NANOMETRICS INC
Form 10-Q
April 29, 2016

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 March 26, 2016

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: 000-13470

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 Number)
1550 Buckeye Drive	
Milpitas, California	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 x No o

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 o

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	o	Accelerated filer	x
Non-accelerated filer	o	Smaller reporting company	o

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

As of April 22, 2016, there were 24,399,157 shares of common stock, $0.001 par value, issued and outstanding.

NANOMETRICS INCORPORATED

INDEX TO QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED MARCH 26, 2016

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
NANOMETRICS INCORPORATED

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands except share and per share amounts)

(Unaudited)

	March 26, 2016	December 26, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$38,673	$ 38,154
Marketable securities	44,672	44,931
Accounts receivable, net of allowances of $145 and $150, respectively	44,482	37,832
Inventories	49,893	47,749
Inventories-delivered systems	4,138	2,856
Prepaid expenses and other	6,060	6,592
Total current assets	187,918	178,114
Property, plant and equipment, net	43,068	44,493
Goodwill	9,592	9,415
Intangible assets, net	1,425	1,867
Deferred income tax assets	1,191	1,118
Other assets	525	533
Total assets	$243,719	$ 235,540
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$13,212	$ 11,675
Accrued payroll and related expenses	8,592	10,097
Deferred revenue	16,010	12,790
Other current liabilities	8,978	8,878
Income taxes payable	704	1,771
Total current liabilities	47,496	45,211
Deferred revenue	250	827
Income taxes payable	805	775
Deferred tax liability	563	521
Other long-term liabilities	859	878
Total liabilities	49,973	48,212
Commitments and contingencies (Note 11)		
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: 24,371,657 and 24,224,286, respectively, issued and outstanding	24	24
Additional paid-in capital	260,679	258,715
Accumulated deficit	(62,742)	(66,209)
Accumulated other comprehensive income	(4,215)	(5,202)
Total stockholders' equity	193,746	187,328
Total liabilities and stockholders' equity	$243,719	$235,540

See Notes to Condensed Consolidated Financial Statements

NANOMETRICS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands except per share amounts)

(Unaudited)

	Three Months Ended	
	March 26, 2016	March 28, 2015
Net revenues:		
Products	$39,214	$38,339
Service	8,275	12,037
Total net revenues	47,489	50,376
Costs of net revenues:		
Cost of products	18,079	19,992
Cost of service	4,484	6,373
Amortization of intangible assets	435	632
Total costs of net revenues	22,998	26,997
Gross profit	24,491	23,379
Operating expenses:		
Research and development	8,068	8,159
Selling	7,249	7,116
General and administrative	5,420	5,767
Amortization of intangible assets	24	38
Restructuring charge	—	58
Total operating expenses	20,761	21,138
Income from operations	3,730	2,241
Other (income) expense:		
Interest income	9	10
Interest expense	(117)	(82)
Other income, net	225	704
Total other income, net	117	632
Income before income taxes	3,847	2,873
Provision for income taxes	380	317
Net income	$3,467	$2,556
Net income per share:		
Basic	$0.14	$0.11
Diluted	$0.14	$0.11
Weighted average shares used in per share calculation:		
Basic	24,308	23,866
Diluted	24,597	24,257

See Notes to Condensed Consolidated Financial Statements

NANOMETRICS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended	
	March 26, 2016	March 28, 2015
Net income	$3,467	$2,556
Other comprehensive income (loss):		
Change in foreign currency translation adjustment	952	(1,727)
Net change on unrealized gains on available-for-sale investments	35	29
Other comprehensive income (loss):	987	(1,698)
Comprehensive income	$4,454	$858

See Notes to Condensed Consolidated Financial Statements

NANOMETRICS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended	
	March 26, 2016	March 28, 2015
Cash flows from operating activities:		
Net income	$3,467	$2,556
Reconciliation of net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,176	2,324
Stock-based compensation	1,689	1,571
Disposal of fixed assets	99	485
Inventory write-down	651	403
Deferred income taxes	(30)	55
Changes in fair value of contingent payments to Zygo Corporation	55	35
Changes in assets and liabilities:		
Accounts receivable	(5,197)	(13,340)
Inventories	(1,871)	(2,442)
Inventories-delivered systems	(1,283)	1,164
Prepaid expenses and other	605	(94)
Accounts payable, accrued and other liabilities	(1,468)	3,947
Deferred revenue	2,643	(2,468)
Income taxes payable	(1,037)	(70)
Net cash provided by (used in) operating activities	499	(5,874)
Cash flows from investing activities:		
Sales of marketable securities	—	1,082
Maturities of marketable securities	13,153	9,592
Purchases of marketable securities	(12,953)	(10,613)
Purchases of property, plant and equipment	(610)	(502)
Net cash used in investing activities	(410)	(441)
Cash flows from financing activities:		
Payments to Zygo Corporation related to acquisition	(84)	(224)
Proceeds from sale of shares under employee stock option plans and purchase plan	934	2,357
Taxes paid on net issuance of stock awards	(658)	(764)
Repurchases of common stock	-	(1,721)
Net cash provided by (used in) financing activities	192	(352)
Effect of exchange rate changes on cash and cash equivalents	238	(74)

Net increase (decrease) in cash and cash equivalents	519	(6,741)
Cash and cash equivalents, beginning of period	38,154	34,676
Cash and cash equivalents, end of period	$38,673	$27,935
Supplemental disclosure of non-cash investing activities:		
Transfer of inventory to property, plant and equipment, net	$—	$435
Transfer of property, plant and equipment to inventory, net	$491	$—

See Notes to Consolidated Financial Statements

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 optical critical dimension ("OCD"), thin film 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 Company's OCD 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 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 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 26, 2015, and include all normal recurring adjustments necessary to fairly state 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 ("U.S. GAAP"). 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 26, 2015, which were included in the Company's Annual Report on Form 10-K filed with the SEC on February 24, 2016.

Fiscal Period – The Company uses a 52/53 week fiscal year ending on the last Saturday of the calendar year. All references to the quarter refer to Nanometrics' fiscal quarter. The fiscal quarters reported herein are comprised of 13 week periods.

Upgrade Revenue and Related Cost - During the first quarter of 2016, revenues associated with upgrade sales are now included under Products Revenues, and the related costs in Cost of Products Revenue. This change was due to the types of upgrades currently being sold, which are primarily system software and hardware performance upgrades to extend the features and functionality of a product. Previously upgrades consisted of a group of parts and/or software that change the existing configuration of a product. For the three months ended March 28, 2015, $4.6 million related to upgrade sales, and $1.8 million of costs, are included in Service Revenues and Costs of Service Revenues, respectively, in the accompanying Condensed Consolidated Statement of Operations.

Use of Estimates – The preparation of financial statements in conformity with U.S. GAAP 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, valuation of intangible and long-lived assets, warranty accruals, income taxes, valuation of stock-based compensation, and contingencies.

Revenue Recognition – The Company derives revenue from the sale of process control metrology and inspection systems and related upgrades (“product revenue”) as well as spare part sales, billable service and service contracts (together “service revenue”). Upgrades are system software and hardware performance upgrades that extend the features and functionality of a product. As discussed above, commencing in the first quarter of 2016, they are included in 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.

NANOMETRICS INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

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 have 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.

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, which terms can be up to twelve months. The Company does not grant its customers a general right of return or any refund terms and imposes a penalty on orders cancelled 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. 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 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.

NANOMETRICS INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Note 2. Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board ("FASB") issued an accounting standards update that simplifies several aspects of the accounting for share-based payment award transactions, including income tax consequences, classification of awards as equity or liability, and classification on the statement of cash flows. The new standard is effective for public companies for annual reporting periods beginning after December 16, 2016, and interim periods within those annual periods. Early adoption is permitted. The Company is currently evaluating the timing and effects of the adoption of this standard on its consolidated financial statements.

In March 2016, the FASB issued an accounting standards update that clarifies the implementation guidance on principal versus agent considerations to improve operability and understandability of the revenue recognition guidance. The amendments in this update affect the recently issued guidance in accounting standards update 2014-09, Revenue from Contracts with Customers, which is effective for public companies for annual reporting periods beginning after December 15, 2017 and interim periods within those fiscal years. Thus, the effective date and transition requirements for the amendments in this Update are the same. This updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. The Company has not yet selected a transition method and is currently evaluating the timing and effects of the adoption of this standard and related updates on its consolidated financial statements and related disclosures.

In February 2016, the FASB issued an accounting standards update which requires lessees to record a right-of-use asset and a corresponding lease liability on the balance sheet (with the exception of short-term leases). For lessees, leases will continue to be classified as either operating or financing in the income statement. The new standard is effective for public companies for annual reporting periods beginning after December 15, 2018, including interim periods within those fiscal years. This standard is required to be applied with a modified retrospective transition approach. Early adoption is permitted. The Company is currently evaluating the effect of this standard on its Consolidated Financial Statements and related disclosures.

Note 3. Fair Value Measurements and Disclosures

The Company determines the fair values of its financial instruments based on the fair value hierarchy established in FASB Accounting Standards Codification ("ASC") 820, Fair Value Measurement, 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 the following 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.

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.

NANOMETRICS INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

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), as of the following dates:

	March 26, 2016 Fair Value Measurements Using Input Types				December 26, 2015 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	$1,075	$—	$—	$1,075	$590	$—	$—	$590
Commercial paper and corporate debt securities	—	4,452	—	4,452	—	4,568	—	4,568
Total cash equivalents	$1,075	$4,452	$—	$5,527	$590	$4,568	$—	$5,158
Marketable securities:								
U.S. Treasury, U.S. Government and U.S. Government agency debt securities	6,973	23,227	—	30,200	4,401	20,164	—	24,565
Commercial paper, municipal securities and corporate debt securities	—	14,473	—	14,473	—	20,366	—	20,366
Total marketable securities	$6,973	$37,700	$—	$44,673	$4,401	$40,530	$—	$44,931
Total(1)	$8,048	$42,152	$—	$50,200	$4,991	$45,098	$—	$50,089
Liabilities:								
Contingent consideration payable	$—	$—	$1,461	$1,461	$—	$—	$1,490	$1,490

(1) Excludes $33.1 million and $33.0 million held in operating accounts as of March 26, 2016 and December 26, 2015, respectively.

The fair values of the marketable securities that are classified as Level 1 in the table above were derived from quoted market prices for identical assets or liabilities in active markets that the Company has the ability to access. The fair value of marketable securities that are classified as Level 2 in the table above were derived from non-binding market consensus prices that were corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques with all significant inputs derived from or corroborated by observable market data. There were no transfers of instruments between Level 1, Level 2 and Level 3 during the financial periods presented.

Changes in Level 3 liabilities	(in thousands)
Fair value at December 26, 2015	$ 1,490
Payments made to Zygo Corporation	(84)
Change in fair value included in earnings	55
Fair value at March 26, 2016	$ 1,461

As of March 26, 2016, the Company had liabilities of $1.5 million resulting from the acquisition of certain assets from Zygo Corporation, a wholly-owned subsidiary of AMETEK, Inc. ("Zygo"), which are measured at fair value on a recurring basis, and changes in fair value recorded in other income (expense), net. Of the $1.4 million of Zygo liabilities at March 26, 2016, $1.0 million was a current liability and $0.5 million was a long-term liability. As of December 26, 2015, the liabilities totaled $1.5 million of which $0.9 million was a current liability and $0.6 million was a long-term liability. The fair values of these liabilities were determined using Level 3 inputs applying a discounted cash flow model incorporating assumptions that market participants would use in their estimates of fair value. Some of these assumptions included estimates for discount rate, and timing and the amount of cash flows.

Derivatives

The Company uses foreign currency forward contracts to mitigate variability in gains and losses generated from the re-measurement of certain monetary assets and liabilities denominated in foreign currencies. These derivatives are carried at fair value

NANOMETRICS INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

with changes recorded in other income (expense), net in the consolidated statements of operations. Changes in the fair value of these derivatives are largely offset by re-measurement of the underlying assets and liabilities. The derivatives have maturities of approximately 30 days.

The loss on settlement of forward foreign currency contracts included in the three months ended March 26, 2016 and March 28, 2015 was $0.5 million and zero, respectively and are included in other income (expense), net, in the consolidated statements of operations.

The following table summarizes the Company's outstanding derivative instruments on a gross basis as of March 26, 2016:

	Notional Principal (in millions)
Undesignated Hedges:	
Forward Foreign Currency Contracts	$ 23.3

Note 4. Cash and Investments

The following tables present cash, cash equivalents, and available-for-sale investments as of the following dates (in thousands):

	March 26, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
Cash	$33,145	$ —	$ —	$ 33,145
Cash equivalents:				
Money market funds	1,075	—	—	1,075
Commercial paper and corporate debt securities	4,452	—	—	4,452
Marketable securities:				
Commercial paper	699	—	—	699
U.S. Treasury securities	6,971	2	—	6,973
U.S. Government agency securities	23,231			