accounting and reporting standards for the ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in the parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. FAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. FAS 160 will be effective for us for the first quarter of fiscal 2010, beginning October 1, 2009. We are evaluating the impact of FAS 160 on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Information about market risks for the period ended March 31, 2009 does not differ materially from that discussed under Item 7A of our fiscal 2008 Annual Report on Form 10-K.

Item 4. Controls and Procedures

As of March 31, 2009, we carried out an evaluation, under the supervision and with the participation of our management, including our President and Chief Executive Officer and our Executive Vice President and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based upon that evaluation, our President and Chief Executive Officer and our Executive Vice President and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of that date.

There were no changes in our internal control over financial reporting that occurred during our fiscal quarter ended March 31, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents***Part II. Other Information******Item 1. Legal Proceedings******Respirator Liabilities***

We have 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 our 2008 10-K, our respirator liabilities involve claims for personal injury, including asbestosis, silicosis and coal worker s pneumoconiosis, allegedly resulting from the use of AO respirators that are alleged to have been negligently designed or labeled. As of March 31, 2009, there were approximately 54,000 claimants in pending cases asserting claims against AO in connection with respiratory products. We have a reserve to cover our expected share of liability for existing and future respirator liability claims. The book value of the reserve at March 31, 2009 is approximately \$13 million on a discounted basis (or approximately \$23 million on an undiscounted basis).

AVX

On March 8, 2004, AVX Corporation (AVX) filed an action against the Company in the United States District Court for the District of Massachusetts. The complaint alleges that Cabot violated the federal antitrust laws in connection with the parties January 1, 2001 tantalum supply agreement (the Supply Agreement) by purportedly tying AVX s purchases of Cabot s flake tantalum powder to its purchases of Cabot s nodular tantalum powder. In February 2009, the court granted the Company s motion for summary judgment and dismissed the case against Cabot. AVX has appealed the court s order.

In September 2005, AVX filed an action in the Superior Court of Massachusetts for Suffolk County, which, in November 2005, was moved to the Business Litigation Section of the Superior Court of Massachusetts. The action alleges that Cabot improperly administered the parties Supply Agreement for the years 2003 through 2005. In particular, AVX claims that we have not provided all of the price relief due to AVX under the most favored customer (MFC) provisions of the Supply Agreement. AVX seeks a judicial declaration of the rights of the parties to the Supply Agreement, an accounting of monies paid, due or owing under the MFC provisions, and an award of any sums not paid that should have been. We filed an answer and counterclaims against AVX asserting that AVX actually underpaid for tantalum products in the period 2003 through 2005. On December 31, 2007, the court issued an order allowing AVX s motion for partial summary judgment on one significant legal issue involving interpretation of the Supply Agreement, but denied AVX s motion and our cross-motion in all other respects, including AVX s motion to dismiss Cabot s affirmative defenses that would negate AVX s claims. Prior to July 2008, AVX had indicated that it believed it is owed additional MFC benefits of approximately \$24 million, which we dispute. In July 2008, AVX attempted to assert new legal theories that increased its damage claim for additional MFC benefits to approximately \$96 million. We subsequently filed a motion to strike AVX s revised claim for MFC benefits and in November 2008, the court granted our motion and denied AVX s additional damage claim for MFC benefits of \$72 million, thereby, we believe, limiting AVX s claim to the previously stated \$24 million. AVX subsequently filed a motion requesting the court to reconsider or clarify this ruling, which was denied in its entirety. Despite this ruling, AVX has most recently filed a new damage report seeking damages in excess of \$24 million. We have filed a new motion to strike this report based on the court s prior ruling. This motion has not yet been decided. In March 2009, the court established a trial date of October 16, 2009 for this matter.

We believe that we have valid defenses to all of AVX s claims, including the one on which partial summary judgment was granted, and will continue to assert these defenses and our counterclaims vigorously. In addition, if necessary, we have the right to appeal the court s order allowing AVX s motion for partial summary judgment.

Carbon Black Antitrust Litigation

Cabot was one of several carbon black manufacturer defendants in federal and state class actions initially filed in 2003 alleging that the defendants violated federal and state antitrust laws in connection with the sale of carbon black. As of March 31, 2009, the only pending state action was in Florida, with all of the other federal and state class actions having been previously settled. In November 2008, the parties in the Florida action entered into a settlement agreement for less than \$1 million in total, which received the required preliminary court approval. In February 2009, the court declined to grant final approval of the settlement and vacated the settlement on several grounds. The parties are now seeking to negotiate a modified settlement that will address the court s concerns. Any new settlement will require the court s approval. We deny any wrongdoing of any kind in these cases and strongly believe we have good defenses to the claims, but agreed to the settlements to avoid

further expense, inconvenience, risk and the distraction of burdensome and protracted litigation.

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Other Matters

We have various other lawsuits, claims and contingent liabilities arising in the ordinary course of our business, including a number of claims asserting premises liability for asbestos exposure, and in respect of our divested businesses. In our opinion, although final disposition of some or all of these other suits and claims may impact our financial statements in a particular period, they should not, in the aggregate, have a material adverse effect on our consolidated financial position.

Item 1A. Risk Factors

There have been no material changes from the risk factors disclosed in the Risk Factors section of our Annual Report on Form 10-K for the year ended September 30, 2008.

Table of Contents**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The table below sets forth information regarding the Company's purchases of its equity securities during the quarter ended March 31, 2009.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
January 1, 2009 - January 31, 2009	11,100	\$ 11.13		4,311,557
February 1, 2009 - February 28, 2009	86,300	\$ 11.07		4,311,557
March 1, 2009 - March 31, 2009	17,800	\$ 11.30		4,311,557
Total	115,200			

(1) On May 11, 2007, we announced publicly that our Board of Directors authorized us to repurchase five million shares of our common stock in the open market or in privately negotiated transactions. On September 14, 2007, our Board of Directors increased the share repurchase authorization to 10 million shares. This authority does not have a set expiration date.

Included in the shares repurchased from time to time by Cabot under the Board's authorization are shares of common stock repurchased from employees at fair market value to satisfy tax withholding obligations that arise on the vesting of shares of restricted stock and the exercise of stock options. During the second quarter of fiscal 2009, no shares were repurchased from employees to satisfy tax withholding obligations.

From time to time, we also repurchase shares of unvested restricted stock from employees whose employment is terminated before such shares vest. These shares are repurchased pursuant to the terms of our equity incentive plans and are not included in the shares repurchased under the Board's authorization. During the second quarter of fiscal 2009, we repurchased 115,200 forfeited shares pursuant to the terms of our equity incentive plans. The purchase price for these repurchased shares was the lower of the fair market value on the date of termination and the employee's original purchase price for the stock.

Table of Contents**Item 4. Submission of Matters to a Vote of Security Holders**

We held our Annual Meeting of Stockholders on March 12, 2009. There was no solicitation in opposition to management's nominees as listed in our proxy statement and all such nominees were elected to the class of directors whose term expires in 2012. In addition, the stockholders ratified the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending September 30, 2009 and approved the 2009 Long-Term Incentive Plan. The proposals for the election of directors and to ratify the appointment of Deloitte & Touche were routine matters and, therefore, there were no broker non-votes relating to those matters. The results of the voting for each of these proposals were as follows:

1. *Election of Directors Whose Terms Expire in 2012:*

	FOR	AGAINST	ABSTAIN
John K. McGillicuddy	58,334,020	1,892,959	158,639
John F. O'Brien	57,387,222	2,874,766	123,630
Lydia W. Thomas	57,157,967	3,091,642	136,009
Mark S. Wrighton	50,403,003	9,833,785	148,830

2. *Proposal to Ratify the Appointment of Deloitte & Touche LLP*

For:	60,134,618
Against:	173,930
Abstain:	77,070

3. *Proposal to Approve Cabot's 2009 Long-Term Incentive Plan*

For:	40,088,127
Against:	15,914,006
Abstain:	203,730
Brokers Non-Votes:	4,179,755

In addition to the directors elected at the meeting to the class of directors whose term expires in 2012, the terms of office of the following directors continued after the meeting: John S. Clarkeson, Juan Enriquez-Cabot, Arthur L. Goldstein, Gautam S. Kaji, Roderick C.G. MacLeod, Henry F. McCance, Patrick M. Prevost, Ronaldo H. Schmitz and Shengman Zhang.

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Item 6. Exhibits

The following Exhibits are filed herewith:

Exhibit 10.1*	Cabot Corporation 2009 Long-Term Incentive Plan (incorporated herein by reference to Appendix B of Cabot Corporation's Proxy Statement on Schedule 14A relating to the 2009 Annual Meeting of Stockholders, File No. 1-5667, filed with the Commission on January 28, 2009).
Exhibit 31.1	Certification of Principal Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act.
Exhibit 31.2	Certification of Principal Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act.
Exhibit 32	Certifications of the Principal Executive Officer and the Principal Financial Officer pursuant to 18 U.S.C. Section 1350.

* Management contract or compensatory plan or arrangement.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CABOT CORPORATION

Date: May 11, 2009

By: /s/ EDUARDO E. CORDEIRO
Eduardo E. Cordeiro
Executive Vice President and Chief Financial Officer

(Duly Authorized Officer)

Date: May 11, 2009

By: /s/ JAMES P. KELLY
James P. Kelly
Vice President and Controller

(Chief Accounting Officer)

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Exhibit Index

Exhibit No.	Description
Exhibit 10.1*	Cabot Corporation 2009 Long-Term Incentive Plan (incorporated herein by reference to Appendix B of Cabot Corporation's Proxy Statement on Schedule 14A relating to the 2009 Annual Meeting of Stockholders, File No. 1-5667, filed with the Commission on January 28, 2009.
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