NANOMETRICS INC
Form 10-Q
May 06, 2014

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 29, 2014
OR
o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission file number 0-13470

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes Q No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such file) Yes Q No £

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

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

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

As of April 28, 2014, there were 23,896,138 shares of common stock, $0.001 par value, issued and outstanding.

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FOR QUARTER ENDED MARCH 29, 2014

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	March 29, 2014	December 28, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$38,833	$44,765
Marketable securities	49,204	48,097
Accounts receivable, net of allowances of $293 and $293, respectively	32,417	31,436
Inventories	37,855	34,520
Inventories-delivered systems	2,249	6,901
Prepaid expenses and other	8,972	10,519
Deferred income tax assets	14,008	14,516
Total current assets	183,538	190,754
Property, plant and equipment, net	47,131	47,439
Goodwill	11,865	11,743
Intangible assets, net	7,139	7,864
Deferred income tax assets	4,345	4,338
Other assets	699	696
Total assets	$254,717	$262,834
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$7,409	$10,604
Accrued payroll and related expenses	8,200	7,853
Deferred revenue	11,542	21,749
Other current liabilities	8,185	7,993
Income taxes payable	557	758
Total current liabilities	35,893	48,957
Deferred revenue	3,310	3,718
Income taxes payable	599	1,171
Other long-term liabilities	1,645	1,615
Total liabilities	41,447	55,461
Commitments and contingencies (Note 16)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 3,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, $0.001 par value, 47,000,000 shares authorized; 23,876,666 and 23,537,275, respectively, issued and outstanding	24	24
Additional paid-in capital	248,824	244,733
Accumulated deficit	(36,401)	(37,996)
Accumulated other comprehensive income	823	612
Total stockholders' equity	213,270	207,373

Total liabilities and stockholders' equity	$254,717	$262,834

See Notes to Condensed Consolidated Financial Statements

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

	Three Months Ended	
	March 29, 2014	March 30, 2013
Net revenues:		
Products	$43,280	$13,079
Service	8,296	11,473
Total net revenues	51,576	24,552
Costs of net revenues:		
Cost of products	21,639	7,960
Cost of service	5,114	5,448
Amortization of intangible assets	674	658
Total costs of net revenues	27,427	14,066
Gross profit	24,149	10,486
Operating expenses:		
Research and development	8,314	7,447
Selling	7,373	6,932
General and administrative	6,338	5,512
Amortization of intangible assets	108	198
Total operating expenses	22,133	20,089
Income (loss) from operations	2,016	(9,603)
Other income (expense)		
Interest income	14	25
Interest expense	(100)	(226)
Other expense, net	252	40
Total other income (expense), net	166	(161)
Income (loss) before income taxes	2,182	(9,764)
Provision for (benefit from) income taxes	587	(4,182)
Net income (loss)	$1,595	$(5,582)
Net income (loss) per share:		
Basic	$0.07	$(0.24)
Diluted	$0.07	$(0.24)
Weighted shares used in per share calculation:		
Basic	23,711	23,341
Diluted	24,159	23,341

See Notes to Condensed Consolidated Financial Statements

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

	Three Months Ended	
	March 29, 2014	March 30, 2013
Net income (loss)	$1,595	$(5,582)
Other comprehensive income (loss):		
Change in foreign currency translation adjustment	104	(1,944)
Net change on unrealized gains on available-for-sale investments	107	5
Other comprehensive income (loss)	211	(1,939)
Comprehensive income (loss)	$1,806	$(7,521)

See Notes to Condensed Consolidated Financial Statements

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

	Three Months Ended	
	March 29, 2014	March 30, 2013
Cash flows from operating activities:		
Net income (loss)	$1,595	$(5,582)
Reconciliation of net income (loss) to net cash used in operating activities:		
Depreciation and amortization	2,429	2,108
Stock-based compensation	1,634	1,457
Excess tax benefit from equity awards	—	367
Loss on disposal of fixed assets	—	12
Inventory write-down	669	1,321
Deferred income taxes	519	(4,065)
Changes in fair value of contingent consideration	(5)	389
Changes in assets and liabilities:		
Accounts receivable	(967)	1,268
Inventories	(3,142)	(5,631)
Inventories-delivered systems	4,652	750
Prepaid expenses and other	1,845	592
Accounts payable, accrued and other liabilities	(2,536)	(351)
Deferred revenue	(10,619)	(796)
Income taxes payable	(766)	(360)
Net cash used in operating activities	(4,692)	(8,521)
Cash flows from investing activities:		
Maturities of marketable securities	7,000	10,111
Purchases of marketable securities	(8,410)	(11,292)
Purchases of property, plant and equipment	(2,193)	(997)
Net cash used in investing activities	(3,603)	(2,178)
Cash flows from financing activities:		
Payments of contingent consideration	(100)	(133)
Repayments of debt obligations	—	(227)
Proceeds from sale of shares under employee stock option and purchase plans	3,115	1,598
Excess tax benefit from equity awards	—	(367)
Taxes paid on net issuance of stock awards	(659)	(86)
Repurchases of common stock	—	(5,000)
Net cash provided by (used in) financing activities	2,356	(4,215)
Effect of exchange rate changes on cash and cash equivalents	7	(656)
Net decrease in cash and cash equivalents	(5,932)	(15,570)
Cash and cash equivalents, beginning of period	44,765	62,915
Cash and cash equivalents, end of period	$38,833	$47,345

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

Basis of Presentation – The accompanying condensed consolidated financial statements ("financial statements") have been prepared on a consistent basis with the audited consolidated financial statements as of December 28, 2013, and include all normal recurring adjustments necessary to fairly present the information set forth therein. All significant intercompany accounts and transactions have been eliminated in consolidation.
The financial statements have been prepared in accordance with the regulations of the United States Securities and Exchange Commission (“SEC”) for interim periods in accordance with S-X Article 10, and, therefore, omit certain information and footnote disclosure necessary to present the statements in accordance with accounting principles generally accepted in the United States of America. The operating results for interim periods are not necessarily indicative of the operating results that may be expected for the entire year. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended December 28, 2013, which were included in the Company’s Annual Report on Form 10-K filed with the SEC on March 7, 2014.

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

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

Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ materially from those estimates. Estimates are used for, but not limited to, revenue recognition, the provision for doubtful accounts, the provision for excess, obsolete, or slow moving inventories, 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 systems (“product revenue”) as well as spare part sales, billable service, service contracts and upgrades (together “service revenue”). Upgrades are a group of parts and/or software that change the existing configuration of a product and are included in service revenue. They are distinguished from product revenue, which consists of complete, advanced process control metrology and inspection systems (the “system(s)”). Nanometrics' systems consist of hardware and software components that function together to deliver the essential functionality of the system. Arrangements for sales of systems often include defined customer-specified acceptance criteria.

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

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

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

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

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

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

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

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

Note 2. Recent Accounting Pronouncements

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In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force) ("ASU 2013-11"), which provides that a liability related to an unrecognized tax benefit would be offset against a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. In situations in which a net operating loss carryforward, a similar tax loss or a tax credit carryforward is not available at the reporting date under the tax law of the jurisdiction or the tax law of the jurisdiction does not require, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit will be presented in the financial statements as a liability and will not be combined with deferred tax assets. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. ASU 2013-11 is effective for fiscal years and interim periods beginning after December 15, 2013. The Company adopted this standard during the three months ended March 29, 2014 resulting in a one-time tax benefit of $0.3 million, a reduction in deferred tax assets of $0.3 million, and a reduction in long-term income taxes payable of $0.6 million.

Note 3. Fair Value Measurements and Disclosures

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

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

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NOTES TO CONDENSED 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):

	March 29, 2014 Fair Value Measurements Using Input Types				December 28, 2013 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	$586	$—	$—	$586	$876	$—	$—	$876
Commercial paper and corporate debt securities	—	—	—	—	—	750	—	750
Total cash equivalents	586	—	—	586	876	750	—	1,626
Marketable securities:								
U.S. Treasury, U.S. Government and U.S. Government agency debt securities	5,023	11,772	—	16,795	5,036	11,980	—	17,016
Commercial paper and corporate debt securities	—	32,409	—	32,409	—	31,081	—	31,081
Total marketable securities	5,023	44,181	—	49,204	5,036	43,061	—	48,097
Total [(1)]	$5,609	$44,181	$—	$49,790	$5,912	$43,811	$—	$49,723
Liabilities:								
Contingent consideration payable	$—	$—	$2,678	$2,678	$—	$—	$2,783	$2,783

[(1)] Excludes cash of $38.2 million and $43.1 million held in operating accounts as of March 29, 2014 and December 28, 2013, 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 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 28, 2013	$2,783
Payments made to Zygo Corporation	(100)
Change in fair value included in earnings	(5)
Fair Value at March 29, 2014	$2,678

As of March 29, 2014, the Company had liabilities of $2.7 million resulting from the acquisition of certain assets from Zygo Corporation ("Zygo"), which are measured at fair value on a recurring basis, with changes in fair value recorded in other income (expense), net. Of the $2.7 million of Zygo liabilities at March 29, 2014, $1.2 million was a current liability and $1.5 million was a long-term liability. As of December 28, 2013, the liabilities totaled $2.8 million of which $1.3 million was a current liability and $1.5 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, timing and the amount of cash flows.

Note 4. Cash and Investments

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NANOMETRICS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

The following table presents cash, cash equivalents, and available-for-sale investments as of March 29, 2014 and December 28, 2013 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
March 29, 2014				
Cash	$ 38,247	—	$—	$ 38,247
Cash equivalents:				
Money market funds	586	—	—	586
Marketable securities:				
Commercial paper and corporate debt securities	800	—	—	800
U.S. Treasury securities	5,022	1	—	5,023
U.S. Government agency securities	11,768	6	(2)	11,772
Municipal securities	10,367	7	(1)	10,373
Corporate debt securities	21,238	5	(7)	21,236
Total cash, cash equivalents, and marketable securities	$ 88,028	$ 19	$ (10)	$ 88,037
December 28, 2013				
Cash	$ 43,139	$—	$—	$ 43,139
Cash equivalents:				
Money market funds	876	—	—	876
Commercial paper	750	—	—	750
Marketable securities:				
U.S. Treasury Securities	5,036	—	—	5,036
U.S. Government agency securities	11,980	4	(4)	11,980
Municipal securities	9,756	11	(4)	9,763
Corporate debt securities	21,316	7	(5)	21,318
Total cash, cash equivalents, and marketable securities	$ 92,853	$ 22	$ (13)	$ 92,862

Available-for-sale marketable securities, readily convertible to cash, with maturity dates of 90 days or less are classified as cash equivalents, while those with maturity dates greater than 90 days are classified as marketable securities within short-term assets. All marketable securities as of March 29, 2014 and December 28, 2013 were available-for-sale and reported at fair value based on the estimated or quoted market prices as of the balance sheet date. Unrealized gains or losses, net of tax effect, are recorded in accumulated other comprehensive income (loss) within stockholders' equity. Both the gross unrealized gains and gross unrealized losses for the three month periods ended March 29, 2014 and March 30, 2013 were insignificant and no marketable securities had other than temporary impairment. All marketable securities as of March 29, 2014 and December 28, 2013, had maturity dates of less than two years and were not invested in foreign entities.

Note 5. Accounts Receivable

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The Company maintains arrangements under which eligible accounts receivables in Japan are sold without recourse to unrelated third party financial institutions. These receivables were not included in the consolidated balance sheets as the criteria for sale treatment had been met. The Company pays administrative fees as well as interest ranging from 1.23% to 1.68% based on the anticipated length of time between the date the sale is consummated and the expected collection date of the receivables sold. The Company sold $0.6 million and $1.4 million of receivables during the three month periods ended March 29, 2014 and March 30, 2013, respectively. There were no material gains or losses on the sale of such receivables. There were no amounts due from such third party financial institutions at March 29, 2014 and December 28, 2013, respectively.

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NANOMETRICS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

Note 6. Inventories
Inventories are stated at the lower of standard cost (which approximates actual cost on a first-in, first-out basis) or market. Inventories consist of the following (in thousands):

	At March 29, 2014	December 28, 2013
Raw materials and sub-assemblies	$21,061	$19,655
Work in process	8,917	7,597
Finished goods	7,877	7,268
Inventories	37,855	34,520
Inventories-delivered systems	2,249	6,901
Total inventories	$40,104	$41,421

The Company reflects the cost of systems that were invoiced upon shipment but deferred for revenue recognition purposes separate from its inventory held for sale as "Inventories-delivered systems."

Note 7. Property, Plant and Equipment
Property, plant and equipment, net, consist of the following (in thousands):

	At March 29, 2014	December 28, 2013
Land	$ 15,572	$ 15,569
Building and improvements	19,402	19,403
Machinery and equipment	26,708	27,820
Furniture and fixtures	2,298	2,308
Software	7,777	1,851
Capital in progress	1,551	5,833
Total property, plant and equipment, gross	73,308	72,784
Accumulated depreciation	(26,177)	(25,345)
Total property, plant and equipment, net	$47,131	$47,439

Total depreciation expense for the three month periods ended March 29, 2014 and March 30, 2013 was $1.6 million and $1.3 million, respectively.

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NANOMETRICS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

Note 8. Goodwill and Intangible Assets

The following table summarizes the activity in the Company's goodwill during the three months ended March 29, 2014 (in thousands):

Balance as of December 28, 2013	$11,743
Foreign currency movements	122
Balance as of March 29, 2014	$11,865

Finite-lived intangible assets are recorded at cost, less accumulated amortization. Finite-lived intangible assets as of March 29, 2014 and December 28, 2013 consisted of the following (in thousands):

	As of March 29, 2014		
	Adjusted cost	Accumulated amortization	Net carrying amount
Developed technology	$18,197	$(11,738)	$6,459
Customer relationships	9,584	(9,352)	232
Brand names	1,927	(1,726)	201
Patented technology	2,252	(2,005)	247
Trademark	80	(80)	—
	$32,040	$(24,901)	$7,139

	As of December 28, 2013		
	Adjusted cost	Accumulated amortization	Net carrying amount
Developed technology	$18,095	$(11,032)	$7,063
Customer relationships	9,573	(9,263)	310
Brand names	1,927	(1,700)	227
Patented technology	2,252	(1,988)	264
Trademark	80	(80)	—
	$31,927	$(24,063)	$7,864

The amortization of finite-lived intangibles is computed using the straight-line method. Estimated lives of finite-lived intangibles range from 2 to 10 years. Total amortization expense for each of the three month periods ended March 29, 2014 and March 30, 2013 was $0.8 million and $0.9 million, respectively.

At March 29, 2014, estimated future amortization expense of intangible assets were as follows (in thousands):

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NANOMETRICS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

Fiscal years	Amount
2014 (remaining nine months)	$2,337
2015	2,424
2016	1,966
2017	206
2018	140
Thereafter	66
Total future amortization expense	$7,139

Note 9. Other Current Liabilities

Other current liabilities consist of the following (in thousands):

	At March 29, 2014	December 28, 2013
Accrued warranty	$3,575	$3,426
Accrued professional services	799	545
Customer deposits	947	867
Fair value of contingent payments to Zygo Corporation related to acquisition - current portion	1,205	1,344
Other	1,659	1,811
Total other current liabilities	$8,185	$7,993

Note 10. Line of Credit and Debt Obligations

Line of Credit - On April 23, 2012, the Company amended its revolving line of credit facility (i) to extend the maturity date of such facility by two years to April 30, 2014, (ii) decreased the unused revolving line commitment fee from 0.1875% per annum to 0.10% per annum, and (iii) reduced the minimum interest rate on borrowings from 5.75% to 3.00% per annum. The instrument governing the line of credit facility includes certain financial covenants regarding tangible net worth. The revolving line of credit agreement includes a provision for the issuance of commercial or standby letters of credit by the bank on behalf of the Company. The value of all letters of credit outstanding reduces the total line of credit available. The revolving line of credit is collateralized by a blanket lien on all of the Company’s domestic assets excluding intellectual property and real estate. The minimum borrowing interest rate is 3.00% per annum. Borrowing is limited to the lesser of (a) $7.5 million plus the borrowing base, or (b) $20.0 million. The total borrowing available as of March 29, 2014 was $12.9 million. As of March 29, 2014, the Company was not in breach of any restrictive covenants in connection with this line of credit. There were no outstanding amounts drawn on this facility as of March 29, 2014. Subsequent to the end of the quarter, the maturity date of this facility was extended to May 31, 2014. There were no other changes to the terms of this facility. Although management has no current plans to request advances under this credit facility, the Company may use the proceeds of any future borrowing for general corporate purposes, future acquisitions or expansion of the Company's business.

Mortgage Loan - In July 2008, the Company entered into a mortgage loan agreement with General Electric Commercial Finance ("GE") pursuant to which it borrowed $13.5 million, secured, in part, by a lien on and security interest in the building and land comprising the Company's principal offices in Milpitas, California. The loan initially bore interest at the rate of 7.18% per annum, which rate was scheduled to reset in August 2013 to 3.03% over the weekly average yield of five-year U.S Dollar Interest Rate Swaps as published by the Federal Reserve. Monthly principal and interest payments were based on a 20 year amortization for the first 60 months and 15 year amortization thereafter. The remaining principal balance of the loan and any accrued but unpaid interest will be due on August 1, 2018. According to the terms of the loan agreement, the Company could make annual pre-payments of up to 20% of the outstanding principal balance without incurring any penalty. GE subsequently sold the mortgage on March 31, 2011 to Sterling Saving Bank; however, no changes were made to the terms of the original loan agreement with GE as a result of the sale. In July 2012, the Company prepaid $1.4 million of the loan, representing 20% of the outstanding balance at the time of prepayment. On July 18, 2013, the Company repaid $4.8 million of the loan, representing the entire outstanding principal balance of the loan and all accrued interest. The Company did not incur any fees associated with the prepayment of the loan. As of March 29, 2014, there was no outstanding balance and no available amounts to borrow on the loan.

Note 11. Net Income (Loss) Per Share

The Company presents both basic and diluted net income (loss) per share on the face of its condensed consolidated statements of operations. Basic net income (loss) per share are computed by dividing net income (loss) by the weighted-average number of shares of common stock outstanding for the period. Diluted net income (loss) per share are computed using the weighted-average number of shares of common stock outstanding plus the effect of all dilutive securities representing potential shares of common stock outstanding during the period.
A reconciliation of the share denominator of the basic and diluted net income (loss) per share computations for the three month periods ended March 29, 2014 and March 30, 2013 is as follows (in thousands):

	Three Months Ended	
	March 29, 2014	March 30, 2013
Weighted average common shares outstanding used in basic net income (loss) per share calculation	23,711	23,341
Dilutive common stock equivalents, using treasury stock method	448	—
Shares used in diluted net income (loss) per share computation	24,159	23,341

The Company excluded an insignificant amount of ESPP shares for the three month period ended March 29, 2014 since their inclusion would have been anti-dilutive. Since the Company had a net loss for the three month period ended March 30, 2013, 0.4 million potentially dilutive securities were not included in the computation of diluted shares for the period since inclusion of such shares would have been anti-dilutive. Accordingly, basic and diluted net loss per share were the same for the three month period ending March 30, 2013.

Note 12. Equity and Stock Based Compensation Plans
Options
The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model and the assumptions noted in the following table. The expected life of options granted was calculated using the simplified method. The risk-free rate is based on the U.S. Treasury rates in effect during the corresponding period of grant. The expected volatility is based on the historical volatility of the Company's stock price. The dividend yield reflects that the Company has not paid any cash dividends since inception and does not intend to pay any cash dividends in the foreseeable future.

	Three Months Ended			
	March 29, 2014		March 30, 2013	
Stock Options				
Expected life	4.6 years		4.5 years	
Expected volatility	56.79	%	73.12	%
Risk-free interest rate	1.53	%	0.86	%
Dividends	—		—	
Employee Stock Purchase Plan				
Expected life	0.5 years		0.5 years	
Expected volatility	32.60	%	27.61	%

Risk-free interest rate	1.00	%	0.11	%
Dividends	—		—	

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The weighted average fair value per share of the stock options awarded in the three month periods ended March 29, 2014 and March 30, 2013 was $8.69 and $8.88, respectively, based on the fair market value of the Company’s common stock on the grant dates.

A summary of activity under the Company’s stock option plans during the three month period ended March 29, 2014 is as follows:

	Number of Shares Outstanding (Options)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in Thousands)
Options:				
Outstanding at December 28, 2013	1,909,039	$13.22	4.02	$10,341
Exercised	(217,848)	10.64		
Granted	44,300	18.28		
Cancelled	(34,342)	15.49		
Outstanding at March 29, 2014	1,701,149	$13.64	4.03	$8,510
Exercisable at March 29, 2014	1,069,675	$12.31	3.18	$6,772

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company’s closing stock price of $17.91 as of March 29, 2014, which would have been received by the option holders had all option holders exercised their options as of that date. The total intrinsic value of options exercised during the three month periods ended March 29, 2014 and March 30, 2013 was $1.7 million and $0.8 million, respectively.

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Restricted Stock Units ("RSUs")
A summary of activity for RSUs during the three month period ended March 29, 2014 is as follows:

	Number of RSUs	Weighted Average Fair Value
Outstanding RSUs as of December 28, 2013	334,444	$ 18.61
Granted	189,000	$ 18.68
Released	(91,817)	$ 18.61
Cancelled	(8,073)	$ 18.43
Outstanding RSUs as of March 29, 2014	423,554	$ 18.61

Stock-based Compensation Expense
Stock-based compensation expense for all share-based payment awards made to the Company's employees and directors pursuant to the employee stock option and employee stock purchase plans by function was as follows (in thousands):

	Three Months Ended	
	March 29, 2014	March 30, 2013
Cost of products	$ 61	$ 45
Cost of service	84	59
Research and development	340	317
Selling	427	440
General and administrative	722	596
Total stock-based compensation expense	$ 1,634	$ 1,457

Note 13. Accumulated Other Comprehensive Income (Loss)

The following table shows a summary of changes in accumulated other comprehensive income (loss) by component for the three months ended March 29, 2014 (in thousands):

	Defined Benefit Pension Plans	Foreign Currency Translations	Unrealized Gain on Investment	Total
Balance as of December 28, 2013	$ (28)	$ 635	$ 5	$ 612
Other comprehensive income	—	104	107	211
Balance as of March 29, 2014	$ (28)	$ 739	$ 112	$ 823

Note 14. Warranties
The Company sells the majority of its products with a 12 months repair or replacement warranty from the date of acceptance or shipment date. The Company provides an accrual for estimated future warranty costs based upon the historical relationship of warranty costs to the cost of products sold. The estimated future warranty obligations related to product sales are recorded in the period in which the related revenue is recognized. The estimated future warranty

obligations are affected by the warranty periods, sales volumes, product failure rates, material usage, and labor and replacement costs incurred in correcting a product failure. If actual product failure rates, material usage, labor or replacement costs were to differ from the Company's estimates, revisions to the estimated warranty obligations would be required. For new product introductions where limited or no historical information exists, the Company may use warranty information from other previous product introductions to guide it in estimating its warranty accrual. The warranty accrual represents the best estimate of the amount necessary to settle future and existing claims on products sold as of the balance sheet date. The Company periodically assesses the adequacy of its reported warranty reserve and adjusts such amounts in accordance with changes in these factors. Components of the warranty accrual, which were included in the accompanying condensed consolidated balance sheets with other current liabilities, were as follows (in thousands):

	Three Months Ended	
	March 29, 2014	March 30, 2013
Beginning balance	$3,426	$4,203
Accruals for warranties issued during period	1,100	423
Aggregate changes in liabilities related to preexisting warranties	217	217
Settlements during the period	(1,168)	(1,188)
Ending balance	$3,575	$3,655

Note 15. Income Taxes

The Company accounts for income taxes under the provisions of ASC 740, Accounting for Income Taxes. The Company adjusts its effective tax rate each quarter to be consistent with the estimated annual effective tax rate. The Company also records the tax effect of unusual or infrequently occurring discrete items, including changes in judgment about valuation allowances and effects of changes in tax laws or tax rates, in the interim period in which they occur. The Company's effective tax rate reflects the impact of a portion of its earnings being taxed in foreign jurisdictions as well as a valuation allowance maintained on certain deferred tax assets.

The Company recorded a tax provision of $0.6 million and a tax benefit of $4.2 million for the three month periods ended March 29, 2014 and March 30, 2013, respectively. The change during the three months ended March 29, 2014, compared to the corresponding periods in 2013, was primarily related to the profitability of the Company during the three months ended March 29, 2014, as well as a one-time benefit of $0.6 million recorded during the three month period ended March 30, 2013 related to the retroactive reinstatement of the 2012 Federal R&D tax credit.

As of March 29, 2014, the Company continued to maintain a valuation allowance against certain net deferred tax assets as a result of uncertainties regarding the realization of the asset due to cumulative losses and uncertainty of future taxable income in various tax jurisdictions. In the event that the Company determines that the deferred tax assets are realizable, an adjustment to the valuation allowance will be reflected in the tax provision for the period such determination is made.

The Company is subject to taxation in the U.S. and various states including California, and foreign jurisdictions including South Korea, Japan and United Kingdom. Due to tax attribute carry-forwards, the Company is subject to examination for tax years from 2003 forward for U.S. tax purposes. The Company is also subject to examination in various states for tax years from 2002 forward. The Company is subject to examination for tax years from 2006 forward for various foreign jurisdictions.

On September 13, 2013, the U.S. Treasury Department and the IRS issued final regulations that address costs incurred in acquiring, producing, or improving tangible property (the "tangible property regulations"). The tangible property regulations are generally effective for tax years beginning on or after January 1, 2014, and may be adopted in earlier years. The tangible property regulations required the Company to make additional tax accounting method changes as of January 1, 2014. The impact of these changes was not material to the Company’s consolidated financial

position or its results of operations.
The Company accrues interest and penalties related to unrecognized tax benefits in its provision for income taxes. The total amount of accrued penalties and interest was immaterial for the three month period ended March 29, 2014. During the next twelve months, the Company anticipates increases in its unrecognized tax benefits of approximately $0.3 million.

Note 16. Commitments and Contingencies

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Intellectual Property Indemnification Obligations – The Company will, from time to time, in the normal course of business, agree to indemnify certain customers, vendors or others against third party claims that the Company's products, when used for their intended purpose(s), or the Company's intellectual property, infringe the intellectual property rights of such third parties or other claims made against parties with which it enters into contractual relationships. It is not possible to determine the maximum potential amount of liability under these indemnification obligations due to the limited history of prior indemnification claims and the unique facts and circumstances that are likely to be involved in each particular claim. Historically, the Company has not made payments under these obligations and believes that the estimated fair value of these agreements is immaterial. Accordingly, no liabilities have been recorded for these obligations in the accompanying condensed consolidated balance sheets as of March 29, 2014 and December 28, 2013.

Note 17. Geographic and Significant Customer Information
The Company has one operating segment, which is the sale, design, manufacture, marketing and support of thin film and optical critical dimension systems. The following tables summarize total net revenues (based on the deployments and service location of the systems) and long-lived assets (excluding intangible assets) attributed to significant geographic regions (in thousands):

	Three Months Ended	
	March 29, 2014	March 30, 2013
Total net revenues:		
United States	$6,741	$9,433
Japan	3,684	5,212
Taiwan	4,416	2,310
China	15,488	644
South Korea	15,889	3,547
Other	5,358	3,406
Total net revenues	$51,576	$24,552

	At	
	March 29, 2014	December 28, 2013
Long-lived tangible assets:		
United States	$44,545	$44,775
Japan	122	125
South Korea	401	445
All Other	2,063	2,094
Total long-lived tangible assets	$47,131	$47,439

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The following customers accounted for 10% or more of total accounts receivable:

	At			
	March 29, 2014		December 28, 2013	
Intel Corporation	19.0	%	14.4	%
SK Hynix	10.9			