MKS INSTRUMENTS INC
Form 10-Q
May 06, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 March 31, 2016

or

¨ **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 0-23621

MKS INSTRUMENTS, INC.

(Exact name of registrant as specified in its charter)

Massachusetts	**04-2277512**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
2 Tech Drive, Suite 201, Andover, Massachusetts	**01810**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (978) 645-5500

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 (§ 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 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 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 x	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 x

As of April 29, 2016, the registrant had 53,373,754 shares of common stock outstanding.

MKS INSTRUMENTS, INC.

FORM 10-Q

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

MKS INSTRUMENTS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

	March 31, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 357,855	$ 227,574
Short-term investments	308,768	430,663
Trade accounts receivable, net	113,472	101,883
Inventories, net	151,650	152,631
Other current assets	27,388	26,760
Total current assets	959,133	939,511
Property, plant and equipment, net	67,561	68,856
Goodwill	199,999	199,703
Intangible assets, net	42,575	44,027
Other assets	21,392	21,250
Total assets	$ 1,290,660	$ 1,273,347
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 28,076	$ 23,177
Accrued compensation	20,983	28,424
Income taxes payable	3,510	4,024
Other current liabilities	45,372	35,359
Total current liabilities	97,941	90,984
Other liabilities	21,650	21,482
Commitments and contingencies (Note 17)		
Stockholders equity:		
Preferred Stock, $0.01 par value per share, 2,000,000 shares authorized; none issued and outstanding		
Common Stock, no par value, 200,000,000 shares authorized; 53,305,017 and 53,199,720 shares issued and outstanding at March 31, 2016 and December 31, 2015, respectively	113	113
Additional paid-in capital	745,840	744,725

Retained earnings		434,803		427,214
Accumulated other comprehensive loss		(9,687)		(11,171)
Total stockholders equity		1,171,069		1,160,881
Total liabilities and stockholders equity	$	1,290,660	$	1,273,347

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

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MKS INSTRUMENTS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME

(in thousands, except per share data)

(Unaudited)

	Three Months Ended March 31, 2016	2015
Net revenues:		
Products	$ 153,621	$ 186,096
Services	30,060	27,743
Total net revenues	183,681	213,839
Cost of revenues:		
Cost of products	85,352	98,652
Cost of services	20,416	18,141
Total cost of revenues (exclusive of amortization shown separately below)	105,768	116,793
Gross profit	77,913	97,046
Research and development	17,227	16,680
Selling, general and administrative	33,950	30,867
Acquisition costs	2,494	30
Restructuring		788
Amortization of intangible assets	1,683	1,671
Income from operations	22,559	47,010
Interest and other income, net	1,246	504
Income before income taxes	23,805	47,514
Provision for income taxes	6,242	13,728
Net income	$ 17,563	$ 33,786
Other comprehensive income:		
Changes in value of financial instruments designated as cash flow hedges, net of tax benefit(1)	$ (1,546)	$ (822)
Foreign currency translation adjustments, net of tax of $0	2,652	(3,206)
Unrealized gain on investments, net of tax expense(2)	378	334
Total comprehensive income	$ 19,047	$ 30,092

Net income per share:				
Basic	$	0.33	$	0.63
Diluted	$	0.33	$	0.63
Cash dividends per common share	$	0.17	$	0.165
Weighted average common shares outstanding:				
Basic		53,235		53,214
Diluted		53,563		53,529

(1) Tax benefit was $1,041 and $133 for the three months ended March 31, 2016 and 2015, respectively.

(2) Tax expense was $254 and $54 for the three months ended March 31, 2016 and 2015, respectively.

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

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MKS INSTRUMENTS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Three Months Ended March 31, 2016	2015
Cash flows provided by operating activities:		
Net income	$ 17,563	$ 33,786
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,278	5,532
Stock-based compensation	4,152	3,212
Provision for excess and obsolete inventory	2,948	2,683
Provision for bad debt	17	(172)
Deferred income taxes	347	736
Excess tax benefits from stock-based compensation	(233)	(524)
Other	68	1
Changes in operating assets and liabilities:		
Trade accounts receivable	(10,084)	(19,030)
Inventories	(844)	(12,817)
Income taxes	2,316	2,034
Other current assets	(3,562)	(5,029)
Accrued compensation	(7,086)	(4,930)
Other current and non-current liabilities	7,718	2,735
Accounts payable	4,772	3,587
Other assets	(189)	7,801
Net cash provided by operating activities	23,181	19,605
Cash flows provided by (used in) investing activities:		
Acquisition of businesses, net of cash acquired		(9,867)
Purchases of investments	(82,135)	(164,327)
Maturities of investments	76,972	38,205
Sales of investments	128,250	17,414
Purchases of property, plant and equipment	(2,156)	(2,504)
Other		5
Net cash provided by (used in) investing activities	120,931	(121,074)
Cash flows used in financing activities:		
Repurchase of common stock	(1,545)	
Net payments related to employee stock awards	(2,587)	(2,105)
Dividend payments to common stockholders	(9,056)	(8,784)

Excess tax benefits from stock-based compensation		233		524
Net cash used in financing activities		(12,955)		(10,365)
Effect of exchange rate changes on cash and cash equivalents		(876)		(890)
Increase (decrease) in cash and cash equivalents		130,281		(112,724)
Cash and cash equivalents at beginning of period		227,574		305,437
Cash and cash equivalents at end of period	$	357,855	$	192,713

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

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MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data)

1) Basis of Presentation

The terms MKS and the Company refer to MKS Instruments, Inc. and its subsidiaries. The interim financial data as of March 31, 2016 and for the three months ended March 31, 2016 and 2015 are unaudited; however, in the opinion of MKS, the interim data includes all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of the results for the interim periods. The condensed consolidated balance sheet presented as of December 31, 2015 has been derived from the consolidated audited financial statements as of that date. The unaudited condensed consolidated financial statements presented herein have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and note disclosures required by United States generally accepted accounting principles (U.S. GAAP). The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the MKS Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission on February 26, 2016.

The preparation of these unaudited condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments, including those related to revenue recognition, stock-based compensation, inventory, intangible assets, goodwill and other long-lived assets, acquisition expenses, income taxes and investments. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

2) Recently Issued Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-09, Compensation - Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting. This standard simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The provisions of this ASU are effective for annual periods beginning after December 15, 2016, including interim periods within those fiscal years and early adoption is permitted. The Company is currently evaluating the requirements of this ASU and has not yet determined its impact on the Company s consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This standard requires the recognition of lease assets and liabilities for all leases, with certain exceptions, on the balance sheet. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. This ASU is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the requirements of this ASU and has not yet determined its impact on the Company s consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805) Simplifying the Accounting for Measurement-Period Adjustments. This standard requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustments are identified, including the cumulative effect of the change in the provisional amount as if the accounting had been completed at the acquisition date. This ASU is effective for annual periods beginning after December 15, 2015, including interim periods within those fiscal years. The Company adopted this ASU in the first quarter of 2016. Adoption of this ASU could have a material impact on the Company s consolidated financial position and results of operations when accounting for future acquisitions.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330) Simplifying the Measurement of Inventory. The amendments in this ASU apply to all inventory that is measured using first-in, first-out or average cost. This standard requires that an entity measure inventory within the scope of this update at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The amendments in this ASU are effective for annual periods beginning after December 15, 2016, including interim periods within those fiscal years. Adoption of this ASU is not expected to have a material impact on the Company s consolidated statements of financial position and results of operations.

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MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern. Under this guidance, management will be required to assess an entity s ability to continue as a going concern, and to provide related footnote disclosures in certain circumstances. The provisions of this ASU are effective for annual periods beginning after December 15, 2016, and for annual and interim periods thereafter. This ASU is not expected to have an impact 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 all existing revenue recognition requirements, including most industry-specific guidance. This standard requires a company to recognize revenue when it transfers goods and services to customers in an amount that reflects the consideration that the company expects to be entitled to in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and assets recognized from costs incurred to obtain or fulfill a contract. This pronouncement is effective for annual periods beginning after December 15, 2017, including interim periods within that reporting period. The two permitted transition methods under the new standard are the full retrospective method, in which case the standard would be applied to each prior reporting period presented, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application. The Company has not yet selected a transition method. The Company is currently evaluating the requirements of this ASU and has not yet determined its impact on the Company s consolidated financial statements.

3) Investments

The fair value of investments classified as short-term consists of the following:

	March 31, 2016	December 31, 2015
Available-for-sale investments:		
Time deposits and certificates of deposit	$ 23,005	$ 11,892
Bankers acceptance drafts	1,646	728
Asset-backed securities	74,057	124,997
Corporate obligations	90,856	165,109
Municipal bonds	4,611	8,355
U.S. treasury obligations	4,360	
U.S. agency obligations	110,233	119,582
	$ 308,768	$ 430,663

The following tables show the gross unrealized gains and (losses) aggregated by investment category for short-term available-for-sale investments:

As of March 31, 2016:	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Short-term investments:				
Available-for-sale investments:				
Time deposits and certificates of deposit	$ 23,005	$	$	$ 23,005
Bankers acceptance drafts	1,646			1,646
Asset-backed securities	74,068	27	(38)	74,057
Corporate obligations	90,944	52	(140)	90,856
Municipal bonds	4,604	9	(2)	4,611
U.S. treasury obligations	4,355	5		4,360
U.S. agency obligations	110,216	24	(7)	110,233
	$ 308,838	$ 117	$ (187)	$ 308,768

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

As of December 31, 2015:	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Short-term investments:				
Available-for-sale investments:				
Time deposits and certificates of deposit	$ 11,893	$	$ (1)	$ 11,892
Bankers acceptance drafts	728			728
Asset-backed securities	125,271		(274)	124,997
Corporate obligations	165,445	5	(341)	165,109
Municipal bonds	8,346	13	(4)	8,355
U.S. agency obligations	119,699	3	(120)	119,582
	$ 431,382	$ 21	$ (740)	$ 430,663

The tables above, which show the gross unrealized gains and (losses) aggregated by investment category for available-for-sale investments as of March 31, 2016 and December 31, 2015, reflect the inclusion within short-term investments of investments with contractual maturities greater than one year from the date of purchase.

Management has the ability, if necessary, to liquidate any of its investments in order to meet the Company s liquidity needs in the next 12 months. Accordingly, those investments with contractual maturities greater than one year from the date of purchase are classified as short-term on the accompanying balance sheets.

Interest income is accrued as earned. Dividend income is recognized as income on the date the stock trades ex-dividend. The cost of marketable securities sold is determined by the specific identification method. Realized gains or losses are reflected in income and were not material for the three months ended March 31, 2016 and 2015.

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MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

4) Fair Value Measurements

In accordance with the provisions of fair value accounting, a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability and defines fair value based upon an exit price model.

The fair value measurement guidance establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities assessed as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 Observable inputs other than Level 1 prices, 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 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments or securities or derivative contracts that are valued using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

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. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the Company categorizes such assets and liabilities based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

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MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

Assets and liabilities of the Company are measured at fair value on a recurring basis as of March 31, 2016 and are summarized as follows:

		Fair Value Measurements at Reporting Date Using		
Description	March 31, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents:				
Money market funds	$ 197,650	$ 197,650	$	$
Bankers acceptance drafts	15		15	
Commercial paper	9,999		9,999	
U.S. agency obligations	35,496		35,496	
Available-for-sale investments:				
Time deposits and certificates of deposit	23,005		23,005	
Bankers acceptance drafts	1,646		1,646	
Asset-backed securities	74,057		74,057	
Corporate obligations	90,856		90,856	
Municipal bonds	4,611		4,611	
U.S. treasury obligations	4,360		4,360	
U.S. agency obligations	110,233		110,233	
Derivatives currency forward contracts	487		487	
Total assets	$ 552,415	$ 197,650	$ 354,765	$
Liabilities:				
Derivatives currency forward contracts	$ 2,193	$	$ 2,193	$
Reported as follows:				
Assets:				
Cash and cash equivalents[(1)]	$ 243,160	$ 197,650	$ 45,510	$
Short-term investments	308,768		308,768	
Other current assets	487		487	

Total current assets	$ 552,415	$ 197,650	$ 354,765	$
Liabilities:				
Other current liabilities	$ (2,193)	$	$ (2,193)	$

(1) The cash and cash equivalent amounts presented in the table above do not include cash of $102,950 and non-negotiable time deposits of $11,745 as of March 31, 2016.

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

Assets and liabilities of the Company are measured at fair value on a recurring basis as of December 31, 2015 and are summarized as follows:

		Fair Value Measurements at Reporting Date Using		
Description	December 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents:				
Money market funds	$ 106,099	$ 106,099	$	$
Bankers acceptance drafts	11		11	
Corporate obligations	330		330	
Available-for-sale investments:				
Time deposits and certificates of deposit	11,892		11,892	
Bankers acceptance drafts	728		728	
Asset-backed securities	124,997		124,997	
Corporate obligations	165,109		165,109	
Municipal bonds	8,355		8,355	
U.S. agency obligations	119,582		119,582	
Derivatives currency forward contracts	1,486		1,486	
Total assets	$ 538,589	$ 106,099	$ 432,490	$
Liabilities:				
Derivatives currency forward contracts				
Total liabilities	$ 263	$	$ 263	$
Reported as follows:				
Assets:				
Cash and cash equivalents[(1)]	$ 106,440	$ 106,099	$ 341	$
Short-term investments	430,663		430,663	
Other current assets	1,486		1,486	
Total current assets	$ 538,589	$ 106,099	$ 432,490	$
Liabilities:				

Other current liabilities	$	263	$		$	263	$

(1) The cash and cash equivalents amounts presented in the table above do not include cash of $110,118 and non-negotiable time deposits of $11,016 as of December 31, 2015.

Money Market Funds

Money market funds are cash and cash equivalents and are classified within Level 1 of the fair value hierarchy.

Available-For-Sale Investments

As of March 31, 2016, available-for-sale investments consisted of time deposits and drafts denominated in the Euro currency, certificates of deposit, bankers acceptance drafts, asset-backed securities (which include auto loans, credit card receivables and equipment trust receivables), corporate obligations, municipal bonds, U.S. treasury obligations and U.S. agency obligations.

The Company measures its debt and equity investments at fair value. The Company s available-for-sale investments are classified within Level 1 and Level 2 of the fair value hierarchy.

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

Derivatives

As a result of the Company s global operating activities, the Company is exposed to market risks from changes in foreign currency exchange rates, which may adversely affect its operating results and financial position. When deemed appropriate, the Company minimizes its risks from foreign currency exchange rate fluctuations through the use of derivative financial instruments. The principal market in which the Company executes its foreign currency contracts is the institutional market in an over-the-counter environment with a relatively high level of price transparency. The market participants usually are large commercial banks. The forward foreign currency exchange contracts are valued using broker quotations, or market transactions and are classified within Level 2 of the fair value hierarchy.

5) Derivatives

The Company enters into derivative instruments for risk management purposes only, including derivatives designated as hedging instruments and those utilized as economic hedges. The Company operates internationally and, in the normal course of business, is exposed to fluctuations in interest rates and foreign exchange rates. These fluctuations can increase the costs of financing, investing and operating the business. The Company has used derivative instruments, such as forward contracts, to manage certain foreign currency exposure.

By nature, all financial instruments involve market and credit risks. The Company enters into derivative instruments with major investment grade financial institutions, for which no collateral is required. The Company has policies to monitor the credit risk of these counterparties. While there can be no assurance, the Company does not anticipate any material non-performance by any of these counterparties.

The Company hedges a portion of its forecasted foreign currency-denominated intercompany sales of inventory, over a maximum period of eighteen months, using forward foreign exchange contracts accounted for as cash-flow hedges related to Japanese, South Korean, British, Euro and Taiwanese currencies. To the extent these derivatives are effective in off-setting the variability of the hedged cash flows, and otherwise meet the hedge accounting criteria, changes in the derivatives fair value are not included in current earnings but are included in other comprehensive income (loss) (OCI) in stockholders equity. These changes in fair value will subsequently be reclassified into earnings, as applicable, when the forecasted transaction occurs. To the extent that a previously designated hedging transaction is no longer an effective hedge, any ineffectiveness measured in the hedging relationship is recorded currently in earnings in the period it occurs. The cash flows resulting from forward exchange contracts are classified in the consolidated statements of cash flows as part of cash flows from operating activities. The Company does not enter into derivative instruments for trading or speculative purposes.

To the extent the hedge accounting criteria is not met, the related foreign currency forward contracts are considered as economic hedges and changes in the fair value of these contracts are recorded immediately in earnings in the period in which they occur. These include hedges that are used to reduce exchange rate risks arising from the change in fair value of certain foreign currency-denominated assets and liabilities (i.e., payables, receivables) and other economic hedges where the hedge accounting criteria were not met.

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

As of March 31, 2016 and December 31, 2015, the Company had outstanding forward foreign exchange contracts with gross notional values of $65,796 and $89,989, respectively. The following tables provide a summary of the primary net hedging positions and corresponding fair values held as of March 31, 2016 and December 31, 2015:

	March 31, 2016	
Currency Hedged (Buy/Sell)	Gross Notional Value	Fair Value[(1)] Asset/(Liability)
U.S. Dollar/Japanese Yen	$ 19,664	$ (1,333)
U.S. Dollar/South Korean Won	26,906	(208)
U.S. Dollar/Euro	7,600	(286)
U.S. Dollar/U.K. Pound Sterling	2,950	128
U.S. Dollar/Taiwan Dollar	8,676	(7)
Total	$ 65,796	$ (1,706)

(1) Represents the fair value of the net (liability) asset amount included in the consolidated balance sheet.

	December 31, 2015	
Currency Hedged (Buy/Sell)	Gross Notional Value	Fair Value[(1)] Asset/(Liability)
U.S. Dollar/Japanese Yen	$ 26,848	$ (136)
U.S. Dollar/South Korean Won	34,777	915
U.S. Dollar/Euro	10,987	19
U.S. Dollar/U.K. Pound Sterling	4,587	61
U.S. Dollar/Taiwan Dollar	12,790	364
Total	$ 89,989	$ 1,223

(1) Represents the fair value of the net (liability) asset amount included in the consolidated balance sheet.

The following table provides a summary of the fair value amounts of the Company s derivative instruments:

Derivatives Designated as Hedging Instruments	March 31, 2016	December 31, 2015
Derivative assets:		
Forward exchange contracts	$ 487	$ 1,486
Derivative liabilities:		
Forward exchange contracts	(2,193)	(263)
Total net derivative (liabilities) assets designated as hedging instruments(1)	$ (1,706)	$ 1,223

(1) The derivative asset of $487 and derivative liability of $2,193 are classified in other current assets and other current liabilities in the consolidated balance sheet as of March 31, 2016. The derivative asset of $1,486 and derivative liability of $263 are classified in other current assets and other current liabilities in the consolidated balance sheet as of December 31, 2015. These foreign exchange contracts are subject to a master netting agreement with one financial institution. However, the Company has elected to record these contracts on a gross basis in the balance sheet.

The net amount of existing gains as of March 31, 2016 that the Company expects to reclassify from OCI into earnings within the next twelve months is immaterial.

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

The following table provides a summary of the (losses) gains on derivatives designated as hedging instruments:

Derivatives Designated as Cash Flow Hedging Instruments	Three Months Ended March 31, 2016	2015
Forward exchange contracts:		
Net loss recognized in OCI[1]	$ (3,418)	$ (2,090)
Net gain reclassified from accumulated OCI into income[2]	$ 696	$ 1,193

(1) Net change in the fair value of the effective portion classified in OCI.
(2) Effective portion classified in cost of products for the three months ended March 31, 2016 and 2015. The tax effect of the gains or losses reclassified from accumulated OCI into income is immaterial.

The following table provides a summary of the (losses) gains on derivatives not designated as hedging instruments:

Derivatives Not Designated as Hedging Instruments	Three Months Ended March 31, 2016	2015
Forward exchange contracts:		
Net (loss) gain recognized in income[1]	$ (565)	$ 98

(1) The Company enters into foreign exchange contracts to hedge against changes in the balance sheet for certain subsidiaries. These derivatives are not designated as hedging instruments and gains or losses from these derivatives are recorded immediately in selling, general and administrative expenses.

6) Inventories

Inventories consist of the following:

	March 31, 2016	December 31, 2015
Raw materials	$ 78,707	$ 78,352
Work-in-process	24,665	23,297
Finished goods	48,278	50,982
	$ 151,650	$ 152,631

7) Acquisitions

Newport Corporation

See Note 18 for information on the acquisition of Newport Corporation.

Precisive, LLC

On March 17, 2015, the Company acquired Precisive, LLC (Precisive) for $12,085, net of cash acquired of $435. The purchase price included a deferred payment amount of $2,600 to cover any potential indemnification claims, which amount will be paid to the sellers after 15 months assuming there are no indemnification claims. Precisive is an innovative developer of optical analyzers based on Tunable Filter Spectroscopy, which provide real-time gas analysis in the natural gas and hydrocarbon processing industries, including refineries, hydrocarbon processing plants, gas-to-power machines, biogas processes and fuel gas transportation and metering, while delivering customers a lower total cost of ownership.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition:

Current assets	$ 693
Non-current assets	18
Intangible assets	5,110
Goodwill	7,042
Total assets acquired	12,863
Total current liabilities assumed	(343)
Fair value of assets acquired and liabilities assumed	12,520
Less cash acquired	(435)
Total purchase price, net of cash acquired	$ 12,085

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

Substantially all of the purchase price is deductible for tax purposes. The following table reflects the allocation of the acquired intangible assets and related estimates of useful lives. These acquired intangibles will be amortized on a straight-line basis, which approximates the pattern of use.

Order backlog	$ 50	18 months
Customer relationships	1,430	8 years
Exclusive patent license	2,600	10 years
Trade names	210	10 years
Developed technology	820	10 years
	$ 5,110	

The fair value of the acquired intangibles was determined using the income approach. This acquisition resulted in a purchase price that exceeded the estimated fair value of tangible and intangible assets, the excess amount of which was allocated to goodwill. The Company believes the amount of goodwill relative to identifiable intangible assets relates to several factors including: (1) potential buyer-specific synergies related to market opportunities for a combined product offering; (2) potential to leverage the Company s sales force and intellectual property to attract new customers and revenue; and (3) potential to strengthen and expand into new but complementary markets, including targeting new applications such as natural gas processing, hydrocarbon processing and other oil and gas segments.

The results of this acquisition were included in the Company s consolidated operations beginning on March 17, 2015. Precisive is included in the Company s Instruments, Control and Vacuum Products group and the Advanced Manufacturing Capital Equipment reportable segment.

8) Goodwill and Intangible Assets

Goodwill

The Company s methodology for allocating the purchase price relating to purchase acquisitions is determined through established and generally accepted valuation techniques. Goodwill is measured as the excess of the cost of the acquisition over the sum of the amounts assigned to tangible and identifiable intangible assets acquired less liabilities assumed. The Company assigns assets acquired (including goodwill) and liabilities assumed to one or more reporting units as of the date of acquisition. Typically acquisitions relate to a single reporting unit and thus do not require the allocation of goodwill to multiple reporting units. If the products obtained in an acquisition are assigned to multiple reporting units, the goodwill is distributed to the respective reporting units as part of the purchase price allocation process.

Goodwill and purchased intangible assets with indefinite useful lives are not amortized, but are reviewed for impairment annually during the fourth quarter of each fiscal year and whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The process of evaluating the potential impairment of goodwill and intangible assets requires significant judgment. The Company regularly monitors current business conditions and other factors including, but not limited to, adverse industry or economic trends, restructuring actions and lower projections of profitability that may impact future operating results.

The changes in the carrying amount of goodwill and accumulated impairment (loss) during the three months ended March 31, 2016 and year ended December 31, 2015 were as follows:

	2016			2015		
	Gross Carrying Amount	Accumulated Impairment (Loss)	Net	Gross Carrying Amount	Accumulated Impairment (Loss)	Net
Beginning balance at January 1	$ 339,117	$ (139,414)	$ 199,703	$ 331,795	$ (139,414)	$ 192,381
Acquired goodwill[(1)]				8,017		8,017
Foreign currency translation	296		296	(695)		(695)
Ending balance at March 31, 2016 and December 31, 2015	$ 339,413	$ (139,414)	$ 199,999	$ 339,117	$ (139,414)	$ 199,703

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(in thousands, except share and per share data)

(1) During 2015, the Company recorded $7,042 of goodwill related to the acquisition of Precisive. During the second quarter of 2015, the Company recorded a purchase accounting adjustment of $975 primarily related to an inventory valuation adjustment related to the acquisition of Granville-Phillips.

Intangible Assets

Components of the Company s intangible assets are comprised of the following:

As of March 31, 2016:	Gross	Accumulated Amortization	Foreign Currency Translation	Net
Completed technology	$ 101,200	$ (82,939)	$ (142)	$ 18,119
Customer relationships	37,251	(17,251)	105	20,105
Patents, trademarks, trade names and other[1]	30,396	(26,056)	11	4,351
	$ 168,847	$ (126,246)	$ (26)	$ 42,575

As of December 31, 2015	Gross	Accumulated Amortization	Foreign Currency Translation	Net
Completed technology [1]	$ 101,200	$ (82,330)	$ (272)	$ 18,598
Customer relationships [1]	37,251	(16,345)	10	20,916
Patents, trademarks, trade names and other [1]	30,396	(25,888)	5	4,513
	$ 168,847	$ (124,563)	$ (257)	$ 44,027

(1) During 2015, the Company recorded $5,110 of separately identified intangible assets related to the acquisition of Precisive, of which $820 was completed technology, $1,430 was customer relationships and $2,860 was patents, trademarks, trade names and other.

Aggregate amortization expense related to acquired intangibles for the three months ended March 31, 2016 and 2015 was $1,683 and $1,671, respectively. Estimated amortization expense for each of the remaining fiscal years is as follows:

Year	Amount
2016 (remaining)	$ 4,990
2017	6,601
2018	6,586
2019	6,543
2020	6,489
2021	4,709
Thereafter	6,657

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

9) Other Assets

	March 31, 2016	December 31, 2015
Other Current Assets:		
Income tax receivable	$ 6,233	$ 8,682
Prepaid income tax	6,562	4,755
VAT tax receivable	186	3,264
Prepaid service and support	3,290	2,970
Other	11,117	7,089
Total other current assets	$ 27,388	$ 26,760
Other Assets:		
Deferred tax assets, net	$ 19,139	$ 19,252
Other	2,253	1,998
Total other assets	$ 21,392	$ 21,250

10) Other Liabilities

	March 31, 2016	December 31, 2015
Other Current Liabilities:		
VAT payable	$ 5,221	$ 3,075
Customer prepayments	2,621	1,741
Product warranties	5,039	5,205
Deferred revenue	7,832	7,189
Other	24,659	18,149
Total other current liabilities	$ 45,372	$ 35,359
Other Liabilities:		
Long-term income tax payable	$ 3,832	$ 4,483
Accrued compensation	13,939	13,395
Other	3,879	3,604
Total other liabilities	$ 21,650	$ 21,482

11) Debt

The Company s Japanese subsidiary has lines of credit and short-term borrowing arrangements with two financial institutions, which arrangements generally expire and are renewed at three-month intervals. The lines of credit provided for aggregate borrowings as of March 31, 2016 of up to an equivalent of $20,455 U.S. dollars. One of the borrowing arrangements has an interest rate based on the Tokyo Interbank Offer Rate at the time of borrowing and the other has an interest rate based on the Japanese Short-term Prime Lending Rate. There were no borrowings outstanding under these arrangements at March 31, 2016 and December 31, 2015.

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

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12) Product Warranties

The Company records the estimated costs to fulfill customer warranty obligations upon the recognition of the related revenue. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers, the Company s warranty obligation is affected by shipment volume, product failure rates, utilization levels, material usage, and supplier warranties on parts delivered to the Company. Should actual product failure rates, utilization levels, material usage, or supplier warranties on parts differ from the Company s estimates, revisions to the estimated warranty liability would be required. The product warranty liability is included in other current liabilities in the consolidated balance sheets.

Product warranty activities were as follows:

	Three Months Ended March 31,	
	2016	2015
Beginning of period	$ 5,205	$ 6,266
Provision for product warranties	783	1,109
Direct charges to warranty liability	(984)	(1,244)
Foreign currency translation	35	(67)
End of period	$ 5,039	$ 6,064

13) Income Taxes

The Company s effective tax rate for the three months ended March 31, 2016 and 2015 was 26.2% and 28.9%, respectively. The effective tax rate for the three months ended March 31, 2016 was lower than the U.S. statutory tax rate primarily due to the geographic mix of income and profits earned by the Company s international subsidiaries being taxed at rates lower than the U.S. statutory tax rate, the deduction for domestic production activities, and the federal research credit offset by state income taxes. The effective tax rate for the three months ended March 31, 2015 was lower than the U.S. statutory tax rate primarily due to the impact of lower tax rates on foreign income and the deduction for domestic production activities.

As of March 31, 2016, the total amount of gross unrecognized tax benefits, which excludes interest and penalties, was approximately $3,712. At December 31, 2015, the total amount of gross unrecognized tax benefits, which excludes interest and penalties, was approximately $4,332. The net decrease from December 31, 2015 was primarily attributable to a release of reserves for uncertain tax positions due to the expiration of the statute of limitations related to a previously open tax year. As of March 31, 2016, if these benefits were recognized in a future period, the timing of which is not estimable, the net unrecognized tax benefit of $3,707, excluding interest and penalties, would impact the Company s effective tax rate. The Company accrues interest expense, and if applicable, penalties, for any uncertain tax positions. Interest and penalties are classified as a component of income tax expense. As of March 31, 2016 and December 31, 2015, the Company had accrued interest on unrecognized tax benefits of approximately $125 and $157, respectively.

Over the next 12 months it is reasonably possible that the Company may recognize approximately $1,469 of previously net unrecognized tax benefits related to various U.S. federal, state and foreign tax positions primarily as a result of the expiration of certain statutes of limitations.

The Company and its subsidiaries are subject to examination by U.S. federal, state and foreign tax authorities. The United States Internal Revenue Service commenced an examination of the Company s U.S. federal tax filings for tax years 2011 through 2013 during the quarter ended March 31, 2015. The audit was effectively settled during the three months ended December 31, 2015 upon the Company s acceptance of the income tax examination changes. As part of the audit the Company consented to extend the U.S. statute of limitations for tax year 2011 until September 30, 2016.

The U.S. statute of limitations remains open for tax years 2011 through present. The statute of limitations for the Company s tax filings in other jurisdictions varies between fiscal years 2008 through present.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

14) Net Income Per Share

The following table sets forth the computation of basic and diluted net income per share:

	Three Months Ended March 31, 2016	2015
Numerator:		
Net income	$ 17,563	$ 33,786
Denominator:		
Shares used in net income per common share basic	53,235,000	53,214,000
Effect of dilutive securities:		
Stock options, restricted stock and employee stock purchase plan	328,000	315,000
Shares used in net income per common share diluted	53,563,000	53,529,000
Net income per common share:		
Basic	$ 0.33	$ 0.63
Diluted	$ 0.33	$ 0.63

Basic earnings per share (EPS) is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding during the period. The computation of diluted EPS is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding (using the treasury stock method) if securities containing potentially dilutive common shares (stock options and restricted stock units) had been converted to such common shares, and if such assumed conversion is dilutive.

As of March 31, 2016, restricted stock units related to an aggregate of approximately 737,000 shares were outstanding. For the three months ended March 31, 2016 and 2015, there were no weighted-average restricted stock units that would have an anti-dilutive effect on EPS, and would thus need to be excluded from the computation of diluted weighted-average shares.

15) Stockholder s Equity

Stock Repurchase Program

On July 25, 2011, the Company s Board of Directors approved a share repurchase program for the repurchase of up to an aggregate of $200,000 of its outstanding common stock from time to time in open market purchases, privately negotiated transactions or through other appropriate means. The timing and quantity of any shares repurchased depends upon a variety of factors, including business conditions, stock market conditions, debt agreement limitations and business development activities, including, but not limited to, merger and acquisition opportunities. These repurchases may be commenced, suspended or discontinued at any time without prior notice.

During the three months ended March 31, 2016, the Company repurchased approximately 45,000 shares of its common stock for $1,545, or an average price of $34.50 per share. During the three months ended March 31, 2015, the Company did not repurchase any shares of common stock.

Cash Dividends

Holders of the Company s common stock are entitled to receive dividends when they are declared by the Company s Board of Directors. During the three months ended March 31, 2016, the Company s Board of Directors declared a cash dividend of $0.17 per share, which dividends totaled $9,056. During the three months ended March 31, 2015, the Board of Directors authorized a cash dividend of $0.165 per share, which dividends totaled $8,784.

On May 2, 2016, the Company s Board of Directors declared a quarterly cash dividend of $0.17 per share to be paid on June 10, 2016 to shareholders of record as of May 30, 2016. Future dividend declarations, if any, as well as the record and payment dates for such dividends, are subject to the final determination of the Company s Board of Directors.

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

16) Business Segment, Geographic Area, Product and Significant Customer Information

The Company develops, manufactures, sells and services products that measure, control, power and monitor critical parameters of advanced manufacturing processes. The Company s Chief Operating Decision Maker (CODM) utilizes consolidated financial information to make decisions about allocating resources and assessing performance for the entire Company. In addition, certain disaggregated financial information is also provided to the CODM, which is used in the decision making process to assess performance. Based upon the information provided to the CODM, the Company has determined it has four reportable segments.

The Company s reportable segments are Advanced Manufacturing Capital Equipment, Global Service, Asia Region Sales and Other. The Company has reported corporate expenses and certain intercompany pricing transactions in a Corporate and Eliminations reconciling column.

The Advanced Manufacturing Capital Equipment segment includes the development, manufacturing and sales of instruments and control products, power and reactive gas products, materials delivery products and vacuum products, all of which are utilized in semiconductor processing and other similar advanced manufacturing processes. Sales in this segment include both external sales and intercompany product sales, which are recorded at transfer prices in accordance with applicable tax requirements.

The Global Service segment includes the worldwide servicing of instruments and control products, power and reactive gas products, materials delivery products and vacuum products, all of which are utilized in semiconductor processing and other similar advanced manufacturing processes. It also includes sales of custom fabrication services.

The Asia Region Sales segment mainly resells products from the Advanced Manufacturing Capital Equipment and Other segments into Asia regions.

The Other segment includes operating segments that are not required to be reported separately as a reportable segment and includes sales for products that are re-sold from the Advanced Manufacturing Capital Equipment into Europe regions as well as sales from other operating segments.

The Company derives its segment results directly from the manner in which results are reported in its management reporting system. The accounting policies that the Company uses to derive reportable segment results are substantially the same as those used for external reporting purposes except that a substantial portion of the sales of the Advanced Manufacturing Capital Equipment and Other segments are intercompany sales to the regions at tax-based transfer prices and certain significant costs, including stock-based compensation and management incentive compensation, are not allocated to the segments and are included in Corporate and Eliminations. The CODM reviews several metrics of each operating segment, including net revenues and gross profit (loss).

The Company does not maintain balance sheets for the majority of its operating segments and, as such, amounts have not been allocated to the reportable segments. The Company does not disclose external or intersegment revenues separately by reportable segment as this information is not presented to the CODM for decision making purposes.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

The following is net revenues by reportable segment:

	Three Months Ended March 31,	
	2016	2015
Advanced Manufacturing Capital Equipment	$ 153,570	$ 179,233
Global Service	30,060	27,743
Asia Region Sales[1]	43,848	55,377
Other	16,327	21,216
Corporate and Eliminations	(60,124)	(69,730)
	$ 183,681	$ 213,839

The following is a reconciliation of segment gross profit to consolidated net income:

	Three Months Ended March 31,	
	2016	2015
Gross profit by reportable segment:		
Advanced Manufacturing Capital Equipment	$ 67,630	$ 78,688
Global Service	9,644	9,603
Asia Region Sales[1]	2,413	6,920
Other	4,370	6,843
Corporate and Eliminations	(6,144)	(5,008)
Total gross profit by reportable segment	77,913	97,046
Operating expenses:		
Research and development	17,227	16,680
Selling, general and administrative	33,950	30,867
Acquisition costs	2,494	30
Restructuring		788
Amortization of intangible assets	1,683	1,671
Income from operations	22,559	47,010
Interest and other income, net	1,246	504
Income before income taxes	23,805	47,514
Provision for income taxes	6,242	13,728

Net income	$ 17,563	$ 33,786

(1) The Asia Region Sales segment does not represent total geographical Asia financial information. This sales operation only represents the sales from the resale of Advanced Manufacturin