SYNAPTICS Inc
Form 10-Q
November 03, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 24, 2016

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 000-49602

SYNAPTICS INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware	77-0118518
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1251 McKay Drive

San Jose, California 95131

(Address of principal executive offices) (Zip code)

(408) 904-1100

(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 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
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

Number of shares of Common Stock outstanding at October 28, 2016: 34,899,756

SYNAPTICS INCORPORATED

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 24, 2016

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ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

SYNAPTICS INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in millions, except par value and share amounts)

(unaudited)

	September 30, 2016	June 30, 2016
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 301.4	$ 352.2
Accounts receivable, net of allowances of $3.8 and $3.7 at September 30, 2016 and June 30, 2016, respectively	239.5	252.6
Inventories	152.9	146.4
Prepaid expenses and other current assets	32.2	28.9
Total current assets	726.0	780.1
Property and equipment at cost, net of accumulated depreciation of $93.2 and $87.3 at September 30, 2016 and June 30, 2016, respectively	109.4	112.7
Goodwill	206.8	206.8
Acquired intangibles, net	143.6	160.3
Non-current other assets	55.4	40.3
	$ 1,241.2	$ 1,300.2
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 153.8	$ 172.8
Accrued compensation	30.7	39.9
Income taxes payable	13.8	11.5
Acquisition-related liabilities	12.7	25.5
Other accrued liabilities	78.9	82.3
Current portion of long-term debt	15.0	18.8
Total current liabilities	304.9	350.8
Long-term debt, net of issuance costs	213.2	216.7
Acquisition-related liabilities	6.4	6.2
Deferred tax liabilities	5.2	9.0
Other long-term liabilities	12.7	12.5
Total liabilities	542.4	595.2

Stockholders' Equity:		
Common stock:		
$0.001 par value; 120,000,000 shares authorized, 59,679,709 and 59,532,148 shares issued, and 34,851,639 and 35,212,141 shares outstanding, at September 30, 2016 and June 30, 2016, respectively	0.1	0.1
Additional paid-in capital	944.0	928.6
Treasury stock: 24,828,070 and 24,320,007 common treasury shares at September 30, 2016 and June 30, 2016, respectively, at cost	(917.3)	(892.3)
Accumulated other comprehensive income	3.0	3.3
Retained earnings	669.0	665.3
Total stockholders' equity	698.8	705.0
	$ 1,241.2	$ 1,300.2

See accompanying notes to condensed consolidated financial statements (unaudited).

SYNAPTICS INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in millions, except per share data)

(unaudited)

	Three Months Ended September 30,	
	2016	2015
Net revenue	$386.2	$470.0
Cost of revenue	262.8	306.2
Gross margin	123.4	163.8
Operating expenses:		
Research and development	73.4	80.5
Selling, general, and administrative	34.6	40.2
Acquired intangibles amortization	4.5	4.7
Change in contingent consideration	-	2.7
Restructuring costs	5.3	1.9
Total operating expenses	117.8	130.0
Operating income	5.6	33.8
Interest and other expense, net	(0.9)	(0.8)
Income before provision for income taxes	4.7	33.0
Provision for income taxes	1.0	9.2
Net income	$3.7	$23.8
Net income per share:		
Basic	$0.11	$0.65
Diluted	$0.10	$0.62
Shares used in computing net income per share:		
Basic	34.8	36.8
Diluted	35.6	38.2

See accompanying notes to condensed consolidated financial statements (unaudited).

SYNAPTICS INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)

(unaudited)

	Three Months Ended September 30,	
	2016	2015
Net income	$3.7	$23.8
Other comprehensive loss:		
Change in unrealized net loss on investments	-	(0.3)
Reclassification from accumulated other comprehensive income to interest income for accretion of non-current investments	(0.3)	(0.4)
Net current period-other comprehensive loss	(0.3)	(0.7)
Comprehensive income	$3.4	$23.1

See accompanying notes to condensed consolidated financial statements (unaudited).

SYNAPTICS INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(unaudited)

	Three Months Ended September 30,	
	2016	2015
Cash flows from operating activities		
Net income	$3.7	$23.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Share-based compensation costs	14.6	11.9
Depreciation and amortization	8.6	7.9
Acquired intangibles amortization	16.7	19.1
Accretion and remeasurement of contingent consideration liability	-	2.7
Deferred taxes	(5.7)	(6.0)
Impairment of property and equipment	-	2.4
Non-cash interest	(0.3)	(0.4)
Amortization of debt issuance costs	0.3	0.1
Foreign currency remeasurement loss	-	0.8
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable, net	13.1	(24.5)
Inventories	(6.5)	(6.3)
Prepaid expenses and other current assets	(0.3)	9.2
Other assets	(1.5)	1.3
Accounts payable	(19.3)	(14.0)
Accrued compensation	(9.3)	(2.3)
Acquisition-related liabilities	(12.8)	(9.6)
Income taxes payable	2.1	(8.6)
Other accrued liabilities	(3.4)	4.8
Net cash provided by operating activities	(0.0)	12.3
Cash flows from investing activities		
Proceeds from sales of investments	-	0.6
Purchase of intangible assets	-	(4.4)
Purchases of property and equipment	(5.7)	(9.9)
Investment in direct financing lease	(14.3)	-
Net cash used in investing activities	(20.0)	(13.7)
Cash flows from financing activities		
Payment of debt	(7.5)	(1.9)
Purchases of treasury stock	(25.0)	(125.0)
Proceeds from issuance of shares	2.0	3.4
Excess tax benefit from share-based compensation	0.6	2.4
Payroll taxes for deferred stock and market stock units	(1.4)	(3.2)
Net cash used in financing activities	(31.3)	(124.3)
Effect of exchange rate changes on cash and cash equivalents	0.5	0.3

Net decrease in cash and cash equivalents	(50.8)	(125.4)
Cash and cash equivalents at beginning of period	352.2	399.9
Cash and cash equivalents at end of period	$301.4	$274.5
Supplemental disclosures of cash flow information		
Cash paid for taxes	$2.9	$20.2
Cash refund on taxes	$0.7	$9.7
Non-cash investing and financing activities:		
Property and equipment received but unpaid	$2.7	$2.6

See accompanying notes to condensed consolidated financial statements (unaudited).

SYNAPTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission, or the SEC, and U.S. generally accepted accounting principles, or U.S. GAAP. However, certain information or footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to SEC rules and regulations. In our opinion, the financial statements include all adjustments, which are of a normal and recurring nature and necessary for the fair presentation of the results of the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the operating results for the full fiscal year or any future period. These financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended June 25, 2016.

The consolidated financial statements include our financial statements and those of our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated upon consolidation.

Our fiscal year is the 52- or 53-week period ending on the last Saturday in June. Our fiscal 2017 and 2016 years are 52-week periods ending on June 24, 2017 and June 25, 2016, respectively. The quarterly fiscal periods presented in this report were 13-week periods for the three months ended September 24, 2016 and September 26, 2015, respectively. For simplicity, the accompanying condensed consolidated financial statements have been shown as ending on calendar quarter end dates as of and for all periods presented, unless otherwise indicated.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, cost of revenue, inventories, loss on purchase commitments, product warranty, accrued liabilities, share-based compensation costs, provision for income taxes, deferred income tax asset valuation allowances, uncertain tax positions, goodwill, intangible assets, investments, contingent consideration liability and loss contingencies. We base our estimates on historical experience, applicable laws and regulations, and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Foreign Currency Transactions and Foreign Exchange Contracts

The U.S. dollar is our functional and reporting currency. We remeasure our monetary assets and liabilities not denominated in the functional currency into U.S. dollar equivalents at the rate of exchange in effect on the balance sheet date. We measure and record non-monetary balance sheet accounts at the historical rate in effect at the date of transaction. We remeasure foreign currency expenses at the weighted average exchange rate in the month that the transaction occurred. Our foreign currency transactions and remeasurement gains and losses are included in selling, general, and administrative expenses in the condensed consolidated statements of income, and resulted in net losses of $0.1 million and $1.4 million in the three months ended September 30, 2016, and 2015, respectively.

We enter into foreign currency contracts to manage exposure related to certain foreign currency obligations. The foreign currency contracts are not designated as hedging instruments and, accordingly, are not subject to hedge accounting. In fiscal year 2015, we entered into foreign currency forward contracts to purchase Japanese yen, using U.S. dollars. As of September 30, 2016, we had no outstanding foreign currency forward contracts. In the three months ended September 30, 2016, and 2015 we recognized net gains of zero and $1.7 million, respectively, on the foreign currency forward contracts.

Recently Issued Accounting Pronouncements Not Yet Effective

In October 2016, the Financial Accounting Standards Board, or FASB, issued an accounting standard update, or ASU, on Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory, which reduces the complexity in the accounting standards by allowing the recognition of current and deferred income taxes for an intra-entity asset transfer, other than inventory, when the transfer occurs. Historically, recognition of the income tax consequence was not recognized until the asset was sold to an outside party. This amendment should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. There are no new disclosure requirements. This ASU is effective for us beginning in the first quarter of fiscal 2019, and early option is permitted. We are evaluating the impact of this ASU on our condensed consolidated financial statements.

In August 2016, the FASB issued an ASU on Statement of Cash Flows-Classification of Certain Cash Receipts and Cash Payments. This ASU will be effective for us beginning in the first quarter of fiscal 2019 on a retrospective basis, and early adoption is permitted. We are evaluating the impact of this ASU on our condensed consolidated statements of cash flows.

In May 2014, the FASB issued an ASU on Revenue from Contracts with Customers. The ASU will supersede most of the existing revenue recognition guidance in U.S. GAAP when the new standard becomes effective, and requires entities to recognize revenue when they transfer promised goods or services to customers in an amount that reflects the consideration which the entity expects to be entitled to in exchange for those goods or services. The ASU is effective for us in our fiscal year 2019, with early adoption permitted in the first quarter of fiscal 2018. We are currently in the process of evaluating the impact of the adoption of the ASU on our condensed consolidated financial statements and considering additional disclosure requirements. The new standard permits the use of either the retrospective or cumulative effect transition method. We have not yet selected a transition method or determined the effect of the standard on our ongoing financial reporting.

In March 2016, the FASB issued an ASU for Compensation-Stock Compensation. This update simplifies several aspects of the accounting for employee share-based payment transactions including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The ASU will be effective for us beginning in the first quarter of fiscal 2018, with early adoption permitted. We are evaluating the effects of adoption of this ASU on our condensed consolidated financial statements.

In February 2016, the FASB issued an ASU on Leases. This update requires organizations that lease assets with lease terms of more than 12 months to recognize assets and liabilities for the rights and obligations created by those leases on their balance sheets. It also requires new qualitative and quantitative disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. The new standard will be effective for us beginning in the first quarter of our fiscal year 2020, with early adoption permitted. We are evaluating the effects of adoption of this ASU on our condensed consolidated financial statements.

In January 2016, the FASB issued an ASU on Recognition and Measurement of Financial Assets and Financial Liabilities, which provides guidance for the recognition, measurement, presentation, and disclosure of financial assets and liabilities. This ASU will be effective for us beginning in our first quarter of fiscal 2019, with early adoption permitted. We are evaluating the effects of the adoption of this ASU on our condensed consolidated financial statements.

In July 2015, the FASB issued an ASU that requires an entity to measure inventory at the lower of cost and net realizable value when the first-in, first-out, or average cost method is used. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The ASU will become effective for us in our first quarter of fiscal 2018, with early adoption permitted. We are evaluating the effects of the adoption of this ASU on our condensed consolidated financial statements.

2. Revenue Recognition

We recognize revenue from product sales when there is persuasive evidence that an arrangement exists, delivery has occurred and title has transferred, the price is fixed or determinable, and collection is reasonably assured. We accrue for estimated sales returns, incentives, and other allowances at the time we recognize revenue. Our products contain embedded firmware and software, which together with, or consisting of, our ASIC chip, deliver the essential functionality of our products and, as such, software revenue recognition guidance is not applicable. Our sales to distributors are made under agreements that generally do not provide for price adjustments after purchase and revenue recognition and provide for only limited return rights under product warranty. Revenue on these sales is recognized in the same manner as sales to our non-distributor customers. When sales rebates and price allowances are applicable they are estimated and recorded in the period the related revenue is recognized.

3. Net Income Per Share

The computation of basic and diluted net income per share was as follows (in millions, except per share data):

	Three Months Ended September 30,	
	2016	2015
Numerator:		
Net income	$3.7	$23.8
Denominator:		
Shares, basic	34.8	36.8
Effect of dilutive share-based awards	0.8	1.4
Shares, diluted	35.6	38.2
Net income per share:		
Basic	$0.11	$0.65
Diluted	$0.10	$0.62

Our basic net income per share amounts for each period presented have been computed using the weighted average number of shares of common stock outstanding over the period measured. Our diluted net income per share amounts for each period presented include the weighted average effect of potentially dilutive shares. We use the “treasury stock” method to determine the dilutive effect of our stock options, deferred stock units, or DSUs, and market stock units, or MSUs.

Dilutive net income per share amounts do not include the potential weighted average effect of 1,402,302 and 535,708 shares of common stock related to certain share-based awards that were outstanding during the three months ended September 30, 2016 and 2015, respectively. These share-based awards were not included in the computation of diluted net income per share because their effect would have been antidilutive.

4. Fair Value

Financial assets measured at fair value on a recurring basis by level within the fair value hierarchy, consisted of the following (in millions):

	September 30, 2016			June 30, 2016		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Assets:						
Money market funds	$263.6	$ -	$ -	$319.1	$ -	$ -
Auction rate securities	-	-	8.6	-	-	8.6
Total available-for-sale securities	$263.6	$ -	$ 8.6	$319.1	$ -	$ 8.6

In our condensed consolidated balance sheets as of September 30, 2016 and June 30, 2016, money market balances were included in cash and cash equivalents, and auction rate securities, or ARS investments, were included in non-current other assets.

There were no changes in fair value of our Level 3 financial assets as of September 30, 2016. There were no transfers in or out of our Level 1, 2, or 3 assets during the three months ended September 30, 2016 and 2015.

The fair values of our accounts receivable and accounts payable approximate their carrying values because of the short-term nature of those instruments. Intangible assets, property and equipment, and goodwill are measured at fair value on a non-recurring basis if impairment is indicated. The interest rate on our bank debt is variable, which is subject to change from time to time to reflect a market interest rate; accordingly, the carrying value of our bank debt approximates fair value.

5. Auction Rate Securities

Our ARS investments, which are included in non-current other assets in the condensed consolidated balance sheets, have failed to settle in auctions beginning in 2007. These investments are not liquid, and in the event we need to access these funds, we will not be able to do so without a loss of principal, unless redeemed by the issuers or a future auction on these investments is successful.

As there are currently no active markets for our various failed ARS investments, we have estimated the fair value of these investments as of September 30, 2016 using a trinomial discounted cash flow analysis. The analysis considered, among others, the following factors:

- the collateral underlying the security investments;
- the creditworthiness of the counterparty;
- the timing of expected future cash flows;
- the probability of a successful auction in a future period;
- the underlying structure of each investment;
- the present value of future principal and interest payments discounted at rates considered to reflect current market conditions;
- a consideration of the probabilities of default, a successful future auction, or redemption at par for each period; and
- estimates of the recovery rates in the event of default for each investment.

When possible, our failed ARS investments were compared to other observable market data or securities with similar characteristics. Our estimate of the fair value of our ARS investments could fluctuate from period to period depending on future market conditions.

We have ARS investments with a fair value of $7.1 million maturing in fiscal year 2018 and $1.5 million fair value with no maturity date. All of our ARS investments are below investment grade.

The ARS investments we held as of September 30, 2016, including the original cost basis, other-than-temporary impairment included in retained earnings, new cost basis, unrealized gain, and fair value, consisted of the following (in millions):

	Original Cost Basis	Other-than-temporary Impairment in Retained Earnings	New Cost Basis	Unrealized Gain	Fair Value
Credit linked notes	$ 7.5	$ (1.9) (1)	$ 5.6	$ 1.5	$ 7.1
Preferred stock	5.0	(5.0)	-	1.5	1.5
Total ARS	$ 12.5	$ (6.9)	$ 5.6	$ 3.0	$ 8.6

(1) Other-than-temporary impairment in retained earnings is partially offset by cumulative accretion of $4.7 million on non-current investments. Accretion is reclassified from accumulated other comprehensive income and recorded in the condensed consolidated statements of income as non-cash interest income.

The ARS investments we held as of June 30, 2016, including the original cost basis, other-than-temporary impairment included in retained earnings, new cost basis, unrealized gain, and fair value, consisted of the following (in millions):

Original	Other-than-temporary	New Cost	Unrealized Gain	Fair Value

	Cost Basis	Impairment in Retained Earnings	Basis		
Credit linked notes	$ 7.5	$ (2.2)(1)	$ 5.3	$ 1.8	$ 7.1
Preferred stock	5.0	(5.0)	-	1.5	1.5
Total ARS	$ 12.5	$ (7.2)	$ 5.3	$ 3.3	$ 8.6

(1) Other-than-temporary impairment in retained earnings is partially offset by cumulative accretion of $4.4 million on non-current investments. Accretion is reclassified from accumulated other comprehensive income and recorded in the condensed consolidated statements of income as non-cash interest income.

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We have accounted for our ARS investments as non-current as we are not able to reasonably determine when the ARS markets will recover or be restructured. Based on our ability to access our cash and cash equivalents, our expected operating cash flows, and our other sources of cash, we do not intend to sell the ARS investments and it is not more likely than not that we will be required to sell our ARS investments before the recovery of the amortized cost basis.

6. Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market and consisted of the following (in millions):

	September 30, 2016	June 30, 2016
Raw materials	$ 78.1	$ 59.2
Finished goods	74.8	87.2
	$ 152.9	$ 146.4

We record a write-down, if necessary, to reduce the carrying value of inventory to its net realizable value. The effect of these write-downs is to establish a new cost basis in the related inventory, which we do not subsequently write up. We also record a liability and charge to cost of revenue for estimated losses on inventory we are obligated to purchase from our contract manufacturers when such losses become probable from customer delays, order cancellations, or other factors.

In October 2016, we were notified by a customer that they have cancelled production of a smartphone model, which contains certain customer specific parts, due to safety issues. Due to the lack of forecasted demand, we have recorded additional inventory charges of approximately $2.8 million for our quarter ended September 30, 2016, which has been reflected in cost of revenue.

7. Acquired Intangibles

The following table summarizes the life, the gross carrying value and the related accumulated amortization of our acquired intangible assets as of September 30, 2016 and June 30, 2016 (in millions):

	Weighted Average	September 30, 2016	June 30, 2016

	Life in Years		
Display driver technology	5.3	$ 164.0	$ 164.0
Fingerprint authentication technology	4.3	63.5	75.6
Customer relationships	2.8	48.4	48.4
Licensed technology and other	5.0	1.3	1.3
Patents	7.7	4.7	4.8
Supplier arrangement		-	22.0
Acquired intangibles, gross	4.5	281.9	316.1
Accumulated amortization		(138.3)	(155.8)
Acquired intangibles, net		$ 143.6	$ 160.3

The total amortization expense for the acquired intangible assets was $16.7 million and $19.1 million for the three months ended September 30, 2016 and 2015, respectively. Amortization expense was included in our condensed consolidated statements of income in cost of revenue and acquired intangibles amortization.

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The following table presents expected annual fiscal year aggregate amortization expense as of September 30, 2016 (in millions):

Remainder of 2017	$42.6
2018	48.6
2019	34.2
2020	10.6
2021	3.5
2022	