Fabrinet
Form 10-Q
November 09, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2016

OR

¨ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File Number: 001-34775

FABRINET

(Exact name of registrant as specified in its charter)

Cayman Islands **(State or other jurisdiction of** **incorporation or organization)**	**Not Applicable** **(I.R.S. Employer** **Identification No.)**

c/o Intertrust Corporate Services (Cayman) Limited **190 Elgin Avenue** **George Town** **Grand Cayman** **Cayman Islands** **(Address of principal executive offices)**	**KY1-9005** **(Zip Code)**

+66 2-524-9600

(Registrant s telephone number, including area code)

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 (the Exchange Act) during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes x No ¨

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 x No ¨

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if 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 x No

As of November 4, 2016, the registrant had 36,856,532 ordinary shares, $0.01 par value, outstanding.

FABRINET

FORM 10-Q

QUARTER ENDED SEPTEMBER 30, 2016

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PART I: FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FABRINET

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands of U.S. dollars, except share data)	**September 30, 2016**	**June 24, 2016**
Assets		
Current assets		
Cash and cash equivalents	$ 105,860	$ 142,804
Marketable securities	147,702	141,709
Trade accounts receivable, net	212,684	196,145
Inventory, net	205,484	181,499
Deferred tax assets		1,358
Prepaid expenses	3,511	3,114
Other current assets	5,210	6,662
Total current assets	680,451	673,291
Non-current assets		
Restricted cash in connection with business acquisition	3,379	
Property, plant and equipment, net	205,845	178,410
Intangibles, net	5,091	499
Goodwill	2,994	
Deferred tax assets	2,503	1,806
Deferred debt issuance costs on revolving loan and other non-current assets	1,040	1,851
Total non-current assets	220,852	182,566
Total Assets	$ 901,303	**$** 855,857
Liabilities and Shareholders Equity		
Current liabilities		
Bank borrowings, net of unamortized debt issuance costs	$ 37,516	$ 24,307
Trade accounts payable	179,741	172,052
Fixed assets payable	19,694	20,628
Capital lease liability, current portion	122	
Income tax payable	3,077	2,010
Accrued payroll, bonus and related expenses	12,417	12,300
Accrued expenses	6,462	8,072
Other payables	10,214	16,356

Total current liabilities		269,243	255,725
Non-current liabilities			
Long-term loan from bank, non-current portion, net of unamortized debt issuance costs		32,759	36,100
Deferred tax liability			854
Capital lease liability, non-current portion		1,556	
Deferred liability in connection with business acquisition		3,379	
Severance liabilities		7,154	6,684
Other non-current liabilities		2,179	2,075
Total non-current liabilities		47,027	45,713
Total Liabilities		316,270	301,438
Commitments and contingencies (Note 16)			
Shareholders equity			
Preferred shares (5,000,000 shares authorized, $0.01 par value; no shares issued and outstanding as of September 30, 2016 and June 24, 2016)			
Ordinary shares (500,000,000 shares authorized, $0.01 par value; 36,700,468 shares and 36,156,446 shares issued and outstanding as of September 30, 2016 and June 24, 2016, respectively)		367	362
Additional paid-in capital		109,772	102,325
Accumulated other comprehensive income		987	591
Retained earnings		473,907	451,141
Total Shareholders Equity		585,033	554,419
Total Liabilities and Shareholders Equity	$	901,303	$ 855,857

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(in thousands of U.S. dollars, except per share amounts)	Three Months Ended September 30, 2016	Three Months Ended September 25, 2015
Revenues	$ 332,043	$ 216,433
Cost of revenues	(292,435)	(190,422)
Gross profit	39,608	26,011
Selling, general and administrative expenses	(15,832)	(11,900)
Other expense related to flooding		(864)
Operating income	23,776	13,247
Interest income	437	442
Interest expense	(1,322)	(402)
Foreign exchange gain (loss), net	1,657	(10,492)
Other income	143	103
Income before income taxes	24,691	2,898
Income tax expense	(1,925)	(1,295)
Net income	22,766	1,603
Other comprehensive income, net of tax:		
Change in net unrealized (loss) gains on marketable securities	(187)	87
Change in net unrealized loss on derivative instruments	(158)	
Change in foreign currency translation adjustment	741	
Total other comprehensive income, net of tax	396	87
Net comprehensive income	$ 23,162	$ 1,690
Earnings per share		
Basic	$ 0.63	$ 0.05
Diluted	$ 0.61	$ 0.04
Weighted-average number of ordinary shares outstanding (thousands of shares)		
Basic	36,404	35,579
Diluted	37,330	36,315

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of U.S. dollars)	Three Months Ended September 30, 2016	Three Months Ended September 25, 2015
Cash flows from operating activities		
Net income for the period	$ 22,766	$ 1,603
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	5,113	4,063
Gain on disposal of property, plant and equipment	(40)	(26)
Loss from sales and maturities of available-for-sale securities	100	92
Amortization of investment premium	166	298
Amortization of deferred debt issuance costs	908	171
Allowance for doubtful accounts (reversal of)	3	(4)
Unrealized (gain) loss on exchange rate and fair value of derivative instruments	(1,913)	10,855
Share-based compensation	5,611	2,673
Deferred income tax	311	157
Other non-cash expenses	453	386
(Reversal of) inventory obsolescence	(62)	150
Loss from written-off inventory due to flood loss		233
Changes in operating assets and liabilities		
Trade accounts receivable	(11,876)	(4,948)
Inventory	(21,290)	(13,150)
Other current assets and non-current assets	3,285	(668)
Trade accounts payable	3,103	3,053
Income tax payable	1,035	707
Other current liabilities and non-current liabilities	(8,675)	(1,106)
Net cash (used in) provided by operating activities	(1,002)	4,539
Cash flows from investing activities		
Purchase of marketable securities	(32,737)	(38,773)
Proceeds from sales of marketable securities	13,061	16,687
Proceeds from maturities of marketable securities	13,230	12,528
Payments in connection with business acquisition, net of cash acquired	(9,664)	
Restricted cash in connection with business acquisition	(3,379)	
Purchase of property, plant and equipment	(27,090)	(8,452)
Purchase of intangibles	(178)	(68)
Deposits for land purchase		(2,352)
Proceeds from disposal of property, plant and equipment	107	28
Net cash used in investing activities	(46,650)	(20,402)

Cash flows from financing activities		
Payment of debt issuance costs		(353)
Proceeds from revolving loans	13,500	
Repayment of long-term loans from bank	(4,900)	(1,500)
Proceeds from issuance of ordinary shares under employee share option plans	2,708	1,547
Withholding tax related to net share settlement of restricted share units	(867)	(878)
Net cash provided by (used in) financing activities	10,441	(1,184)
Net decrease in cash and cash equivalents	(37,211)	(17,047)
Movement in cash and cash equivalents		
Cash and cash equivalents at beginning of period	142,804	112,978
Decrease in cash and cash equivalents	(37,211)	(17,047)
Effect of exchange rate on cash and cash equivalents	267	(466)
Cash and cash equivalents at end of period	$ 105,860	$ 95,465
Non-cash investing and financing activities		
Construction and equipment-related payables	$ 19,694	$ 5,123

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of U.S. dollars unless otherwise noted)

1. Business and organization

General

Fabrinet (Fabrinet or the Parent Company) was incorporated on August 12, 1999, and commenced operations on January 1, 2000. The Parent Company is an exempted company incorporated in the Cayman Islands, British West Indies. The Company refers to Fabrinet and its subsidiaries as a group.

The Company provides advanced optical packaging and precision optical, electro-mechanical and electronic manufacturing services to original equipment manufacturers (OEMs) of complex products, such as optical communication components, modules and sub-systems, industrial lasers, medical devices and sensors. The Company offers a broad range of advanced optical and electro-mechanical capabilities across the entire manufacturing process, including process design and engineering, supply chain management, manufacturing, complex printed circuit board assembly, advanced packaging, integration, final assembly and testing. The Company focuses primarily on the production of low-volume, high-mix products. The principal subsidiaries of Fabrinet include Fabrinet Co., Ltd. (Fabrinet Thailand), Casix, Inc. (Casix) and Fabrinet West, Inc. (Fabrinet West).

2. Accounting policies

Basis of presentation

The accompanying unaudited condensed consolidated financial statements for Fabrinet as of September 30, 2016 and for the three months ended September 30, 2016 and September 25, 2015 includes normal recurring adjustments, necessary for a fair presentation of the financial statements set forth herein, in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, such information does not include all of the information and footnotes required by U.S. GAAP for annual financial statements. For further information, please refer to the consolidated financial statements and footnotes thereto included in Fabrinet s Annual Report on Form 10-K for the year ended June 24, 2016.

The balance sheet as of June 24, 2016 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The results for the three months ended September 30, 2016 may not be indicative of results for the year ending June 30, 2017 or any future periods.

Where necessary, comparative figures have been reclassified to conform to the current period accounting policies and presentation adopted.

On September 14, 2016, the Company acquired 100% of the shares of Global CEM Solutions, Ltd. and all of its subsidiaries, a privately-held group located in Wiltshire, United Kingdom (Exception EMS). The unaudited condensed consolidated financial statements of the Company include the financial position, results of operations and the cash flows of Exception EMS commencing as of the acquisition date. See Note 8 - Business acquisitions for further details on the accounting for this transaction.

Use of Estimates

The preparation of the Company s condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, and the reported amount of total revenues and expenses during the year. The Company bases estimates on historical experience and various assumptions about the future that are believed to be reasonable based on available information. The Company s reported financial position or results of operations may be materially different under different conditions or when using different estimates and assumptions, particularly with respect to significant accounting policies, which are discussed below. Significant assumptions are used in accounting for share-based compensation, allowance for doubtful accounts, income taxes, inventory obsolescence and valuation of intangible assets related to business acquisition, among others. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be different from these estimates. In the event that estimates or assumptions prove to differ from actual results, adjustments will be made in subsequent periods to reflect more current information.

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Fiscal years

The Company utilizes a 52-53 week fiscal year ending on the Friday in June closest to June 30. The three months ended September 30, 2016 and September 25, 2015 each consisted of 14 weeks and 13 weeks, respectively. Fiscal year 2017 will be comprised of 53 weeks and will end on June 30, 2017.

Concentration of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents, marketable securities, derivatives, and accounts receivable.

Cash, cash equivalents, and marketable securities are maintained with several financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with financial institutions with reputable credit and therefore bear minimal credit risk. The Company seeks to mitigate its credit risks by spreading such risks across multiple counterparties and monitoring the risk profiles of these counterparties. The Company limits its investments in marketable securities to securities with a maturity not in excess of three years, and all marketable securities that the Company invests in are rated A1, P-1, F1, or better.

The Company performs ongoing credit evaluations for credit worthiness of its customers and usually does not require collateral from its customers. Management has implemented a program to closely monitor near term cash collection and credit exposures to mitigate any material losses.

Derivatives

The derivatives assets and liabilities are recognized on the consolidated balance sheets as other current assets or accrued expenses measured at fair value.

The Company applies hedge accounting to arrangements that qualify and are designated for cash flow hedge accounting treatment. Hedge accounting is discontinued prospectively if the hedging relationship ceases to be effective or the hedging or hedged items cease to exist as a result of maturity, sale, termination or cancellation.

Derivatives designated and qualifying as hedges of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges which include forward currency contracts. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative is initially recorded in accumulated other comprehensive income (loss) (AOCI), while any ineffective portion is recognized directly in earnings, as a component of other income (expense). The portion of gain or loss on the derivative instrument remains in AOCI until the forecasted transaction is recognized in earnings.

The Company also enters into derivative contracts that are intended to economically hedge certain of the Company s risks. The changes in the fair value of the derivatives are recorded directly in earnings as a component of other income (expense), net. In accordance with the fair value measurement guidance, the Company s accounting policy is to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio. The Company executes derivative instruments with financial institutions that are credit-worthy, defined as institutions that hold an investment grade credit rating.

Business acquisition

For the acquisition of Exception EMS, the Company allocated the fair value of purchase consideration to the assets acquired and liability assumed based on their fair values at the acquisition date. The total consideration and the allocation of consideration to the individual net assets is preliminary, as there are remaining uncertainties to be resolved, including the settlement of the final net working capital adjustment and the finalization of the estimated fa