

II-VI INC
Form 10-Q
November 06, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2015

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the transition period from _____ to _____.

Commission File Number: 0-16195

II-VI INCORPORATED

(Exact name of registrant as specified in its charter)

PENNSYLVANIA	25-1214948
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification No.)

375 Saxonburg Boulevard	
Saxonburg, PA	16056
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: 724-352-4455

N/A

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

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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 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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

At November 2, 2015, 61,138,290 shares of Common Stock, no par value, of the registrant were outstanding.

II-VI INCORPORATED

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

II-VI Incorporated and Subsidiaries

Condensed Consolidated Balance Sheets (Unaudited)

(\$000)

	September 30, 2015	June 30, 2015
Assets		
Current Assets		
Cash and cash equivalents	\$ 163,779	\$ 173,634
Accounts receivable - less allowance for doubtful accounts of \$1,271 at September 30, 2015 and \$1,048 at June 30, 2015	133,305	140,772
Inventories	167,266	164,388
Deferred income taxes	13,141	13,260
Prepaid and refundable income taxes	7,532	6,881
Prepaid and other current assets	12,130	14,033
Total Current Assets	497,153	512,968
Property, plant & equipment, net	201,001	203,812
Goodwill	194,594	195,894
Other intangible assets, net	119,097	122,462
Investment	12,178	11,914
Deferred income taxes	1,013	2,210
Other assets	8,990	8,904
Total Assets	\$ 1,034,026	\$ 1,058,164
Liabilities and Shareholders' Equity		
Current Liabilities		
Current portion of long-term debt	\$ 20,000	\$ 20,000
Accounts payable	39,357	45,275
Accrued compensation and benefits	31,485	39,310
Accrued income taxes payable	10,376	9,310
Deferred income taxes	659	685
Other accrued liabilities	22,921	24,576
Total Current Liabilities	124,798	139,156
Long-term debt	142,493	155,957
Deferred income taxes	5,565	7,105
Other liabilities	26,409	26,865
Total Liabilities	299,265	329,083
Shareholders' Equity		
Preferred stock, no par value; authorized - 5,000,000 shares; none issued	-	-
Common stock, no par value; authorized - 300,000,000 shares; issued - 72,153,590 shares at September 30, 2015; 71,779,704 shares at June 30, 2015	231,369	226,609
Accumulated other comprehensive income	550	8,665

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Retained earnings	604,516	587,302
	836,435	822,576
Treasury stock, at cost - 11,052,754 shares at September 30, 2015 and 10,565,209 shares at June 30, 2015	(101,674)	(93,495)
Total Shareholders' Equity	734,761	729,081
Total Liabilities and Shareholders' Equity	\$1,034,026	\$1,058,164

- See notes to condensed consolidated financial statements.

II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Earnings (Unaudited)

(\$000 except per share data)

	Three Months Ended September 30,	
	2015	2014
Revenues		
Domestic	\$70,751	\$61,981
International	118,456	123,852
Total Revenues	189,207	185,833
Costs, Expenses and Other Expense (Income)		
Cost of goods sold	118,018	117,974
Internal research and development	13,151	12,943
Selling, general and administrative	36,310	35,520
Interest expense	649	1,204
Other expense (income), net	(1,057)	1,682
Total Costs, Expenses and Other Expense (Income)	167,071	169,323
Earnings Before Income Taxes	22,136	16,510
Income Taxes	4,922	4,208
Net Earnings	\$17,214	\$12,302
Basic Earnings Per Share:	\$0.28	\$0.20
Diluted Earnings Per Share:	\$0.27	\$0.20

- See notes to condensed consolidated financial statements.

II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

(\$000)

	Three Months Ended September 30, 2015 2014	
Net earnings	\$17,214	\$12,302
Other comprehensive income (loss):		
Foreign currency translation adjustments	(8,151)	(2,675)
Pension adjustment, net of taxes of \$10 and (\$57) for the three months ended, respectively	36	(304)
Comprehensive income	\$9,099	\$9,323

- See notes to condensed consolidated financial statements.

II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

(\$000)

	Three Months Ended September 30,	
	2015	2014
Cash Flows from Operating Activities		
Net earnings	\$17,214	\$12,302
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	10,345	10,511
Amortization	2,960	3,050
Share-based compensation expense	4,009	3,594
(Gain) Loss on foreign currency remeasurements and transactions	(712)	2,181
Earnings from equity investment	(264)	(267)
Deferred income taxes	(360)	1,979
Excess tax benefits from share-based compensation expense	(30)	-
Increase (decrease) in cash from changes in:		
Accounts receivable	6,459	(30,686)
Inventories	(5,489)	(672)
Accounts payable	(5,073)	2,975
Income taxes	766	159
Other operating net assets	(7,646)	(4,270)
Net cash provided by operating activities	22,179	856
Cash Flows from Investing Activities		
Additions to property, plant & equipment	(9,424)	(21,530)
Other investing activities	25	-
Net cash used in investing activities	(9,399)	(21,530)
Cash Flows from Financing Activities		
Proceeds from borrowings	4,000	-
Payments on borrowings	(17,500)	(5,000)
Purchases of treasury stock	(5,884)	(5,093)
Proceeds from exercises of stock options	766	1,504
Other financing activities	(1,650)	(1,248)
Net cash used in financing activities	(20,268)	(9,837)
Effect of exchange rate changes on cash and cash equivalents	(2,367)	1,266
Net decrease in cash and cash equivalents	(9,855)	(29,245)
Cash and Cash Equivalents at Beginning of Period	173,634	174,660
Cash and Cash Equivalents at End of Period	\$163,779	\$145,415
Cash paid for interest	\$657	\$1,169
Cash paid for income taxes	\$4,535	\$4,440
Non cash transactions:		
Purchases of treasury stock recorded in Other accrued liabilities	\$400	\$1,200

- See notes to condensed consolidated financial statements.

e II-VI Incorporated and Subsidiaries

Condensed Consolidated Statement of Shareholders' Equity (Unaudited)

(000)

	Common Stock		Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock		Total
	Shares	Amount			Shares	Amount	
Balance - June 30, 2015	71,780	\$226,609	\$ 8,665	\$587,302	(10,565)	\$(93,495)	\$729,081
Shares issued under share-based compensation plans	360	766	-	-	-	-	766
Shares acquired in satisfaction of minimum tax withholding obligations	-	-	-	-	(94)	(1,680)	(1,680)
Net earnings	-	-	-	17,214	-	-	17,214
Purchases of treasury stock	-	-	-	-	(381)	(6,284)	(6,284)
Treasury stock under deferred compensation arrangements	13	215	-	-	(13)	(215)	-
Foreign currency translation adjustments	-	-	(8,151)	-	-	-	(8,151)
Share-based compensation expense	-	4,009	-	-	-	-	4,009
Pension adjustment, net of taxes of \$10	-	-	36	-	-	-	36
Tax deficiency from share-based compensation expense	-	(230)	-	-	-	-	(230)
Balance - September 30, 2015	72,153	\$231,369	\$ 550	\$604,516	(11,053)	\$(101,674)	\$734,761

- See notes to condensed consolidated financial statements.

II-VI Incorporated and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1. Basis of Presentation

The condensed consolidated financial statements of II-VI Incorporated (“II-VI” or the “Company”) for the three months ended September 30, 2015 and 2014 are unaudited. In the opinion of management, all adjustments considered necessary for a fair presentation for the periods presented have been included. All adjustments are of a normal recurring nature unless disclosed otherwise. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2015. The consolidated results of operations for the three months ended September 30, 2015 are not necessarily indicative of the results to be expected for the full fiscal year. The June 30, 2015 Condensed Consolidated Balance Sheet information was derived from the Company’s audited financial statements.

Note 2. Recent Accounting Pronouncements

In July 2015, the Financial Accounting Standards Board (“FASB”) issued an Accounting Standard Update (“ASU”) 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. This update simplifies the measurement of inventory valuation at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The new inventory measurement requirements will be effective for the Company’s 2018 fiscal year and will replace the current inventory valuation guidance that requires the use of a lower of cost or market framework. The adoption of this ASU is not expected to have a material effect on the Company’s Consolidated Financial Statements.

In April 2015, the FASB issued ASU 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement. This update provides guidance about whether a cloud computing arrangement includes a software license. The update will be effective for annual reporting periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. The update allows for the use of either a prospective or retrospective adoption approach. Management is currently evaluating the available transition methods and the potential impact of adoption on the Company’s Consolidated Financial Statements.

In April 2015, the FASB issued ASU 2015-03, Interest – Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs. This ASU requires entities to present debt issuance costs in the balance sheet as a direct deduction from the carrying amount of the corresponding debt liability, consistent with debt discounts. The guidance does not address situations in which debt issuance costs do not have an associated debt liability or exceed the carrying amount of the associated debt liability. The update will be effective for annual reporting periods, including interim periods

within those annual periods, beginning after December 15, 2015. The adoption of this ASU is not expected to have a material effect on the Company's Consolidated Financial Statements.

In February 2015, the FASB issued, ASU 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis, which affects reporting organizations that are required to evaluate whether they should consolidate certain legal entities. The update will be effective for interim and annual reporting periods in fiscal years beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. The update allows for the use of either a full retrospective or a modified retrospective adoption approach. The adoption of this ASU is not expected to have a material effect on the Company's Consolidated Financial Statements.

In May 2014, the FASB issued ASU 2014-09: Revenue from Contracts with Customers (Topic 606) which supersedes virtually all existing revenue recognition guidance under U.S. GAAP. The update's core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The update allows for the use of either the retrospective or modified retrospective approach of adoption. On July 9, 2015 the FASB approved a one year deferral of the effective date of the update. The update will be effective for fiscal years, and interim periods within those years, beginning after December 15, 2017 (the first quarter of our fiscal year 2019). We have not yet selected a transition method and are currently evaluating the impact of this guidance on the Company's Consolidated Financial Statements.

In April 2014, the FASB issued ASU 2014-08: Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. Under the new guidance, a discontinued operation is defined as a disposal of a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has or will have a major effect on an

entity's operations and financial results. The new standard was effective for the Company in the first quarter of fiscal year 2016. The adoption of this standard did not have a significant impact on the Company's Consolidated Financial Statements.

Note 3. Investment

The Company has an equity investment of 20.2% in Guangdong Fuxin Electronic Technology ("Fuxin") based in Guangdong Province, China, which is accounted for under the equity method of accounting. The total carrying value of the investment recorded at September 30, 2015 and June 30, 2015 was \$12.2 million and \$11.9 million, respectively. During each of the three months ended September 30, 2015 and 2014, the Company's pro-rata share of earnings from this investment was \$0.3 million and was recorded in Other expense (income), net in the Condensed Consolidated Statements of Earnings.

Note 4. Inventories

The components of inventories were as follows (\$000):

	September 30, 2015	June 30, 2015
Raw materials	\$ 68,811	\$ 71,210
Work in progress	57,106	52,726
Finished goods	41,349	40,452
	\$ 167,266	\$ 164,388

Note 5. Property, Plant and Equipment

Property, plant and equipment consists of the following (\$000):

	September 30, 2015	June 30, 2015
Land and land improvements	\$ 4,568	\$ 4,566
Buildings and improvements	91,060	91,171
Machinery and equipment	366,827	366,560
Construction in progress	22,164	17,749
	484,619	480,046

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Less accumulated depreciation	(283,618)	(276,234)
	\$201,001	\$203,812

During fiscal year 2015, as part of the Company's restructuring of its military related businesses in the Performance Products segment, the Company implemented a plan to sell one of its manufacturing facilities located in New Port Richey, Florida. The Company anticipates completing the sale within twelve months, has reclassified the carrying value of the land and building of approximately \$1.2 million as assets held for sale and has included the carrying value in Prepaid and other current assets in the Condensed Consolidated Balance Sheets for the periods presented.

Note 6. Goodwill and Other Intangible Assets

Changes in the carrying amount of goodwill were as follows (\$000):

	Three Months Ended September 30, 2015			Total
	II-VI		II- VI	
	Laser Solutions	II-VI Photonics	Performance Products	
Balance-beginning of period	\$43,578	\$99,426	\$52,890	\$195,894
Foreign currency translation	2	(1,302)	-	(1,300)
Balance-end of period	\$43,580	\$98,124	\$52,890	\$194,594

Note 1 of the Notes to Consolidated Financial Statements in the Company's most recent Annual Report on Form 10-K describes the significant accounting policies and methods used in the preparation of the Company's consolidated financial statements. Management has evaluated goodwill for indicators of impairment and has concluded that there are no indicators of impairment as of September 30, 2015.

The gross carrying amount and accumulated amortization of the Company's intangible assets other than goodwill as of September 30, 2015 and June 30, 2015 were as follows (\$000):

	September 30, 2015			June 30, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Technology and Patents	\$50,136	\$ (19,632)	\$30,504	\$50,520	\$ (18,838)	\$31,682
Trademarks	15,732	(1,130)	14,602	15,869	(1,111)	14,758
Customer Lists	102,187	(28,303)	73,884	102,489	(26,583)	75,906
Other	1,572	(1,465)	107	1,572	(1,456)	116
Total	\$169,627	\$ (50,530)	\$119,097	\$170,450	\$ (47,988)	\$122,462

Amortization expense recorded on the Company's intangible assets was \$3.0 million and \$3.1 million for the three months ended September 30, 2015 and 2014, respectively. The technology and patents are being amortized over a range of 60 to 240 months, with a weighted average remaining life of approximately 106 months. The customer lists are being amortized over a range of approximately 120 months to 240 months with a weighted average remaining life of approximately 138 months. The gross carrying amount of trademarks includes \$14.2 million of acquired trade names with indefinite lives that are not amortized but tested annually for impairment or more frequently if a triggering event occurs. Included in the gross carrying amount and accumulated amortization of the Company's intangible assets is the effect of foreign currency translation on that portion of the intangible assets relating to the Company's German and Chinese subsidiaries.

At September 30, 2015, the estimated amortization expense for existing intangible assets for each of the five succeeding fiscal years is as follows (\$000):

Year Ending June 30,	
Remaining 2016	\$9,226
2017	11,607
2018	11,139
2019	10,706
2020	10,593

The components of debt for the periods indicated were as follows (\$000):

	September 30, 2015	June 30, 2015
Line of credit, interest at LIBOR, as defined, plus 1.25%	\$ 100,000	\$ 108,500
Term loan, interest at LIBOR, as defined, plus 1.25%	60,000	65,000
Yen denominated line of credit, interest at LIBOR, as defined, plus 0.625%	2,493	2,457
Total debt	162,493	175,957
Current portion of long-term debt	(20,000)	(20,000)
Long-term debt, less current portion	\$ 142,493	\$ 155,957

The Company's Second Amended and Restated Credit Agreement (the "Credit Facility") provides for a revolving credit facility of \$225 million, as well as a \$100 million Term Loan. The Term Loan is being repaid in consecutive quarterly principal payments on the first business day of each January, April, July and October, with the first payment having commenced on October 1, 2013, as follows: (i) twenty consecutive quarterly installments of \$5 million and (ii) a final installment of all remaining principal due and payable on the maturity date of September 10, 2018. The Credit Facility is unsecured, but is guaranteed by each existing and subsequently acquired or organized wholly-owned domestic subsidiary of the Company. The Company has the option to request an increase to the size of the

Credit Facility in an aggregate additional amount not to exceed \$100 million. The Credit Facility has a five-year term through September 10, 2018 and has an interest rate of LIBOR, as defined in the agreement, plus 0.75% to 1.75% based on the Company's ratio of consolidated indebtedness to consolidated EBITDA. Additionally, the facility is subject to certain covenants, including those relating to minimum interest coverage and maximum leverage ratios. As of September 30, 2015, the Company was in compliance with all financial covenants under its Credit Facility.

The Company's Yen denominated line of credit is a 500 million Yen (approximately \$4.1 million) facility. The Yen line of credit was extended in September 2015 through August 2020 on substantially the same terms. The interest rate is equal to LIBOR, as defined in the loan agreement, plus 0.625% to 1.50%. At September 30, 2015 and June 30, 2015, the Company had 300 million Yen borrowed. Additionally, the facility is subject to certain covenants, including those relating to minimum interest coverage and maximum leverage ratios. As of September 30, 2015, the Company was in compliance with all financial covenants under its Yen facility.

The Company had aggregate availability of \$125.1 million and \$116.6 million under its lines of credit as of September 30, 2015 and June 30, 2015, respectively. The amounts available under the Company's lines of credit are reduced by outstanding letters of credit. As of September 30, 2015 and June 30, 2015, total outstanding letters of credit supported by these credit facilities were \$1.5 million.

The weighted average interest rate of total borrowings was 1.5% and 1.9% for the three months ended September 30, 2015 and 2014, respectively.

Remaining annual principal payments under the Company's existing credit facilities as of September 30, 2015 were as follows:

		Yen	U.S. Dollar	
Period	Term Loan	Line of Credit	Line of Credit	Total
Year 1	\$20,000	\$-	\$-	\$20,000
Year 2	20,000	-	-	20,000
Year 3	20,000	-	100,000	120,000
Year 4	-	-	-	-
Year 5	-	2,493	-	2,493
Total	\$6			