

KEMET CORP
Form 10-Q
October 29, 2010
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

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

Commission File Number: 0-20289

KEMET CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE

57-0923789

Edgar Filing: KEMET CORP - Form 10-Q

(State or other jurisdiction of incorporation or organization)

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

2835 KEMET WAY, SIMPSONVILLE, SOUTH CAROLINA 29681

(Address of principal executive offices, zip code)

(864) 963-6300

(Registrant's telephone number, including area code)

Former name, former address and former fiscal year, if changed since last report: **N/A**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☒ NO ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ☐ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐
(Do not check if a smaller reporting company)

Smaller reporting company ☐

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

The number of shares outstanding of the registrant's common stock, par value \$0.01 per share, as of October 28, 2010 was 81,275,009.

Table of Contents

KEMET CORPORATION AND SUBSIDIARIES

Form 10-Q for the Quarter Ended September 30, 2010

INDEX

	Page
<u>PART I FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets at September 30, 2010 and March 31, 2010</u>	2
<u>Condensed Consolidated Statements of Operations for the Quarters and Six Months Ended September 30, 2010 and September 30, 2009</u>	3
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended September 30, 2010 and September 30, 2009</u>	4
<u>Notes to the Condensed Consolidated Financial Statements</u>	5
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	30
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	50
<u>Item 4. Controls and Procedures</u>	50
<u>PART II OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	50
<u>Item 1A. Risk Factors</u>	50
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	50
<u>Item 3. Defaults Upon Senior Securities</u>	50
<u>Item 4. [Removed and Reserved]</u>	50
<u>Item 5. Other Information</u>	50
<u>Item 6. Exhibits</u>	51
Exhibit 10.1	
Exhibit 31.1	
Exhibit 31.2	
Exhibit 32.1	
Exhibit 32.2	
Exhibit 101	

[Table of Contents](#)**PART I - FINANCIAL INFORMATION****Item 1 - Financial Statements****KEMET CORPORATION AND SUBSIDIARIES****Condensed Consolidated Balance Sheets**

(Amounts in thousands, except per share data)

	September 30, 2010 (Unaudited)	March 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 117,454	\$ 79,199
Accounts receivable, net	154,289	141,795
Inventories, net	183,676	150,508
Prepaid expenses and other	10,749	14,380
Deferred income taxes	3,735	2,129
Total current assets	469,903	388,011
Property and equipment, net of accumulated depreciation of \$708,494 and \$686,958 as of September 30, 2010 and March 31, 2010, respectively	307,684	319,878
Intangible assets, net	20,501	21,806
Other assets	10,513	11,266
Total assets	\$ 808,601	\$ 740,961
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 5,457	\$ 17,880
Accounts payable, trade	82,032	78,829
Accrued expenses	77,608	63,606
Income taxes payable	1,818	1,096
Total current liabilities	166,915	161,411
Long-term debt, less current portion	268,825	231,629
Other non-current obligations	58,874	55,626
Deferred income taxes	9,282	8,023
Stockholders' equity:		
Common stock, par value \$0.01, authorized 300,000 shares, issued 88,525 shares at September 30, 2010 and March 31, 2010	885	885
Additional paid-in capital	478,518	479,115
Retained deficit	(135,967)	(150,789)
Accumulated other comprehensive income	17,120	11,990
Treasury stock, at cost (7,250 and 7,390 shares at September 30, 2010 and March 31, 2010, respectively)	(55,851)	(56,929)
Total stockholders' equity	304,705	284,272
Total liabilities and stockholders' equity	\$ 808,601	\$ 740,961

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents**KEMET CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Operations**

(Amounts in thousands, except per share data)

(Unaudited)

	Quarters Ended September 30,		Six months ended September 30,	
	2010	2009	2010	2009
Net sales	\$ 248,588	\$ 173,265	\$ 492,382	\$ 323,432
Operating costs and expenses:				
Cost of sales	178,870	148,751	361,756	278,412
Selling, general and administrative expenses	24,999	20,513	49,214	38,535
Research and development	6,224	5,569	12,255	10,348
Restructuring charges	2,303	1,267	4,095	1,267
Net (gain) loss on sales and disposals of assets	(1,770)	52	(1,435)	258
Total operating costs and expenses	210,626	176,152	425,885	328,820
Operating income (loss)	37,962	(2,887)	66,497	(5,388)
Other (income) expense:				
Interest income	(84)	(102)	(105)	(133)
Interest expense	7,334	6,491	14,792	12,310
Increase in value of warrant		81,088		81,088
(Gain) loss on early extinguishment of debt			38,248	(38,921)
Other (income) expense, net	(4,792)	999	(3,118)	5,511
Income (loss) before income taxes	35,504	(91,363)	16,680	(65,243)
Income tax expense	593	1,712	1,868	2,742
Net income (loss)	\$ 34,911	\$ (93,075)	\$ 14,812	\$ (67,985)
Net income (loss) per share:				
Basic	\$ 0.43	\$ (1.15)	\$ 0.18	\$ (0.84)
Diluted	\$ 0.23	\$ (1.15)	\$ 0.10	\$ (0.84)

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents**KEMET CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows****(Amounts in thousands)****(Unaudited)**

	Six Months Ended September 30,	
	2010	2009
Sources (uses) of cash and cash equivalents		
Operating activities:		
Net income (loss)	\$ 14,812	\$ (67,985)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
(Gain) loss on early extinguishment of debt	38,248	(38,921)
Increase in value of warrant		81,088
Depreciation and amortization	28,642	25,490
Amortization of debt discount and debt issuance costs	2,754	5,883
Net (gain) loss on sales and disposals of assets	(1,435)	258
Stock-based compensation expense	482	1,628
Change in deferred income taxes	(418)	(13)
Change in operating assets	(39,109)	11,563
Change in operating liabilities	14,376	2,111
Other	(1,907)	(346)
Net cash provided by operating activities	56,445	20,756
Investing activities:		
Capital expenditures	(13,821)	(3,730)
Proceeds from sales of assets	5,425	
Net cash used in investing activities	(8,396)	(3,730)
Financing activities:		
Proceeds from issuance of debt	227,434	57,786
Payments of long-term debt	(228,543)	(47,719)
Net payments under other credit facilities	(1,779)	(1,346)
Debt issuance costs	(7,461)	(4,206)
Debt extinguishment costs	(207)	(3,605)
Net cash provided by (used in) financing activities	(10,556)	910
Net increase in cash and cash equivalents	37,493	17,936
Effect of foreign currency fluctuations on cash	762	272
Cash and cash equivalents at beginning of fiscal period	79,199	39,204
Cash and cash equivalents at end of fiscal period	\$ 117,454	\$ 57,412

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents

Notes to Condensed Consolidated Financial Statements

Note 1. Basis of Financial Statement Presentation

The condensed consolidated financial statements contained herein are unaudited and have been prepared from the books and records of KEMET Corporation and its subsidiaries (KEMET or the Company). In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for the interim periods. The condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q, and therefore, do not include all information and footnotes necessary for a complete presentation of financial position, results of operations, and cash flows in conformity with U.S. generally accepted accounting principles (U.S. GAAP). Although the Company believes that the disclosures are adequate to make the information presented not misleading, it is suggested that these condensed consolidated financial statements be read in conjunction with the audited financial statements and notes thereto included in the Company s fiscal year ended March 31, 2010, Form 10-K (the Company s 2010 Annual Report) and the Company s Current Report on Form 8-K, filed with the SEC on October 26, 2010, to add Note 19, Condensed Consolidating Financial Statements .

Net sales and operating results for the three and six month periods ended September 30, 2010 are not necessarily indicative of the results to be expected for the full year. The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. In consolidation, all significant intercompany amounts and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to current year presentation.

The significant accounting policies followed by the Company are presented in the Company s 2010 Annual Report.

Recently Issued Accounting Pronouncements

New accounting standards adopted

There were no accounting standards adopted in the six month period ended September 30, 2010.

New accounting standards issued but not yet adopted

There are currently no new accounting standards that have been issued that will have a significant impact on the Company s financial position, results of operations or cash flows upon adoption.

Asset Sales

During the second quarter of fiscal year 2011, Ceramics (as hereinafter defined) sold a building and related equipment for net proceeds of \$3.4 million which resulted in a net gain of \$1.6 million which is recognized as a component of the line item Net (gain) loss on sales and disposals of assets on the Condensed Consolidated Statements of Operations.

Restricted Cash

A guarantee was issued by a European bank on behalf of the Company in August 2006 in conjunction with the establishment of a Valued-Added Tax (VAT) registration in The Netherlands. The bank guarantee is in the amount of EUR 1.5 million (\$2.0 million). An interest-bearing deposit was placed with a European bank for EUR 1.7 million (\$2.3 million). The deposit is in KEMET's name, and KEMET receives all interest earned by this deposit. However, the deposit is pledged to the European bank, and the bank can use the money if a valid claim is made. The bank guarantee has no expiration date.

Restricted cash of \$2.3 million and \$2.2 million are included in the line item Prepaid expenses and other on the Condensed Consolidated Balance Sheets as of September 30, 2010 and March 31, 2010, respectively.

Warrant Liability

Concurrent with the consummation of the tender offer as discussed in Note 2, Debt , the Company issued K Financing, LLC (K Financing) a warrant (the Closing Warrant) to purchase up to 80,544,685 shares of the Company's common stock, subject to certain adjustments, representing, at the time of issuance, approximately 49.9% of the Company's outstanding common stock on a post-Closing Warrant basis. The Closing Warrant was subsequently transferred to K Equity, LLC (K Equity). The Closing Warrant was exercisable at a purchase price of \$0.50 per share, subject to an adjustment which reduces the exercise price to a floor of \$0.35 per share based on a sliding scale once the aggregate borrowings under the Platinum Line of Credit Loan (as defined in Note 2, Debt) and the Platinum Working Capital Loan exceed \$12.5 million, at any time prior to the tenth anniversary of the Closing Warrant's date

Table of Contents

of issuance. The floor exercise price was reached on September 29, 2009 when the aggregate borrowings under the Platinum Line of Credit Loan (as defined in Note 2, Debt) and the Platinum Working Capital Loan (as defined in Note 2, Debt) reached \$20.0 million. The Closing Warrant may be exercised in exchange for cash, by means of net settlement of a corresponding portion of amounts owed by the Company under the Revised Amended and Restated Platinum Credit Facility (as defined in Note 2, Debt), by cashless exercise to the extent of appreciation in the value of the Company's common stock above the exercise price of the Closing Warrant, or by any combination of the preceding alternatives.

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, depending on the terms of the specific warrant agreement. The Closing Warrant issued to K Financing under the Revised Amended and Restated Platinum Credit Facility was reviewed as of June 30, 2009, the date of issuance, to determine whether it met the definition of a derivative. The Company's evaluation of the Closing Warrant as of the date of issuance concluded that it was not indexed to the Company's stock since the strike price was not fixed and as such was treated as a freestanding derivative liability. On September 29, 2009, the Company borrowed \$10.0 million from the Platinum Working Capital Loan for general corporate purposes. As a result of this additional borrowing, the strike price of the Closing Warrant was fixed at \$0.35 per share as of September 29, 2009, and the Company assessed whether the Closing Warrant still met the definition of a derivative. The Company's evaluation of the Closing Warrant as of September 29, 2009, concluded that the Closing Warrant was indexed to the Company's own stock and should be classified as a component of equity. The Company valued the Closing Warrant immediately prior to the strike price becoming fixed and recorded a mark-to-market adjustment of \$81.1 million through earnings in the second quarter of fiscal year 2010. Subsequent to the strike price becoming fixed, the Company reclassified the warrant liability of \$112.5 million into the line item Additional paid-in capital on the Condensed Consolidated Balance Sheets and the Closing Warrant is no longer marked-to-market.

At September 30, 2009, the Company estimated the fair value of the Closing Warrant using the Black-Scholes option pricing model using the following assumptions:

Expected life	9.75 years
Expected volatility	66.0%
Risk-free interest rate	3.5%
Dividends	0%

Fair Value Measurement

The Company utilizes three levels of inputs to measure the fair value of (a) nonfinancial assets and liabilities that are recognized or disclosed at fair value in the Company's consolidated financial statements on a recurring basis (at least annually) and (b) all financial assets and liabilities. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs.

The first two inputs are considered observable and the last is considered unobservable. The levels of inputs are as follows:

- Level 1 Quoted prices in active markets for identical assets or liabilities.

Edgar Filing: KEMET CORP - Form 10-Q

- Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Edgar Filing: KEMET CORP - Form 10-Q

Table of Contents

Assets measured at fair value on a recurring basis as of September 30, 2010 and March 31, 2010 are as follows (amounts in thousands):

	Fair Value September 30, 2010	Fair Value Measurement Using			Fair Value March 31, 2010	Fair Value Measurement Using		
		Level 1	Level 2 (2)(3)	Level 3		Level 1	Level 2 (4)	Level 3
Assets:								
Money markets (1)	\$ 22,283	\$ 22,283	\$	\$	\$ 28,761	\$ 28,761	\$	\$
Long-term debt	284,690		284,690		260,496	70,492	190,004	

- (1) Included in the line item Cash and cash equivalents on the Condensed Consolidated Balance Sheets.
- (2) For the 10.5% Senior Notes and the Convertible Notes the Company utilized a bid quote to quantify the fair value. For the other debt a discounted cash flow valuation approach was used to calculate fair value.
- (3) The Convertible Notes moved from a Level 1 to a Level 2 this quarter as there was a lack of trading activity so quoted market prices were not available.
- (4) The valuation approach used to calculate fair value was a discounted cash flow for each respective debt facility.

Revenue Recognition

The Company recognizes revenue only when all of the following criteria are met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the seller's price to the buyer is fixed or determinable, and (4) collectibility is reasonably assured.

A portion of sales is related to products designed to meet customer specific requirements. These products typically have stricter tolerances making them useful to the specific customer requesting the product and to customers with similar or less stringent requirements. Products with customer specific requirements are tested and approved by the customer before the Company mass produces and ships the product. The Company recognizes revenue at shipment as the sales terms for products produced with customer specific requirements do not contain a final customer acceptance provision or other provisions that are unique and would otherwise allow the customer different acceptance rights.

A portion of sales is made to distributors under agreements allowing certain rights of return and price protection on unsold merchandise held by distributors. The Company's distributor policy includes inventory price protection and ship-from-stock and debit (SFSD) programs common in the industry.

The SFSD program provides a mechanism for the distributor to meet a competitive price after obtaining authorization from the Company's local sales office. This program allows the distributor to ship its higher-priced inventory and debit the Company for the difference between KEMET's list price and the lower authorized price for that specific transaction. Management analyzes historical SFSD activity to determine the SFSD

Edgar Filing: KEMET CORP - Form 10-Q

exposure on the global distributor inventory at the balance sheet date. The establishment of these reserves is recognized as a component of the line item Net sales on the Condensed Consolidated Statements of Operations, while the associated reserves are included in the line item Accounts receivable, net on the Condensed Consolidated Balance Sheets.

The Company provides a limited warranty to customers that the Company's products meet certain specifications. The warranty period is generally limited to one year, and the Company's liability under the warranty is generally limited to a replacement of the product or refund of the purchase price of the product. Warranty costs as a percentage of net sales were approximately 1% for the quarters and six month periods ended September 30, 2010 and 2009. The Company recognizes warranty costs when they are both probable and reasonably estimable.

Use of Estimates and Assumptions

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, assumptions, and judgments. Estimates and assumptions are based on historical data and other assumptions that management believes are reasonable. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period.

Table of Contents

The Company's judgments are based on management's assessment as to the effect certain estimates, assumptions, or future trends or events may have on the financial condition and results of operations reported in the unaudited condensed consolidated financial statements. It is important that readers of these unaudited financial statements understand that actual results could differ from these estimates, assumptions, and judgments.

Inventories

Inventories are stated at the lower of cost or market. The components of inventories are as follows (amounts in thousands):

	September 30, 2010	March 31, 2010
Inventories:		
Raw materials and supplies	\$ 81,399	\$ 67,511
Work in process	71,152	61,754
Finished goods	52,747	40,099
	205,298	169,364
Inventory reserves	(21,622)	(18,856)
Total inventory	\$ 183,676	\$ 150,508

Land purchase

On April 28, 2010, the Company purchased land in Italy to be used as the site for a new manufacturing facility in order to consolidate our Italian operations. In the first quarter of fiscal year 2011, the Company paid EUR 2.1 million (\$2.9 million) which was included in the line item "Capital expenditures" on the Condensed Consolidated Statements of Cash Flows. The remaining purchase price will be paid in seven equal annual payments of EUR 489 thousand (\$667 thousand) beginning on April 28, 2013.

Note 2. Debt

A summary of debt is as follows (amounts in thousands):

	September 30, 2010	March 31, 2010
10.5% Senior Notes, net of discount of \$2,983 as of September 30, 2010	\$ 227,079	\$
Convertible Debt, net of discount of \$3,343 and \$7,861 as of September 30, 2010 and March 31, 2010, respectively	37,829	73,220
UniCredit Agreement-A (\$3,201 as of March 31, 2010)		71,710
UniCredit Agreement-B (\$3,000 as of March 31, 2010)		44,481
Platinum Term Loan, net of discount of \$22,308 as of March 31, 2010		15,525
		5,944

Edgar Filing: KEMET CORP - Form 10-Q

Platinum Line of Credit Loan, net of discount of \$4,056 as of March 31, 2010

Platinum Working Capital Loan		10,000
Vishay		15,000
Other	9,374	13,629
Total debt	274,282	249,509
Current maturities	(5,457)	(17,880)
Total long-term debt	\$ 268,825	\$ 231,629

The line item Interest expense on the Condensed Consolidated Statements of Operations for the quarters and six month periods ended September 30, 2010 and 2009, is as follows (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Contractual interest expense	\$ 6,504	\$ 3,172	\$ 12,038	\$ 6,427
Amortization of debt issuance costs	177	694	606	994
Amortization of debt discount	653	2,625	2,148	4,889
Total interest expense	\$ 7,334	\$ 6,491	\$ 14,792	\$ 12,310

Table of Contents

10.5% Senior Notes

On May 5, 2010, the Company completed a private placement of \$230.0 million in aggregate principal amount of the Company's 10.5% Senior Notes due 2018 (the "10.5% Senior Notes") to several initial purchasers (the "Initial Purchasers") represented by Banc of America Securities LLC pursuant to an exemption from the registration requirements under the Securities Act of 1933, as amended (the "Securities Act"). The Initial Purchasers subsequently sold the 10.5% Senior Notes to qualified institutional buyers pursuant to Rule 144A under the Securities Act and to persons outside of the United States pursuant to Regulation S under the Securities Act.

On May 5, 2010, in connection with the private placement of the 10.5% Senior Notes, the Company, the Company's domestic restricted subsidiaries (the "Guarantors") and the Initial Purchasers entered into the Registration Rights Agreement. The terms of the Registration Rights Agreement require the Company and the Guarantors to (i) use their commercially reasonable efforts to file with the Securities and Exchange Commission within 210 days after the date of the initial issuance of the 10.5% Senior Notes, a registration statement with respect to an offer to exchange the 10.5% Senior Notes for a new issue of debt securities registered under the Securities Act, with terms substantially identical to those of the 10.5% Senior Notes (except for provisions relating to the transfer restrictions and payment of additional interest); (ii) use our commercially reasonable efforts to consummate such exchange offer within 270 days after the date of the initial issuance of the 10.5% Senior Notes; and (iii) in certain circumstances, file a shelf registration statement for the resale of the 10.5% Senior Notes. On October 26, 2010, the Company filed a Form S-4 to offer, in exchange for its outstanding 10.5% Senior Notes, up to \$230.0 million in aggregate principal amount of 10.5% Senior Notes due 2018 and the guarantees thereof which have been registered under the Securities Act of 1933, as amended.

The private placement of the 10.5% Senior Notes resulted in net proceeds to the Company of \$222.2 million. The Company used a portion of the proceeds of the private placement to repay all of its outstanding indebtedness under the Company's credit facility with K Financing, LLC, the Company's \$60 million credit facility and \$35 million credit facility with UniCredit Corporate Banking S.p.A. ("UniCredit") and the Company's term loan with Vishay Intertechnology, Inc. ("Vishay") and used a portion of the remaining proceeds to fund a previously announced tender offer to purchase \$40.5 million in aggregate principal amount of the Company's 2.25% Convertible Senior Notes (the "Convertible Notes") and to pay costs incurred in connection with the private placement, the tender offer and the foregoing repayments. Debt issuance costs related to the 10.5% Senior Notes, net of amortization, were \$6.3 million as of September 30, 2010; these costs will be amortized over the term of the 10.5% Senior Notes.

The 10.5% Senior Notes were issued pursuant to an Indenture (the "10.5% Senior Notes Indenture"), dated as of May 5, 2010, by and among the Company, Guarantors and Wilmington Trust Company, as trustee (the "Trustee"). The 10.5% Senior Notes will mature on May 1, 2018, and bear interest at a stated rate of 10.5% per annum, payable semi-annually in cash in arrears on May 1 and November 1 of each year, beginning on November 1, 2010. The 10.5% Senior Notes are senior obligations of the Company and will be guaranteed by each of the Guarantors and secured by a first priority lien on 51% of the capital stock of certain of the Company's foreign restricted subsidiaries.

The terms of the 10.5% Senior Notes Indenture will, among other things, limit the ability of the Company and its restricted subsidiaries to (i) incur additional indebtedness or issue certain preferred stock; (ii) pay dividends on, or make distributions in respect of, their capital stock or repurchase their capital stock; (iii) make certain investments or other restricted payments; (iv) sell certain assets; (v) create liens or use assets as security in other transactions; (vi) enter into sale and leaseback transactions; (vii) merge, consolidate or transfer or dispose of substantially all of their assets; (viii) engage in certain transactions with affiliates; and (ix) designate their subsidiaries as unrestricted subsidiaries. These covenants are subject to a number of important limitations and exceptions that are described in the 10.5% Senior Notes Indenture.

Edgar Filing: KEMET CORP - Form 10-Q

The 10.5% Senior Notes will be redeemable, in whole or in part, at any time on or after May 1, 2014, at the redemption prices specified in the 10.5% Senior Notes Indenture. At any time prior to May 1, 2013, the Company may redeem up to 35% of the aggregate principal amount of the 10.5% Senior Notes with the net cash proceeds from certain equity offerings at a redemption price equal to 110.5% of the principal amount thereof, together with accrued and unpaid interest, if any, to the redemption date. In addition, at any time prior to May 1, 2014, the Company may redeem the 10.5% Senior Notes, in whole or in part, at a redemption price equal to 100% of the principal amount of the 10.5% Senior Notes so redeemed, plus a make whole premium and together with accrued and unpaid interest, if any, to the redemption date.

Upon the occurrence of a change of control triggering event specified in the 10.5% Senior Notes Indenture, the Company must offer to purchase the 10.5% Senior Notes at a redemption price equal to 101% of the principal amount thereof, plus accrued and unpaid interest, if any, to the date of purchase.

The 10.5% Senior Notes Indenture provides for customary events of default (subject in certain cases to customary grace and cure periods), which include nonpayment, breach of covenants in the 10.5% Senior Notes Indenture, payment defaults or acceleration

Edgar Filing: KEMET CORP - Form 10-Q

Table of Contents

of other indebtedness, a failure to pay certain judgments and certain events of bankruptcy and insolvency. The 10.5% Senior Notes Indenture also provides for events of default with respect to the collateral, which include default in the performance of (or repudiation, disaffirmation or judgment of unenforceability or assertion of unenforceability) by the Company or a Guarantor with respect to the provision of security documents under the 10.5% Senior Notes Indenture. These events of default are subject to a number of important qualifications, limitations and exceptions that are described in the 10.5% Senior Notes Indenture. Generally, if an event of default occurs, the Trustee or holders of at least 25% in principal amount of the then outstanding 10.5% Senior Notes may declare the principal of and accrued but unpaid interest, including additional interest, on all the 10.5% Senior Notes to be due and payable.

The Company had interest payable related to the 10.5% Senior Notes included in the line item *Accrued expenses* on its Condensed Consolidated Balance Sheets of \$9.8 million at September 30, 2010.

Platinum Credit Facility

On May 5, 2009, the Company executed the Revised Amended and Restated Platinum Credit Facility with K Financing, LLC (*K Financing*), an affiliate of Platinum Equity Capital Partners II, L.P. (the *Revised Amended and Restated Platinum Credit Facility*). The Revised Amended and Restated Platinum Credit Facility consisted of a term loan of \$37.8 million (*Platinum Term Loan*), a line of credit loan (*Platinum Line of Credit Loan*) that could be borrowed from time to time (but not reborrowed after being repaid) of up to \$12.5 million, and a working capital loan (*Platinum Working Capital Loan*) of up to \$12.5 million. The Platinum Term Loan was used to purchase \$93.9 million of the Company's Convertible Notes that are more fully described below.

On June 30, 2009, the Company drew \$10.0 million from the Platinum Line of Credit Loan and used it primarily to pay the fees and expenses related to the execution of the tender offer (described below) and the execution of the Revised Amended and Restated Platinum Credit Facility. The Company incurred \$3.6 million in fees and expense reimbursements related to the execution of the tender offer, \$4.2 million related to the execution of the Revised Amended and Restated Platinum Credit Facility, and \$1.4 million related to the amendments of the UniCredit facilities. On September 29, 2009, the Company borrowed \$10.0 million on the Platinum Working Capital Loan for general corporate purposes.

On May 5, 2010, the Platinum Term Loan, the Platinum Line of Credit Loan, and the Platinum Working Capital Loan were extinguished. The extinguishment of the Platinum facilities resulted in a \$33.3 million loss on early extinguishment of debt. The calculation of the loss is as follows (amounts in thousands):

Reacquisition price:		
Cash paid	\$	57,861
Success fee		5,000
		62,861
Extinguished debt:		
Carrying amount of debt		32,135
Carrying amount of success fee		2,001
Unamortized debt cost		(4,619)
		29,517
Net loss	\$	(33,344)

The Platinum Term Loan accrued interest at an annual rate of 9%. The Platinum Working Capital Loan and the Platinum Line of Credit Loan accrued interest at an annual rate equal to the greater of (i) LIBOR plus 7%, or (ii) 10%, payable monthly in arrears.

The Company's obligations to K Financing arising under the Revised Amended and Restated Platinum Credit Facility were secured by substantially all of the Company's assets located in the United States, Mexico, Indonesia and China (other than accounts receivable owing by account debtors located in the United States, Singapore and Hong Kong, which exclusively secured obligations to an affiliate of Vishay). As further described in the Offer to Purchase for the Convertible Notes, in connection with entering into the Revised Amended and Restated Platinum Credit Facility, K Financing and UniCredit entered into a letter of understanding with respect to their respective guarantor and collateral pools and the Company's assets in Europe that were not pledged to either lender. The letter of understanding also set forth each lender's agreement not to interfere with the other lender's exercise of remedies pertaining to their respective collateral pools.

Concurrent with the consummation of the tender offer, the Company issued K Financing the Closing Warrant to purchase up to 80,544,685 shares of its common stock, subject to certain adjustments, representing at the time of issuance 49.9% of the Company's outstanding common stock on a post-Closing Warrant basis. The Closing Warrant was subsequently transferred to K Equity, LLC (K Equity).

Table of Contents

The Company also entered into an Investor Rights Agreement (the "Investor Rights Agreement") with K Financing, which subsequently transferred its rights thereunder to K Equity. Pursuant to the terms of the Investor Rights Agreement, the Company has, subject to certain terms and conditions, granted Board of Directors ("Board") observation rights to K Financing which would permit K Financing to designate up to three individuals to observe Board meetings and receive information provided to the Board. In addition, the Investor Rights Agreement provides K Financing with certain preemptive rights. Subject to the terms and limitations described in the Investor Rights Agreement, in connection with any proposed issuance of equity securities or securities convertible into equity, the Company would be required to offer to sell to K Financing a pro rata portion of such securities equal to the percentage determined by dividing the number of shares of common stock held by K Financing plus the number of shares of common stock issuable upon exercise of the Closing Warrant, by the total number of shares of common stock then outstanding on a fully diluted basis. The Investor Rights Agreement also provides K Financing with certain registration and information rights.

The Company also entered into a Corporate Advisory Services Agreement with Platinum Equity Advisors, LLC ("Platinum Advisors") for a term of the later of (i) June 30, 2013 and (ii) the termination of the Credit Facility, pursuant to which the Company pays an annual fee of \$1.5 million to Platinum Advisors for certain advisory services. In addition, the Revised Amended and Restated Platinum Credit Facility included various fees totaling \$0.7 million per year for administration and collateral management, the Company incurred a fee of 1% per annum for unused capacity under the Platinum Line of Credit Loan and the Platinum Working Capital Loan and the Company paid K Financing a success fee of \$5.0 million in May 2010. This fee was payable at the time of repayment in full of the Platinum Term Loan, whether at maturity or otherwise.

At the date of issuance, the Company allocated \$31.4 million of the proceeds from the issuance of the Platinum Term Loan and the draw-down on the Platinum Line of Credit Loan to warrant liability. The Company allocated the remainder of the issuance proceeds to the Platinum Term Loan and the Platinum Line of Credit Loan (\$12.0 million and \$4.4 million, respectively) based upon their relative fair values. The carrying amount of the Platinum Term Loan and the Platinum Line of Credit Loan were increased by quarterly accretion to the line item "Interest expense" on the Condensed Consolidated Statements of Operations under the effective interest method over their respective terms of approximately 3.4 years and 2.0 years.

Convertible Notes

In November 2006, the Company sold and issued its Convertible Notes which are unsecured obligations and rank equally with the Company's existing and future unsubordinated and unsecured obligations and are junior to any of the Company's future secured obligations to the extent of the value of the collateral securing such obligations. In connection with the issuance and sale of the Convertible Notes, the Company entered into an indenture (the "Convertible Notes Indenture") dated as of November 1, 2006, with Wilmington Trust Company, as trustee.

The Convertible Notes bear interest at a rate of 2.25% per annum, payable in cash semi-annually in arrears on each May 15 and November 15. The Convertible Notes are convertible into (i) cash in an amount equal to the lesser of the principal amount of the Convertible Notes and the conversion value of the Convertible Notes on the conversion date and (ii) cash or shares of the Company's common stock ("Common Stock") or a combination of cash and shares of the Common Stock, at the Company's option, to the extent the conversion value at that time exceeds the principal amount of the Convertible Notes, at any time prior to the close of business on the business day immediately preceding the maturity date of the Convertible Notes, unless the Company has redeemed or purchased the Convertible Notes, subject to certain conditions. The initial conversion rate was 103.0928 shares of Common Stock per \$1,000 principal amount of the Convertible Notes, which represents an initial conversion price of approximately \$9.70 per share, subject to adjustments.

The holder may surrender the holder's Convertible Notes for conversion if any of the following conditions are satisfied:

- During any fiscal quarter, the closing sale price of the Common Stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter exceeds 130% of the conversion price per share on such last trading day;
- The Company has called the Convertible Notes for redemption;
- The average of the trading prices of the Convertible Notes for any five consecutive trading day period is less than 98% of the average of the conversion values of the Convertible Notes during that period;
- The Company makes certain significant distributions to the holders of the Common Stock; or

Table of Contents

- In connection with a transaction or event constituting a fundamental change (as defined in the Convertible Notes Indenture).

The Company received net proceeds from the sale of the Convertible Notes of approximately \$170.2 million, after deducting discounts and estimated offering expenses of approximately \$4.8 million. Net proceeds from the sale were used to repurchase approximately 3.3 million shares of Common Stock at a cost of approximately \$24.9 million (concurrent with the initial closing of the Convertible Notes offering). Debt issuance costs are being amortized over a period of five years.

Issuance and transaction costs incurred at the time of the issuance of the Convertible Notes with third parties are allocated to the liability and equity components and accounted for as debt issuance costs and equity issuance costs, respectively. Debt issuance costs related to the Convertible Notes, net of amortization, were \$0.2 million as of September 30, 2010 and equity issuance costs were \$1.3 million. The deferred tax liability and a corresponding valuation allowance adjustment in the same amount related to the Convertible Notes were \$1.1 million as of September 30, 2010.

As of September 30, 2010, the remaining unamortized debt discount of the Convertible Notes will be amortized over a period of 13 months, the remaining expected term of the Convertible Notes. The effective interest rate on the liability component is 9.1% on an annual basis.

On June 26, 2009, \$93.9 million in aggregate principal amount of the Convertible Notes were validly tendered (representing 53.7% of the outstanding Convertible Notes). As a result of the retrospective adoption effective April 1, 2009 of new guidance within ASC 470-20, *Debt With Conversion and Other Options*, the carrying value of the aggregate principal value of the tendered Convertible Notes was \$81.0 million. Holders of the Convertible Notes received \$400 for each \$1,000 principal amount of Convertible Notes purchased in the tender offer, plus accrued and unpaid interest up to, but not including, the date of payment for the Convertible Notes accepted for payment. As a result of the consummated tender offer, on June 30, 2009, the Company used the \$37.8 million Platinum Term Loan under the Revised Amended and Restated Platinum Credit Facility to extinguish the tendered Convertible Notes. The extinguishment of these Convertible Notes resulted in a \$38.9 million net gain (\$0.48 per share) included in the line item (Gain) loss on early extinguishment of debt on the Condensed Consolidated Statements of Operations for the quarter and six month period ended September 30, 2009. The calculation of the gain is as follows (amounts in thousands):

Reacquisition price:		
Cash paid	\$	37,568
Tender offer fees		3,605
		41,173
Extinguished debt:		
Carrying amount of debt		80,987
Unamortized debt cost		(893)
		80,094
Net gain	\$	38,921

On May 17, 2010, \$40.5 million in aggregate principal amount of the Convertible Notes was extinguished. The extinguishment resulted in a \$1.6 million loss on extinguishment of debt. The calculation of the loss is as follows (amounts in thousands):

Edgar Filing: KEMET CORP - Form 10-Q

Reacquisition price:		
Cash paid	\$	37,867
Tender offer fees		207
		38,074
Extinguished debt:		
Carrying amount of debt		36,770
Unamortized debt cost		(248)
		36,522
Net loss		
	\$	(1,552)

The terms of the Convertible Notes are governed by the Convertible Notes Indenture. The Convertible Notes mature on November 15, 2026 unless earlier redeemed, repurchased or converted. The Company may redeem the Convertible Notes for cash, either in whole or in part, anytime after November 20, 2011 at a redemption price equal to 100% of the principal amount of the Convertible Notes to be redeemed plus accrued and unpaid interest, including additional interest, if any, up to but not including the

Table of Contents

date of redemption. In addition, holders of the Convertible Notes will have the right to require the Company to repurchase for cash all or a portion of their Convertible Notes on November 15, 2011, 2016 and 2021, at a repurchase price equal to 100% of the principal amount of the Convertible Notes to be repurchased plus accrued and unpaid interest, if any, in each case, up to but not including, the date of repurchase.

The Convertible Notes are convertible into Common Stock at a rate equal to 103.0928 shares per \$1,000 principal amount of the Convertible Notes (equal to an initial conversion price of approximately \$9.70 per share), subject to adjustment as described in the Convertible Notes Indenture. Upon conversion, the Company will deliver for each \$1,000 principal amount of Convertible Notes, an amount consisting of cash equal to the lesser of \$1,000 and the conversion value (as defined in the Convertible Notes Indenture) and, to the extent that the conversion value exceeds \$1,000, at the Company's election, cash or shares of Common Stock with respect to the remainder. The contingent conversion feature was not required to be bifurcated and accounted for separately.

If the Company undergoes a fundamental change, holders of the Convertible Notes will have the right, subject to certain conditions, to require the Company to repurchase for cash all or a portion of their Convertible Notes at a repurchase price equal to 100% of the principal amount of the Convertible Notes to be repurchased plus accrued and unpaid interest, including contingent interest and additional amounts, if any. One occurrence creating a fundamental change is the Company's common stock ceasing to be listed on the New York Stock Exchange (NYSE) or another national securities exchange in the United States, without then being quoted on an established automated over-the-counter trading market in the United States. The transfer of the trading of the Company's stock from the NYSE to the OTC Bulletin Board did not constitute a fundamental change. On June 22, 2010, the Company's common stock began trading on the NYSE Amex. As a matter of information, such listing does not constitute a fundamental change.

The Company will pay a make-whole premium on the Convertible Notes converted in connection with any fundamental change that occurs prior to November 20, 2011. The amount of the make-whole premium, if any, will be based on the Company's stock price and the effective date of the fundamental change. The maximum make-whole premium, expressed as a number of additional shares of the Common Stock to be received per \$1,000 principal amount of the Convertible Notes, would be 30.95 upon the conversion of Convertible Notes in connection with the occurrence of a fundamental change prior to November 1, 2010, or November 20, 2011 if the stock price at that date is at least \$7.46 per share of Common Stock. The Convertible Notes Indenture contains a detailed description of how the make-whole premium will be determined and a table showing the make-whole premium that would apply at various stock prices and fundamental change effective dates. No make-whole premium will be paid if the price of the Common Stock on the effective date of the fundamental change is less than \$7.46 per share. Any make-whole premium will be payable in shares of Common Stock (or the consideration into which the Company's Common Stock has been exchanged in the fundamental change) on the conversion date for the Convertible Notes converted in connection with the fundamental change.

The estimated fair value of the Convertible Notes, based on quoted market prices as of September 30, 2010 and March 31, 2010, was approximately \$36 million and \$71 million, respectively. The Company had interest payable related to the Convertible Notes included in the line item Accrued expenses on its Condensed Consolidated Balance Sheets of \$0.4 million and \$0.7 million at September 30, 2010 and March 31, 2010, respectively.

UniCredit Credit Facility

As of March 31, 2010 the Company had two Senior Facility Agreements outstanding with UniCredit. As of March 31, 2010, Facility A had EUR 53.2 million (\$71.7 million) outstanding and Facility B had EUR 33.0 million (\$44.5 million) outstanding.

Edgar Filing: KEMET CORP - Form 10-Q

On May 5, 2010, Facility A and Facility B were extinguished. The extinguishment resulted in a \$3.3 million loss on extinguishment of debt. The calculation of the loss is as follows (amounts in thousands):

Reacquisition price:		
Cash paid	\$	104,683
Extinguished debt:		
Carrying amount of debt		104,674
Unamortized debt cost		(3,343)
		101,331
Net loss	\$	(3,352)

Table of Contents

Material terms and conditions of Facility A were as follows:

- | | |
|--------------------|--|
| (i) Interest Rate: | Floating at six-month EURIBOR plus 2.5% |
| (ii) Structure: | Secured with Italian real property, certain European accounts receivable and shares of two of the Company's Italian subsidiaries |

Material terms and conditions of Facility B were as follows:

- | | |
|--------------------|---|
| (i) Interest Rate: | Floating at six-month EURIBOR plus 2.5% |
| (ii) Structure: | Unsecured |

Effective as of September 30, 2009, the Company entered into an amendment to Facility A. Under the terms of the amendment, the amortization schedule of Facility A was modified, including the addition of an October 1, 2009 principal installment. In connection with the amendment, the Company simultaneously executed a fee letter in which it agreed to pay to UniCredit an amendment fee and reimburse it for certain legal expenses incurred in relation to the amendment. These fees were \$1.5 million and were amortized as an adjustment of interest expense over the term of the Facility, the remaining balance at the time of extinguishment was included in the calculation of the loss on extinguishment of debt.

Vishay Loan

In the second quarter of fiscal year 2009, the Company sold assets related to the production and sale of wet tantalum capacitors to a subsidiary of Vishay. The Company received \$33.7 million in cash proceeds, net of amounts held in escrow, from the sale of these assets. Concurrently, the Company entered into a three-year term loan agreement for \$15.0 million and a security agreement with Vishay. The loan carried an interest rate of LIBOR plus 4% which was payable monthly. Pursuant to the security agreement, the loan was secured by certain accounts receivable of the Company. On May 5, 2010, the Vishay loan was paid in full.

Revolving Line of Credit

On September 30, 2010, KEMET Electronics Corporation ("KEC") and KEMET Electronics Marketing (S) Pte Ltd. ("KEMET Singapore") (each a "Borrower" and, collectively, the "Borrowers") entered into a Loan and Security Agreement (the "Loan and Security Agreement"), with Bank of America, N.A., as the administrative agent and the initial lender. The Loan and Security Agreement provides a \$50 million revolving line of credit, which is bifurcated into a U.S. facility (for which KEC is the Borrower) and a Singapore facility (for which KEMET Singapore is the Borrower). The size of the U.S. facility and Singapore facility can fluctuate as long as the Singapore facility does not exceed \$30 million and the total facility does not exceed \$50 million. A portion of the U.S. facility and of the Singapore facility can be used to issue letters of credit. The facilities expire on September 30, 2014.

Revolving loans may be used to pay fees and transaction expenses associated with the closing of the credit facilities, to pay obligations outstanding under the Loan and Security Agreement and for working capital and other lawful corporate purposes of KEC and KEMET

Edgar Filing: KEMET CORP - Form 10-Q

Singapore. Borrowings under the U.S. and Singapore facilities are subject to a borrowing base. The borrowing base consists of:

- in the case of the U.S. facility, (A) 85% of KEC's accounts receivable that satisfy certain eligibility criteria plus (B) the lesser of \$4 million and 40% of the net book value of inventory of KEC that satisfy certain eligibility criteria plus (C) the lesser of \$3 million and 70% of the net orderly liquidation percentage of the appraised value of equipment that satisfies certain eligibility criteria less (D) certain reserves, including certain reserves imposed by the administrative agent in its permitted discretion; and
- in the case of the Singapore facility, (A) 85% of KEMET Singapore's accounts receivable that satisfy certain eligibility criteria less (B) certain reserves, including certain reserves imposed by the administrative agent in its permitted discretion.

Interest is payable on borrowings monthly at a rate equal to the London Interbank Offer Rate (LIBOR) or the base rate, plus an applicable margin, as selected by the Borrower. Depending upon the fixed charge coverage ratio of KEMET Corporation and its subsidiaries on a consolidated basis as of the latest test date, the applicable margin under the U.S. facility varies between 3.00% and 3.50% for LIBOR advances and 2.00% and 2.50% for base rate advances, and under the Singapore facility varies between 3.25% and 3.75% for LIBOR advances and 2.25% and 2.75% for base rate advances.

The base rate is subject to a floor that is 100 basis points above LIBOR.

Table of Contents

An unused line fee is payable monthly in an amount equal to 0.75% per annum of the average daily unused portion of the facilities during any month; provided, that such percentage rate is reduced to (a) 0.50% per annum for any month in which the average daily balance of the facilities is greater than 33.3% of the total revolving commitment and less than 66.6% of the total revolving commitment, and (b) 0.375% per annum for any month in which the average daily balance of the facilities is greater than or equal to 66.6% of the total revolving commitment. A customary fee is also payable to the administrative agent on a quarterly basis.

KEC's ability to draw funds under the U.S. facility and KEMET Singapore's ability to draw funds under the Singapore facility are conditioned upon, among other matters:

- the absence of the existence of a Material Adverse Effect (as defined in the Loan and Security Agreement);
- the absence of the existence of a default or an event of default under the Loan and Security Agreement; and
- the representations and warranties made by KEC and KEMET Singapore in the Loan and Security Agreement continuing to be correct in all material respects.

The parent corporation of KEC - KEMET Corporation - and the Guarantors guarantee the U.S. facility obligations and the U.S. facility obligations are secured by a lien on substantially all of the assets of KEC and the Guarantors (other than assets that secure the 10.5% Senior Notes due 2018). The collection accounts of the Borrowers and Guarantors are subject to a daily sweep into a concentration account and the concentration account will become subject to full cash dominion in favor of the administrative agent (i) upon an event of default, (ii) if for five consecutive business days, aggregate availability of all facilities has been less than the greater of (A) 15% of the aggregate revolver commitments at such time and (B) \$7.5 million, or (iii) if for five consecutive business days, availability of the U.S. facility has been less than \$3.75 million (each such event, a "Cash Dominion Trigger Event").

KEC and the Guarantors guarantee the Singapore facility obligations. In addition to the assets that secure the U.S. facility, the Singapore obligations are also secured by a pledge of 100% of the stock of KEMET Singapore and a security interest in substantially all of KEMET Singapore's assets. Within 90 days after the closing date, KEMET Singapore's bank accounts will be transferred over to Bank of America and upon a Cash Dominion Trigger Event will become subject to full cash dominion in favor of the administrative agent.

A fixed charge coverage ratio of at least 1.1:1.0 must be maintained as at the last day of each fiscal quarter ending immediately prior to or during any period in which any of the following occurs and is continuing until none of the following occurs for a period of at least forty-five consecutive days: (i) an event of default, (ii) aggregate availability of all facilities has been less than the greater of (A) 15% of the aggregate revolver commitments at such time and (B) \$7.5 million, or (iii) availability of the U.S. facility has been less than \$3.75 million. The fixed charge coverage ratio tests the EBITDA and fixed charges of KEMET Corporation and its subsidiaries on a consolidated basis.

In addition, the Loan and Security Agreement includes negative covenants that, subject to exceptions, limit the ability of KEMET Corporation and its direct and indirect subsidiaries to, among other things:

- incur additional indebtedness;

- create liens on assets;
- make capital expenditures;
- engage in mergers, consolidations, liquidations and dissolutions;
- sell assets (including pursuant to sale leaseback transactions);
- pay dividends and distributions on or repurchase capital stock;
- make investments (including acquisitions), loans, or advances;
- prepay certain junior indebtedness;
- engage in certain transactions with affiliates;
- enter into restrictive agreements;
- amend material agreements governing certain junior indebtedness; and
- change its lines of business.

The Loan and Security Agreement includes certain customary representations and warranties, affirmative covenants and events of default, which are set forth in more detail in the Loan and Security Agreement.

Debt issuance costs related to the Loan and Security Agreement, net of amortization, were \$1.1 million as of September 30, 2010, these costs will be amortized over the term of the Loan and Security Agreement. There were no borrowings against the revolving line of credit as of September 30, 2010.

Table of Contents**Note 3. Segment and Geographic Information**

The Company is organized into three business groups: the Tantalum Business Group (Tantalum), the Ceramic Business Group (Ceramics), and the Film and Electrolytic Business Group (Film and Electrolytic). Each business group is responsible for the operations of certain manufacturing sites as well as all related research and development efforts. The sales and marketing functions are shared by the business groups and are allocated to each business group based on the business group's respective budgeted net sales. In addition, all corporate costs are allocated to the business groups based on the business group's respective budgeted net sales.

Tantalum

Tantalum operates in five manufacturing sites in the United States, Mexico, China, and Portugal. This business group produces tantalum and aluminum polymer capacitors. Tantalum also maintains a product innovation center in the United States. Tantalum products are sold in all regions of the world.

Ceramics

Ceramics operates in two manufacturing locations in Mexico and a manufacturing facility in China. This business group produces ceramic capacitors. In addition, the business group has a product innovation center in the United States. Ceramics' products are sold in all regions of the world.

Film and Electrolytic

Film and Electrolytic operates in fourteen manufacturing sites in Europe, Asia and Mexico. This business group produces film, paper, and electrolytic capacitors. In addition, the business group has a product innovation center in Sweden. Film and Electrolytic products are sold in all regions in the world.

The following table reflects each business group's net sales, operating income (loss), depreciation and amortization expenses and sales by region for the quarters and six month periods ended September 30, 2010 and 2009 (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Net sales:				
Tantalum	\$ 123,873	\$ 81,987	\$ 237,441	\$ 154,355
Ceramics	56,730	40,998	111,054	73,946

Edgar Filing: KEMET CORP - Form 10-Q

Film and Electrolytic	67,985	50,280	143,887	95,131
	\$ 248,588	\$ 173,265	\$ 492,382	\$ 323,432

Operating income (loss) (1)(2):

Tantalum	\$ 27,466	\$ 4,330	\$ 44,972	\$ 8,132
Ceramics	13,324	4,461	24,354	6,909
Film and Electrolytic	(2,828)	(11,678)	(2,829)	(20,429)
	\$ 37,962	\$ (2,887)	\$ 66,497	\$ (5,388)

Depreciation and amortization expenses:

Tantalum	\$ 8,788	\$ 7,338	\$ 17,106	\$ 14,563
Ceramics	4,653	2,205	6,922	4,617
Film and Electrolytic	691	3,683	4,614	6,310
	\$ 14,132	\$ 13,226	\$ 28,642	\$ 25,490

Sales by region:

North and South America (Americas)	\$ 70,915	\$ 43,375	\$ 127,701	\$ 79,497
Europe, Middle East, Africa (EMEA)	85,651	60,407	172,023	115,074
Asia and Pacific Rim (APAC)	92,022	69,483	192,658	128,861
	\$ 248,588	\$ 173,265	\$ 492,382	\$ 323,432

Edgar Filing: KEMET CORP - Form 10-Q

Table of Contents

The following table reflects each business group's total assets as of September 30, 2010 and March 31, 2010 (amounts in thousands):

	September 30, 2010		March 31, 2010	
Total assets:				
Tantalum	\$	410,891	\$	378,344
Ceramics		173,354		169,564
Film and Electrolytic		224,356		193,053
	\$	808,601	\$	740,961

(1) Restructuring charges included in Operating income (loss) were as follows:

	Quarters Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Total restructuring:				
Tantalum	\$	322	\$	108
Ceramics		93		51
Film and Electrolytic		1,888		1,108
	\$	2,303	\$	1,267

(2) Net (gain) loss on sales and disposals of assets included in Operating income (loss) was:

	Quarters Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Net (gain) loss on sales and disposals of assets:				
Tantalum	\$	(121)	\$	31
Ceramics		(1,655)		21
Film and Electrolytic		6		212
	\$	(1,770)	\$	52

Note 4. Restructuring Charges

A summary of the expenses aggregated on the Condensed Consolidated Statements of Operations line item "Restructuring charges" in the quarters and six month periods ended September 30, 2010 and 2009, is as follows (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Manufacturing relocation costs	\$	1,642	\$	3,080
Personnel reduction costs		661		1,015
Restructuring charges	\$	2,303	\$	4,095

Edgar Filing: KEMET CORP - Form 10-Q

Six Months Ended September 30, 2010

In fiscal year 2010, the Company initiated the first phase of a plan to restructure Film and Electrolytic and to reduce overhead within the Company as a whole. The restructuring plan includes implementing programs to make the Company more competitive, removing excess capacity, moving production to lower cost locations and eliminating unnecessary costs throughout the Company. Restructuring charges in the six months ended September 30, 2010 relate to this new plan and are primarily comprised of manufacturing relocation costs of \$3.1 million for relocation of equipment from various plants to Mexico or China as well as a distribution center relocation project. In addition, the Company incurred \$1.0 million in personnel reduction costs due primarily to headcount reductions within Film and Electrolytic.

Six Months Ended September 30, 2009

Restructuring expense in the first half of fiscal year 2010 is primarily comprised of a headcount reduction of 57 employees in Finland. Restructuring charges of \$1.3 million were incurred in the second quarter of fiscal year 2010 and remain as a liability on the Condensed Consolidated Balance Sheets at September 30, 2009.

Table of Contents

A reconciliation of the beginning and ending liability balances for restructuring charges included in the line items Accrued expenses and Other non-current obligations on the Condensed Consolidated Balance Sheets were as follows (amounts in thousands):

	Quarter Ended September 30, 2010		Quarter Ended September 30, 2009	
	Personnel Reductions	Manufacturing Relocations	Personnel Reductions	Manufacturing Relocations
Beginning of period	\$ 6,696	\$	\$ 5,937	\$
Costs charged to expense	661	1,642	1,267	
Costs paid or settled	(1,280)	(1,642)	(1,317)	
Change in foreign exchange	662		176	
End of period	\$ 6,739	\$	\$ 6,063	\$

	Six Months Ended September 30, 2010		Six Months Ended September 30, 2009	
	Personnel Reductions	Manufacturing Relocations	Personnel Reductions	Manufacturing Relocations
Beginning of period	\$ 8,398	\$	\$ 7,893	\$
Costs charged to expense	1,015	3,080	1,267	
Costs paid or settled	(2,770)	(3,080)	(3,596)	
Change in foreign exchange	96		499	
End of period	\$ 6,739	\$	\$ 6,063	\$

Note 5. Accumulated Other Comprehensive Income (Loss)

Comprehensive income (loss) for the quarters and six month periods ended September 30, 2010 and 2009 includes the following components (amounts in thousands):

	Quarter Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Net income (loss)	\$ 34,911	\$ (93,075)	\$ 14,812	\$ (67,985)
Amortization of postretirement benefit plan	(75)	127	(150)	40
Amortization of defined benefit pension plans	37	(722)	112	(722)
Currency translation gain (1)	15,942	2,648	5,168	9,156
Total net income (loss) and other comprehensive income (loss)	\$ 50,815	\$ (91,022)	\$ 19,942	\$ (59,511)

(1) Due primarily to established valuation allowances, there was no significant deferred tax effect associated with the Accumulated other comprehensive income movement.

The components of Accumulated other comprehensive income on the Condensed Consolidated Balance Sheets are as follows (amounts in thousands):

Edgar Filing: KEMET CORP - Form 10-Q

	September 30, 2010		March 31, 2010	
Foreign currency translation gain	\$	19,360	\$	14,192
Defined benefit postretirement plan adjustments		2,261		2,411
Defined benefit pension plans		(4,501)		(4,613)
Total Accumulated other comprehensive income	\$	17,120	\$	11,990

Table of Contents**Note 6. Intangible Assets**

The following table highlights the Company's intangible assets (amounts in thousands):

	September 30, 2010		March 31, 2010	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
<u>Indefinite Lived Intangibles:</u>				
Trademarks	\$ 7,617	\$	\$ 7,617	\$
<u>Amortized Intangibles:</u>				
Customer relationships, patents and other (3-18 years)	20,158	7,274	18,911	4,722
	\$ 27,775	\$ 7,274	\$ 26,528	\$ 4,722

The Company completed its annual impairment test on the indefinite lived intangible assets in the first quarter of fiscal year 2011 and concluded no impairment existed.

Note 7. Income Taxes

During the second quarter of fiscal year 2011, the net income tax expense of \$0.6 million is comprised of a \$0.6 million income tax expense related to foreign operations. There was no federal or state tax expense due to the utilization of net operating loss carryforward deductions and a valuation allowance on net deferred tax assets.

During the second quarter of fiscal year 2010, the net income tax expense of \$1.7 million was comprised of \$1.6 million of income tax expense from foreign operations and \$0.1 million of state income tax expense.

Note 8. Concentrations of Risks*Sales and Credit Risk*

The Company sells to customers globally. Credit evaluations of the Company's customers' financial condition are performed periodically, and the Company generally does not require collateral from its customers. One customer, TTI, Inc. accounted for over 10% of the Company's net sales in the three and six month periods ended September 30, 2010 and 2009. There were no customers' accounts receivable balances exceeding 10% of gross accounts receivable at September 30, 2010 or March 31, 2010.

Electronics distributors are an important distribution channel in the electronics industry and accounted for 52% and 46% of the Company's net sales in the six month periods ended September 30, 2010 and 2009, respectively. As a result of the Company's concentration of sales to electronics distributors, the Company may experience fluctuations in the Company's operating results as electronics distributors experience fluctuations in end-market demand or adjust their inventory stocking levels.

Employee Risks

As of September 30, 2010, KEMET had 10,900 employees, of whom 500 are located in the United States, 5,700 are located in Mexico, 2,600 in Asia and 2,100 in Europe. The number of employees represented by labor organizations at KEMET locations in each of the following countries is: 4,600 hourly employees in Mexico (as required by Mexican law), 820 employees in the three Italian plants, 550 employees in the Batam, Indonesia plant, 350 employees in the Evora, Portugal plant, 310 employees in the Anting, China plant, 280 employees in the Kyustendil, Bulgaria plant, 200 employees in the Suomussalmi, Finland plant and 80 employees in our Swedish locations. For fiscal year 2010 and the current fiscal year to date, we have not experienced any major work stoppages. Our labor costs in Mexico, Asia and various locations in Europe are denominated in local currencies, and a significant depreciation or appreciation of the United States dollar against the local currencies would increase or decrease our labor costs.

Note 9. Stock-based Compensation

Stock Options

At September 30, 2010, the Company had three stock option plans that reserved shares of common stock for issuance to executives and key employees: the 1992 Key Employee Stock Option Plan, the 1995 Executive Stock Option Plan, and the 2004 Long-Term Equity Incentive Plan. All of these plans were approved by the Company's stockholders. Collectively, these plans authorized the grant of up to 12.1 million shares of the Company's common stock. Options issued under these plans usually vest in

Table of Contents

one or two years and expire ten years from the grant date. Stock options granted to the Chief Executive Officer on January 27, 2010 vest 50% on June 30, 2014 and 50% on June 30, 2015.

The compensation expense associated with stock-based compensation for the quarters and six month periods ended September 30, 2010 and 2009, respectively were recorded on the Condensed Consolidated Statements of Operations as follows (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Cost of sales	\$ 32	\$ 354	\$ 70	\$ 415
Selling, general and administrative expenses	301	1,033	412	1,213
Total stock-based compensation expense	\$ 333	\$ 1,387	\$ 482	\$ 1,628

In the Operating activities section of the Condensed Consolidated Statements of Cash Flows, stock-based compensation expense was treated as an adjustment to net income (loss) for the quarters and six month periods ended September 30, 2010 and 2009. No stock options were exercised during the quarters and six month periods ended September 30, 2010 and 2009.

Restricted Stock

The Company grants shares of its common stock as restricted stock to members of the Board of Directors and the Chief Executive Officer. Restricted stock granted to the Board of Directors vests in one year while restricted stock granted to the Chief Executive Officer on January 27, 2010 vest 50% on June 30, 2014 and 50% on June 30, 2015. The contractual term on restricted stock is indefinite. In the second quarter of fiscal year 2011, 140,000 shares of restricted stock were granted to the Board of Directors. As of September 30, 2010, unrecognized compensation costs related to the unvested restricted stock share based compensation arrangements granted was \$0.8 million. The expense is to be recognized over the respective vesting periods.

2011/2012 LTIP

During the first quarter of fiscal year 2011, the Board of Directors of the Company approved a new long-term incentive plan (2011/2012 LTIP) based upon the achievement of an EBITDA target for the two-year period comprised of fiscal years ending in March 2011 and 2012. At the time of the award, participants will receive at least 10% of the award, in restricted shares of the Company's common stock; and the remainder will be realized in cash. The Company assesses the likelihood of meeting the EBITDA financial metric on a quarterly basis and has recorded an expense of \$2.2 million in the six month period ended September 30, 2010, based on this assessment. The Company will continue to monitor the likelihood of whether the EBITDA financial metric will be realized and will adjust compensation expense to match expectations.

2010/2011 LTIP

Edgar Filing: KEMET CORP - Form 10-Q

During the second quarter of fiscal year 2010, the Board of Directors of the Company approved a long-term incentive plan (2010/2011 LTIP) based upon the achievement of an EBITDA target for the two-year period comprised of fiscal years ending in March 2010 and 2011. At the time of the award and at the sole discretion of the Compensation Committee, participants may receive up to 15% of the award as restricted shares of the Company's common stock, and the remainder of the award will be realized in cash. The Company assesses the likelihood of meeting the EBITDA financial metric on a quarterly basis and has recorded an expense of \$2.6 million in the six month period ended September 30, 2010, based on this assessment. In total, the Company has accrued \$4.8 million based upon this assessment. The Company will continue to monitor the the EBITDA financial metric, however, there will not be any additional expense.

[Table of Contents](#)**Note 10. Reconciliation of Basic and Diluted Income (Loss) Per Common Share**

The following table presents a reconciliation of basic EPS to diluted EPS.

Computation of Basic and Diluted Income (Loss) Per Share

(Amounts in thousands, except per share data)

	Quarters Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Numerator:				
Net income (loss)	\$ 34,911	\$ (93,075)	\$ 14,812	\$ (67,985)
Denominator:				
Weighted-average shares outstanding:				
Basic	81,275	80,868	81,275	80,866
Assumed conversion of employee stock options	915		779	
Assumed conversion of Closing Warrant	71,392		69,533	
Diluted	153,582	80,868	151,587	80,866
Net income (loss) per share:				
Basic	\$ 0.43	\$ (1.15)	\$ 0.18	\$ (0.84)
Diluted	\$ 0.23	\$ (1.15)	\$ 0.10	\$ (0.84)

Common stock equivalents that could potentially dilute income per basic share in the future, but were not included in the computation of diluted earnings per share because the impact would have been antidilutive, were as follows (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Assumed conversion of employee stock options	2,328	3,940	2,435	3,666
Assumed conversion of Closing Warrant		80,545		80,545

Note 11. Pension and Other Postretirement Benefit Plans

The Company sponsors defined benefit pension plans which include seven in Europe, one in Singapore and two in Mexico and a postretirement plan in the United States. Costs recognized for these benefit plans are recorded using estimated amounts, which may change as actual costs for the fiscal year are determined.

Edgar Filing: KEMET CORP - Form 10-Q

The components of net periodic benefit costs relating to the Company's pension and other postretirement benefit plans are as follows for the quarters ended September 30, 2010 and 2009 (amounts in thousands):

	Pension		Other Benefits	
	Quarters Ended September 30,	Quarters Ended September 30,	Quarters Ended September 30,	Quarters Ended September 30,
	2010	2009	2010	2009
Net service cost	\$ 266	\$ 225	\$ 16	\$ 19
Interest cost	457	406		
Expected return on net assets	(164)	(134)		
Amortization:				
Actuarial (gain) loss	31	42	(79)	(97)
Prior service cost	5	5		
Total net periodic benefit (income) costs	\$ 595	\$ 544	\$ (63)	\$ (78)

Table of Contents

The components of net periodic benefit costs relating to the Company's pension and other postretirement benefit plans are as follows for the six month period ended September 30, 2010 and 2009 (amounts in thousands):

	Pension		Other Benefits	
	Six Months Ended September 30,	Six Months Ended September 30,	Six Months Ended September 30,	Six Months Ended September 30,
	2010	2009	2010	2009
Net service cost	\$ 532	\$ 451	\$	\$
Interest cost	914	811	31	39
Expected return on net assets	(328)	(268)		
Amortization:				
Actuarial (gain) loss	62	84	(158)	(194)
Prior service cost	10	10		
Total net periodic benefit (income) costs	\$ 1,190	\$ 1,088	\$ (127)	\$ (155)

In fiscal year 2011, the Company expects to contribute up to \$2.8 million to the pension plans of which the Company has contributed \$0.5 million as of September 30, 2010. The Company expects to make no contributions to fund the Company's other benefits in fiscal year 2011 as the Company's policy is to pay benefits as costs are incurred.

Note 12. Condensed Consolidating Financial Statements

The 10.5% Senior Notes are fully and unconditionally guaranteed, jointly and severally, on a senior basis by certain of the Company's 100% owned domestic subsidiaries (Guarantor Subsidiaries) and secured by a first priority lien on 51% of the capital stock of certain of our foreign restricted subsidiaries (Non-Guarantor Subsidiaries). The Company's Guarantor Subsidiaries and Non-Guarantor Subsidiaries are not consistent with the Company's business groups or geographic operations; accordingly this basis of presentation is not intended to present the Company's financial condition, results of operations or cash flows for any purpose other than to comply with the specific requirements for subsidiary guarantor reporting. We are required to present condensed consolidating financial information in order for the subsidiary guarantors of the Company's public debt to be exempt from reporting under the Securities Exchange Act of 1934.

Condensed consolidating financial statements for the Company's Guarantor Subsidiaries and Non-Guarantor Subsidiaries are presented in the following tables (amounts in thousands):

Table of Contents**Condensed Consolidating Balance Sheet****September 30, 2010****(Unaudited)**

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 6,329	\$ 89,153	\$ 21,972	\$	\$ 117,454
Accounts receivable, net	4	55,783	98,502		154,289
Intercompany receivable	201,644	173,125	174,566	(549,335)	
Inventories, net		105,689	78,290	(303)	183,676
Prepaid expenses and other	215	5,862	4,672		10,749
Deferred income taxes		536	3,199		3,735
Total current assets	208,192	430,148	381,201	(549,638)	469,903
Property and equipment, net	137	79,587	227,960		307,684
Investments in subsidiaries	282,982	329,815		(612,797)	
Intangible assets, net		9,127	11,374		20,501
Other assets	6,524	3,114	875		10,513
Long-term intercompany receivable	80,916	98,299		(179,215)	
Total assets	\$ 578,751	\$ 950,090	\$ 621,410	\$ (1,341,650)	\$ 808,601
LIABILITIES AND STOCKHOLDERS EQUITY					
Current liabilities:					
Current portion of long-term debt	\$	\$	\$ 5,457	\$	\$ 5,457
Accounts payable, trade	172	28,366	53,494		82,032
Intercompany payable	165	417,320	132,193	(549,678)	
Accrued expenses	10,020	23,388	44,200		77,608
Income taxes payable	(1,214)	1,263	1,769		1,818
Total current liabilities	9,143	470,337	237,113	(549,678)	166,915
Long-term debt, less current portion	264,908		3,917		268,825
Other non-current obligations		5,625	53,249		58,874
Deferred income taxes		1,271	8,011		9,282
Long-term intercompany payable		80,916	98,299	(179,215)	
Stockholders' equity	304,700	391,941	220,821	(612,757)	304,705
Total liabilities and stockholders' equity	\$ 578,751	\$ 950,090	\$ 621,410	\$ (1,341,650)	\$ 808,601

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents**Condensed Consolidating Balance Sheet****March 31, 2010**

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 11,602	\$ 54,707	\$ 12,890	\$	\$ 79,199
Accounts receivable, net		48,797	92,998		141,795
Intercompany receivable	189,207	170,268	138,548	(498,023)	
Inventories, net		85,603	65,182	(277)	150,508
Prepaid expenses and other	1,476	5,908	6,996		14,380
Deferred income taxes	42	(1,066)	3,153		2,129
Total current assets	202,327	364,217	319,767	(498,300)	388,011
Property and equipment, net	158	88,155	231,565		319,878
Investments in subsidiaries	213,201	327,617		(540,818)	
Intangible assets, net		9,615	12,191		21,806
Other assets	8,690	1,651	925		11,266
Long-term intercompany receivable	85,576	97,083		(182,659)	
Total assets	\$ 509,952	\$ 888,338	\$ 564,448	\$ (1,221,777)	\$ 740,961
LIABILITIES AND STOCKHOLDERS EQUITY					
Current liabilities:					
Current portion of long-term debt	\$ 10,387	\$	\$ 7,493	\$	\$ 17,880
Accounts payable, trade	40	32,481	46,308		78,829
Intercompany payable	165	393,011	105,125	(498,301)	
Accrued expenses	4,551	19,771	39,284		63,606
Income taxes payable			1,096		1,096
Total current liabilities	15,143	445,263	199,306	(498,301)	161,411
Long-term debt, less current portion	210,495	14,999	6,135		231,629
Other non-current obligations		5,383	50,243		55,626
Deferred income taxes	42	(386)	8,367		8,023
Long-term intercompany payable		85,576	97,082	(182,658)	
Stockholders equity	284,272	337,503	203,315	(540,818)	284,272
Total liabilities and stockholders equity	\$ 509,952	\$ 888,338	\$ 564,448	\$ (1,221,777)	\$ 740,961

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents**Condensed Consolidating Statements of Operations****For the Quarter Ended September 30, 2010****(Unaudited)**

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Net sales	\$	\$ 242,856	\$ 236,659	\$ (230,927)	\$ 248,588
Operating costs and expenses:					
Cost of sales		183,304	216,192	(220,626)	178,870
Selling, general and administrative expenses	11,925	15,031	6,949	(8,906)	24,999
Research and development		4,840	1,384		6,224
Restructuring charges		1,540	763		2,303
Net (gain) loss on sales and disposals of assets		(1,807)	37		(1,770)
Total operating costs and expenses	11,925	202,908	225,325	(229,532)	210,626
Operating income (loss)	(11,925)	39,948	11,334	(1,395)	37,962
Interest income	(4)	(131)	(9)	60	(84)
Interest expense	7,093		301	(60)	7,334
Other (income) expense, net	(12,005)	3,145	3,742	326	(4,792)
Equity in earnings of subsidiaries	(41,920)			41,920	
Income before income taxes	34,911	36,934	7,300	(43,641)	35,504
Income tax expense		40	585	(32)	593
Net income	\$ 34,911	\$ 36,894	\$ 6,715	\$ (43,609)	\$ 34,911

Table of Contents**Condensed Consolidating Statements of Operations****For the Quarter Ended September 30, 2009****(Unaudited)**

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Net sales	\$	\$ 168,548	\$ 179,998	\$ (175,281)	\$ 173,265
Operating costs and expenses:					
Cost of sales		146,371	169,435	(167,055)	148,751
Selling, general and administrative expenses	2,134	16,943	9,157	(7,721)	20,513
Research and development		4,123	1,446		5,569
Restructuring charges		225	1,042		1,267
Net loss on sales and disposals of assets		36	16		52
Total operating costs and expenses	2,134	167,698	181,096	(174,776)	176,152
Operating income (loss)	(2,134)	850	(1,098)	(505)	(2,887)
Other expense (income):					
Interest income		(397)	(25)	320	(102)
Interest expense	6,306		505	(320)	6,491
Increase in value of warrant	81,088				81,088
Other (income) expense, net	(1,004)	1,214	816	(27)	999
Equity in subsidiaries	4,491			(4,491)	
Income (loss) before income taxes	(93,015)	33	(2,394)	4,013	(91,363)
Income tax expense	60	60	1,859	(267)	1,712
Net loss	\$ (93,075)	\$ (27)	\$ (4,253)	\$ 4,280	\$ (93,075)

Table of Contents**Condensed Consolidating Statements of Operations****For the Six Months Ended September 30, 2010****(Unaudited)**

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Net sales	\$	\$ 472,045	\$ 484,838	\$ (464,501)	\$ 492,382
Operating costs and expenses:					
Cost of sales		364,608	441,000	(443,852)	361,756
Selling, general and administrative expenses	20,614	28,299	19,358	(19,057)	49,214
Research and development		9,162	3,093		12,255
Restructuring charges		3,072	1,023		4,095
Net (gain) loss on sales and disposals of assets		(1,783)	348		(1,435)
Total operating costs and expenses	20,614	403,358	464,822	(462,909)	425,885
Operating income (loss)	(20,614)	68,687	20,016	(1,592)	66,497
Interest income	(13)	(137)	(15)	60	(105)
Interest expense	14,212	94	546	(60)	14,792
Loss on early extinguishment of debt	38,248				38,248
Other (income) expense, net	(14,680)	12,260	(795)	97	(3,118)
Equity in earnings of subsidiaries	(73,193)			73,193	
Income before income taxes	14,812	56,470	20,280	(74,882)	16,680
Income tax expense		107	1,761		1,868
Net income	\$ 14,812	\$ 56,363	\$ 18,519	\$ (74,882)	\$ 14,812

Table of Contents**Condensed Consolidating Statements of Operations****For the Six Months Ended September 30, 2009****(Unaudited)**

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Net sales	\$	\$ 315,809	\$ 334,052	\$ (326,429)	\$ 323,432
Operating costs and expenses:					
Cost of sales		271,647	317,160	(310,395)	278,412
Selling, general and administrative expenses	8,450	27,174	18,734	(15,823)	38,535
Research and development		7,910	2,438		10,348
Restructuring charges		225	1,042		1,267
Net loss on sales and disposals of assets		241	17		258
Total operating costs and expenses	8,450	307,197	339,391	(326,218)	328,820
Operating income (loss)	(8,450)	8,612	(5,339)	(211)	(5,388)
Other expense (income):					
Interest income		(418)	(35)	320	(133)
Interest expense	11,074	389	1,167	(320)	12,310
Increase in value of warrant	81,088				81,088
Gain on early extinguishment of debt	(38,921)				(38,921)
Other (income) expense, net	(6,540)	7,534	4,517		5,511
Equity in subsidiaries	12,674			(12,674)	
Income (loss) before income taxes	(67,825)	1,107	(10,988)	12,463	(65,243)
Income tax expense	160	132	2,450		2,742
Net income (loss)	\$ (67,985)	\$ 975	\$ (13,438)	\$ 12,463	\$ (67,985)

Condensed Consolidating Statements of Cash Flows**For the Six Months Ended September 30, 2010****(Unaudited)**

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Sources (uses) of cash and cash equivalents					
Net cash provided by (used in) operating activities	\$ (13,977)	\$ 48,573	\$ 21,849	\$	\$ 56,445
Investing activities:					
Capital expenditures		(4,524)	(9,297)		(13,821)

Edgar Filing: KEMET CORP - Form 10-Q

Proceeds from sales of assets	5,425			5,425
Net cash provided by (used in) investing activities	901	(9,297)		(8,396)
Financing activities:				
Proceeds from issuance of debt	226,976	458		227,434
Payments of long-term debt	(210,604)	(15,000)	(2,939)	(228,543)
Net payments under other credit facilities			(1,779)	(1,779)
Debt issuance costs	(7,461)			(7,461)
Debt extinguishment costs	(207)			(207)
Net cash provided by (used in) financing activities	8,704	(15,000)	(4,260)	(10,556)
Net increase (decrease) in cash and cash equivalents	(5,273)	34,474	8,292	37,493
Effect of foreign currency fluctuations on cash		(28)	790	762
Cash and cash equivalents at beginning of fiscal period	11,602	54,707	12,890	79,199
Cash and cash equivalents at end of fiscal period	\$ 6,329	\$ 89,153	\$ 21,972	\$ 117,454

Table of Contents**Condensed Consolidating Statements of Cash Flows****For the Six Months Ended September 30, 2009****(Unaudited)**

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Sources (uses) of cash and cash equivalents					
Net cash provided by (used in) operating activities	\$ (8,413)	\$ 25,582	\$ 3,587	\$	\$ 20,756
Investing activities:					
Capital expenditures	(12)	(2,073)	(1,645)		(3,730)
Net cash used in investing activities	(12)	(2,073)	(1,645)		(3,730)
Financing activities:					
Proceeds from issuance of debt	57,786				57,786
Payments of long-term debt	(45,284)		(2,435)		(47,719)
Net payments under other credit facilities			(1,346)		(1,346)
Permanent intercompany financing	7,717	(7,717)			
Debt issuance costs	(4,206)				(4,206)
Debt extinguishment costs	(3,605)				(3,605)
Dividends received (paid)		248	(248)		
Net cash provided by (used in) financing activities	12,408	(7,469)	(4,029)		910
Net increase (decrease) in cash and cash equivalents	3,983	16,040	(2,087)		17,936
Effect of foreign currency fluctuations on cash		(220)	492		272
Cash and cash equivalents at beginning of fiscal period	26	25,869	13,309		39,204
Cash and cash equivalents at end of fiscal period	\$ 4,009	\$ 41,689	\$ 11,714	\$	\$ 57,412

Note 13. Subsequent Events

The Company has evaluated events and material transactions for potential recognition or disclosure occurring between the end of the Company's most recent quarterly period and through the time that this Form 10-Q was filed with the SEC.

On October 12, 2010, KEMET Corporation filed a Definitive Proxy Statement with respect to a special meeting of stockholders to be held on November 3, 2010 in order to vote on an amendment to our Restated Certificate of Incorporation to effect a reverse stock split. Stockholder approval of the amendment to our Restated Certificate of Incorporation will permit our board of directors to effect a reverse stock split at the board's discretion within one year of the special meeting.

Edgar Filing: KEMET CORP - Form 10-Q

On October 21, 2010, the Company filed a registration statement on Form S-3 with the SEC using a shelf registration process. This filing relates to the possible resale of up to 30.0 million shares of the Company's common stock by K Equity.

On October 26, 2010, the Company filed a Form S-4 to offer, in exchange for our outstanding 10.5% Senior Notes due 2018 (Old Notes), up to \$230.0 million in aggregate principal amount of 10.5% Senior Notes due 2018 and the guarantees thereof which have been registered under the Securities Act of 1933, as amended.

On October 26, 2010, the Company's board of directors approved (subject to shareholder approval) a reverse stock split of the Company's issued and outstanding common stock, as well as the shares available for issuance under the Company's employee and director equity plans at a ratio of one-for-three (1:3).

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This report contains certain statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Actual outcomes and results may differ materially from those expressed in, or implied by, the Company's forward-looking statements. Words such as expects, anticipates, believes, estimates and other similar expressions or future or conditional verbs such as will, should, would, could are intended to identify such forward-looking statements. Readers of this report should not rely solely on the forward-looking statements and should consider all uncertainties and risks throughout this report as well as those discussed under Part I, Item 1A of the Company's 2010 Annual Report. The statements are representative only as of the date they are made, and the Company undertakes no obligation to update any forward-looking statement.

All forward-looking statements, by their nature, are subject to risks and uncertainties. The Company's actual future results may differ materially from those set forth in the Company's forward-looking statements. The Company faces risks that are inherent in the businesses and the market places in which the Company operates. While management believes these forward-looking statements are accurate and reasonable, uncertainties, risks and factors, including those described below, could cause actual results to differ materially from those reflected in the forward-looking statements.

Factors that may cause actual outcome and results to differ materially from those expressed in, or implied by, these forward-looking statements include, but are not necessarily limited to the following: (i) adverse economic conditions could impact our ability to realize operating plans if the demand for our products declines, and such conditions could adversely affect our liquidity and ability to continue to operate; (ii) adverse economic conditions could cause further reevaluation and the write down of long-lived assets; (iii) an increase in the cost or a decrease in the availability of our principle raw materials; (iv) changes in the competitive environment; (v) uncertainty of the timing of customer product qualifications in heavily regulated industries; (vi) economic, political, or regulatory changes in the countries in which we operate; (vii) difficulties, delays or unexpected costs in completing the restructuring plan; (viii) inability to attract, train and retain effective employees and management; (ix) inability to develop innovative products to maintain customer relationships and offset potential price erosion in older products; (x) the impact of laws and regulations that apply to our business, including those relating to environmental matters; (xi) volatility of financial and credit markets which would affect our access to capital; (xii) needing to reduce costs of our products to remain competitive; (xiii) potential limitation on use of net operating losses to offset possible future taxable income; and (xiv) exercise of the warrant by K Equity, LLC which could potentially result in the existence of a controlling stockholder.

Additional risks and uncertainties not presently known to the Company or that the Company currently deems immaterial also may impair the Company's business operations and could cause actual results to differ materially from those included, contemplated or implied by the forward-looking statements made in this report, and the reader should not consider the above list of factors to be a complete set of all potential risks or uncertainties.

ACCOUNTING POLICIES AND ESTIMATES

The following discussion and analysis of financial condition and results of operations are based on the unaudited condensed consolidated financial statements included herein. The Company's significant accounting policies are described in Note 1 to the consolidated financial statements in the Company's 2010 Annual Report. The Company's critical accounting policies are described under the caption Critical Accounting Policies in Item 7 of the Company's 2010 Annual Report.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, assumptions, and judgments. Estimates and assumptions are based on historical data and other assumptions that management believes are reasonable. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period.

The Company's judgments are based on management's assessment as to the effect certain estimates, assumptions, or future trends or events may have on the financial condition and results of operations reported in the unaudited condensed consolidated financial statements. It is important that readers of these unaudited financial statements understand that actual results could differ from these estimates, assumptions, and judgments.

Table of Contents

Business Overview

We are a leading global manufacturer of a wide variety of capacitors. Our product offerings include tantalum, multilayer ceramic, solid and electrolytic aluminum, and film and paper capacitors. Capacitors are fundamental components of most electronic circuits and are found in communication systems, data processing equipment, personal computers, cellular phones, automotive electronic systems, defense and aerospace systems, consumer electronics, power management systems and many other electronic devices and systems. Capacitors are typically used to filter out interference, smooth the output of power supplies, block the flow of direct current while allowing alternating current to pass and for many other purposes. We manufacture a broad line of capacitors in many different sizes and configurations using a variety of raw materials. Our product line consists of over 250,000 distinct part configurations distinguished by various attributes, such as dielectric (or insulating) material, configuration, encapsulation, capacitance level and tolerance, performance characteristics and packaging. Most of our customers have multiple capacitance requirements, often within each of their products. Our broad offering allows us to meet the majority of those needs independent of application and end use. In fiscal year 2010, we shipped approximately 31 billion capacitors and in the six month period ended September 30, 2010, we shipped approximately 19 billion capacitors. We believe the medium-to-long term demand for the various types of capacitors offered by us will grow on a regional and global basis due to a variety of factors, including increasing demand for and complexity of electronic products, growing demand for technology in emerging markets and the ongoing development of new solutions for energy generation and conservation.

Our Competitive Strengths

We believe our Company benefits from the following competitive strengths:

Strong Customer Relationships. We have a large and diverse customer base. We believe that our persistent emphasis on quality control and history of performance establishes loyalty with Original Equipment Manufacturers (OEMs), Electronic Manufacturing Service (EMS) providers and distributors. Our customer base includes nearly all of the world's major electronics OEMs (including Alcatel-Lucent USA Inc., Apple Inc., Cisco Systems, Inc., Dell Inc., Hewlett-Packard Company, International Business Machines Corporation, Intel Corporation, Motorola, Inc. and Nokia Corporation), EMSs (including Celestica Inc., Elcoteq SE, Flextronics International LTD., Jabil Circuit, Inc. and Sanmina-SCI Corporation) and distributors (including TTI, Inc., Arrow Electronics, Inc. and Avnet, Inc.). Our strong, extensive and efficient worldwide distribution network is one of our differentiating factors.

Breadth of Our Diversified Product Offering and Markets. We believe that we have the most complete line of primary capacitor types, across a full spectrum of dielectric materials including tantalum, ceramic, solid and electrolytic aluminum, film and paper. As a result, we believe we can satisfy virtually all of our customers' capacitance needs, thereby strengthening our position as their supplier of choice. We sell our products into a wide range of different end markets, including computing, industrial, telecommunications, transportation, consumer, defense and healthcare markets across all geographic regions. No single end market segment accounted for more than 30% and only one customer, TTI, Inc., accounted for more than 10% of our net sales in the six month period ended September 30, 2010. Our largest customer is a distributor, and no single end use customer accounted for more than 5% of our net sales in the quarter and six month periods ended September 30, 2010. We believe that well-balanced product, geographic and customer diversification help us mitigate some of the negative financial impact through economic cycles.

Leading Market Positions and Operating Scale. Based on net sales, we believe that we are the largest manufacturer of tantalum capacitors in the world and one of the largest manufacturers of direct current film capacitors in the world and have a significant market position in the specialty ceramic and custom wet aluminum electrolytic markets. We believe the demand for our products is growing and we are well-positioned to take advantage of that trend due to our strengths and the diversity of our product offerings.

Strong Presence in Specialty Products. We engage in design collaboration with our customers in order to meet their specific needs and provide them with customized products satisfying their engineering specifications. During the six month period ended September 30, 2010, specialty products accounted for 30.3% of our revenue. By allocating an increasing portion of our management resources and research and development investment to specialty products, we have established ourselves as one of the leading innovators in this fast growing emerging segment of the market, which includes healthcare, renewable energy, telecom infrastructure and oil and gas. For example, in August 2009, we were selected as one of thirty companies to receive a grant from the Department of Energy. Our \$15.1 million award will enable us to produce film and electrolytic capacitors within the United States to support alternative energy products and emerging green technologies such as hybrid electric drive vehicles. Producing these parts in the United States will allow us to compete effectively in the alternative energy market in North America and South America (Americas). We believe our ability to provide innovative and flexible service offerings, superior customer support and focus on speed-to-market result in a more rewarding customer experience, earning us a high degree of customer loyalty.

Low-Cost Production. We believe we have some of the lowest cost production facilities in the industry. Many of our key customers have relocated their production facilities to Asia, particularly China, and we have a growing list of customers that are based

Table of Contents

in Asia. We believe our manufacturing facilities in China have low production costs and close proximity to the large and growing Chinese market as well as the ability to increase capacity and change our product mix to meet our customers' needs. We also believe our operations in Mexico, which are our primary production facilities supporting our North American and, to a large extent, European customers, are among the most cost efficient in the world.

Our Brand. Founded by Union Carbide in 1919 as KEMET Laboratories, we believe that KEMET has a reputation as a high quality, efficient and affordable partner that sets our customers' needs as the top priority. This has allowed us to successfully attract loyal clientele and enabled us to expand our operations and market share over the past few years. We believe our commitment to the needs of the industry in which we operate has differentiated us among other competitors and established us as the Easy-To-Buy-From company.

Our People. We believe that we have successfully developed a unique corporate culture based on innovation, customer focus and commitment. We have a strong, highly experienced and committed team in each of our markets. Many of our professionals have developed unparalleled experience in building leadership positions in new markets, as well as successfully integrating acquisitions. Combined, our 15 member management team has an average of over 11 years of experience with us and an average of over 25 years of experience in the manufacturing industry and has grown our revenue to \$736.3 million in fiscal year 2010 from \$425.3 million in fiscal year 2005, representing a compound annual growth rate of 11.6%.

Business Strategy

Our strategy is to use our position as a leading, high-quality manufacturer of capacitors to capitalize on the increasingly demanding requirements of our customers. Key elements of our strategy include:

Develop Our Significant Customer Relationships and Industry Presence. We intend to continue to be responsive to our customers' needs and requirements and to make order entry and fulfillment easier, faster, more flexible and more reliable for our customers by focusing on building products around customers' needs, giving decision making authority to customer-facing personnel and providing purpose-built systems and processes, such as our Easy-To-Buy-From order entry system.

Continue to Pursue Low-Cost Production Strategy. We intend to actively pursue measures that will allow us to maintain our position as a low-cost producer of capacitors with facilities close to our customers. These measures include shifting production to low cost locations; reducing material and labor costs; developing more cost-efficient manufacturing equipment and processes; designing manufacturing plants for more efficient production; and reducing work-in-process (WIP) inventory by building products from start to finish in one factory. Additionally, we intend to continue to implement Lean and Six Sigma methods to drive towards zero product defects so that quality remains a given in the minds of our customers. Between August 2008 and January 2009, we implemented rationalization plans which have resulted in an annual savings of approximately \$45 million. In addition, we have implemented numerous cost reduction initiatives and process improvements which we believe will result in meaningful savings from (i) the successful renegotiation of unfavorable sourcing contracts; (ii) relocation of tantalum manufacturing to Mexico and Suzhou, China; (iii) relocation of Film and Electrolytic manufacturing to Bulgaria and Mexico; and (iv) the integration of Evox Rifa and Arcotronics.

Edgar Filing: KEMET CORP - Form 10-Q

Leverage Our Technological Competence and Expand Our Leadership in Specialty Products. We continue to leverage our technological competence to introduce new products in a timely and cost efficient manner and generate an increasing portion of our sales from new and customized solutions to improve financial performance as well as to meet our customers' varied and evolving capacitor needs. We believe that by continuing to build on our strength in the higher growth and higher margin specialty segments of the capacitor market, we will be well positioned to achieve our long-term growth targets while also improving our profitability. During the second quarter of fiscal year 2011, we introduced 11,783 new products of which 34 were first to market, and specialty products accounted for 31.3% of our revenue over this period. During the six month period ended September 30, 2010, we introduced 13,237 new products of which 66 were first to market, and specialty products accounted for 30.8% of our revenue over this period.

Further Expand Our Broad Capacitance Capabilities. We define ourselves as "The Capacitance Company" and strive to be the supplier of choice for all our customers' capacitance needs across the full spectrum of dielectric materials including tantalum, ceramic, solid and electrolytic aluminum, film and paper. While we believe we have the most complete line of capacitor technologies across these primary capacitor types, we intend to continue to research additional capacitance technologies and solutions in order to maximize the breadth of our product offerings.

Selectively Target Complementary Acquisitions. We expect to continue to evaluate and pursue strategic acquisition opportunities, some of which may be significant in size, which would enable us to enhance our competitive position and expand our market presence. Our strategy is to acquire complementary capacitor and other related businesses that would allow us to leverage our business model, including those involved in other passive components that are synergistic with our customers' technologies and current product offerings.

Promote the KEMET Brand Globally. We are focused on promoting the KEMET brand globally by highlighting the high quality and high reliability of our products and our superior customer service. We will continue to market our products to new and existing customers around the world in order to expand our business. We continue to be recognized by our customers as a leading

Table of Contents

global supplier. For example, in November 2009, we received the Outstanding Performance Award for quality and delivery from Sanmina-SCI Corporation, a leading EMS provider.

Global Sales & Marketing Strategy. Our motto Think Global Act Local describes our approach to sales and marketing. Each of our three sales regions (Americas, Europe, Middle East and Africa (EMEA) and Asia and Pacific Rim (APAC),) has account managers, field application engineers and strategic marketing managers in the region. In addition, we also have local customer and quality-control support in each region. This organizational structure allows us to respond to the needs of our customers on a timely basis and in their native language. The regions are managed locally and report to a senior manager who is on the KEMET Leadership Team. Furthermore, this organizational structure ensures the efficient communication of our global goals and strategies and allows us to serve the language, cultural and other region-specific needs of our customers.

We manufacture capacitors in Bulgaria, China, Finland, Germany, Indonesia, Italy, Mexico, Portugal, Sweden, the United Kingdom, and the United States. Commodity manufacturing in the United States has been substantially relocated to our lower-cost manufacturing facilities in Mexico and China. Production that remains in the United States focuses primarily on early-stage manufacturing of new products and other specialty products for which customers are predominantly located in North America.

The market for all of our capacitors is highly competitive. The capacitor industry is characterized by, among other factors, a long-term trend toward lower prices for capacitors, low transportation costs, and few import barriers. Competitive factors that influence the market for our products include product quality, customer service, technical innovation, pricing and timely delivery. It is our belief that we compete favorably on the basis of each of these factors.

We are organized into three business groups: Tantalum, Ceramics, and Film and Electrolytic. Each business group is responsible for the operations of certain manufacturing sites as well as all related research and development efforts. The sales and marketing functions are shared by each of the business groups and the costs of which are allocated to the business groups. In addition, all corporate costs are allocated to the business groups.

We believe our Mexican operations are among the most cost efficient in the world, and they continue to be our primary production facilities supporting North America and, to a large extent, European customers. We also believe that our China manufacturing facilities benefit from low production costs and proximity to large and growing markets, which have caused some of our key customers to relocate production facilities to Asia, particularly China. As a result, one of our strategies is to continue to shift production to low-cost locations which provide us the best opportunity to be a low-cost producer of capacitors.

Net sales for the quarter ended September 30, 2010 were \$248.6 million, which is a 43.5% increase over the same quarter last fiscal year and a 2.0% increase over the prior fiscal quarter ended June 30, 2010. Net sales for the six month period ended September 30, 2010 were \$492.4 million, which is a 52.2% increase over the same six month period last fiscal year.

On April 8, 2010, we reported that we reached an agreement with three labor unions in Italy and with the regional government in Emilia Romagna, Italy to proceed with our planned restructuring process. We intend to focus on producing specialty products in Europe and the U.S. and shift standard and commodity production to lower cost regions.

Issuance of 10.5% Senior Notes

On May 5, 2010, we completed a private placement of \$230.0 million in aggregate principal amount of our 10.5% Senior Notes due 2018 (the "10.5% Senior Notes"). The private placement of the 10.5% Senior Notes resulted in proceeds to us of \$222.2 million. We used a portion of the proceeds of the private placement to repay all of the outstanding indebtedness under our credit facility with K Financing, LLC, our \$60 million credit facility and \$35 million credit facility with UniCredit and our term loan with Vishay. We used a portion of the remaining proceeds to fund a previously announced tender offer to purchase \$40.5 million in aggregate principal amount of our 2.25% Convertible Senior Notes (the "Convertible Notes") and to pay costs incurred in connection with the private placement, the tender offer and the foregoing repayments. We incurred approximately \$6.6 million in costs related to the execution of the offering.

Revolving Line of Credit

On September 30, 2010, KEMET Electronics Corporation ("KEC") and KEMET Electronics Marketing (S) Pte Ltd. ("KEMET Singapore") (each a "Borrower" and, collectively, the "Borrowers") entered into a Loan and Security Agreement (the "Loan and Security Agreement"), with Bank of America, N.A., as the administrative agent and the initial lender. The Loan and Security Agreement provides a \$50 million revolving line of credit, which is bifurcated into a U.S. facility (for which KEC is the Borrower) and a Singapore facility (for which KEMET Singapore is the Borrower). The size of the U.S. facility and Singapore facility can fluctuate as long as the Singapore facility does not exceed \$30 million and the total facility does not exceed \$50 million.

Table of Contents

A portion of the U.S. facility and of the Singapore facility can be used to issue letters of credit. The facilities expire on September 30, 2014.

Listing

As announced on June 21, 2010, the Company's common stock was approved for listing on the NYSE Amex. Trading commenced on the NYSE Amex on June 22, 2010 under the ticker symbol KEM (NYSE Amex: KEM).

CONDENSED CONSOLIDATED RESULTS OF OPERATIONS

Comparison of the Second Quarter of Fiscal Year 2011 with the Second Quarter of Fiscal Year 2010

The following table sets forth the operating income (loss) and certain components thereof for each of our business segments for the quarters ended September 30, 2010 and 2009, as well as the relative percentages that these amounts represent to total net sales. The table also sets forth certain other consolidated statement of operations data, as well as the relative percentages that these amounts represent to total net sales (amounts in thousands, except percentages):

Table of Contents

	Quarters Ended			
	September 30, 2010		September 30, 2009	
	Amount	% to Total Sales	Amount	% to Total Sales
Net sales				
Tantalum	\$ 123,873	49.8%	\$ 81,987	47.3%
Ceramics	56,730	22.8%	40,998	23.7%
Film and Electrolytic	67,985	27.3%	50,280	29.0%
Total	\$ 248,588	100.0%	\$ 173,265	100.0%
Gross margin				
Tantalum	\$ 41,752	16.8%	\$ 16,127	9.3%
Ceramics	19,416	7.8%	10,505	6.1%
Film and Electrolytic	8,550	3.4%	(2,118)	-1.2%
Total	69,718	28.0%	24,514	14.1%
SG&A expenses				
Tantalum	10,981	4.4%	8,775	5.1%
Ceramics	6,000	2.4%	4,554	2.6%
Film and Electrolytic	8,018	3.2%	7,184	4.1%
Total	24,999	10.1%	20,513	11.8%
R&D expenses				
Tantalum	3,104	1.2%	2,883	1.7%
Ceramics	1,654	0.7%	1,418	0.8%
Film and Electrolytic	1,466	0.6%	1,268	0.7%
Total	6,224	2.5%	5,569	3.2%
Restructuring charges				
Tantalum	322	0.1%	108	0.1%
Ceramics	93		51	
Film and Electrolytic	1,888	0.8%	1,108	0.6%
Total	2,303	0.9%	1,267	0.7%
Net (gain) loss on sales and disposals of assets				
Tantalum	(121)		31	
Ceramics	(1,655)	-0.7%	21	
Film and Electrolytic	6			
Total	(1,770)	-0.7%	52	
Operating income (loss)				
Tantalum	27,466	11.0%	4,330	2.5%
Ceramics	13,324	5.4%	4,461	2.6%
Film and Electrolytic	(2,828)	-1.1%	(11,678)	-6.7%
Total	37,962	15.3%	(2,887)	-1.7%
Other expense, net	2,458	1.0%	88,476	51.1%
Income (loss) before income taxes	35,504	14.3%	(91,363)	-52.7%
Income tax expense	593	0.2%	1,712	1.0%
Net income (loss)	\$ 34,911	14.0%	\$ (93,075)	-53.7%

Table of Contents

Consolidated Comparison of the Second Quarter of Fiscal Year 2011 with the Second Quarter of Fiscal Year 2010

Net Sales

Net sales for quarter ended September 30, 2010 were \$248.6 million, which represented a 43.5% increase from net sales of \$173.3 million in the second quarter of fiscal year 2010 due to an improvement in business across all segments. Net sales for the second quarter of fiscal year 2011 improved by 2.0% when compared to first quarter of fiscal year 2011.

By region, 29% of net sales for the quarter ended September 30, 2010 were to customers in the Americas, 37% were to customers in APAC, and 34% were to customers in EMEA. For the quarter ended September 30, 2009, 25% of net sales were to customers in the Americas, 40% were to customers in APAC, and 35% were to customers in EMEA.

By channel, 53% of net sales for the quarter ended September 30, 2010, were to distribution customers, 15% were to electronic manufacturing services customers, and 32% were to original equipment manufacturing customers. For the quarter ended September 30, 2009, 46% of net sales were to distribution customers, 15% were to electronic manufacturing services customers, and 39% were to original equipment manufacturing customers.

Gross Margin

Our gross margin for the second quarter of fiscal year 2011 increased \$45.2 million when compared to the second quarter of fiscal year 2010. Gross margin as a percent to net sales improved to 28.0% of net sales in the second quarter of fiscal year 2011, up from 14.1% of net sales in the second quarter of fiscal year 2010. The primary contributor to the higher gross margin was the increase in volume and overall average selling prices, while fixed cost reductions previously initiated in headcount and other manufacturing expenses were sustained during the second quarter of fiscal year 2011.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses were \$25.0 million, or 10.1% of net sales for the second quarter of fiscal year 2011 compared to \$20.5 million, or 11.8% of net sales for second quarter of fiscal year 2010. The \$4.5 million increase in SG&A expenses includes an increase of \$1.4 million in selling expenses consistent with the increase in sales. In addition, there was an increase of \$3.2 million related to incentive accruals, \$0.4 million related to marketing and \$0.2 million related to ERP integration costs in the second quarter of fiscal year 2011 compared to the second quarter of fiscal year 2010. These increased expenses were offset by a decrease in expense associated with the cancellation of an incentive plan of \$1.1 million which was incurred in the second quarter of fiscal year 2010.

Research and Development

Research and development expenses were \$6.2 million, or 2.5% of net sales for the second quarter of fiscal year 2011, compared to \$5.6 million, or 3.2% of net sales for the second quarter of fiscal year 2010. The 11.8% increase resulted from increased activities to ensure that products are available to support KEMET's growth and to meet customer needs. The growth in spending also reflects KEMET's increased focus on Specialty product development which requires an increase in sampling, tooling, and testing.

Restructuring Charges

We incurred \$1.3 million in restructuring charges in the second quarter of fiscal year 2010 compared to \$2.3 million in restructuring charges for the second quarter of fiscal year 2011. The restructuring charges in the second quarter of fiscal year 2011 included \$1.6 million in charges for the relocation of equipment to Mexico and China as well as a distribution center relocation project and \$0.7 million for reductions in workforce, primarily in Film and Electrolytic.

Operating Income (Loss)

Operating income for the quarter ended September 30, 2010 was \$38.0 million compared to an operating loss of \$2.9 million for the quarter ended September 30, 2009. Gross margin increased \$45.2 million as compared to the second quarter of fiscal year 2010 and a \$1.6 million gain was realized on the sale of an idle facility in the U.S. These improvements were offset by the increase in operating expenses of \$5.1 million and we incurred \$2.3 million in restructuring charges in the second quarter of fiscal year 2011 compared to \$1.3 million during the second quarter of fiscal year 2010.

Table of Contents

Other (Income) Expense, net

Other (income) expense, net was an expense of \$88.5 million in the second quarter of fiscal year 2010 compared to an expense of \$2.5 million in the second quarter of fiscal year 2011. The improvement is mainly attributable to no expense in the second quarter of fiscal year 2011 related to the increase in value of warrant compared to \$81.1 million in the second quarter of fiscal year 2010. In addition, during the second quarter of fiscal year 2011, we granted a supplier of tantalum powder and wire and related materials, a non-exclusive license, with a right to sublicense, concerning certain patents and patent applications which resulted in a net gain of \$2.0 million. Also, there was a gain on foreign currency translation of \$2.7 million in the second quarter of fiscal year 2011 as compared to a loss on foreign currency translation of \$1.4 million in the second quarter of fiscal year 2010, primarily due to the strengthening of the Euro against the dollar. Partially offsetting these favorable items was a \$0.9 million increase in net interest expense in the second quarter of fiscal year 2011 compared with the second quarter of fiscal year 2010.

Income Taxes

Our income tax expense for the second quarter of fiscal year 2011 is \$0.6 million compared to an income tax expense of \$1.7 million for the second quarter of fiscal year 2010. Income tax expense for the second quarter of fiscal year 2011 is comprised of \$0.6 million of income tax expense related to foreign operations. There was no federal or state income tax expense due to the utilization of net operating loss carryforward deductions and a valuation allowance on net deferred tax assets. The effective tax rate for the second quarter of fiscal year 2011 was 1.7%.

During the second quarter of fiscal year 2010, the net income tax expense of \$1.7 million was comprised of \$1.6 million of income tax expense from foreign operations and \$0.1 million of state income tax expense. The effective tax rate for the second quarter of fiscal year 2010 was (1.9)%.

Business Groups Comparison of the Quarter Ended September 30, 2010 with the Quarter Ended September 30, 2009

Tantalum

Net Sales

Net sales increased 51.1% during the second quarter of fiscal year 2011, as compared to the second quarter of fiscal year 2010. Unit sales volume increased 16.5% during the second quarter of fiscal year 2011 as compared to the second quarter of fiscal year 2010. Average selling prices increased 29.7% for the second quarter of fiscal year 2011 as compared to the second quarter of fiscal year 2010. The increase in average selling prices is due primarily to a shift in regional sales quantities to the Americas and EMEA as well as an increase in average selling prices for most product lines. Americas and EMEA unit sales quantities represented 49.4% of the total units sold in the second quarter of the fiscal year 2011 as compared to 37.8% in the same quarter of fiscal year 2010. All three regions and sectors were strong, bolstered by the automotive, industrial, wireless and computer segments.

Gross Margin

Gross margin as a percent to Tantalum net sales increased to 33.7% in the second quarter of fiscal year 2011 as compared to 19.7% in the second quarter of fiscal year 2010. The primary contributor to the higher gross margin was driven by the increase in sales quantities and average selling prices, while reducing fixed cost spending, from the cost reductions initiated throughout fiscal year 2009 in headcount and other manufacturing expenses.

Operating Income

Operating income for the second quarter of fiscal year 2011 improved to \$27.5 million when compared to the second quarter of fiscal year 2010 of \$4.3 million. The improvement is attributable to an increase in gross margin of \$25.6 million and a gain on sales and disposals of assets of \$0.1 million in the second quarter of fiscal year 2011 compared to less than \$0.1 million in the second quarter of fiscal year 2010. This was offset by an increase in operating expenses of \$2.4 million, and an increase in restructuring charges to \$0.3 million as compared to \$0.1 million in the second quarter of fiscal year 2011 as compared to the same quarter of fiscal year 2010.

Ceramics

Net Sales

Net sales increased by 38.4% during the second quarter of fiscal year 2011 as compared to the second quarter of fiscal year 2010, due to higher unit sales volumes and average selling prices. Unit sales volumes increased 25.1% during the second quarter of

Table of Contents

fiscal year 2011, as compared to the same period last year due primarily to strong market demand across all regions. Average selling price increased 10.6% due primarily to region mix and product line mix effects.

Gross Margin

Gross margin as a percent to Ceramics net sales increased to 34.2% in the second quarter of fiscal year 2011 from 25.6% in the second quarter of fiscal year 2010. The improvement in gross margin can be attributed primarily to higher volume and, to a lesser extent, increased efficiencies.

Operating Income

Operating income for the second quarter of fiscal year 2011 was \$13.3 million, an improvement of \$8.9 million when compared to \$4.5 million of operating income in the second quarter of fiscal year 2010. The improvement is primarily attributable to an increase in gross margin of \$8.9 million as well as the gain on sales and disposals of assets of \$1.6 million in the second quarter of fiscal year 2011 compared to a loss on sales and disposals of assets less than \$0.1 million in the second quarter of fiscal year 2010. This improvement was offset by an increase in operating expenses of \$1.6 million in the second quarter of fiscal year 2011 compared to the second quarter of fiscal year 2010.

Film and Electrolytic

Net Sales

Net sales increased from \$50.3 million in the second quarter of fiscal year 2010 to \$68.0 million in the second quarter of fiscal year 2011. Unit sales volume for the second quarter of fiscal year 2011 increased for almost all product lines for a total increase of 41.7% compared to the second quarter of fiscal year 2010. In addition, there was a 4.8% increase in the average selling price in the second quarter of fiscal year 2011 compared to the second quarter of fiscal year 2010 despite the \$4.8 million adverse effect of foreign exchange. Average selling prices increased over almost all product lines.

Gross Margin

Gross margin as a percent to Film and Electrolytic net sales increased to 3.4% in the second quarter of fiscal year 2011 from negative 1.2% in the second quarter of fiscal year 2010. The improvement is due to both increased volume and the improvement in average selling prices which was partially offset by foreign exchange.

Operating (Loss)

Operating loss for the second quarter of fiscal year 2011 was \$2.8 million as compared to an operating loss of \$11.7 million in second quarter of fiscal year 2010. Gross margin increased \$10.7 million in the second quarter of fiscal year 2011 as compared to the second quarter of fiscal year 2010. Offsetting the improvement in gross margin was a \$1.0 million increase in operating expenses as compared to the second quarter of fiscal year 2010. Within the operating expenses increase, research and development costs increased \$0.2 million to ensure that products are available to support our growth and to meet customer needs. In addition, restructuring charges were \$1.9 million in the second quarter of fiscal year 2011 compared to \$1.1 million in the second quarter of fiscal year 2010.

Comparison of the Six Month Period Ended September 30, 2010 with the Six Month Period Ended September 30, 2009

The following table sets forth the operating income (loss) for each of our business segments for the six month periods ended September 30, 2010 and September 30, 2009. The table also sets forth each of the segments' net sales as a percent to total net sales, the net income (loss) components as a percent to total net sales, and the percentage increase or decrease of such components over the comparable prior year period (dollars in thousands):

Table of Contents

	Six Months Ended			
	September 30, 2010		September 30, 2009	
	Amount	% to Total Sales	Amount	% to Total Sales
Net sales				
Tantalum	\$ 237,441	48.2%	\$ 154,355	47.7%
Ceramics	111,054	22.6%	73,946	22.9%
Film and Electrolytic	143,887	29.2%	95,131	29.4%
Total	\$ 492,382	100.0%	\$ 323,432	100.0%
Gross margin				
Tantalum	\$ 73,127	14.9%	\$ 30,199	9.3%
Ceramics	37,377	7.6%	18,491	5.7%
Film and Electrolytic	20,122	4.1%	(3,670)	-1.1%
Total	130,626	26.5%	45,020	13.9%
SG&A expenses				
Tantalum	21,309	4.3%	16,468	5.1%
Ceramics	11,442	2.3%	8,494	2.6%
Film and Electrolytic	16,463	3.3%	13,573	4.2%
Total	49,214	10.0%	38,535	11.9%
R&D expenses				
Tantalum	6,082	1.2%	5,336	1.6%
Ceramics	3,026	0.6%	2,934	0.9%
Film and Electrolytic	3,147	0.6%	2,078	0.6%
Total	12,255	2.5%	10,348	3.2%
Restructuring charges				
Tantalum	779	0.2%	108	
Ceramics	187		51	
Film and Electrolytic	3,129	0.6%	1,108	0.3%
Total	4,095	0.8%	1,267	0.3%
Net (gain) loss on sales and disposals of assets				
Tantalum	(15)		155	
Ceramics	(1,632)	-0.3%	103	
Film and Electrolytic	212			
Total	(1,435)	-0.3%	258	0.1%
Operating income (loss)				
Tantalum	44,972	9.1%	8,132	2.5%
Ceramics	24,354	4.9%	6,909	2.1%
Film and Electrolytic	(2,829)	-0.6%	(20,429)	-6.3%
Total	66,497	13.5%	(5,388)	-1.7%
Other expense, net	49,817	10.1%	59,855	18.5%
Income (loss) before income taxes	16,680	3.4%	(65,243)	-20.2%
Income tax expense	1,868	0.4%	2,742	0.8%
Net income (loss)	\$ 14,812	3.0%	\$ (67,985)	-21.0%

Table of Contents

Consolidated Comparison of the Six Month Period Ended September 30, 2010 with the Six Month Period Ended September 30, 2009

Net Sales

Net sales for the six month period ended September 30, 2010 increased by \$169.0 million, or 52.2% to \$492.4 million compared to the same period in fiscal year 2010.

By region, 26% of net sales for the six month period ended September 30, 2010 were to customers in the Americas, 39% were to customers in APAC, and 35% were to customers in EMEA. For the six month period ended September 30, 2009, 25% of net sales were to customers in the Americas, 40% were to customers in APAC, and 35% were to customers in EMEA.

By channel, 52% of net sales for the six month period ended September 30, 2010 were to distribution customers, 15% were to electronic manufacturing services customers, and 33% were to original equipment manufacturing customers. For the six month period ended September 30, 2009, 46% of net sales were to distribution customers, 15% were to electronic manufacturing services customers, and 39% were to original equipment manufacturing customers.

Gross Margin

Gross margin as a percent to net sales improved to 26.5% of net sales for the six month period ended September 30, 2010, an increase from 13.9% of net sales for the six month period ended September 30, 2009. The primary contributor to the higher gross margin was the increase in volume and overall average selling prices, while fixed cost reductions previously initiated in headcount and other manufacturing expenses were sustained during the first half of fiscal year 2011.

Selling, General and Administrative Expenses

SG&A expenses for the six month period ended September 30, 2010 were \$49.2 million, or 10.0% of net sales, as compared to \$38.5 million, or 11.9% of net sales for the same period in fiscal year 2010. The \$10.7 million increase in SG&A expenses includes an increase of \$3.3 million in selling expenses consistent with the increase in sales. In addition, there was an increase of \$6.2 million related to incentive accruals, \$0.9 million related to marketing expenses and \$0.7 million related to ERP integration costs in the second quarter of fiscal year 2011 compared to the second quarter of fiscal year 2010. These higher expenses were offset by a decrease in expenses associated with the cancellation of an incentive plan of \$1.1 million which were incurred in the second quarter of fiscal year 2010.

Research and Development Expenses

R&D expenses for the six month period ended September 30, 2010 were \$12.3 million, or 2.5% of net sales, as compared to \$10.3 million, or 3.2% of net sales for the same period in fiscal year 2010. The 18.4% increase resulted from increased activities to ensure that products are available to support KEMET's growth and to meet customer needs. The growth in spending also reflects KEMET's increased focus on Specialty product development which requires an increase in sampling, tooling, and testing.

Restructuring Charges

During the six month period ended September 30, 2009, we incurred \$1.3 million in restructuring charges compared to \$4.1 million in restructuring charges for the six month period ended September 30, 2010. The restructuring charges in the six month period ended September 30, 2010 included \$3.1 million in charges for the relocation of equipment to Mexico and China as well as a distribution center relocation project and \$1.0 million for reductions in workforce, primarily in Film and Electrolytic.

Operating Income (Loss)

Operating income for the six month period ended September 30, 2010 was \$66.5 million, compared to operating loss of \$5.4 million for the six month period ended September 30, 2009, an improvement of \$71.9 million. Gross margin increased \$85.6 million and Gain (loss) on sales and disposals of assets improved \$1.7 million compared to the six months ended September 30, 2009. These improvements were offset by the increase in operating expenses of \$12.6 million and \$4.1 million in restructuring charges in the six month period ended September 30, 2010 compared to \$1.3 million during the six month period ended September 30, 2009.

Table of Contents

Other (Income) Expense, net

Other (income) expense, net was an expense of \$49.8 million in the first half of fiscal year 2011 compared to an expense of \$59.9 million in the first half of fiscal year 2010. The improvement is attributable to zero expense in the first half of fiscal year 2011 related to the increase in value of warrant compared to \$81.1 million of expense in the first half of fiscal year 2010. In addition, we granted a supplier of tantalum powder and wire and related materials, a non-exclusive license, with a right to sublicense, concerning certain patents and patent applications which resulted in a net gain of \$2.0 million in the first half of fiscal year 2011. Also, there was a gain on foreign currency translation of \$1.4 million in the first half of fiscal year 2011 as compared to a loss on foreign currency translation of \$5.6 million in first half of fiscal year 2010, primarily due to the strengthening of the Euro against the dollar. These items were offset by a \$38.2 million non-cash loss recognized on the early extinguishment of debt in the first half of fiscal year 2011 compared to a \$38.9 million non-cash gain we recognized on the early extinguishment of debt in the first half of fiscal year 2010. Also offsetting these favorable items was a \$2.5 million increase in net interest expense in the six month period ended September 30, 2010 compared with the six month period ended September 30, 2009 primarily related to the restructuring of our debt to the 10.5% Senior Notes.

Income Taxes

For the six month period ended September 30, 2010, income tax expense of \$1.9 million is comprised of a \$1.8 million income tax expense related to foreign operations and \$0.1 million of federal and state income tax expense. During the six month period ended September 30, 2009, we recognized net income tax expense of \$2.7 million comprised of a \$2.5 million income tax expense related to foreign operations and \$0.2 million of federal and state income tax expense. The effective tax rate was 11.2% and (4.2)% for the six month periods ended September 30, 2010 and 2009, respectively.

Business Groups Comparison of the Six Month Period Ended September 30, 2010 with the Six Month Period Ended September 30, 2009

Tantalum

Net Sales

Net sales increased 53.8% during the six month period ended September 30, 2010, as compared to the same period of fiscal year 2010. Unit sales volume for the six month period ended September 30, 2010 increased 26.1% as compared to the same six month period in fiscal year 2010. Average selling prices increased 22.0% for the six month period ended September 30, 2010 as compared to the six month period ended September 30, 2009. The increase in average selling prices is due primarily to a shift in regional sales quantities to the Americas and EMEA as well as an increase in average selling prices in most product lines. Americas and EMEA unit sales quantities represented 49.4% of the total units sold in the six month period ended September 30, 2010 as compared to 37.8% in the same period of fiscal year 2010. All three regions and sectors were strong, bolstered by the automotive, industrial, wireless and computer segments.

Gross Margin

Gross margin increased by \$42.9 million during the six month period ended September 30, 2010, as compared to the six month period ended September 30, 2009. There was a corresponding increase in gross margin as a percentage to Tantalum net sales which increased to 30.8% during the six month period ended September 30, 2010 from 19.6% during the same period of fiscal year 2010. The primary contributor to the higher gross margin was driven by the increase in sales quantities and average selling prices while minimizing fixed cost spending. In addition, gross margin improved due to the cost reductions initiated throughout fiscal year 2009 in headcount and other manufacturing expenses.

Operating Income (Loss)

Operating income for six month period ended September 30, 2010 was \$45.0 million, as compared to an operating income of \$8.1 million in the first half of fiscal year 2010. The improvement is attributable to the increase in gross margin of \$42.9 million when comparing the six month period ended September 30, 2010 to the six month period ended September 30, 2009 and the first half of fiscal year 2011 had no loss on sales and disposals of assets as compared to \$0.2 million in the first half of fiscal year 2010. This increase was offset by an increase in operating expenses of \$5.6 million, and an increase in restructuring charges of \$0.7 million during the six month period ended September 30, 2010 as compared to the six month period ended September 30, 2009.

Table of Contents

Ceramics

Net Sales

Net sales increased by 50.2% during the six month period ended September 30, 2010, as compared to the same period of fiscal year 2010. The increase was primarily attributable to higher unit volumes and average selling prices. Unit sales volume increased 45.2% during the six month period ended September 30, 2010, as compared to the same period of fiscal year 2010 due to strong market demand across all regions. Average selling prices increased 3.5% due primarily to product mix and region mix improvements over fiscal year 2010.

Gross Margin

Gross margin as a percentage of Ceramics net sales increased to 33.7% from 25.0% in the six month period ended September 30, 2009. The improvement in gross margin can be attributed primarily to higher unit sales volume, higher average selling prices and, to a lesser extent, increased manufacturing efficiencies.

Operating Income

Operating income improved from \$6.9 million in the first half of fiscal year 2010 to an operating income of \$24.4 million in the first half of fiscal year 2011. The increase in operating income of \$17.4 million was attributable to the \$18.9 million increase in gross margin as well as the gain on sales and disposals of assets of \$1.6 million in the first half of fiscal year 2011 compared to a loss on sales and disposals of assets of \$0.1 million in the first half of fiscal year 2010. These increases were offset by an increase in operating expenses of \$3.0 million and an increase in restructuring charges of \$0.1 million during the six month period ended September 30, 2010 as compared to the six month period ended September 30, 2009.

Film and Electrolytic

Net Sales

Net sales increased by 51.3% from \$95.1 million in the first half of fiscal year 2010 to \$143.9 million in the first half of fiscal year 2011. Unit sales volume for the six month period ended September 30, 2010 increased for almost all product lines for a total increase of 53.4% compared to the six month period ended September 30, 2009. In addition, there was a 4.7% increase in the average selling price in the first half of fiscal year 2011 compared to the first half of fiscal year 2010, excluding the foreign exchange impact. Average selling prices increased over all product lines and geographic regions, excluding the foreign exchange impact.

Gross Margin

Gross margin increased \$23.8 million from negative \$3.7 million in the first half of fiscal year 2010 to \$20.1 million in the first half of fiscal year 2011. The increase is due to both increased unit sales volume and the improvement in average selling prices which was partially offset by foreign exchange.

Operating Loss

Operating loss was \$2.8 million in the first half of fiscal year 2011 compared to an operating loss of \$20.4 million in the first half of fiscal year 2010. The improvement in operating loss of \$17.6 million was attributable primarily to the \$23.8 million improvement in gross margin. This increase was offset by an increase in operating expenses of \$4.8 million in the first half of fiscal year 2011 as compared to the first half of fiscal year 2010, an increase in restructuring charges of \$2.0 million during the six month period ended September 30, 2010 as compared to the six month period ended September 30, 2009, and a \$0.2 million loss on sales and disposals of assets in the first half of fiscal year 2011 as compared to zero in the first half of fiscal year 2010.

Table of Contents

Liquidity and Capital Resources

Our liquidity needs arise from working capital requirements, capital expenditures, principal and interest payments on debt, and costs associated with the implementation of our restructuring plans. Historically, these cash needs have been met by cash flows from operations, borrowings under our credit agreements and existing cash balances.

Issuance of 10.5% Senior Notes

On May 5, 2010, we completed a private placement of \$230.0 million in aggregate principal amount of our 10.5% Senior Notes due 2018 (the 10.5% Senior Notes) to several Initial Purchasers (the Initial Purchasers) represented by Banc of America Securities LLC pursuant to an exemption from the registration requirements under the Securities Act of 1933, as amended (the Securities Act). The Initial Purchasers subsequently sold the 10.5% Senior Notes to qualified institutional buyers pursuant to Rule 144A under the Securities Act and to persons outside of the United States pursuant to Regulation S under the Securities Act.

The private placement of the 10.5% Senior Notes resulted in proceeds to us of \$222.2 million. We used a portion of the proceeds of the private placement to repay all of the outstanding indebtedness under our credit facility with K Financing, LLC, our 60 million credit facility and 35 million credit facility with UniCredit and our term loan with Vishay. We used a portion of the remaining proceeds to fund a previously announced tender offer to purchase \$40.5 million in aggregate principal amount of our 2.25% Convertible Senior Notes (the Convertible Notes) and to pay costs incurred in connection with the private placement, the tender offer and the foregoing repayments. We incurred approximately \$6.6 million in costs related to the execution of the offering, and these costs are capitalized and will be amortized over the term of the 10.5% Senior Notes.

The 10.5% Senior Notes were issued pursuant to a 10.5% Senior Notes Indenture, dated as of May 5, 2010, by and among us, our domestic restricted subsidiaries (the Guarantors) and Wilmington Trust Company, as trustee (the Trustee). The 10.5% Senior Notes will mature on May 1, 2018, and bear interest at a stated rate of 10.5% per annum, payable semi-annually in cash in arrears on May 1 and November 1 of each year, beginning on November 1, 2010. The 10.5% Senior Notes are our senior obligations and are guaranteed by each of the Guarantors and secured by a first priority lien on 51% of the capital stock of certain of our foreign restricted subsidiaries.

The terms of the 10.5% Senior Notes Indenture will, among other things, limit our ability and the ability of our restricted subsidiaries to (i) incur additional indebtedness or issue certain preferred stock; (ii) pay dividends on, or make distributions in respect of, our capital stock or repurchase our capital stock; (iii) make certain investments or other restricted payments; (iv) sell certain assets; (v) create liens or use assets as security in other transactions; (vi) enter into sale and leaseback transactions; (vii) merge, consolidate or transfer or dispose of substantially all assets; (viii) engage in certain transactions with affiliates; and (ix) designate subsidiaries as unrestricted subsidiaries. These covenants are subject to a number of important limitations and exceptions that are described in the 10.5% Senior Notes Indenture.

The 10.5% Senior Notes will be redeemable, in whole or in part, at any time on or after May 1, 2014, at the redemption prices specified in the 10.5% Senior Notes Indenture. At any time prior to May 1, 2013, we may redeem up to 35% of the aggregate principal amount of the 10.5% Senior Notes with the net cash proceeds from certain equity offerings at a redemption price equal to 110.5% of the principal amount thereof, together with accrued and unpaid interest, if any, to the redemption date. In addition, at any time prior to May 1, 2014, we may redeem the

Edgar Filing: KEMET CORP - Form 10-Q

10.5% Senior Notes, in whole or in part, at a redemption price equal to 100% of the principal amount of the 10.5% Senior Notes so redeemed, plus a make whole premium and together with accrued and unpaid interest, if any, to the redemption date.

Upon the occurrence of a change of control triggering event specified in the 10.5% Senior Notes Indenture, we must offer to purchase the 10.5% Senior Notes at a redemption price equal to 101% of the principal amount thereof, plus accrued and unpaid interest, if any, to the date of purchase.

The 10.5% Senior Notes Indenture provides for customary events of default (subject in certain cases to customary grace and cure periods), which include nonpayment, breach of covenants in the 10.5% Senior Notes Indenture, payment defaults or acceleration of other indebtedness, a failure to pay certain judgments and certain events of bankruptcy and insolvency. The 10.5% Senior Notes Indenture also provides for events of default with respect to the collateral, which include default in the performance of (or repudiation, disaffirmation or judgment of unenforceability or assertion of unenforceability) by us or a Guarantor with respect to the provision of security documents under the 10.5% Senior Notes Indenture. These events of default are subject to a number of important qualifications, limitations and exceptions that are described in the 10.5% Senior Notes Indenture. Generally, if an event of default occurs, the Trustee or holders of at least 25% in principal amount of the then outstanding 10.5% Senior Notes may declare the principal of and accrued but unpaid interest, including additional interest, on all the 10.5% Senior Notes to be due and payable.

On May 17, 2010, we consummated a tender offer to purchase \$40.5 million in aggregate principal amount of our Convertible Notes. We used \$37.9 million from the bond offering discussed above to extinguish the tendered notes. We incurred

Table of Contents

approximately \$0.2 million in costs related to the execution of this tender offer, and these costs were included in the line item (Gain) loss on early extinguishment of debt on the Condensed Consolidated Statements of Operations.

Registration Rights Agreement

On May 5, 2010, in connection with the private placement of the 10.5% Senior Notes, we, the Guarantors and the Initial Purchasers of the 10.5% Senior Notes entered into the Registration Rights Agreement. The terms of the Registration Rights Agreement require the Company and the Guarantors to (i) use their commercially reasonable efforts to file with the Securities and Exchange Commission within 210 days after the date of the initial issuance of the 10.5% Senior Notes, a registration statement with respect to an offer to exchange the 10.5% Senior Notes for a new issue of debt securities registered under the Securities Act, with terms substantially identical to those of the 10.5% Senior Notes (except for provisions relating to the transfer restrictions and payment of additional interest); (ii) use our commercially reasonable efforts to consummate such exchange offer within 270 days after the date of the initial issuance of the 10.5% Senior Notes; and (iii) in certain circumstances, file a shelf registration statement for the resale of the 10.5% Senior Notes. If we and the Guarantors fail to satisfy our registration obligations under the Registration Rights Agreement, then we will be required to pay additional interest to the holders of the 10.5% Senior Notes, up to a maximum additional interest rate of 1.0% per annum.

The foregoing description of the 10.5% Senior Notes Indenture and the Registration Rights Agreement does not purport to be complete and is qualified in its entirety by reference to the full text of the 10.5% Senior Notes Indenture and Registration Rights Agreement.

On October 26, 2010, the Company filed a Form S-4 to offer, in exchange for our outstanding 10.5% Senior Notes due 2018 (Old Notes), up to \$230.0 million in aggregate principal amount of 10.5% Senior Notes due 2018 and the guarantees thereof which have been registered under the Securities Act of 1933, as amended.

Revolving Line of Credit

On September 30, 2010, KEMET Electronics Corporation (KEC) and KEMET Electronics Marketing (S) Pte Ltd. (KEMET Singapore) (each a Borrower and, collectively, the Borrowers) entered into a Loan and Security Agreement (the Loan and Security Agreement), with Bank of America, N.A, as the administrative agent and the initial lender. The Loan and Security Agreement provides a \$50 million revolving line of credit, which is bifurcated into a U.S. facility (for which KEC is the Borrower) and a Singapore facility (for which KEMET Singapore is the Borrower). The size of the U.S. facility and Singapore facility can fluctuate as long as the Singapore facility does not exceed \$30 million and the total facility does not exceed \$50 million. A portion of the U.S. facility and of the Singapore facility can be used to issue letters of credit. The facilities expire on September 30, 2014.

Revolving loans may be used to pay fees and transaction expenses associated with the closing of the credit facilities, to pay obligations outstanding under the Loan and Security Agreement and for working capital and other lawful corporate purposes of KEC and KEMET Singapore. Borrowings under the U.S. and Singapore facilities are subject to a borrowing base. The borrowing base consists of:

Edgar Filing: KEMET CORP - Form 10-Q

- in the case of the U.S. facility, (A) 85% of KEC's accounts receivable that satisfy certain eligibility criteria plus (B) the lesser of \$4 million and 40% of the net book value of inventory of KEC that satisfy certain eligibility criteria plus (C) the lesser of \$3 million and 70% of the net orderly liquidation percentage of the appraised value of equipment that satisfies certain eligibility criteria less (D) certain reserves, including certain reserves imposed by the administrative agent in its permitted discretion; and

- in the case of the Singapore facility, (A) 85% of KEMET Singapore's accounts receivable that satisfy certain eligibility criteria less (B) certain reserves, including certain reserves imposed by the administrative agent in its permitted discretion.

Interest is payable on borrowings monthly at a rate equal to the London Interbank Offer Rate (LIBOR) or the base rate, plus an applicable margin, as selected by the Borrower. Depending upon the fixed charge coverage ratio of KEMET Corporation and its subsidiaries on a consolidated basis as of the latest test date, the applicable margin under the U.S. facility varies between 3.00% and 3.50% for LIBOR advances and 2.00% and 2.50% for base rate advances, and under the Singapore facility varies between 3.25% and 3.75% for LIBOR advances and 2.25% and 2.75% for base rate advances.

The base rate is subject to a floor that is 100 basis points above LIBOR.

An unused line fee is payable monthly in an amount equal to 0.75% per annum of the average daily unused portion of the facilities during any month; provided, that such percentage rate is reduced to (a) 0.50% per annum for any month in which the average

Table of Contents

daily balance of the facilities is greater than 33.3% of the total revolving commitment and less than 66.6% of the total revolving commitment, and (b) 0.375% per annum for any month in which the average daily balance of the facilities is greater than or equal to 66.6% of the total revolving commitment. A customary fee is also payable to the administrative agent on a quarterly basis.

KEC's ability to draw funds under the U.S. facility and KEMET Singapore's ability to draw funds under the Singapore facility are conditioned upon, among other matters:

- the absence of the existence of a Material Adverse Effect (as defined in the Loan and Security Agreement);
- the absence of the existence of a default or an event of default under the Loan and Security Agreement; and
- the representations and warranties made by KEC and KEMET Singapore in the Loan and Security Agreement continuing to be correct in all material respects.

The parent corporation of KEC - KEMET Corporation - and the Guarantors guarantee the U.S. facility obligations and the U.S. facility obligations are secured by a lien on substantially all of the assets of KEC and the Guarantors (other than assets that secure the 10.5% Senior Notes due 2018). The collection accounts of the Borrowers and Guarantors are subject to a daily sweep into a concentration account and the concentration account will become subject to full cash dominion in favor of the administrative agent (i) upon an event of default, (ii) if for five consecutive business days, aggregate availability of all facilities has been less than the greater of (A) 15% of the aggregate revolver commitments at such time and (B) \$7.5 million, or (iii) if for five consecutive business days, availability of the U.S. facility has been less than \$3.75 million (each such event, a Cash Dominion Trigger Event).

KEC and the Guarantors guarantee the Singapore facility obligations. In addition to the assets that secure the U.S. facility, the Singapore obligations are also secured by a pledge of 100% of the stock of KEMET Singapore and a security interest in substantially all of KEMET Singapore's assets. Within 90 days after the closing date, KEMET Singapore's bank accounts will be transferred over to Bank of America and upon a Cash Dominion Trigger Event will become subject to full cash dominion in favor of the administrative agent.

A fixed charge coverage ratio of at least 1.1:1.0 must be maintained as at the last day of each fiscal quarter ending immediately prior to or during any period in which any of the following occurs and is continuing until none of the following occurs for a period of at least forty-five consecutive days: (i) an event of default, (ii) aggregate availability of all facilities has been less than the greater of (A) 15% of the aggregate revolver commitments at such time and (B) \$7.5 million, or (iii) availability of the U.S. facility has been less than \$3.75 million. The fixed charge coverage ratio tests the EBITDA and fixed charges of KEMET Corporation and its subsidiaries on a consolidated basis.

In addition, the Loan and Security Agreement includes negative covenants that, subject to exceptions, limit the ability of KEMET Corporation and its direct and indirect subsidiaries to, among other things:

- incur additional indebtedness;
- create liens on assets;

- make capital expenditures;
- engage in mergers, consolidations, liquidations and dissolutions;
- sell assets (including pursuant to sale leaseback transactions);
- pay dividends and distributions on or repurchase capital stock;
- make investments (including acquisitions), loans, or advances;
- prepay certain junior indebtedness;
- engage in certain transactions with affiliates;
- enter into restrictive agreements;
- amend material agreements governing certain junior indebtedness; and
- change its lines of business.

The Loan and Security Agreement includes certain customary representations and warranties, affirmative covenants and events of default, which are set forth in more detail in the Loan and Security Agreement.

Short Term Liquidity

Based on our current operating plans management believes that cash generated from operations will be sufficient to cover our operating requirements for the next twelve months, including principal and interest payments and expected capital expenditures for fiscal year 2011 of in the range of \$28 million to \$35 million.

Table of Contents

Our cash and cash equivalents increased by \$38.3 million for the six month period ended September 30, 2010 as compared with an increase of \$18.2 million during the six month period ended September 30, 2009.

The following table provides a summary of cash flows for the periods presented (amounts in thousands):

	Six Months Ended September 30,	
	2010	2009
Cash provided by operating activities	\$ 56,445	\$ 20,756
Cash used in investing activities	(8,396)	(3,730)
Cash provided by (used in) financing activities	(10,556)	910
Effects of foreign currency fluctuations on cash	762	272
Net increase in cash and cash equivalents	\$ 38,255	\$ 18,208

Operations

Cash provided by operating activities improved \$35.7 million in the six month period ended September 30, 2010 compared to the six month period ended September 30, 2009. This improvement is primarily a result of an increase of \$76.1 million related to operations (net income adjusted for non-cash items) for the six month period ended September 30, 2010 compared to the six month period ended September 30, 2009. Offsetting this increase was a decrease in cash from working capital of \$38.4 million. The decrease in cash from working capital when comparing the first half of fiscal year 2011 to the first half of fiscal year 2010 is primarily due to an increase in accounts receivable and inventory related to the increase in sales and demand for our products. Accounts receivables increased \$11.1 million in the first half of fiscal year 2011 compared to an increase of \$3.6 million in the first half of fiscal year 2010 primarily due to an increase in sales. In the six month period ended September 30, 2010, we used \$30.2 million in cash due to an increase in our inventories. For the first half of fiscal year 2011, raw material inventory increased \$20.6 million, due primarily to price increases in Tantalum raw materials as well an increase in the volume of raw materials. The increase in raw material quantities was driven by increased sales levels and accelerating purchases of raw materials that are expected to increase in price. The \$38.2 million loss on early extinguishment of debt was a non-cash item and did not affect cash provided by operations in the first half of fiscal year 2011. Likewise, the \$38.9 million gain on early extinguishment of debt and the \$81.1 million increase in warrant value were non-cash items which did not affect cash provided by operations in the first half of fiscal year 2010. In the six month period ended September 30, 2009, we generated \$14.5 million in cash as we focused on reducing our inventories.

Investing

Cash used in investing activities was \$8.4 million in the six month period ended September 30, 2010 compared to \$3.7 million in the six month period ended September 30, 2009 due to an increase in capital expenditures. The capital expenditure amount for the first half of fiscal year 2011 included \$2.7 million for the acquisition of land in Italy to be used as the site for a new manufacturing facility in order to consolidate our Italian operations. The remaining purchase price for the land in Italy will be paid in seven annual payments of EUR 500 thousand (\$600 thousand) beginning on April 28, 2013. Capital expenditures were offset by proceeds from the sale of assets in the six month period ended September 30, 2010 of \$5.4 million. There were no proceeds from the disposal of assets in the six month period ended September 30, 2009.

Financing

Cash used in financing activities was \$10.6 million in the six month period ended September 30, 2010 as compared to cash provided by financing activities of \$0.9 million in the six month period ended September 30, 2009. In the first half of fiscal year 2011, proceeds from the issuance of debt resulted from the private placement of \$230.0 million in aggregate principal amount of our 10.5% Senior Notes due 2018. The proceeds of \$182.5 million were used to repay all of the outstanding indebtedness under our credit facilities with K Financing, LLC, our 60 million credit facility and 35 million credit facility with UniCredit and our term loan with Vishay. We used \$38.1 million to retire \$40.5 million in aggregate principal amount of our Convertible Notes and \$6.6 million to pay costs incurred in connection with the private placement, the tender offer and the foregoing repayments. We made a principal payment related to UniCredit Facility A on April 1, 2010 for 7.7 million (\$10.4 million). Our next significant maturity is November 15, 2011 when the Convertible Note holders have the right to require us to repurchase for cash all or a portion of the Convertible Notes outstanding of \$40.6 million.

In the first half of fiscal year 2010, proceeds from the issuance of debt resulted primarily from the Platinum Term Loan and the Platinum Line of Credit Loan. Approximately \$37.8 million in proceeds from the Platinum Term Loan were used to retire \$93.9 million in aggregate principal amount of the Convertible Notes (representing 53.7% of the outstanding Convertible Notes) which were validly tendered on June 26, 2009. Proceeds of \$10.0 million from the Platinum Line of Credit Loan were used primarily to pay the

Table of Contents

fees and expenses related to execution of the tender offer. Proceeds of \$10.0 million from the Platinum Working Capital Loan were used for general corporate purposes. The gain on the early extinguishment of the Convertible Notes is shown on the line item (Gain) loss on early extinguishment of debt on the Condensed Consolidated Statements of Operations.

In the first half of fiscal year 2010, payments of debt relate primarily to retirement of the Convertible Notes discussed above as well as a principal payment on UniCredit Facility A.

Commitments

At September 30, 2010, we had contractual obligations in the form of debt and interest payments as follows (amounts in thousands):

	Payments Due by Period				
	Total	Year 1	Years 2-3	Years 4-5	More than 5 years
Debt obligations(1)	\$ 279,955	\$ 5,457	\$ 43,844	\$ 654	\$ 230,000
Interest obligations	184,426	25,151	48,515	48,305	62,455
	\$ 464,381	\$ 30,608	\$ 92,359	\$ 48,959	\$ 292,455

(1) Holders of the Convertible Notes have the right to require us to repurchase for cash all or a portion of the Convertible Notes on November 15, 2011, 2016 and 2021 at a repurchase price equal to 100% of the principal amount of the Convertible Notes to be repurchased plus accrued and unpaid interest, if any, in each case, up to but not including, the date of repurchase. The \$40.6 million of Convertible Notes have been included in the Years 2-3 column above.

Our operating lease obligations, European social security, and pension benefit and other postretirement benefit obligations have not changed materially from those disclosed in the Company's 2010 Annual Report.

Non-GAAP Financial Measures

To complement our Condensed Consolidated Statements of Operations and Cash Flows, we use non-GAAP financial measures of Adjusted operating income (loss), Adjusted net income (loss) and Adjusted EBITDA. Management believes that Adjusted operating income (loss), Adjusted net income (loss) and Adjusted EBITDA are complements to U.S. GAAP amounts and such measures are useful to investors. The presentation of these non-GAAP measures is not meant to be considered in isolation or as an alternative to net income as an indicator of our performance, or as an alternative to cash flows from operating activities as a measure of liquidity.

Adjusted operating income (loss) is calculated as follows (amounts in thousands):

Edgar Filing: KEMET CORP - Form 10-Q

	Quarters Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Operating income (loss)	\$ 37,962	\$ (2,887)	\$ 66,497	\$ (5,388)
Adjustments:				
Restructuring charges	2,303	1,267	4,095	1,267
(Gain) loss on sales and disposals of assets	(1,770)	52	(1,435)	258
Cancellation of incentive plan		1,161		1,161
Write off of capitalized advisor fees		413		413
ERP integration costs	375		655	
Total adjustments	908	2,893	3,315	3,099
Adjusted operating income (loss)	\$ 38,870	\$ 6	\$ 69,812	\$ (2,289)

Edgar Filing: KEMET CORP - Form 10-Q

Table of Contents

Adjusted net income (loss) is calculated as follows (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Net income (loss)	\$ 34,911	\$ (93,075)	\$ 14,812	\$ (67,985)
Adjustments:				
(Gain) loss on early extinguishment of debt			38,248	(38,921)
Restructuring charges	2,303	1,267	4,095	1,267
Amortization included in interest expense	830	3,319	2,754	5,883
(Gain) loss on sales and disposals of assets	(1,770)	52	(1,435)	258
Gain on licensing of patents	(2,000)		(2,000)	
Cancellation of incentive plan		1,161		1,161
Write off of capitalized advisor fees		413		413
ERP integration costs	375		655	
Increase in value of warrant		81,088		81,088
Income tax impact of adjustments	(364)	(67)	(632)	671
Total adjustments	(626)	87,233	41,685	51,820
Adjusted net income (loss)	\$ 34,285	\$ (5,842)	\$ 56,497	\$ (16,165)

Adjusted EBITDA is calculated as follows (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Net income (loss)	\$ 34,911	\$ (93,075)	\$ 14,812	\$ (67,985)
Adjustments:				
Income tax expense	593	1,712	1,868	2,742
Interest expense, net	7,250	6,389	14,687	12,177
Depreciation and amortization expense	14,132	13,226	28,642	25,490
(Gain) loss on early extinguishment of debt			38,248	(38,921)
Increase in value of warrant		81,088		81,088
Restructuring charges	2,303	1,267	4,095	1,267
Foreign exchange transaction (gain) loss	(2,679)	1,416	(1,407)	5,635
Stock-based compensation expense	333	1,379	482	1,628
(Gain) loss on sales and disposals of assets	(1,770)	52	(1,435)	258
ERP integration costs	375		655	
Gain on licensing of patents	(2,000)		(2,000)	
Total adjustments	18,537	106,529	83,835	91,364
Adjusted EBITDA	\$ 53,448	\$ 13,454	\$ 98,647	\$ 23,379

Edgar Filing: KEMET CORP - Form 10-Q

Adjusted operating income (loss) represents operating income (loss), excluding adjustments which are outlined in the quantitative reconciliation provided above. We use Adjusted operating income (loss) to facilitate our analysis and understanding of our business operations and believe that Adjusted operating income (loss) is useful to investors because it provides a supplemental way to understand our underlying operating performance. Adjusted operating income (loss) should not be considered as an alternative to operating income or any other performance measure derived in accordance with U.S. GAAP.

Adjusted net income (loss) represents net income (loss), excluding adjustments which are more specifically outlined in the quantitative reconciliation provided above. We use Adjusted net income (loss) to evaluate our operating performance and believe that Adjusted net income (loss) is useful to investors because it provides a supplemental way to understand our underlying operating

Table of Contents

performance. Adjusted net income (loss) should not be considered as an alternative to net income, operating income or any other performance measures derived in accordance with U.S. GAAP.

Adjusted EBITDA represents net income (loss) before income tax expense, interest expense, net, and depreciation and amortization expense, adjusted to exclude increase in value of warrant, restructuring charges, stock-based compensation expense, (gain) loss on sales and disposals of assets, (gain) loss on the early extinguishment of debt, foreign exchange transaction (gain) loss, ERP integration costs and gain on licensing of patents. We present Adjusted EBITDA as a supplemental measure of our performance and ability to service debt. We also present Adjusted EBITDA because we believe such measure is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry.

We believe Adjusted EBITDA is an appropriate supplemental measure of debt service capacity, because cash expenditures on interest are, by definition, available to pay interest, and tax expense is inversely correlated to interest expense because tax expense goes down as deductible interest expense goes up; and depreciation and amortization are non-cash charges. The other items excluded from Adjusted EBITDA are excluded in order to better reflect our continuing operations.

In evaluating Adjusted EBITDA, you should be aware that in the future we may incur expenses similar to the adjustments noted above. Our presentation of Adjusted EBITDA should not be construed as an inference that our future results will be unaffected by these types of adjustments. Adjusted EBITDA is not a measurement of our financial performance under U.S. GAAP and should not be considered as an alternative to net income, operating income or any other performance measures derived in accordance with U.S. GAAP or as an alternative to cash flow from operating activities as a measure of our liquidity.

Our Adjusted EBITDA measure has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under U.S. GAAP. Some of these limitations are:

- it does not reflect our cash expenditures, future requirements for capital expenditures or contractual commitments;
- it does not reflect changes in, or cash requirements for, our working capital needs;
- it does not reflect the significant interest expense or the cash requirements necessary to service interest or principal payments on our debt;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and our Adjusted EBITDA measure does not reflect any cash requirements for such replacements;

Edgar Filing: KEMET CORP - Form 10-Q

- it is not adjusted for all non-cash income or expense items that are reflected in our statements of cash flows;
- it does not reflect the impact of earnings or charges resulting from matters we consider not be indicative of our ongoing operations;
- it does not reflect limitations on or costs related to transferring earnings from our subsidiaries to us; and
- other companies in our industry may calculate this measure differently than we do, limiting its usefulness as a comparative measure.

Because of these limitations, Adjusted EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business or as a measure of cash that will be available to us to meet our obligations. You should compensate for these limitations by relying primarily on our U.S. GAAP results and using Adjusted EBITDA only supplementally.

Off-Balance Sheet Arrangements

Other than operating lease commitments, we are not a party to any material off-balance sheet financing arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

Impact of Recently Issued Accounting Standards

New accounting standards adopted

There were no accounting standards adopted in the second quarter of fiscal year 2011.

New accounting standards issued but not yet adopted

Table of Contents

There are currently no accounting standards that have been issued that will have a significant impact on the Company's financial position, results of operations or cash flows upon adoption.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no material changes regarding the Company's market risk position from the information included in the Company's 2010 Annual Report.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of September 30, 2010, an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in its reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms, and that information required to be disclosed by the Company in the reports the Company files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There has been no change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) of the Exchange Act) during the quarter ended September 30, 2010 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Edgar Filing: KEMET CORP - Form 10-Q

We or our subsidiaries are at any one time parties to a number of lawsuits arising out of our respective operations, including workers compensation or work place safety cases, some of which involve claims of substantial damages. Although there can be no assurance, based upon information known to us, we do not believe that any liability which might result from an adverse determination of such lawsuits would have a material adverse effect on our financial condition or results of operations.

Item 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed in Part I, Item 1A, of the Company's 2010 Annual Report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. [Removed and Reserved]

Item 5. Other Information

None.

Table of Contents

Item 6. Exhibits

Exhibit 10.1 Loan and Security Agreement, dated as of September 30, 2010, by and among KEMET Electronics Corporation, KEMET Electronics Marketing (S) Pte Ltd., and Bank of America, N.A., as agent and Banc of America Securities LLC, as lead arranger and bookrunner (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated September 30, 2010).

Exhibit 31.1 Rule 13a-14(a)/15d-14(a) Certification - Principal Executive Officer

Exhibit 31.2 Rule 13a-14(a)/15d-14(a) Certification - Principal Financial Officer

Exhibit 32.1 Section 1350 Certification - Principal Executive Officer

Exhibit 32.2 Section 1350 Certification - Principal Financial Officer

Exhibit 101 The following financial information from KEMET Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2010, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Statements of Income for the three and six months ended September 30, 2010 and 2009, (ii) Condensed Consolidated Balance Sheets at September 30, 2010, and March 31, 2010, (iii) Condensed Consolidated Statements of Cash Flows for the six months ended September 30, 2010 and 2009, and (iv) the Notes to Condensed Consolidated Financial Statements, tagged as blocks of text.

SIGNATURE

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

Date: October 29, 2010

KEMET Corporation

/s/ WILLIAM M. LOWE, JR.

William M. Lowe, Jr.

Executive Vice President and Chief Financial Officer

(Principal Financial Officer and Principal Accounting Officer)

(Duly Authorized Officer)

Table of Contents

EXHIBIT INDEX

Exhibit 10.1 Loan and Security Agreement, dated as of September 30, 2010, by and among KEMET Electronics Corporation, KEMET Electronics Marketing (S) Pte Ltd., and Bank of America, N.A., as agent and Banc of America Securities LLC, as lead arranger and bookrunner (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated September 30, 2010).

Exhibit 31.1 Rule 13a-14(a)/15d-14(a) Certification - Principal Executive Officer

Exhibit 31.2 Rule 13a-14(a)/15d-14(a) Certification - Principal Financial Officer

Exhibit 32.1 Section 1350 Certification - Principal Executive Officer

Exhibit 32.2 Section 1350 Certification - Principal Financial Officer

Exhibit 101 The following financial information from KEMET Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2010, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Statements of Income for the three and six months ended September 30, 2010 and 2009, (ii) Condensed Consolidated Balance Sheets at September 30, 2010, and March 31, 2010, (iii) Condensed Consolidated Statements of Cash Flows for the six months ended September 30, 2010 and 2009, and (iv) the Notes to Condensed Consolidated Financial Statements, tagged as blocks of text.