APOGEE ENTERPRISES, INC.
Form 10-Q
January 07, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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x QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended November 28, 2015

o TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 0-6365

APOGEE ENTERPRISES, INC.
(Exact name of registrant as specified in its charter)

Minnesota (State or other jurisdiction of incorporation or organization)	41-0919654 (I.R.S. Employer Identification No.)
4400 West 78th Street – Suite 520, Minneapolis, MN (Address of principal executive offices)	55435 (Zip Code)

Registrant's telephone number, including area code: (952) 835-1874

Not Applicable
(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. x Yes o 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). x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

As of January 6, 2016, 28,884,251 shares of the registrant's common stock, par value $0.33 1/3 per share, were outstanding.

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APOGEE ENTERPRISES, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS
(unaudited)

(In thousands, except per share data)	November 28, 2015	February 28, 2015
Assets		
Current assets		
Cash and cash equivalents	$30,713	$52,185
Short-term available for sale securities	60,653	327
Receivables, net of allowance for doubtful accounts	163,502	171,623
Inventories	64,034	61,408
Refundable income taxes	—	5,115
Deferred tax assets	933	1,359
Other current assets	8,677	6,958
Total current assets	328,512	298,975
Property, plant and equipment, net	194,145	193,540
Available for sale securities	11,022	10,655
Goodwill	74,144	75,857
Intangible assets	20,398	23,280
Other non-current assets	12,307	9,750
Total assets	$640,528	$612,057
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable	$59,688	$56,516
Accrued payroll and related benefits	32,327	36,620
Accrued self-insurance reserves	5,463	8,058
Other current liabilities	27,952	25,557
Billings in excess of costs and earnings on uncompleted contracts	29,624	22,233
Current portion long-term debt	29	44
Accrued income taxes	3,996	—
Total current liabilities	159,079	149,028
Long-term debt	20,793	20,587
Unrecognized tax benefits	4,461	4,477
Long-term self-insurance reserves	7,785	6,185
Deferred tax liabilities	5,018	10,652
Other non-current liabilities	37,282	38,652
Commitments and contingent liabilities		
Shareholders' equity		
Common stock of $0.33-1/3 par value; authorized 50,000,000 shares; issued and outstanding 29,108,251 and 29,049,531 respectively	9,703	9,683
Additional paid-in capital	146,700	138,575
Retained earnings	281,329	256,538
Common stock held in trust	(828)	(801)
Deferred compensation obligations	828	801
Accumulated other comprehensive loss	(31,622)	(22,320)
Total shareholders' equity	406,110	382,476
Total liabilities and shareholders' equity	$640,528	$612,057

See accompanying notes to consolidated financial statements.

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CONSOLIDATED RESULTS OF OPERATIONS
(unaudited)

(In thousands, except per share data)	Three Months Ended		Nine Months Ended	
	November 28, 2015	November 29, 2014	November 28, 2015	November 29, 2014
Net sales	$238,324	$244,410	$719,040	$687,238
Cost of sales	175,898	187,757	544,326	539,826
Gross profit	62,426	56,653	174,714	147,412
Selling, general and administrative expenses	34,568	36,028	106,209	103,474
Operating income	27,858	20,625	68,505	43,938
Interest income	258	243	762	706
Interest expense	159	357	477	774
Other (expense) income, net	(75)	(16)	(120)	1,461
Earnings before income taxes	27,882	20,495	68,670	45,331
Income tax expense	9,361	6,759	23,264	8,703
Net earnings	$18,521	$13,736	$45,406	$36,628
Earnings per share - basic	$0.64	$0.47	$1.56	$1.27
Earnings per share - diluted	$0.63	$0.47	$1.54	$1.25
Weighted average basic shares outstanding	29,181	28,725	29,137	28,759
Weighted average diluted shares outstanding	29,466	29,358	29,479	29,350

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS
(unaudited)

(In thousands)	Three Months Ended November 28, 2015	Three Months Ended November 29, 2014	Nine Months Ended November 28, 2015	Nine Months Ended November 29, 2014
Net earnings	$18,521	$13,736	$45,406	$36,628
Other comprehensive (loss) earnings:				
Unrealized gain (loss) on marketable securities, net of $10, $16, $(24) and $70 of tax expense (benefit), respectively	18	30	(45)	129
Unrealized loss on foreign currency hedge, net of $-, $-, $- and $36 of tax benefit, respectively	—	—	—	(62)
Foreign currency translation adjustments	(4,106)	(4,583)	(9,257)	(2,016)
Other comprehensive loss	(4,088)	(4,553)	(9,302)	(1,949)
Total comprehensive earnings	$14,433	$9,183	$36,104	$34,679

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

(In thousands)	Nine Months Ended November 28, 2015	November 29, 2014
Operating Activities		
Net earnings	$45,406	$36,628
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	23,336	21,558
Share-based compensation	3,686	3,705
Deferred income taxes	(5,026)	(1,022)
Excess tax benefits from share-based compensation	(4,990)	(2,524)
Gain on disposal of assets	(67)	(835)
Other, net	562	(6)
Changes in operating assets and liabilities:		
Receivables	6,552	(20,697)
Inventories	(3,419)	(7,315)
Accounts payable and accrued expenses	1,296	3,041
Billings in excess of costs and earnings on uncompleted contracts	7,391	2,907
Refundable and accrued income taxes	13,159	3,551
Other, net	(1,719)	(1,911)
Net cash provided by operating activities	86,167	37,080
Investing Activities		
Capital expenditures	(26,757)	(18,659)
Sales of restricted investments	—	2,067
Purchases of securities	(64,551)	(6,016)
Sales/maturities of securities	3,765	6,821
Other, net	(3,875)	(535)
Net cash used in investing activities	(91,418)	(16,322)
Financing Activities		
Borrowings on line of credit, net	350	1,904
Shares withheld for taxes, net of stock issued to employees	(3,267)	(3,615)
Excess tax benefits from share-based compensation	4,990	2,524
Repurchase and retirement of common stock	(7,257)	(6,894)
Dividends paid	(9,632)	(8,875)
Net cash used in financing activities	(14,816)	(14,956)
(Decrease) increase in cash and cash equivalents	(20,067)	5,802
Effect of exchange rates on cash	(1,405)	(200)
Cash and cash equivalents at beginning of year	52,185	28,465
Cash and cash equivalents at end of period	$30,713	$34,067
Noncash Activity		
Capital expenditures in accounts payable	Sept 30, 2017	Sept 30, 2016
Weighted-average risk-free interest rates:	2.1%	1.4%
Dividend yield:	—	—
Weighted-average expected life of the option:	7 Years	7 Years
Weighted-average expected stock price volatility:	94%	95%
Weighted-average fair value of the options granted:	$0.55	$0.34

As of September 30, 2017, we did not have any unvested restricted stock or performance shares outstanding.

(8) Significant Customers and Contingencies

Revenue from three customers constituted approximately 58%, 8% and 4%, respectively, of our total revenue for the three months ended September 30, 2017, and 67%, 7% and 4%, respectively, of our total revenue for the nine months ended September 30, 2017. Amounts included in accounts receivable on September 30, 2017 relating to these three customers were approximately $1,078, $222 and $102, respectively. Revenue from these three customers constituted approximately 65%, 4% and 5%, respectively, of our total revenue for the three months ended September 30, 2016, and 69%, 3% and 6%, respectively, of our total revenue for the nine months ended September 30, 2016. Amounts included in accounts receivable on September 30, 2016 relating to these three customers were approximately $784, $69 and $122, respectively. The loss of one of these significant customers, a significant decrease in revenue from one or more of these customers, or the failure to attract new customers could have a material adverse effect on our business, results of operations and financial condition.

We currently have exclusive supply agreements with BASF Corporation ("BASF"), our largest customer, that have contingencies outlined which could potentially result in the license of technology and/or the sale of production equipment from the Company to the customer intended to provide capacity sufficient to meet the customer's production needs. This outcome may occur if we fail to meet certain performance requirements, certain other obligations and/or certain financial condition covenants. The financial condition covenants in one of our supply agreements with BASF "trigger" a technology transfer right (license and equipment sale at BASF's option) in the event (a) that earnings for the twelve month period ending with our most recently published quarterly financial statements are less than zero and our cash, cash equivalents and certain investments are less than $1 million, or (b) of an acceleration of any debt maturity having a principal amount of more than $10 million. Our supply agreements with BASF also "trigger" a technology transfer right in the event of our insolvency, as further defined within the agreements. In the event of an equipment sale, upon incurring a triggering event, the equipment would be sold to the customer at either 115% of the equipment's net book value or the greater of 30% of the original book value of such equipment, and any associated upgrades to it, or 115% of the equipment's net book value, depending on the equipment and related products.

We believe that we have sufficient cash and credit availability (See Liquidity and Capital Resources in Management's Discussion and Analysis in Part I, Item 2 of this Form 10-Q for a further discussion, as well as the description of our Line of Credit Agreement described in Note 5) to operate our business during the remainder of 2017. If a triggering event were to occur and BASF elected to proceed with the license and related equipment sale mentioned above, we would receive royalty payments from this customer for products sold using our technology; however, we would lose both significant revenue and the ability to generate significant revenue to replace that which was lost in the near term. Replacement of necessary equipment that could be purchased and removed by the customer pursuant to this triggering event could take in excess of twelve months. Any additional capital outlays required to rebuild capacity would probably be greater than the proceeds from the purchase of the assets as dictated by our agreement with the customer. Similar consequences would occur if we were determined to have materially breached certain other provisions of the supply agreement with BASF. Any such event would also likely result in the loss of many of our key staff and line employees due to economic realities. We believe that our employees are a critical component of our success and it could be difficult to replace them quickly. Given the occurrence of any such event, we might not be able to hire and retain skilled employees given the stigma relating to such an event and its impact on us. Finally, any shortfall in capital needed to operate the business as management intends, including with respect to avoiding this triggering event as described above, may result in a curtailment of certain activities or anticipated investments.

Should events arise that make it appropriate for us to seek additional financing, such additional financing may not be available on acceptable terms or even at all, and any such financing could be dilutive to our stockholders. Such a financing could be necessitated by such things as the loss of one or more significant customers or a significant decline in revenue from those customers, currently unknown capital requirements, new regulatory requirements, the need to meet cash requirements under our BASF agreement to avoid a triggering event, the continuing costs associated with launching Solésence™, or other circumstances not currently anticipated by us. The failure to obtain sufficient capital may impair or curtail our business plans and under such circumstances may raise doubt regarding our ability to continue as a going concern.

(9) Business Segmentation and Geographical Distribution

Revenue from international sources approximated $276 and $956 for the three and nine months ended September 30, 2017, respectively, compared to $143 and $618 for the same periods in 2016. All of this revenue was product revenue.

Our operations comprise a single business segment and all of our long-lived assets are located within the United States.

(10) Recently Adopted and New Accounting Pronouncements

During May 2014, the FASB issued Accounting Standards Update (“ASU”) No. 2014-09 (“ASU 2014-09”), *Revenue from Contracts with Customers*, and several related updates including ASU No. 2016-08 and ASU No. 2016-10, which supersede nearly all existing revenue recognition guidance under U.S. generally accepted accounting principles. The new standard requires a company to recognize revenue when it transfers goods or services to customers in an amount that reflects the consideration that the company expects to receive for those goods or services. Additionally, the guidance requires certain disclosures designed to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, which is our first quarter of 2018. The new standard allows application either retrospectively to each prior reporting period presented or retrospectively as a cumulative-effect adjustment as of the date of adoption. We are completing the evaluation of the impact of ASU 2014-09, and at this time do not believe it will have a material impact on our financial position, results of operations, or cash flows, though it is expected to impact our related disclosures.

During February 2016, the FASB issued ASU No. 2016-02 (“ASU 2016-02”), *Leases (Topic 842)*. This standard requires the recognition of assets and liabilities arising from lease transactions on the balance sheet and the disclosure of key information about leasing arrangements. Accordingly, a lessee will recognize a lease asset for its right to use the underlying asset and a lease liability for the corresponding lease obligation. Both the asset and liability will initially be measured at the present value of the future minimum lease payments over the lease term. Subsequent measurement, including the presentation of expenses and cash flows, will depend on the classification of the lease as either a finance or an operating lease. Initial costs directly attributable to negotiating and arranging the lease will be included in the asset. For leases with a term of 12 months or less, a lessee can make an accounting policy election by class of underlying asset to not recognize an asset and corresponding liability. Lessees will also be required to provide additional qualitative and quantitative disclosures regarding the amount, timing and uncertainty of cash flows arising from leases. These disclosures are intended to supplement the amounts recorded in the financial statements and provide additional information about the nature of an organization’s leasing activities. The amendments in this standard are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, which is our first quarter of 2019, with early adoption permitted. We are currently evaluating the impact its adoption will have on the presentation of our financial statements and related disclosures.

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During March 2016, the FASB issued ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*, which amends ASC Topic 718, *Compensation - Stock Compensation*. The objective of this update is part of the FASB's Simplification Initiative as it applies to 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 update became effective for fiscal years beginning after December 15, 2016 and interim periods within that reporting period, or January 1, 2017 for us. The adoption did not have a material impact on the presentation of our financial statements, financial position, results of operations, cash flows and related disclosures.

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Nanophase is an advanced materials and applications developer and commercial manufacturer with an integrated family of materials technologies. We produce engineered nano and sub-micron materials for use in a variety of diverse markets: personal care including sunscreens, architectural coatings, industrial coating applications, abrasion-resistant additives, plastics additives, medical diagnostics, energy (including solar control), and a variety of surface finishing technologies (polishing) applications, including optics. We recently expanded our offerings beyond active ingredients to include targeted full formulations of skin care products, marketed and sold by our wholly-owned subsidiary, Solésence ™ LLC ("Solésence"™), which was created during the fall of 2016. The core of these solutions is a new surface coating technique for the particles that we believe will provide enhanced value to the marketplace. We target markets in which we believe practical solutions may be found using our products. We work closely with current and potential customers in these target markets to identify their material and performance requirements and market our materials to various end-use applications manufacturers. Recently developed technologies have made certain new products possible and opened potential new markets. For example, we have applied our skills at producing precisely defined nanomaterials to now create and sell larger, sub-micron material products. Our focus is on customer need where we believe we have an advantage, as opposed to finding uses for one particular technology. We expect growth in end-user (manufacturing customers, including customers of our customers) adoption in 2017 and beyond. Our initiatives in targeted market areas are progressing at differing rates of speed, but we have been broadly moving through testing and development cycles, and in a number of cases believe we are approaching first revenue or next stage revenue with particular customers in the industries referenced above. We believe that successful introduction of our materials with manufacturers may lead to follow-on orders for other materials in their applications.

At the same time, we look for opportunities to partner with established entities in order to further our mutual goals. During June 2017, we entered into a series of agreements with Eminess Technologies, Inc. ("ETI"), an entity that is well established in selling materials for surface finishing (polishing) applications. We intend to continue serving this market while devoting significant assets behind the launch of Solésence™. These agreements are intended to accomplish both. ETI will sell our products, in some cases by making and selling those products themselves under an exclusive license and paying us a royalty, and in other cases through an exclusive supply arrangement with us. ETI purchased equipment from us for $36,000 and paid us a one-time fee of $250,000 for assisting ETI in its development of dispersion technology relevant to polishing solutions.

Results of Operations

Total revenue increased to $2,785,000 for the three months ended September 30, 2017, compared to $2,521,000 for the same period in 2016. Total revenue increased to $9,852,000 for the nine months ended September 30, 2017, compared to $8,415,000 for the same period of 2016. A majority of our revenue for both periods was from our largest customer in personal care and sunscreen applications. The increase during the first nine months of 2017 was primarily due to increased order flow from that customer as well as our largest customer in coatings applications. The increase during the three months ended September 30, 2017 was primarily due to the increase in “other revenue” associated with the ETI payments noted above and discussed below, as well as order increases from our largest customer in coatings applications, and new revenue flow from a new customer in personal care applications. Product revenue, the primary component of our total revenue, increased to $2,524,000 for the three months ended September 30, 2017, compared to $2,510,000 for the same period in 2016. Product revenue increased to $9,525,000 for the nine months ended September 30, 2017, compared to $8,377,000 for the same period in 2016. Revenue from our top three customers was approximately 58%, 8% and 4%, respectively, during the three months ended September 30, 2017, compared to 65%, 4% and 5%, respectively, for the same customers during the same period in 2016. Revenue from our top three customers was approximately 67%, 7% and 4%, respectively, during the nine months ended September 30, 2017, compared to 69%, 3% and 6%, respectively, for the same customers during the same period in 2016.

Other revenue was $261,000 and $327,000 for the three and nine months ended September 30, 2017, compared to $11,000 and $38,000 for the same periods in 2016. This is typically comprised primarily of shipping costs paid by customers, as well as non-recurring project-based fees paid by customers. During the three and nine months ended September 30, 2017, other revenue included $250,000 of non-recurring technology development revenue received from ETI pursuant to our agreement with ETI.

Cost of revenue generally includes costs associated with commercial production and customer development arrangements. Cost of revenue increased to $2,200,000 for the three months ended September 30, 2017, compared to $1,841,000 for the same period in 2016. Cost of revenue increased to $6,862,000 for the nine months ended September 30, 2017, compared to $5,766,000 for the same period in 2016. The increases in cost of revenue were primarily driven by the increase in revenue volume, and impacted by the higher cost of zinc in the marketplace and manufacturing inefficiencies pertaining to new products associated with Solésence ™. While we typically pass through costs to our customers, we sometimes cannot pass through 100% of pricing increases, and even with pass throughs our gross margin percentage is negatively impacted by higher material costs. We expect to continue new nanomaterial development, primarily using our NanoArc® synthesis and dispersion technologies, for targeted applications and new markets beyond 2017. At current revenue levels we have generated a positive gross margin, though margins have been impeded by not having enough revenue to efficiently absorb manufacturing overhead that is required to work with current customers and expected future customers. We believe that our current fixed manufacturing cost structure is sufficient to support higher levels of production. The extent to which margins may grow, as a percentage of total revenue, will be dependent upon revenue mix, revenue volume, and our ability to manage costs and pass commodity market-driven raw materials increases on to customers. We expect that product revenue volume increases would result in our fixed manufacturing costs being more efficiently absorbed, leading to increased margins. We expect to continue to focus on reducing controllable variable product manufacturing costs, with potential variability related to the commodity metals markets, but may or may not realize absolute dollar gross margin growth beyond 2017, dependent upon the factors discussed above.

Research and development expense, which includes all expenses relating to the technology and advanced engineering groups, primarily consists of costs associated with the development or acquisition of new product applications and coating formulations and the cost of enhancing our manufacturing processes. As an example, we have been, and continue to be, engaged in research to enhance our ability to disperse material in a variety of organic and inorganic media for use as coatings and polishing materials. Much of this work has led to several new products and additional potential new products.

Having demonstrated the capability to produce pilot quantities of mixed-metal oxides in a single crystal phase, we do not expect development of further variations on these materials to present material technological challenges. Many of these materials exhibit performance characteristics that can enable them to serve in various catalytic applications. We are now working on several related commercial opportunities using the same materials. We expect that this technique should enable us to scale to large quantity commercial volumes. We also have an ongoing advanced engineering effort that is primarily focused on the development of new nanomaterials as well as the refinement of existing nanomaterials, as dictated by our customer-driven marketing strategy. We are not certain when or if any significant revenue will be generated from the production of the materials described above.

Research and development expense increased to $494,000 and $1,354,000 for the three and nine months ended September 30, 2017, compared to $386,000 and $1,060,000 for the same periods in 2016. We added personnel during 2016 and 2017 and have increased outside product testing and evaluation during 2017 related to our Solésence™ products. We expect quarterly research and development expense to decline by approximately 10% during the fourth quarter of 2017 as we expect the initial effort required to launch the Solésence ™ solutions to lessen, particularly with respect to reduced external testing and validation costs.

Selling, general and administrative expense increased to $725,000 and $2,185,000 for the three and nine month periods ended September 30, 2017, compared to $716,000 and $2,151,000 for the same periods in 2016. Increased costs associated with launching the Solésence ™ brand were largely offset by the reduction of certain administrative costs including professional service fees. We expect selling, general and administrative expense to remain at current levels during the fourth quarter of 2017.

Inflation

We believe inflation has not had a material effect on our operations or financial position. However, supplier price increases and wage and benefit inflation, both of which represent a significant component of our costs of operations, may have a material effect on our operations and financial position in 2017 and beyond if we are unable to pass through any applicable increases under our present contracts or through to our markets in general.

Liquidity and Capital Resources

Our cash, cash equivalents and short-term investments amounted to $1,070,000 on September 30, 2017, compared to $1,779,000 on December 31, 2016 and $1,718,000 on September 30, 2016. The net cash used in our operating activities was $866,000 for the nine months ended September 30, 2017, compared to $354,000 for the same period in 2016. The net use of cash during both periods was driven primarily by a significant increase in accounts receivable at the end of the period related to significant customer shipments during September of each year. Net cash provided by investing activities was $15,000 during the nine months ended September 30, 2017, compared to net cash used by investing activities of $139,000 for the nine months ended September 30, 2016. We received $136,000 during 2017 related to the sale of fixed assets that we no longer utilize. Capital expenditures amounted to $121,000 and $102,000 for the nine months ended September 30, 2017 and 2016, respectively. Net cash provided by financing activities was $142,000 during the nine months ended September 30, 2017, compared to $936,000 for the nine months ended September 30, 2016. We paid off a financing lease in the amount of $60,000 during 2017 related to certain fixed assets that we sold, and had borrowings under our Line of Credit of $250,000 on September 30, 2017, which was subsequently repaid on October 3, 2017. On February 10, 2016, we sold 2.6 million shares of our common stock to our largest stockholder for $988,000 in proceeds. We used the proceeds from the sale of shares for working capital and general corporate purposes. We entered into new capital (financing) leases during 2017, including one for $175,000 during the first quarter of 2017, another lease for $52,000 during the second quarter of 2017 and another for $60,000 during the third quarter of 2017. These leases will be repaid over five years pursuant to their terms. We had no new capital leases during the first nine months of 2016.

Our supply agreements with our largest customer, BASF, contain certain financial covenants which could potentially impact our liquidity. The most restrictive financial covenants under these agreements require that we maintain a minimum of $1 million in cash, cash equivalents and certain investments, and that we not have the acceleration of any debt maturity having a principal amount of more than $10 million, in order to avoid triggering the customer's potential right to transfer certain technology and equipment to that customer at a contractually defined price. We had approximately $1.1 million in cash and cash equivalents on September 30, 2017, with $250,000 in outstanding borrowings on our Line of Credit, subsequently repaid on October 3, 2017. This supply agreement and its covenants are more fully described in Note 8, and our line of credit is more fully described in Note 5, to our Financial Statements in Part I, Item 1 of this Form 10-Q.

We believe that cash from operations and cash, cash equivalents and unused borrowing capacity will be adequate to fund our operating plans through 2017. Our actual future capital requirements in 2017 and beyond will depend, however, on many factors, including customer acceptance of our current and potential nanomaterials and product applications, continued progress in research and development activities and product testing programs, the magnitude of these activities and programs, and the costs necessary to increase and expand our manufacturing capabilities and to market and sell our materials and product applications. Other important issues that will drive future capital requirements will be the development of new markets and new customers as well as the potential for significant unplanned growth with existing customers. Depending on the success of certain projects, we expect that capital spending relating to currently known capital needs for the remainder of 2017 will be between $30,000 and $80,000. If those projects are delayed or ultimately prove unsuccessful, or if we fail to obtain financing on terms acceptable to us, we would expect our capital spending to be below the lower end of that range. If certain projects are successful, the total capital spending may end up higher than that range for the remainder of 2017.

Should events arise that make it appropriate for us to seek additional financing, such additional financing may not be available on acceptable terms or even at all, and any such additional financing could be dilutive to our stockholders. Such financing could be necessitated by such things as: the loss of one or more existing customers or a significant decrease in revenue from those customers; currently unknown capital requirements in light of the factors described above; new regulatory requirements that are outside our control; the need to meet previously discussed cash requirements to avoid a triggering event under our BASF agreements; the continuing costs surrounding the launch of Solésence™, or various other circumstances coming to pass that we currently do not anticipate. The failure to obtain sufficient capital to fund our business plans may result in a curtailment or other change in those plans, and under such circumstances may raise doubt as to our ability to continue as a going concern.

On September 30, 2017, we had a net operating loss carryforward of approximately $82 million for income tax purposes. Because we may have experienced "ownership changes" within the meaning of the U.S. Internal Revenue Code in connection with our various prior equity offerings, future utilization of this carryforward may be subject to certain limitations as defined by the Internal Revenue Code. If not utilized, the carryforward will expire at various dates between January 1, 2018 and December 31, 2036. As a result of the annual limitation and uncertainty as to the amount of future taxable income that will be earned prior to the expiration of the carryforward, we have concluded that it is likely that some portion of this carryforward will expire before ultimately becoming available to reduce income tax liabilities. Changes in Illinois state law that began in 2011 will impact net loss carryforward duration and utilization on the state tax level.

Off−Balance Sheet Arrangements

We have not created, and are not party to, any special-purpose or off-balance sheet entities for the purposes of raising capital, incurring debt or operating our business. We do not have any off-balance sheet arrangements or relationships with entities that are not consolidated into our financial statements that are reasonably likely to materially affect our liquidity or the availability of capital resources.

As more fully described in Note 5 to our Financial Statements, in Part I, Item I of this Form 10-Q, during 2014 we entered into a letter of credit and promissory note for up to $30,000 supporting our obligations under our facility lease agreement. No borrowings have been incurred under this promissory note.

Safe Harbor Provision

We want to provide investors with more meaningful and useful information. As a result, this Quarterly Report on Form 10-Q (the "Form 10-Q") contains and incorporates by reference certain "forward-looking statements", as defined in Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These statements reflect our current expectations of the future results of our operations, performance and achievements. Forward-looking statements are covered under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We have tried, wherever possible, to identify these statements by using words such as "anticipates", "believes", "estimates", "expects", "plans", "intends" and similar expressions. These statements reflect management's current beliefs and are based on information now available to it. Accordingly, these statements are subject to certain risks, uncertainties and contingencies that could cause our actual results, performance or achievements in 2017 and beyond to differ materially from those expressed in, or implied by, such statements. These risks, uncertainties and factors include, without limitation: our ability to be consistently profitable despite the losses we have incurred since our incorporation; a decision by a customer to cancel a purchase order or supply agreement in light of our dependence on a limited number of key customers; the terms of our supply agreements with BASF, which could trigger a requirement to transfer technology and/or sell equipment to that customer; our potential inability to obtain working capital when needed on acceptable terms or at all; our ability to obtain materials at costs we can pass through to our customers, including Rare Earth elements, specifically cerium oxide, as well as high purity zinc; uncertain demand for, and acceptance of, our nanocrystalline materials; our manufacturing capacity and product mix flexibility in light of customer demand; our limited marketing experience, now particularly relevant to our launch of our new Solésence ™ products; changes in development and distribution relationships; the impact of competitive products and technologies; our dependence on patents and protection of proprietary information; the resolution of litigation or other legal proceedings in which we may become involved; our ability to maintain an appropriate electronic trading venue for our securities; and the impact of any potential new governmental regulations that could be difficult to respond to or costly to comply with. In addition, our forward-looking statements could be affected by general industry and market conditions and growth rates. Readers of this Quarterly Report on Form 10-Q should not place undue reliance on any forward-looking statements. Except as required by federal securities laws, we undertake no obligation to update or revise these forward-looking statements to reflect new events or uncertainties.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not required for a smaller reporting company.

Item 4.

Controls and Procedures

Disclosure controls

We are responsible for establishing and maintaining disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports filed by us under the Exchange Act is: (a) recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms; and (b) accumulated and communicated to our management, including our principal executive and principal financial officers, to allow timely decisions regarding required disclosures. It should be noted that in designing and evaluating our disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and that our management necessarily was required to apply its judgment regarding the design of our disclosure controls and procedures. As of the end of the period covered by this report, we conducted an evaluation, under the supervision (and with the participation) of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at reaching that level of reasonable assurance.

Internal control over financial reporting

We implemented a new enterprise resource planning (“ERP”) system across the organization during April 2017 and discontinued the use of our prior ERP system. We expect the new ERP system to improve the efficiency of our business transaction processes and relevant analytics. We have considered changes associated with this conversion in the design of our internal control over financial reporting and testing for the effectiveness of our internal control over financial reporting. We have concluded that the implementation of the new ERP has not materially impacted the effectiveness of our internal control over financial reporting.

The Company’s management, including the CEO and CFO, confirm that there was no change in the Company’s internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1.

Legal Proceedings

We are not a party to any pending legal proceedings or claims that we believe will result in a material adverse effect on our business, financial condition, or operating results.

Item 1A.

Risk Factors

In addition to the information set forth in this Quarterly Report on Form 10-Q and before deciding to invest in, or retain, shares of our common stock, you also should carefully review and consider the information contained in our other reports and periodic filings that we make with the Securities and Exchange Commission, including, without limitation, the information contained under the caption Part I, Item 1A "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016. Those risk factors could materially affect our business, financial condition and results of operations. Additional risks and uncertainties that we do not currently know about, we currently believe are immaterial or we have not predicted may also harm our business operations or adversely affect us. If any of these risks or uncertainties actually occurs, our business, financial condition, results of operations, cash flows or stock price could be materially adversely affected. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2016.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5.

Other Information

On November 8, 2017, Frank J. Cesario, our Chief Financial Officer, resigned from his position effective November 17, 2017. Mr. Cesario's decision to resign was not related to any disagreement between him and the Company relating to our financial reporting, operations, policies or practices. We are currently seeking a replacement.

Item 6. Exhibits

Exhibit 31.1

Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Exchange Act.

Exhibit 31.2

Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Exchange Act.

Exhibit 32

Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350.

Exhibit 101

The following materials from Nanophase Technologies Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, formatted in XBRL (Extensible Business Reporting Language): (1) the Balance Sheets, (2) the Statements of Operations, (3) the Statements of Cash Flows, and (4) the Notes to Unaudited Financial Statements.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	NANOPHASE TECHNOLOGIES CORPORATION
Date: November 14, 2017	By: /s/ JESS A. JANKOWSKI Jess A. Jankowski President and Chief Executive Officer
Date: November 14, 2017	By: /s/ FRANK J. CESARIO Frank J. Cesario Chief Financial Officer

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