II-VI INC
Form 10-Q
February 08, 2013


# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the quarterly period ended December 31, 2012**

¨ **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)**

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 x 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 x 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 | x | 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 x

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

At February 1, 2013, 62,199,324 shares of Common Stock, no par value, of the registrant were outstanding.

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**PART I FINANCIAL INFORMATION**

Item 1. Financial Statements

II-VI Incorporated and Subsidiaries

Condensed Consolidated Balance Sheets (Unaudited)

($000)

| | December 31, 2012 | June 30, 2012 |
|---|---|---|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | $ 162,810 | $ 134,944 |
| Accounts receivable less allowance for doubtful accounts of $1,498 at December 31, 2012 and $1,536 at June 30, 2012 | 93,758 | 104,761 |
| Inventories | 151,942 | 137,607 |
| Deferred income taxes | 10,861 | 10,796 |
| Prepaid and refundable income taxes | 4,936 | 8,488 |
| Prepaid and other current assets | 12,613 | 13,777 |
| Total Current Assets | 436,920 | 410,373 |
| Property, plant & equipment, net | 184,025 | 153,918 |
| Goodwill | 123,075 | 80,748 |
| Other intangible assets, net | 76,094 | 44,014 |
| Investment | 11,254 | 10,661 |
| Deferred income taxes | 6,519 | 145 |
| Other assets | 8,973 | 6,627 |
| Total Assets | $ 846,860 | $ 706,486 |
| Liabilities and Shareholders Equity | | |
| Current Liabilities | | |
| Accounts payable | $ 29,930 | $ 29,420 |
| Accrued compensation and benefits | 26,919 | 27,234 |
| Accrued income tax payable | 6,504 | 8,761 |
| Deferred income taxes | 129 | 209 |
| Other accrued liabilities | 18,978 | 18,104 |
| Total Current Liabilities | 82,460 | 83,728 |
| Long-term debt | 124,482 | 12,769 |
| Deferred income taxes | 4,632 | 5,883 |
| Other liabilities | 17,827 | 12,720 |
| Total Liabilities | $ 229,401 | $ 115,100 |
| 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 69,888,663 shares at December 31, 2012; 69,626,883 shares at June 30, 2012 | 186,136 | 176,295 |
| Accumulated other comprehensive income | 13,576 | 10,238 |
| Retained earnings | 463,589 | 438,671 |

| | | |
|---|---|---|
| | $ 663,301 | $ 625,204 |
| Treasury stock, at cost, 7,487,965 shares at December 31, 2012 and 6,793,928 shares at June 30, 2012 | 47,519 | 35,247 |
| Total II-VI Incorporated Shareholders Equity | $ 615,782 | $ 589,957 |
| Noncontrolling Interests | 1,677 | 1,429 |
| Total Shareholders Equity | $ 617,459 | $ 591,386 |
| Total Liabilities and Shareholders Equity | $ 846,860 | $ 706,486 |

*See notes to condensed consolidated financial statements.*

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Earnings (Unaudited)

($000 except per share data)

| | Three Months Ended December 31, 2012 | Three Months Ended December 31, 2011 |
|---|---|---|
| Revenues | | |
| Domestic | $ 51,479 | $ 50,156 |
| International | 74,410 | 76,601 |
| Total Revenues | 125,889 | 126,757 |
| Costs, Expenses and Other Expense (Income) | | |
| Cost of goods sold | 79,019 | 83,289 |
| Internal research and development | 5,626 | 5,016 |
| Selling, general and administrative | 26,309 | 24,214 |
| Interest expense | 223 | 77 |
| Other expense (income), net | (4,551) | (1,506) |
| Total Costs, Expenses, and Other Expense (Income) | 106,626 | 111,090 |
| Earnings Before Income Taxes | 19,263 | 15,667 |
| Income Taxes | 6,796 | 2,147 |
| Net Earnings | 12,467 | 13,520 |
| Less: Net Earnings Attributable to Noncontrolling Interests | 267 | 233 |
| Net Earnings Attributable to II-VI Incorporated | $ 12,200 | $ 13,287 |
| Net Earnings Attributable to II-VI Incorporated: Basic Earnings Per Share: | $ 0.19 | $ 0.21 |
| Net Earnings Attributable to II-VI Incorporated: Diluted Earnings Per Share: | $ 0.19 | $ 0.21 |

*See notes to condensed consolidated financial statements.*

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Earnings (Unaudited)

($000 except per share data)

| | Six Months Ended December 31, 2012 | Six Months Ended December 31, 2011 |
|---|---|---|
| Revenues | | |
| Domestic | $ 103,762 | $ 105,725 |
| International | 154,419 | 159,405 |
| Total Revenues | 258,181 | 265,130 |
| Costs, Expenses and Other Expense (Income) | | |
| Cost of goods sold | 162,476 | 166,652 |
| Internal research and development | 11,211 | 10,179 |
| Selling, general and administrative | 52,965 | 51,026 |
| Interest expense | 259 | 136 |
| Other expense (income), net | (5,312) | (3,136) |
| Total Costs, Expenses, and Other Expense (Income) | 221,599 | 224,857 |
| Earnings Before Income Taxes | 36,582 | 40,273 |
| Income Taxes | 10,983 | 8,039 |
| Net Earnings | 25,599 | 32,234 |
| Less: Net Earnings Attributable to Noncontrolling Interests | 681 | 368 |
| Net Earnings Attributable to II-VI Incorporated | $ 24,918 | $ 31,866 |
| Net Earnings Attributable to II-VI Incorporated: Basic Earnings Per Share: | $ 0.40 | $ 0.51 |
| Net Earnings Attributable to II-VI Incorporated: Diluted Earnings Per Share: | $ 0.39 | $ 0.50 |

*See notes to condensed consolidated financial statements.*

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

($000)

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Net earnings | $ 12,467 | $ 13,520 | $ 25,599 | $ 32,234 |
| Other comprehensive income: | | | | |
| Foreign currency translation adjustments | 2,043 | (343) | 3,122 | 597 |
| Comprehensive income | $ 14,510 | $ 13,177 | $ 28,721 | $ 32,831 |
| Net earnings attributable to noncontrolling interests: | $ 267 | $ 233 | $ 681 | $ 368 |
| Other comprehensive income attributable to noncontrolling interests: | | | | |
| Foreign currency translation adjustments attributable to noncontrolling interests | 57 | | (216) | |
| Comprehensive income attributable to noncontrolling interests | $ 324 | $ 233 | $ 465 | $ 368 |
| Comprehensive income attributable to II-VI Incorporated | $ 14,186 | $ 12,944 | $ 28,256 | $ 32,463 |

*See notes to condensed consolidated financial statements.*

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

($000)

| | Six Months Ended December 31, 2012 | Six Months Ended December 31, 2011 |
|---|---|---|
| Cash Flows from Operating Activities | | |
| Net earnings | $ 25,599 | $ 32,234 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation | 16,860 | 14,784 |
| Amortization | 2,374 | 2,048 |
| Share-based compensation expense | 6,534 | 7,176 |
| Impairment of property, plant and equipment | | 434 |
| Loss (gain) on foreign currency remeasurements and transactions | 810 | (595) |
| Earnings from equity investments | (593) | (484) |
| Deferred income taxes | 2,307 | (433) |
| Excess tax benefits from share-based compensation expense | (387) | (122) |
| Increase (decrease) in cash from changes in: | | |
| Accounts receivable | 20,932 | 7,694 |
| Inventories | (6,445) | (14,501) |
| Accounts payable | (4,640) | 1,464 |
| Income taxes | 1,688 | 797 |
| Other operating net assets | (4,062) | (7,583) |
| Net cash provided by operating activities | 60,977 | 42,913 |
| Cash Flows from Investing Activities | | |
| Additions to property, plant & equipment | (13,177) | (23,068) |
| Purchase of businesses, net of cash acquired | (126,397) | (46,141) |
| Proceeds received on contractual settlement from Thailand flood | 2,436 | |
| Proceeds from the collection of note receivable | 1,395 | |
| Other investing activities | 70 | 24 |
| Net cash used in investing activities | (135,673) | (69,185) |
| Cash Flows from Financing Activities | | |
| Proceeds from long-term borrowings | 113,000 | 7,000 |
| Payments on long-term borrowings | (1,000) | (6,295) |
| Payment of debt issuance costs | (560) | |
| Purchases of treasury stock | (10,840) | |
| Distribution of noncontrolling interests | (217) | |
| Minimum tax withholding requirements | (137) | |
| Proceeds from exercises of stock options | 1,625 | 452 |
| Excess tax benefits from share-based compensation expense | 387 | 122 |
| Net cash provided by financing activities | 102,258 | 1,279 |
| Effect of exchange rate changes on cash and cash equivalents | 304 | (634) |
| Net increase (decrease) in cash and cash equivalents | 27,866 | (25,627) |

| | | |
|---|---|---|
| Cash and Cash Equivalents at Beginning of Period | 134,944 | 149,460 |
| Cash and Cash Equivalents at End of Period | $ 162,810 | $ 123,833 |
| Cash paid for interest | $ 184 | $ 119 |
| Cash paid for income taxes | $ 6,379 | $ 7,602 |
| Non-cash transactions: | | |
| Purchase of business utilizing earnout arrangement recorded in other long-term liabilities | $ 4,200 | $ |
| Purchase of business utilizing deferred purchase price recorded in other current liabilities | $ 700 | $ |

*See notes to condensed consolidated financial statements.*

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statement of Shareholders Equity (Unaudited)

(000)

| | Common Stock | | Accumulated Other Comprehensive Income | Retained Earnings | Treasury Stock | | Non-Controlling Interests | Total |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | | | Shares | Amount | | |
| Balance June 30, 2012 | 69,627 | $ 176,295 | $ 10,238 | $ 438,671 | (6,794) | $ (35,247) | $ 1,429 | $ 591,386 |
| Shares issued under share-based compensation plans | 262 | 1,625 | | | | | | 1,625 |
| Minimum tax withholding requirements | | | | | (7) | (137) | | (137) |
| Share-based compensation expense | | 6,534 | | | | | | 6,534 |
| Net earnings | | | | 24,918 | | | 681 | 25,599 |
| Purchases of treasury stock | | | | | (617) | (10,840) | | (10,840) |
| Treasury stock under deferred compensation arrangements | | 1,295 | | | (70) | (1,295) | | |
| Excess tax benefits from share-based compensation | | 387 | | | | | | 387 |
| Distributions of noncontrolling interests | | | | | | | (217) | (217) |
| Foreign currency translation adjustments | | | 3,338 | | | | (216) | 3,122 |
| Balance December 31, 2012 | 69,889 | $ 186,136 | $ 13,576 | $ 463,589 | (7,488) | $ (47,519) | $ 1,677 | $ 617,459 |

*See notes to condensed consolidated financial statements.*

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**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 (sometimes referred to herein as II-VI or the Company ) for the three and six months ended December 31, 2012 and 2011 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 ( Annual Report ) for the year ended June 30, 2012. The consolidated results of operations for the three and six months ended December 31, 2012 are not necessarily indicative of the results to be expected for the full fiscal year. The consolidated results of operations for the three and six months ended December 31, 2012, include M Cubed Technologies, Inc. and the Oclaro thin film filter business and product line since their respective dates of acquisition. LightWorks Optics, Inc. was acquired near the end of the quarter ended December 31, 2012 and had no contribution to our operating results during the three and six months ended December 31, 2012. For further information, see Note 3. Acquisitions. The June 30, 2012 Condensed Consolidated Balance Sheet information was derived from the Company s audited financial statements.

Effective July 1, 2012, the Company changed its reportable segments in accordance with how the Company s chief operating decision maker receives and reviews financial information. Effective July 1, 2012, VLOC Incorporated ( VLOC ) has been included in the Military & Materials operating segment for financial reporting purposes. Prior to July 1, 2012, the Company s VLOC business unit was included in the Near-Infrared Optics operating segment. The Company has revised the consolidated segment information for all periods presented in this Quarterly Report on Form 10-Q to reflect this reclassification.

**Note 2. Recent Accounting Pronouncements**

In July 2012, the Financial Accounting Standards Board ( FASB ) issued an accounting standard update related to impairment testing of indefinite-lived intangible assets. The update simplifies the guidance of testing for potential impairment of indefinite-lived intangible assets other than goodwill. The amendment provides entities the option to first assess qualitative factors to determine whether it is necessary to perform the quantitative impairment test. An entity electing to perform a qualitative assessment is no longer required to calculate the fair value of an indefinite-lived intangible asset unless the organization determines, based on a qualitative assessment, that it is more likely than not (that is, a likelihood of more than 50 percent) that the asset is impaired. The amendments in this update are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The adoption of this standard is not expected to have a significant impact on the Company s consolidated financial statements and indefinite-lived intangible asset impairment testing.

In September 2011, the FASB issued an accounting standard update related to goodwill impairment testing. The objective of the accounting standard update is to simplify how entities test goodwill for impairment by permitting an assessment of qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. This update also allows entities an unconditional option to bypass this qualitative assessment and proceed directly to performing the first step of the goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period. This accounting standard update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning on or after December 15, 2011, with early adoption permitted. The adoption of this standard is not expected to have a significant impact on the Company s consolidated financial statements and goodwill impairment testing.

In June 2011, the FASB issued changes to the presentation of comprehensive income that require entities to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The option to present components of other comprehensive income as part of the statement of changes in stockholders equity is no longer permitted. This guidance, with retrospective application, was adopted by the Company in the first quarter of fiscal year 2013. Other than the change in presentation, these changes have had no impact on the consolidated financial statements and the calculation and presentation of earnings per share.

**Note 3. Acquisitions**

***M Cubed Technologies, Inc.***

On November 1, 2012, the Company acquired all of the outstanding shares of M Cubed Technologies, Inc. ( M Cubed ), a privately-held company based in Connecticut with manufacturing locations in Monroe and Newtown, Connecticut, and Newark, Delaware. The total consideration consisted of cash of $68.2 million, net of cash acquired of $5.7 million. M Cubed develops advanced ceramic materials and precision motion control products addressing the semiconductor, display, industrial and defense markets. As a result of the acquisition, the Company will diversify its engineered materials product portfolio in the reaction bonded silicon carbide ceramics and metal matrix composite markets while realizing synergies in engineered materials growth and processes. Due to the timing of the

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acquisition, the Company is still in the process of completing its fair market valuation, including the valuation of certain tangible, and intangible assets as well as deferred income taxes. The following table presents the preliminary allocation of the purchase price of the assets acquired and liabilities assumed at the date of acquisition, as the Company intends to finalize its accounting for the acquisition of M Cubed during fiscal year 2013 ($000):

| | |
|---|---|
| **Assets** | |
| Accounts receivable, net | $ 7,424 |
| Inventories | 4,811 |
| Prepaid and other assets | 518 |
| Deferred income taxes | 21,089 |
| Property, plant & equipment | 19,884 |
| Intangible assets | 11,078 |
| Goodwill | 18,132 |
| Total assets acquired | $ 82,936 |
| **Liabilities** | |
| Accounts payable | $ 2,807 |
| Deferred income taxes | 11,100 |
| Other accrued liabilities | 864 |
| Total liabilities assumed | $ 14,771 |
| Net assets acquired | $ 68,165 |

The goodwill of M Cubed of $18.1 million is included in the Advanced Products Group segment and is attributed to the expected synergies and the assembled workforce of M Cubed. None of the goodwill is deductible for income tax purposes. The fair value of accounts receivable acquired was $7.4 million with the gross contractual amount being $7.5 million. At the time of acquisition, the Company expected $0.1 million of accounts receivable to be uncollectible. The majority of the deferred tax assets of M Cubed are related to net operating loss carryforwards. The Company has considered any carryforward limitations and expirations and expects to fully utilize these carryforwards to offset future income taxes.

The amount of revenues of M Cubed included in the Company s Condensed Consolidated Statement of Earnings for the three and six months ended December 31, 2012 was $7.3 million. The amount of earnings of M Cubed included in the Company s Condensed Consolidated Statements of Earnings for the three and six months ended December 31, 2012 were not material.

***Thin Film Filter Business and Interleaver Product Line***

On December 3, 2012, the Company purchased the thin film filter and interleaver product line of Oclaro, Inc. ( Oclaro ) for $27.4 million in cash. These businesses design and manufacture thin film filter optical chips and products for optical communications, life sciences, and industrial applications and will report within the Company s Photop Technologies, Inc. ( Photop ) business unit as part of the Company s Near-Infrared Optics operating segment for financial reporting purposes. Due to the timing of the acquisition, the Company is still in the process of completing its fair market valuation, including the valuation of certain tangible and intangible assets. The following table presents the preliminary allocation of the purchase price of the assets acquired at the date of acquisition, as the Company intends to finalize its accounting for this acquisition during fiscal year 2013 ($000):

| | |
|---|---|
| **Assets** | |
| Inventories | $ 1,085 |

| | |
|---|---|
| Prepaid and other assets | 129 |
| Property, plant & equipment | 10,400 |
| Intangible assets | 7,882 |
| Goodwill | 7,951 |
| Total assets acquired | $ 27,447 |

The goodwill of $8.0 million is included in the Near-Infrared Optics segment and is attributed to the expected synergies and the assembled workforce of the business and is fully deductible for income tax purposes.

The amount of revenues and earnings of these businesses included in the Company s Condensed Consolidated Statement of Earnings for the three and six months ended December 31, 2012 were not material.

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***LightWorks Optics, Inc.***

On December 21, 2012, the Company purchased all of the outstanding shares of LightWorks Optics, Inc. ( LightWorks ), a privately held company based in Tustin, California with manufacturing locations in both Tustin and Vista, California. Under the terms of the merger agreement, the initial consideration consisted of cash paid at acquisition date of $30.8 million and other closing adjustments of $0.7 million, which are expected to be paid by March 31, 2013. In addition, the agreement provided up to a maximum of $4.2 million of additional cash earnout arrangement based upon LightWorks achieving certain agreed upon financial targets for revenues and customer orders in calendar year 2013, which if earned, would be payable in March 2014. The final purchase price is subject to customary closing adjustments, including working capital adjustments. LightWorks manufactures precision optical systems and components, including visible, infrared, and laser-based systems and subassemblies addressing the defense, aerospace, industrial and life science markets. LightWorks will work cooperatively with the Company s Exotic Electro-Optics ( EEO ) business unit to broaden and expand current product offerings in the defense and aerospace markets while strengthening customer relationships through complementary technology and product development. Due to the timing of the acquisition, the Company is still in the process of completing its fair market valuation, including the valuation of certain tangible and intangible assets, as well as the earnout arrangement. The following table presents the preliminary allocation of the purchase price of the assets acquired and liabilities assumed at the date of acquisition, as the Company intends to finalize its accounting for the acquisition of LightWorks during fiscal year 2013 ($000):

| | |
|---|---|
| **Assets** | |
| Accounts receivable, net | $ 2,412 |
| Inventories | 463 |
| Prepaid and other assets | 270 |
| Property, plant & equipment | 3,453 |
| Intangible assets | 15,351 |
| Goodwill | 15,894 |
| Total assets acquired | $ 37,843 |
| **Liabilities** | |
| Accounts payable | $ 692 |
| Other accrued liabilities | 1,451 |
| Total liabilities assumed | $ 2,143 |
| Net assets acquired | $ 35,700 |

The goodwill of LightWorks of $15.9 million is included in the Military & Materials segment and is attributed to the expected synergies and the assembled workforce of LightWorks. All goodwill acquired is deductible for income tax purposes. The gross contractual amount and fair value of accounts receivable acquired was $2.4 million as the Company believes the entire amount to be fully collectible.

In conjunction with the acquisitions of M Cubed, the Oclaro business and interleaver product line and LightWorks, the Company expensed transaction costs of approximately $0.9 million and $1.2 million, respectively, during the three and six months ended December 31, 2012, which are recorded in selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings.

***Pro Forma Information***

The following unaudited pro forma consolidated results of operations for fiscal year 2013 have been prepared as if the acquisitions of M Cubed, the Oclaro business and interleaver product line and LightWorks had occurred on July 1, 2011, the beginning of the Company s fiscal year 2012, which is the fiscal year prior to acquisition ($000 except per share data).

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Net revenues | $ 139,172 | $ 145,191 | $ 296,746 | $ 301,897 |
| Net earnings attributable to II-VI Incorporated | 13,009 | 13,845 | 30,179 | 31,439 |
| Basic earnings per share | | | | |