

RICHARDSON ELECTRONICS LTD/DE
Form 10-Q
October 06, 2016

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 August 27, 2016

OR

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

For the transition period from _____ To _____

Commission File Number: 0-12906

RICHARDSON ELECTRONICS, LTD.

(Exact name of registrant as specified in its charter)

**Delaware 36-2096643
(State or other jurisdiction of (I.R.S. Employer**

incorporation or organization) Identification No.)

40W267 Keslinger Road, P.O. Box 393

LaFox, Illinois 60147-0393

(Address of principal executive offices)

Registrant's telephone number, including area code: (630) 208-2200

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

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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. (Check one):

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer (Do not check if a smaller reporting company) Smaller Reporting Company

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

As of October 3, 2016, there were outstanding 10,702,932 shares of Common Stock, \$0.05 par value and 2,140,631 shares of Class B Common Stock, \$0.05 par value, which are convertible into Common Stock of the registrant on a share for share basis.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Richardson Electronics, Ltd.

Consolidated Balance Sheets

(in thousands, except per share amounts)

	Unaudited August 27, 2016	Audited May 28, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$57,488	\$60,454
Accounts receivable, less allowance of \$380 and \$364	21,545	24,928
Inventories, net	45,187	45,422
Prepaid expenses and other assets	1,744	1,758
Deferred income taxes	—	1,078
Income tax receivable	30	17
Investments - current	6,392	2,268
Total current assets	132,386	135,925
Non-current assets:		
Property, plant and equipment, net	14,425	12,986
Goodwill	6,332	6,332
Intangible assets, net	3,714	3,818
Non-current deferred income taxes	1,304	1,270
Investments - non-current	2,410	7,799
Total non-current assets	28,185	32,205
Total assets	\$160,571	\$168,130
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	12,581	14,896
Accrued liabilities	8,000	9,135
Total current liabilities	20,581	24,031
Non-current liabilities:		
Non-current deferred income tax liabilities	237	1,457
Other non-current liabilities	1,196	967
Total non-current liabilities	1,433	2,424
Total liabilities	22,014	26,455
Stockholders' equity		
Common stock, \$0.05 par value; issued and outstanding 10,703 shares at August 27, 2016, and at May 28, 2016	535	535
Class B common stock, convertible, \$0.05 par value; issued and outstanding 2,141 shares at August 27, 2016, and at May 28, 2016	107	107
Preferred stock, \$1.00 par value, no shares issued	—	—
Additional paid-in-capital	59,072	58,969
Common stock in treasury, at cost, no shares at August 27, 2016, and at May 28, 2016	—	—

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Retained earnings	75,685	79,292
Accumulated other comprehensive income	3,158	2,772
Total stockholders' equity	138,557	141,675
Total liabilities and stockholders' equity	\$160,571	\$168,130

Richardson Electronics, Ltd.**Unaudited Consolidated Statements of Comprehensive Loss***(in thousands, except per share amounts)*

	Three Months Ended	
	August 27, 2016	August 29, 2015
Statements of Comprehensive Loss		
Net sales	\$33,373	\$37,071
Cost of sales	23,133	25,809
Gross profit	10,240	11,262
Selling, general, and administrative expenses	12,327	12,267
Gain on disposal of assets	—	(1)
Operating loss	(2,087)	(1,004)
Other (income) expense:		
Investment/interest income	(11)	(191)
Foreign exchange loss	278	182
Other, net	(1)	36
Total other expense	266	27
Loss before income taxes	(2,353)	(1,031)
Income tax provision	497	368
Net loss	(2,850)	(1,399)
Foreign currency translation gain (loss), net of tax	379	(503)
Fair value adjustments on investments gain (loss)	7	(60)
Comprehensive loss	\$(2,464)	\$(1,962)
Loss per share:		
Common shares - Basic	\$(0.23)	\$(0.10)
Class B common shares - Basic	\$(0.20)	\$(0.10)
Common shares - Diluted	\$(0.23)	\$(0.10)
Class B common shares - Diluted	\$(0.20)	\$(0.10)
Weighted average number of shares:		
Common shares - Basic	10,703	11,486
Class B common shares - Basic	2,141	2,141
Common shares - Diluted	10,703	11,486
Class B common shares - Diluted	2,141	2,141
Dividends per common share	\$0.060	\$0.060
Dividends per Class B common share	\$0.054	\$0.054

Richardson Electronics, Ltd.**Unaudited Consolidated Statements of Cash Flows***(in thousands)*

	Three Months Ended	
	August 27, 2016	August 29, 2015
Operating activities:		
Net loss	\$(2,850)	\$(1,399)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	715	485
Gain on sale of investments	(2)	(11)
Gain on disposal of assets	—	(1)
Share-based compensation expense	103	90
Deferred income taxes	(158)	1
Change in assets and liabilities, net of effect of acquired business:		
Accounts receivable	3,555	(2,525)
Income tax receivable	(13)	548
Inventories	411	(593)
Prepaid expenses and other assets	41	(581)
Accounts payable	(2,338)	(1,521)
Accrued liabilities	(1,144)	(804)
Non-current deferred income tax liabilities	—	228
Long-term liabilities-accrued pension	—	(465)
Other	5	35
Net cash used in operating activities	(1,675)	(6,513)
Investing activities:		
Cash consideration paid for acquired business	—	(12,209)
Capital expenditures	(2,064)	(984)
Proceeds from maturity of investments	1,465	18,350
Proceeds from sales of available-for-sale securities	88	100
Purchases of available-for-sale securities	(88)	(100)
Other	(3)	60
Net cash (used in) provided by investing activities	(602)	5,217
Financing activities:		
Repurchase of common stock	—	(3,308)
Cash dividends paid	(758)	(806)
Other	—	(4)
Net cash used in financing activities	(758)	(4,118)
Effect of exchange rate changes on cash and cash equivalents	69	(695)
Decrease in cash and cash equivalents	(2,966)	(6,109)
Cash and cash equivalents at beginning of period	60,454	74,535
Cash and cash equivalents at end of period	\$57,488	\$68,426

Richardson Electronics, Ltd.**Unaudited Consolidated Statement of Stockholders' Equity***(in thousands)*

	Common	Class B Common	Par Value	Additional Paid In Capital	Common Stock in Treasury	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance May 28, 2016:	10,703	2,141	\$642	\$58,969	\$ —	\$79,292	\$ 2,772	\$141,675
Comprehensive loss								
Net loss	—	—	—	—	—	(2,850)	—	(2,850)
Foreign currency translation	—	—	—	—	—	—	379	379
Fair value adjustments on investments	—	—	—	—	—	—	7	7
Share-based compensation:								
Stock options	—	—	—	103	—	—	—	103
Dividends paid to:								
Common (\$0.06 per share)	—	—	—	—	—	(641)	—	(641)
Class B (\$0.054 per share)	—	—	—	—	—	(116)	—	(116)
Balance August 27, 2016:	10,703	2,141	\$642	\$59,072	\$ —	\$75,685	\$ 3,158	\$138,557

RICHARDSON ELECTRONICS, LTD.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF THE COMPANY

Richardson Electronics, Ltd. is a leading global provider of engineered solutions, power grid and microwave tubes and related consumables; power conversion and RF and microwave components; high value displays, flat panel detector solutions and replacement parts for diagnostic imaging equipment; and customized display solutions. We serve customers in the alternative energy, healthcare, aviation, broadcast, communications, industrial, marine, medical, military, scientific and semiconductor markets. The Company's strategy is to provide specialized technical expertise and "engineered solutions" based on our core engineering and manufacturing capabilities. The Company provides solutions and adds value through design-in support, systems integration, prototype design and manufacturing, testing, logistics, and aftermarket technical service and repair through its global infrastructure.

Our products include electron tubes and related components, microwave generators, subsystems used in semiconductor manufacturing, and visual technology solutions. These products are used to control, switch or amplify electrical power signals, or are used as display devices in a variety of industrial, commercial, medical, and communication applications.

We have three operating and reportable segments, which we define as follows:

Power and Microwave Technologies Group ("PMT") combines our core engineered solutions, power grid and microwave tube business with new RF and power technologies. As a manufacturer and authorized distributor, PMT's strategy is to provide specialized technical expertise and engineered solutions based on our core engineering and manufacturing capabilities. We provide solutions and add value through design-in support, systems integration, prototype design and manufacturing, testing, logistics, and aftermarket technical service and repair—all through our existing global infrastructure. PMT's focus is on products for power, RF and microwave applications for customers in alternative energy, aviation, broadcast, communications, industrial, marine, medical, military, scientific, and semiconductor markets. PMT focuses on various applications including broadcast transmission, CO2 laser cutting, diagnostic imaging, dielectric and induction heating, high energy transfer, high voltage switching, plasma, power conversion, radar, and radiation oncology. PMT also offers its customers technical services for both microwave and industrial equipment.

Canvys provides customized display solutions serving the corporate enterprise, financial, healthcare, industrial, and medical original equipment manufacturers ("OEM") markets.

Healthcare manufactures, distributes and services high value replacement parts for the healthcare market including hospitals, medical centers, independent service organizations, and multi-vendor service providers. Products include power grid tubes, hydrogen thyratrons, klystrons, magnetrons; Image Systems medical displays and workstations for picture archiving and communication systems ("PACS"); visual solutions for operating rooms/surgical environments; digital radiography solutions including replacement flat panel detectors and upgrades; and additional replacement components currently under development for the diagnostic imaging service market. Through a combination of newly developed products and partnerships, service offerings, and training programs, we believe we can help our customers

improve efficiency and deliver better clinical outcomes while lowering the cost of healthcare delivery.

We currently have operations in the following major geographic regions: North America, Asia/Pacific, Europe, and Latin America.

2. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with United States Generally Accepted Accounting Principles (“GAAP”) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and notes required by GAAP for complete financial statements.

Our fiscal quarter ends on the Saturday nearest the end of the quarter-ending month. The first three months of fiscal 2017 and 2016 contained 13 weeks, respectively.

In the opinion of management, all adjustments, which are of a normal and recurring nature, necessary for a fair presentation of the results of interim periods have been made. All inter-company transactions and balances have been eliminated. The unaudited consolidated financial statements presented herein include the accounts of our wholly owned subsidiaries. Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. The results of our operations for the three months ended August 27, 2016, are not necessarily indicative of the results that may be expected for the fiscal year ending May 27, 2017.

The financial information contained in this report should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended May 28, 2016, that we filed on July 29, 2016.

3. CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Inventories: Our consolidated inventories are stated at the lower of cost or market, generally using a weighted-average cost method. Our inventories include approximately \$39.7 million of finished goods, \$4.4 million of raw materials, and \$1.1 million of work-in-progress as of August 27, 2016, as compared to approximately \$40.0 million of finished goods, \$4.4 million of raw materials, and \$1.0 million of work-in-progress as of May 28, 2016.

At this time, we do not anticipate any material risks or uncertainties related to possible future inventory write-downs. Provisions for obsolete or slow moving inventories are recorded based upon regular analysis of stock rotation privileges, obsolescence, the exiting of certain markets, and assumptions about future demand and market conditions. If future demand, changes in the industry, or market conditions differ from management's estimates, additional provisions may be necessary. Inventory reserves were approximately \$3.4 million as of August 27, 2016, and as of May 28, 2016.

Revenue Recognition: Our product sales are recognized as revenue upon shipment, when title passes to the customer, when delivery has occurred or services have been rendered, and when collectability is reasonably assured. We also record estimated discounts and returns based on our historical experience. Our products are often manufactured to meet the specific design needs of our customers' applications. Our engineers work closely with customers to ensure that our products will meet their needs. Our customers are under no obligation to compensate us for designing the products we sell.

Loss Contingencies: We accrue a liability for loss contingencies when it is probable that a liability has been incurred and the amount can be reasonably estimated. When only a range of possible loss can be established, the most probable amount in the range is accrued. If no amount within this range is a better estimate than any other amount within the range, the minimum amount in the range is accrued. If we determine that there is at least a reasonable possibility that a loss may have been incurred, we will include a disclosure describing the contingency.

Intangible Assets: Intangible assets are initially recorded at their fair market values determined on quoted market prices in active markets, if available, or recognized valuation models. Intangible assets that have finite useful lives are amortized over their useful lives either on a straight-line basis or over their projected future cash flows and are tested for impairment when events or changes in circumstances occur that indicate possible impairment.

Income Taxes: We recognize deferred tax assets and liabilities based on the differences between financial statement carrying amounts and the tax bases of assets and liabilities. We regularly review our deferred tax assets for recoverability and determine the need for a valuation allowance based on a number of factors, including both positive and negative evidence. These factors include historical taxable income or loss, projected future taxable income or loss, the expected timing of the reversals of existing temporary differences, and the implementation of tax planning strategies. In circumstances where we, or any of our affiliates, have incurred three years of cumulative losses which constitute significant negative evidence, positive evidence of equal or greater significance is needed to overcome the negative evidence before a tax benefit is recognized for deductible temporary differences and loss carryforwards.

In November 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes." ASU 2015-17 eliminates the prior US GAAP guidance in Topic 740, Income Taxes, that required an entity to separate deferred tax liabilities and assets between current and noncurrent amounts in a classified balance sheet. The amendments in ASU 2015-17 require that all deferred tax liabilities and assets of the same tax jurisdiction or a tax filing group, as well as

any related valuation allowance, be offset and presented as a single noncurrent amount in a classified balance sheet. ASU 2015-17 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. In order to simplify presentation of deferred tax balances, the Company adopted this standard prospectively in the quarter ended August 27, 2016. Periods prior to August 27, 2016 were not retrospectively adjusted.

Accrued Liabilities: Accrued liabilities consist of the following (*in thousands*):

	August 27, 2016	May 28, 2016
Compensation and payroll taxes	\$3,510	\$ 4,054
Professional fees	406	775
Deferred revenue	1,831	1,879
Other accrued expenses	2,253	2,427
Accrued Liabilities	\$8,000	\$ 9,135

4. ACQUISITION

On June 15, 2015, Richardson Electronics, Ltd (“the Company”), acquired certain assets of International Medical Equipment and Services, Inc. (“IMES”), for a purchase price of \$12.2 million. This includes the purchase of inventory, receivables, fixed assets, and certain other assets of the Company. The Company did not acquire any liabilities of IMES. The total consideration paid excludes transaction costs.

IMES, based in South Carolina, provides reliable, cost-saving solutions worldwide for major brands of CT and MRI equipment. This acquisition positions Richardson Healthcare to provide cost effective diagnostic imaging replacement parts and training to hospitals, diagnostic imaging centers, medical institutions, and independent service organizations. IMES offers an extensive selection of replacement parts, as well as an interactive training center, on-site test bays and experienced technicians who provide 24/7 customer support. Replacement parts are readily available and triple tested to provide peace of mind when uptime is critical. IMES core operations have remained in South Carolina. Richardson Healthcare plans to expand IMES’ replacement parts and training offerings geographically to leverage the Company’s global infrastructure. During the fourth quarter of fiscal 2016, IMES opened up their first foreign location in Amsterdam.

The consideration paid by the Company to IMES at closing was \$12.2 million in cash. The following table summarizes the fair values of the assets acquired at the date of the closing of the acquisition (*in thousands*):

Accounts receivable	\$737
Inventories	1,420
Property, plant and equipment	230
Goodwill	6,332
Other intangibles	3,490
Net assets acquired	\$12,209

Intangible assets include trade names with an estimated life of 3 years for \$0.6 million, customer relationships with an estimated life of 20 years for \$2.5 million, non-compete agreements with an estimated life of 5 years for \$0.2 million, and technology with an estimated life of 10 years for \$0.2 million.

Goodwill recognized represents value the Company expects to be created by combining the operations of IMES with the Company’s operations, including the expansion into markets within existing business segments and geographic regions, access to new customers and potential cost savings and synergies.

Goodwill related to the acquisition is deductible for tax purposes.

In connection with the acquisition of IMES, the Company also entered into an Employment, Non-Disclosure, and Non-Compete Agreement (“Employment Agreement”) with Lee A. McIntyre III as the Company’s Executive Vice President, IMES. During the term of his employment, Mr. McIntyre will earn an annual base salary of \$300,000. In addition to his base salary, he will be entitled to an annual bonus equal to 20% of the EBITDA of IMES provided that the EBITDA of the bus