NANOMETRICS INC
Form 10-Q
November 07, 2013

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 28, 2013
OR
o 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 0-13470

NANOMETRICS INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	94-2276314
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)
1550 Buckeye Drive, Milpitas, CA	95035
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (408) 545-6000

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 Q 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 such shorter period that the registrant was required to submit and post such file) Yes Q 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.

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

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

As of November 4, 2013 there were 23,349,469 shares of common stock, $0.001 par value, issued and outstanding.

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FOR QUARTER ENDED SEPTEMBER 28, 2013

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NANOMETRICS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands except share and per share amounts)
(Unaudited)

	September 28, 2013	December 29, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$43,833	$62,915
Marketable securities	49,057	46,993
Accounts receivable, net of allowances of $227 and $82, respectively	22,924	21,388
Inventories	36,543	39,659
Inventories-delivered systems	2,313	2,274
Prepaid expenses and other	7,534	7,492
Deferred income tax assets	18,091	8,593
Total current assets	180,295	189,314
Property, plant and equipment, net	46,597	43,213
Goodwill	11,580	11,352
Intangible assets, net	8,559	10,980
Deferred income tax assets	3,566	3,671
Other assets	723	924
Total assets	$251,320	$259,454
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$11,967	$6,398
Accrued payroll and related expenses	7,982	6,670
Deferred revenue	11,272	8,485
Other current liabilities	8,043	7,822
Income taxes payable	325	424
Current portion of debt obligations	—	928
Total current liabilities	39,589	30,727
Deferred revenue	3,531	4,307
Income taxes payable	2,334	2,135
Other long-term liabilities	2,064	2,140
Debt obligations	—	4,374
Total liabilities	47,518	43,683
Commitments and contingencies (Note 18)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 3,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, $0.001 par value, 47,000,000 shares authorized; 23,316,477 and 23,250,429, respectively, issued and outstanding	23	23
Additional paid-in capital	241,879	238,326
Accumulated deficit	(38,552)	(23,850)
Accumulated other comprehensive income	452	1,272

Total stockholders' equity	203,802	215,771
Total liabilities and stockholders' equity	$251,320	$259,454

See Notes to Condensed Consolidated Financial Statements

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NANOMETRICS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands except per share amounts)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Net revenues:				
Products	$30,164	$32,314	$69,776	$121,728
Service	8,880	11,624	28,372	30,883
Total net revenues	39,044	43,938	98,148	152,611
Costs of net revenues:				
Cost of products	18,116	15,778	40,908	63,224
Cost of service	4,469	5,379	14,510	15,507
Amortization of intangible assets	658	629	1,963	1,903
Total costs of net revenues	23,243	21,786	57,381	80,634
Gross profit	15,801	22,152	40,767	71,977
Operating expenses:				
Research and development	8,926	7,176	24,695	22,296
Selling	6,758	6,308	20,303	20,560
General and administrative	5,424	4,861	16,442	16,525
Amortization of intangible assets	195	193	588	580
Restructuring charge	1,740	—	1,740	—
Total operating expenses	23,043	18,538	63,768	59,961
Income (loss) from operations	(7,242)	3,614	(23,001)	12,016
Other income (expense)				
Interest income	7	28	51	113
Interest expense	(118)	(262)	(549)	(795)
Other expense, net	(334)	(121)	(930)	(345)
Total other expense, net	(445)	(355)	(1,428)	(1,027)
Income (loss) before income taxes	(7,687)	3,259	(24,429)	10,989
Provision for (benefit from) income taxes	(3,133)	1,356	(9,727)	2,877
Net income (loss)	$(4,554)	$1,903	$(14,702)	$8,112
Net income (loss) per share:				
Basic	$(0.20)	$0.08	$(0.63)	$0.35
Diluted	$(0.20)	$0.08	$(0.63)	$0.34
Shares used in per share calculation:				
Basic	23,261	23,310	23,247	23,351
Diluted	23,261	23,760	23,247	23,874

See Notes to Condensed Consolidated Financial Statements

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NANOMETRICS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Net income (loss)	$(4,554)	$1,903	$(14,702)	$8,112
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	1,142	1,108	(837)	190
Net change on unrealized gains (losses) on available-for-sale investments	20	1	17	(3)
Other comprehensive loss	1,162	1,109	(820)	187
Comprehensive income (loss)	$(3,392)	$3,012	$(15,522)	$8,299

See Notes to Condensed Consolidated Financial Statements

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NANOMETRICS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 28, 2013	September 29, 2012
Cash flows from operating activities:		
Net income (loss)	$(14,702)	$8,112
Reconciliation of net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	6,536	5,991
Stock-based compensation	5,912	4,535
Excess tax benefit from equity awards	467	(939)
Loss on disposal of fixed assets	173	246
Inventory write down	6,307	2,602
Deferred income taxes	(9,659)	2,948
Changes in fair value of contingent consideration	1,045	307
Changes in assets and liabilities:		
Accounts receivable	(1,818)	(831)
Inventories	(7,173)	(429)
Inventories-delivered systems	(300)	(571)
Prepaid expenses and other	820	(1,655)
Accounts payable, accrued and other liabilities	6,798	(12,242)
Deferred revenue	2,044	4,418
Income taxes payable	(363)	283
Net cash provided by (used in) operating activities	(3,913)	12,775
Cash flows from investing activities:		
Maturities of marketable securities	38,030	500
Escrow payment received related to Nanda acquisition	—	508
Sales of marketable securities	—	3,000
Purchases of marketable securities	(40,797)	(40,929)
Purchases of property, plant and equipment	(3,516)	(3,705)
Net cash used in investing activities	(6,283)	(40,626)
Cash flows from financing activities:		
Payments of contingent consideration	(735)	(232)
Repayments of debt obligations	(5,224)	(1,989)
Proceeds from sale of shares under employee stock option and purchase plans	3,192	3,463
Excess tax benefit from equity awards	(467)	939
Taxes paid on net issuance of stock awards	(86)	(16)
Repurchases of common stock	(5,000)	(4,960)
Net cash used in financing activities	(8,320)	(2,795)
Effect of exchange rate changes on cash and cash equivalents	(566)	411
Net decrease in cash and cash equivalents	(19,082)	(30,235)
Cash and cash equivalents, beginning of period	62,915	97,699
Cash and cash equivalents, end of period	$43,833	$67,464

See Notes to Condensed Consolidated Financial Statements

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NANOMETRICS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Note 1. Nature of Business and Basis of Presentation

Description of Business – Nanometrics Incorporated (“Nanometrics” or the “Company”) and its wholly owned subsidiaries design, manufacture, market, sell and support thin film, optical critical dimension and overlay dimension metrology and inspection systems used primarily in the manufacturing of semiconductors, solar photovoltaics (“solar PV”) and high-brightness LEDs (“HB-LED”), as well as by customers in the silicon wafer and data storage industries. Nanometrics' metrology systems precisely measure a wide range of film types deposited on substrates during manufacturing to control manufacturing processes and increase production yields in the fabrication of integrated circuits. The thin film metrology systems use a broad spectrum of wavelengths, high-sensitivity optics, proprietary software, and patented technology to measure the thickness and uniformity of films deposited on silicon and other substrates as well as their chemical composition. The Company’s optical critical dimension technology is a patented critical dimension measurement technology that is used to precisely determine the dimensions on the semiconductor wafer that directly control the resulting performance of the integrated circuit devices. The overlay metrology systems are used to measure the overlay accuracy of successive layers of semiconductor patterns on wafers in the photolithography process. Nanometrics' inspection systems are used to find defects on patterned and unpatterned wafers at nearly every stage of the semiconductor production flow. The corporate headquarters of Nanometrics is located in Milpitas, California.

Basis of Presentation – The accompanying condensed consolidated financial statements ("financial statements") have been prepared on a consistent basis with the audited consolidated financial statements as of December 29, 2012, and include all normal recurring adjustments necessary to fairly present the information set forth therein. All significant intercompany accounts and transactions have been eliminated in consolidation.
The financial statements have been prepared in accordance with the regulations of the United States Securities and Exchange Commission (“SEC”) for interim periods in accordance with S-X Article 10, and, therefore, omit certain information and footnote disclosure necessary to present the statements in accordance with accounting principles generally accepted in the United States of America. The operating results for interim periods are not necessarily indicative of the operating results that may be expected for the entire year. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended December 29, 2012, which were included in the Company’s Annual Report on Form 10-K filed with the SEC on March 12, 2013.

Fiscal Period – The Company uses a 52/53 week fiscal year ending on the Saturday nearest to December 31. All references to the quarter refer to Nanometrics' fiscal quarter. The fiscal quarters presented herein include 13 weeks.

Reclassification – Certain prior year amounts have been reclassified to conform to the current year presentation.

Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ materially from those estimates. Estimates are used for, but not limited to, revenue recognition, the provision for doubtful accounts, the provision for excess, obsolete, or slow moving inventories, depreciation and amortization, valuation of intangible assets and long-lived assets, warranty accruals, income taxes, valuation of stock-based compensation, and contingencies.

Foreign Currency Translation – The assets and liabilities of foreign subsidiaries are translated from their respective functional currencies at exchange rates in effect at the balance sheet date and income and expense accounts are translated at average exchange rates during the reporting period. Resulting translation adjustments are reflected in

"Accumulated other comprehensive income (loss)," a component of stockholders' equity. Foreign currency transaction gains and losses are reflected in "Other income (expense)" in the consolidated statements of operations in the period incurred and consists of a $0.4 million loss and a $0.1 million loss for the three-month periods ended September 28, 2013, and September 29, 2012, respectively, and a $0.4 million loss in both the nine-month periods ended September 28, 2013, and September 29, 2012.

Revenue Recognition – The Company derives revenue from the sale of process control metrology systems ("product revenue") as well as spare part sales, billable service, service contracts, and upgrades (together "service revenue"). Upgrades are a group of parts and/or software that change the existing configuration of a product and are included in service revenue. They are distinguished from product revenue, which consists of complete, advanced process control metrology and inspection systems (the “system(s)”). Nanometrics' systems consist of hardware and software components that function together to deliver the essential functionality of the system. Arrangements for sales of systems often include defined customer-specified acceptance criteria.

In summary, the Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller's price is fixed or determinable, and collectability is reasonably assured.

For product sales to existing customers, revenue recognition occurs at the time title and risk of loss transfer to the customer, which usually occurs upon shipment from the Company's manufacturing location, if it can be reliably demonstrated that the product has successfully met the defined customer specified acceptance criteria and all other recognition criteria has been met. For initial sales where the product has not previously met the defined customer specified acceptance criteria, product revenues are recognized upon the earlier of receipt of written customer acceptance or expiration of the contractual acceptance period. In Japan, where contractual terms with the customer specify risk of loss and title transfers upon customer acceptance, revenue is recognized upon receipt of written customer acceptance, provided that all other recognition criteria have been met.

The Company warrants its products against defects in manufacturing. Upon recognition of product revenue, a liability is recorded for anticipated warranty costs. On occasion, customers request a warranty period longer than the Company's standard warranty. In those instances where extended warranty services are separately quoted to the customer, the associated revenue is deferred and recognized as service revenue ratably over the term of the contract. The portion of service contracts and extended warranty services agreements that are uncompleted at the end of any reporting period are included in deferred revenue.

As part of its customer services, the Company sells software that is considered to be an upgrade to a customer's existing systems. These standalone software upgrades are not essential to the tangible product's functionality and are accounted for under software revenue recognition rules which require vendor specific objective evidence ("VSOE") of fair value to allocate revenue in a multiple element arrangement. Revenue from upgrades is recognized when the upgrades are delivered to the customer, provided that all other recognition criteria have been met.

Revenue related to spare parts is recognized upon shipment. Revenue related to billable services is recognized as the services are performed. Service contracts may be purchased by the customer during or after the warranty period and revenue is recognized ratably over the service contract period.

Frequently, the Company delivers products and various services in a single transaction. The Company's deliverables consist of tools, installation, upgrades, billable services, spare parts, and service contracts. The Company's typical multi-element arrangements include a sale of one or multiple tools that include installation and standard warranty. Other arrangements consist of a sale of tools bundled with service elements or delivery of different types of services. The Company's tools, upgrades, and spare parts are generally delivered to customers within a period of up to six months from order date. Installation is usually performed soon after delivery of the tool. The portion of revenue associated with installation is deferred based on relative selling price and that revenue is recognized upon completion of the installation. Billable services are billed on a time and materials basis and performed as requested by customers. Under service contract arrangements, services are provided as needed over the fixed arrangement term. The Company does not grant its customers a general right of return or any refund terms and imposes a penalty on orders canceled prior to the scheduled shipment date.

The Company regularly evaluates its revenue arrangements to identify deliverables and to determine whether these deliverables are separable into multiple units of accounting. In accordance with revenue recognition guidance, the Company allocates the arrangement consideration among the deliverables based on relative selling prices. The Company has established VSOE for some of its products and services when a substantial majority of selling prices falls within a narrow range when sold separately. For deliverables with no established VSOE, the Company uses best estimate of selling price to determine standalone selling price for such deliverable. The Company does not use third party evidence ("TPE") to determine standalone selling price since this information is not widely available in the market as the Company's products contain a significant element of proprietary technology and the solutions offered differ substantially from competitors. The Company has established a process for developing estimated selling prices, which incorporates historical selling prices, the effect of market conditions, gross margin objectives, pricing practices, as well as entity-specific factors. The Company monitors and evaluates estimated selling price on a regular basis to ensure that changes in circumstances are accounted for in a timely manner.

When certain elements in multiple-element arrangements are not delivered or accepted at the end of a reporting period, the relative selling prices of undelivered elements are deferred until these elements are delivered and/or accepted. If deliverables cannot be accounted for as separate units of accounting, the entire arrangement is accounted for as a single unit of accounting and revenue is deferred until all elements are delivered and all revenue recognition requirements are met.

Note 2. Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force) ("ASU 2013-11"), which provides that a liability related to an unrecognized tax benefit would be offset against a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. In situations in which a net operating loss carryforward, a similar tax loss or a tax credit carryforward is not available at the reporting date under the tax law of the jurisdiction or the tax law of the jurisdiction does not require, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit will be presented in the financial statements as a liability and will not be combined with deferred tax assets. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. ASU 2013-11 is effective for fiscal years and interim periods beginning after December 15, 2013. The Company expects adoption of this standard to cause a balance sheet reclassification reducing long-term liability and deferred tax assets.

In February 2013, the FASB issued ASU No. 2013-02, Comprehensive Income (Topic 220) - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income ("ASU 2013-02") to require reclassification adjustments from other comprehensive income to be presented either in the financial statements or in the notes to the financial statements, which we have done within Note 13 - "Equity and Stock Based Compensation Plans". ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. ASU 2013-02 was effective for the period ending March 30, 2013, and is applied prospectively.

Note 3. Fair Value Measurements and Disclosures

Fair value is defined as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The standard assumes that the transaction to sell the asset or transfer the liability occurs in the principal or most advantageous market for the asset or liability and establishes that the fair value of an asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability.

The Company determines the fair values of its financial instruments based on the fair value hierarchy established in ASC 820, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The classification of a financial asset or liability within the hierarchy is based upon the lowest level input that is significant to the fair value measurement. The fair value hierarchy prioritizes the inputs into three levels that may be used to measure fair value:

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

Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument.

Level 3 — Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Such unobservable inputs include an estimated discount rate used in the Company's discounted present value analysis of future cash flows, which reflects the Company's estimate of debt with similar terms in the current credit markets. As there is currently minimal activity in such markets, the actual rate could be materially different.

The following tables present the Company's assets and liabilities measured at estimated fair value on a recurring basis, excluding accrued interest components, categorized in accordance with the fair value hierarchy (in thousands):

	September 28, 2013 Fair Value Measurements Using Input Types				December 29, 2012 Fair Value Measurements Using Input Types			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents:								
Money market funds	$748	$—	$—	$748	$109	$—	$—	$109
Commercial paper	—	—	—	—	—	2,600	—	2,600
Municipal securities	—	—	—	—	—	—	—	—
Total cash equivalents	748	—	—	748	109	2,600	—	2,709
Marketable securities:								
U.S. Treasury securities and U.S. Government agency securities	20,738	—	—	20,738	20,568	—	—	20,568
Commercial paper, corporate debt securities, and municipal securities	—	28,319	—	28,319	—	26,425	—	26,425
Total marketable securities	20,738	28,319	—	49,057	20,568	26,425	—	46,993
Total [1]	$21,486	$28,319	$—	$49,805	$20,677	$29,025	$—	$49,702

Liabilities: