

KEMET CORP
Form 10-Q
November 03, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

or

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

For the transition period from to

Commission File Number: 001-15491

KEMET CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

57-0923789

(I.R.S. Employer Identification No.)

2835 KEMET WAY, SIMPSONVILLE, SOUTH CAROLINA 29681

(Address of principal executive offices, zip code)

(864) 963-6300

(Registrant's telephone number, including area code)

Former name, former address and former fiscal year, if changed since last report: N/A

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 ☒ NO ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ☒ 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 ☐

Accelerated filer ☒

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Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ☐ YES ☒ NO

The number of shares outstanding of the registrant's common stock, par value \$0.01 per share, as of October 29, 2015 was 45,777,561.

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KEMET CORPORATION AND SUBSIDIARIES
Form 10-Q for the Quarter ended September 30, 2015

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PART I - FINANCIAL INFORMATION

Item 1 - Financial Statements

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KEMET CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Amounts in thousands, except per share data)

(Unaudited)

	September 30, 2015	March 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$37,315	\$56,362
Accounts receivable, net	93,099	90,857
Inventories, net	183,667	171,843
Prepaid expenses and other	42,428	41,503
Deferred income taxes	8,933	10,762
Total current assets	365,442	371,327
Property, plant and equipment, net of accumulated depreciation of \$816,386 and \$804,286 as of September 30, 2015 and March 31, 2015, respectively	245,353	249,641
Goodwill	40,294	35,584
Intangible assets, net	34,282	33,282
Investment in NEC TOKIN	42,156	45,016
Restricted cash	1,849	1,775
Deferred income taxes	5,096	5,111
Other assets	4,441	11,056
Total assets	\$738,913	\$752,792
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$5,000	\$962
Accounts payable	70,108	69,785
Accrued expenses	57,178	60,456
Income taxes payable and deferred income taxes	—	1,017
Total current liabilities	132,286	132,220
Long-term debt, less current portion	390,076	390,409
Other non-current obligations	78,966	57,131
Deferred income taxes	7,313	8,350
Stockholders' equity:		
Preferred stock, par value \$0.01, authorized 10,000 shares, none issued	—	—
Common stock, par value \$0.01, authorized 175,000 shares, issued 46,508 shares at September 30, 2015 and March 31, 2015	465	465
Additional paid-in capital	453,782	461,191
Retained deficit	(275,737)	(245,881)
Accumulated other comprehensive income	(35,387)	(28,796)
Treasury stock, at cost (731 and 1,056 shares at September 30, 2015 and March 31, 2015, respectively)	(12,851)	(22,297)
Total stockholders' equity	130,272	164,682
Total liabilities and stockholders' equity	\$738,913	\$752,792

See accompanying notes to the unaudited condensed consolidated financial statements.

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KEMET CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

(Amounts in thousands, except per share data)

(Unaudited)

	Quarters Ended September 30,		Six Month Periods Ended September 30,	
	2015	2014	2015	2014
Net sales	\$186,123	\$215,293	\$373,713	\$428,174
Operating costs and expenses:				
Cost of sales	143,317	169,538	291,194	349,462
Selling, general and administrative expenses	22,948	25,510	53,378	50,289
Research and development	6,152	6,338	12,426	12,927
Restructuring charges	23	1,687	1,847	3,517
Net (gain) loss on sales and disposals of assets	(304)	) (550)	) (362)	) (185)
Total operating costs and expenses	172,136	202,523	358,483	416,010
Operating income (loss)	13,987	12,770	15,230	12,164
Non-operating (income) expense:				
Interest income	(3)	) (3)	) (6)	) (6)
Interest expense	9,811	10,287	19,824	20,743
Change in value of NEC TOKIN options	(2,200)	) (6,600)	) 27,000	(10,700)
Other (income) expense, net	(2,091)	) (995)	) (1,175)	) (428)
Income (loss) from continuing operations before income taxes and equity income	8,470	10,081	(30,413)	) 2,555
(loss) from NEC TOKIN				
Income tax expense (benefit)	1,438	2,583	1,190	3,865
Income (loss) from continuing operations before equity income (loss) from NEC TOKIN	7,032	7,498	(31,603)	) (1,310)
Equity income (loss) from NEC TOKIN	162	232	1,747	(1,443)
Income (loss) from continuing operations	7,194	7,730	(29,856)	) (2,753)
Income (loss) from discontinued operations, net of income tax expense (benefit) of \$0, \$1,017, \$0 and \$1,935 respectively	—	(1,400)	) —	5,543
Net income (loss)	\$7,194	\$6,330	\$(29,856)	) \$2,790
Net income (loss) per basic share:				
Net income (loss) from continuing operations	\$0.16	\$0.17	\$(0.65)	) \$(0.06)
Net income (loss) from discontinued operations	\$—	\$(0.03)	) \$—	\$0.12
Net income (loss)	\$0.16	\$0.14	\$(0.65)	) \$0.06
Net income (loss) per diluted share:				
Net income (loss) from continuing operations	\$0.14	\$0.15	\$(0.65)) \$(0.05)
	\$—	\$(0.03)) \$—	\$0.11

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Net income (loss) from discontinued
operations

Net income (loss)	\$0.14	\$0.12	\$(0.65) \$0.06
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Weighted-average shares outstanding:

Basic	45,767	45,400	45,660	45,337
Diluted	50,004	52,521	45,660	52,562

See accompanying notes to the unaudited condensed consolidated financial statements.

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KEMET CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income (Loss)

(Amounts in thousands)

(Unaudited)

	Quarters Ended September 30,		Six Month Periods Ended September 30,		
	2015	2014	2015	2014	
Net income (loss)	\$7,194	\$6,330	\$(29,856	) \$2,790	
Other comprehensive income (loss):					
Foreign currency translation gains (losses)	(4,466	) (13,659	) 1,399	(14,759)
Defined benefit pension plans, net of tax impact	245	81	412	141	
Post-retirement plan adjustments	(39	) (52	) (79	) (104)
Equity interest in NEC TOKIN's other comprehensive income (loss)	(3,674	) 2,982	(4,606	) 3,473	
Foreign exchange contracts	(770	) —	(3,717) —	
Other comprehensive income (loss)	(8,704	) (10,648	) (6,591	) (11,249)
Total comprehensive income (loss)	\$(1,510	) \$(4,318	) \$(36,447	) \$(8,459)

See accompanying notes to the unaudited condensed consolidated financial statements.

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KEMET CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Amounts in thousands)
(Unaudited)

	Six Month Periods Ended September 30,	
	2015	2014
Net income (loss)	\$ (29,856	) \$ 2,790
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Gain on sale of discontinued operations	—	(5,809)
Net cash provided by (used in) operating activities of discontinued operations	—	(1,357)
Depreciation and amortization	19,182	20,974
Equity (income) loss from NEC TOKIN	(1,747	) 1,443
Amortization of debt and financing costs	437	1,248
Stock-based compensation expense	2,607	1,952
Long-term receivable write down	—	59
Change in value of NEC TOKIN options	27,000	(10,700)
Net (gain) loss on sales and disposals of assets	(362	) (185)
Pension and other post-retirement benefits	333	37
Change in deferred income taxes	52	2,142
Change in operating assets	(14,474	) (4,268)
Change in operating liabilities	(14,514	) (6,341)
Other	410	(391)
Net cash provided by (used in) operating activities	(10,932	) 1,594
Investing activities:		
Capital expenditures	(9,268	) (11,975)
Acquisitions, net of cash received	(2,892) —
Proceeds from sale of assets	247	2,451
Change in restricted cash	—	558
Proceeds from sale of discontinued operations	—	10,125
Net cash provided by (used in) investing activities	(11,913	) 1,159
Financing activities:		
Proceeds from revolving line of credit	8,000	14,300
Payments on revolving line of credit	(3,500	) (7,500)
Deferred acquisition payments	—	(11,597)
Payments on long-term debt	(481	) (3,135)
Purchase of treasury stock	(575) —
Proceeds from exercise of stock options	—	25
Net cash provided by (used in) financing activities	3,444	(7,907)
Net increase (decrease) in cash and cash equivalents	(19,401	) (5,154)
Effect of foreign currency fluctuations on cash	354	(1,199)
Cash and cash equivalents at beginning of fiscal period	56,362	57,929
Cash and cash equivalents at end of fiscal period	\$ 37,315	\$ 51,576

See accompanying notes to the unaudited condensed consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1. Basis of Financial Statement Presentation

The condensed consolidated financial statements contained herein are unaudited and have been prepared from the books and records of KEMET Corporation and its subsidiaries ("KEMET" or the "Company"). In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for the interim periods. The condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q, and therefore, do not include all information and footnotes necessary for a complete presentation of financial position, results of operations, and cash flows in conformity with U.S. generally accepted accounting principles ("U.S. GAAP"). Although the Company believes the disclosures are adequate to make the information presented not misleading, it is suggested that these condensed consolidated financial statements be read in conjunction with the audited financial statements and notes thereto included in the Company's Form 10-K for the fiscal year ended March 31, 2015 (the "Company's 2015 Annual Report").

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. In consolidation, all significant intercompany amounts and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to current year presentation. Net sales and operating results for the quarter and six month periods ended September 30, 2015 are not necessarily indicative of the results to be expected for the full year.

The Company's significant accounting policies are presented in the Company's 2015 Annual Report.

Use of Estimates and Assumptions

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, assumptions, and judgments based on historical data and other assumptions that management believes are reasonable. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period.

The Company's judgments are based on management's assessment as to the effect certain estimates, assumptions, or future trends or events may have on the financial condition and results of operations reported in the unaudited condensed consolidated financial statements. It is important that readers of these unaudited financial statements understand that actual results could differ from these estimates, assumptions, and judgments.

Recently Issued Accounting Pronouncements

New accounting standards adopted/issued

In September 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-16, Simplifying the Accounting for Measurement-Period Adjustments. The ASU requires that an acquirer recognize adjustments to provisional amounts recognized in a business combination in the reporting period in which the adjustment amounts are determined. It also requires disclosure of the adjustment recorded in current period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. ASU 2015-16 eliminates the requirement to retrospectively revise comparative information for prior periods. ASU 2015-16 will be effective for interim and annual reporting

periods beginning April 1, 2016. Early application is permitted. Upon adoption, the Company will apply the new standard to measurement period adjustments related to business acquisitions.

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory. The ASU requires an entity that uses first-in, first-out or average cost to measure its inventory at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. ASU 2015-11 will be effective for interim and annual reporting periods beginning April 1, 2017. Early application is permitted. The Company is currently evaluating the impact of the adoption of ASU 2015-11 on its operating results and financial position.

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In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The ASU specifies that debt issuance costs related to a note shall be reported in the balance sheet as a direct reduction from the face amount of the note. The ASU is effective for the Company for interim and annual periods beginning April 1, 2016. Early adoption is permitted. The ASU will require the Company to reclassify its capitalized debt issuance costs currently recorded as assets on the consolidated condensed balance sheets. The ASU will have no effect on the Company's results of operations or liquidity.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements-Going Concern. The new guidance is effective for the Company's fiscal year that begins on April 1, 2017 and interim periods within that fiscal year and requires management to assess if there is substantial doubt about an entity's ability to continue as a going concern for each annual and interim period. If conditions or events give rise to substantial doubt, disclosures are required. This new guidance is not expected to have a material impact on the Company's Consolidated Financial Statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which supersedes existing accounting standards for revenue recognition and creates a single framework. The new guidance is effective for the Company's fiscal year that begins on April 1, 2018 and interim periods within that fiscal year and requires either a retrospective or a modified retrospective approach to adoption. The Company is currently evaluating the potential impact on its Consolidated Financial Statements and related disclosures, as well as the available transition methods. Early adoption is permitted, but not before Company's fiscal year that begins on April 1, 2017 (the original effective date of the ASU). We are currently in the process of assessing the impact the adoption of this guidance will have on our consolidated financial statements.

There are currently no other accounting standards that have been issued that will have a significant impact on the Company's financial position, results of operations or cash flows upon adoption.

Restricted Cash

A bank guarantee in the amount of €1.5 million (\$1.7 million) was issued by a European bank on behalf of the Company in August 2006 in conjunction with the establishment of a Value-Added Tax ("VAT") registration in The Netherlands. Accordingly, a deposit was placed with the European bank for €1.7 million (\$1.8 million). While the deposit is in KEMET's name, and KEMET receives all interest earned by this deposit, the deposit is pledged to the European bank, and the bank can use the funds if a valid claim against the bank guarantee is made. The bank guarantee will remain valid until it is discharged by the beneficiary.

Fair Value Measurement

The Company utilizes three levels of inputs to measure the fair value of (a) nonfinancial assets and liabilities that are recognized or disclosed at fair value in the Company's consolidated financial statements on a recurring basis (at least annually) and (b) all financial assets and liabilities. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs.

The first two inputs are considered observable and the last is considered unobservable. The levels of inputs are as follows:

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 or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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Assets and liabilities measured at fair value on a recurring basis as of September 30, 2015 and March 31, 2015 are as follows (amounts in thousands):

	Carrying Value September 30, 2015	Fair Value September 30, 2015	Fair Value Measurement Using			Carrying Value March 31, 2015	Fair Value March 31, 2015	Fair Value Measurement Using		
			Level 1	Level 2	Level 3			Level 1	Level 2	Level 3
Assets										
(Liabilities):										
Money markets	\$ 739	\$ 739	\$ 739	\$ —	\$ —	\$ 738	\$ 738	\$ 738	\$ —	\$ —
(1)										
Total debt	(395,076)	(361,055)	(328,375)	(32,680)	—	(391,371)	(391,283)	(362,988)	(28,295)	—
NEC TOKIN										
options,	(21,300)	(21,300)	—	—	(21,300)	5,700	5,700	—	—	5,700
net (3)										

(1) Included in the line item “Cash and cash equivalents” on the Condensed Consolidated Balance Sheets.

(2) The valuation approach used to calculate fair value was a discounted cash flow based on the borrowing rate for each respective debt facility.

See Note 6, Investment in NEC TOKIN, for a description of the NEC TOKIN options (of which the call options expired in the first quarter of fiscal year 2016). The value of the options depend on the enterprise value of NEC TOKIN Corporation and its forecasted EBITDA over the duration of the options. The options have been valued using option pricing methods in a Monte Carlo simulation.

The table below summarizes NEC TOKIN option valuation activity using significant unobservable inputs (Level 3) (amounts in thousands):

March 31, 2015	\$5,700
Change in value of NEC TOKIN options	(27,000)
September 30, 2015	\$(21,300)

Inventories

Inventories are stated at the lower of cost or market. The components of inventories are as follows (amounts in thousands):

	September 30, 2015	March 31, 2015
Raw materials and supplies	\$87,220	\$83,372
Work in process	55,659	52,759
Finished goods	57,818	53,211
	200,697	189,342
Inventory reserves	(17,030)	(17,499)
	\$183,667	\$171,843

Warrant

As of September 30, 2015 and March 31, 2015, 8.4 million shares were subject to the warrant (which expires June 30, 2019) held by K Equity, LLC.

Revenue Recognition

The Company ships products to customers based upon firm orders and revenue is recognized when the sales process is complete. This occurs when products are shipped to the customer in accordance with the terms of an agreement of sale, there is a fixed or determinable selling price, title and risk of loss have been transferred and collectability is reasonably assured. Shipping and handling costs are included in cost of sales. The Company recognizes revenue when title to the products transfers to the customer.

A portion of sales is made to distributors under agreements allowing certain rights of return and price protection on unsold merchandise held by distributors. The Company's distributor policy includes inventory price protection and "ship-from-stock and debit" ("SFSD") programs common in the industry.

KEMET's SFSD program provides authorized distributors with the flexibility to meet marketplace prices by allowing them, upon a pre-approved case-by-case basis, to adjust their purchased inventory cost to correspond with current market demand. Requests for SFSD adjustments are considered on an individual basis, require a pre-approved cost adjustment quote

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from their local KEMET sales representative and apply only to a specific customer, part, specified special price amount, specified quantity, and are only valid for a specific period of time. To estimate potential SFSD adjustments corresponding with current period sales, KEMET records a sales reserve based on historical SFSD credits, distributor inventory levels, and certain accounting assumptions, all of which are reviewed quarterly.

Most of the Company's distributors have the right to return to KEMET a certain portion of the purchased inventory, which, in general, does not exceed 6% of their purchases from the previous fiscal quarter. KEMET estimates future returns based on historical return patterns and records a corresponding allowance on the Condensed Consolidated Balance Sheets. The Company also offers volume based rebates on a case-by-case basis to certain customers in each of the Company's sales channels.

The establishment of sales allowances is recognized as a component of the line item "Net sales" on the Condensed Consolidated Statements of Operations, while the associated reserves are included in the line item "Accounts receivable, net" on the Condensed Consolidated Balance Sheets. Estimates used in determining sales allowances are subject to various factors. This includes, but is not limited to, changes in economic conditions, pricing changes, product demand, inventory levels in the supply chain, the effects of technological change, and other variables that might result in changes to the Company's estimates.

The Company provides a limited warranty to customers that the Company's products meet certain specifications. The warranty period is generally limited to one year, and the Company's liability under the warranty is generally limited to a replacement of the product or refund of the purchase price of the product. Warranty costs as a percentage of net sales were less than 1.0% for the quarters and six month periods ended September 30, 2015 and 2014. The Company recognizes warranty costs when they are both probable and reasonably estimable.

Note 2. Discontinued Operations

The Film and Electrolytic business group ("Film and Electrolytic") completed the sale of its machinery division in April 2014, which resulted in a gain of \$5.8 million on the sale of the business (after income tax expense) partially offset by a loss from machinery operations of \$0.3 million during the six month period ended September 30, 2014 resulting in net income from discontinued operations of \$5.5 million.

Net sales and operating income (loss) from the Company's discontinued operation for the quarters and six month periods ended September 30, 2015 and 2014 were (amounts in thousands):

	Quarters Ended September 30,		Six Month Periods Ended September 30,	
	2015	2014	2015	2014
Net sales	\$—	\$—	\$—	\$104
Operating income (loss)	—	165	—	(266)

Note 3. Debt

A summary of debt is as follows (amounts in thousands):

	September 30, 2015	March 31, 2015
10.5% Senior Notes, net of premium of \$2,094 and \$2,461 as of September 30, 2015 and March 31, 2015, respectively	\$357,095	\$357,461
Revolving line of credit	37,981	33,448
Other	—	462
Total debt	395,076	391,371

Current maturities	(5,000) (962)
Total long-term debt	\$390,076	\$390,409	

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The line item “Interest expense” on the Condensed Consolidated Statements of Operations for the quarters and six month periods ended September 30, 2015 and 2014, consists of the following (amounts in thousands):