KEMET CORP
Form 10-Q
February 03, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2014
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number: 001-15491

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

| | |
|---|---|
| DELAWARE | 57-0923789 |
| (State or other jurisdiction of incorporation or organization) | (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 ý NO o

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 ý NO o

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

| | |
|---|---|
| Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

The number of shares outstanding of the registrant's common stock, par value $0.01 per share, as of January 30, 2015 was 45,428,192.

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KEMET CORPORATION AND SUBSIDIARIES
Form 10-Q for the Quarter ended December 31, 2014

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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)

| | December 31, 2014 | March 31, 2014 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $55,582 | $57,929 |
| Accounts receivable, net | 92,485 | 98,947 |
| Inventories, net | 187,614 | 187,974 |
| Prepaid expenses and other | 38,836 | 36,871 |
| Deferred income taxes | 6,695 | 6,695 |
| Current assets of discontinued operations | — | 12,160 |
| Total current assets | 381,212 | 400,576 |
| Property, plant and equipment, net of accumulated depreciation of $816,317 and $805,687 as of December 31, 2014 and March 31, 2014, respectively | 264,968 | 292,648 |
| Goodwill | 35,584 | 35,584 |
| Intangible assets, net | 34,595 | 37,184 |
| Investment in NEC TOKIN | 52,168 | 46,419 |
| Restricted cash | 2,003 | 13,512 |
| Deferred income taxes | 6,691 | 6,778 |
| Other assets | 22,523 | 10,130 |
| Non-current assets of discontinued operations | — | 836 |
| Total assets | $799,744 | $843,667 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | $12,521 | $7,297 |
| Accounts payable | 62,132 | 74,818 |
| Accrued expenses | 58,611 | 76,468 |
| Income taxes payable and deferred income taxes | 396 | 980 |
| Current liabilities of discontinued operations | — | 7,269 |
| Total current liabilities | 133,660 | 166,832 |
| Long-term debt, less current portion | 392,082 | 391,292 |
| Other non-current obligations | 49,963 | 55,864 |
| Deferred income taxes | 8,131 | 5,203 |
| Non-current liabilities of discontinued operations | — | 2,592 |
| 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 December 31, 2014 and March 31, 2014 | 465 | 465 |
| Additional paid-in capital | 462,586 | 465,027 |
| Retained deficit | (226,034) | (231,738) |
| Accumulated other comprehensive income | 3,857 | 18,184 |
| Treasury stock, at cost (1,080 and 1,301 shares at December 31, 2014 and March 31, 2014, respectively) | (24,966) | (30,054) |
| Total stockholders' equity | 215,908 | 221,884 |
| Total liabilities and stockholders' equity | $799,744 | $843,667 |

See accompanying notes to the unaudited condensed consolidated financial statements.

KEMET CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(Amounts in thousands, except per share data)
(Unaudited)

| | Quarters Ended December 31, | | Nine Month Periods Ended December 31, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Net sales | $201,310 | $207,339 | $629,484 | $617,845 |
| Operating costs and expenses: | | | | |
| Cost of sales | 156,842 | 169,677 | 506,304 | 530,723 |
| Selling, general and administrative expenses | 23,374 | 22,431 | 73,663 | 70,826 |
| Research and development | 6,303 | 6,027 | 19,230 | 17,703 |
| Restructuring charges | 6,063 | 2,194 | 9,580 | 8,168 |
| Write down of long-lived assets | — | 3,358 | — | 3,358 |
| Net (gain) loss on sales and disposals of assets | (574) | 29 | (759) | 71 |
| Total operating costs and expenses | 192,008 | 203,716 | 608,018 | 630,849 |
| Operating income (loss) | 9,302 | 3,623 | 21,466 | (13,004) |
| Non-operating (income) expense: | | | | |
| Interest income | (5) | (7) | (11) | (182) |
| Interest expense | 9,938 | 10,349 | 30,681 | 30,291 |
| Other (income) expense, net | (3,701) | (1,351) | (14,829) | (50) |
| Income (loss) from continuing operations before income taxes and equity income (loss) from NEC TOKIN | 3,070 | (5,368) | 5,625 | (43,063) |
| Income tax expense | 1,359 | 1,033 | 5,224 | 4,293 |
| Income (loss) from continuing operations before equity income (loss) from NEC TOKIN | 1,711 | (6,401) | 401 | (47,356) |
| Equity income (loss) from NEC TOKIN | 1,367 | 1,657 | (76) | (2,963) |
| Income (loss) from continuing operations | 3,078 | (4,744) | 325 | (50,319) |
| Income (loss) from discontinued operations, net of income tax expense (benefit) of $41, $67, $1,976 and $(293), respectively | (164) | (1,076) | 5,379 | (3,737) |
| Net income (loss) | $2,914 | $(5,820) | $5,704 | $(54,056) |
| Net income (loss) per basic share: | | | | |
| Net income (loss) from continuing operations | $0.07 | $(0.11) | $0.01 | $(1.12) |
| Net income (loss) from discontinued operations | $— | $(0.02) | $0.12 | $(0.08) |
| Net income (loss) | $0.07 | $(0.13) | $0.13 | $(1.20) |
| | | | | |
| Net income (loss) per diluted share: | | | | |
| Net income (loss) from continuing operations | $0.06 | $(0.11) | $0.01 | $(1.12) |
| Net income (loss) from discontinued operations | $— | $(0.02) | $0.10 | $(0.08) |

| | | | | |
|---|---|---|---|---|
| Net income (loss) | $0.06 | $(0.13) | $0.11 | $(1.20) |
| Weighted-average shares outstanding: | | | | |
| Basic | 45,407 | 45,120 | 45,360 | 45,078 |
| Diluted | 52,228 | 45,120 | 52,549 | 45,078 |

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 December 31, | | Nine Month Periods Ended December 31, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Net income (loss) | $2,914 | $(5,820) | $5,704 | $(54,056) |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation gains (losses) | (5,743) | 3,879 | (20,502) | 12,510 |
| Defined benefit pension plans, net of tax impact | 86 | 106 | 227 | 402 |
| Post-retirement plan adjustments | (36) | (81) | (140) | (212) |
| Equity interest in NEC TOKIN's other comprehensive income (loss) | 2,615 | 1,113 | 6,088 | (62) |
| Other comprehensive income (loss) | (3,078) | 5,017 | (14,327) | 12,638 |
| Total comprehensive income (loss) | $(164) | $(803) | $(8,623) | $(41,418) |

See accompanying notes to the unaudited condensed consolidated financial statements.

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

| | Nine Month Periods Ended December 31, | |
|---|---|---|
| | 2014 | 2013 |
| Net income (loss) | $5,704 | $(54,056) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Gain on sale of discontinued operations | (5,644) | — |
| Net cash provided by (used in) operating activities of discontinued operations | (679) | 461 |
| Depreciation and amortization | 30,694 | 37,352 |
| Equity (income) loss from NEC TOKIN | 76 | 2,963 |
| Amortization of debt and financing costs | 1,706 | 2,817 |
| (Gain) loss on early extinguishment of debt | (1,003) | — |
| Stock-based compensation expense | 3,185 | 2,330 |
| Long-term receivable write down | 27 | 1,484 |
| Change in value of NEC TOKIN options | (13,200) | (1,334) |
| Net (gain) loss on sales and disposals of assets | (759) | 71 |
| Pension and other post-retirement benefits | 87 | 24 |
| Write down of long-lived assets | — | 3,358 |
| Change in deferred income taxes | 1,276 | (2,496) |
| Change in operating assets | (208) | 8,579 |
| Change in operating liabilities | (24,732) | (28,296) |
| Other | 200 | 431 |
| Net cash provided by (used in) operating activities | (3,270) | (26,312) |
| Investing activities: | | |
| Capital expenditures | (17,474) | (24,993) |
| Proceeds from sale of assets | 4,540 | — |
| Change in restricted cash | 11,509 | 3,532 |
| Proceeds from sale of discontinued operations | 9,564 | — |
| Net cash provided by (used in) investing activities | 8,139 | (21,461) |
| Financing activities: | | |
| Proceeds from revolving line of credit | 42,340 | 21,000 |
| Payments on revolving line of credit | (14,342) | — |
| Deferred acquisition payments | (11,899) | (11,703) |
| Payments on long-term debt | (21,733) | (2,858) |
| Proceeds from exercise of stock options | 24 | 86 |
| Net cash provided by (used in) financing activities | (5,610) | 6,525 |
| Net increase (decrease) in cash and cash equivalents | (741) | (41,248) |
| Effect of foreign currency fluctuations on cash | (1,606) | 864 |
| Cash and cash equivalents at beginning of fiscal period | 57,929 | 95,978 |
| Cash and cash equivalents at end of fiscal period | $55,582 | $55,594 |

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, 2014 (the "Company's 2014 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 nine month periods ended December 31, 2014 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 2014 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

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update 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, 2017 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 prohibited.

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

As discussed in Note 3, Debt, the Company repaid the outstanding balance of the original equipment manufacturer (“OEM”) Advance Payment (as defined in Note 3, Debt) and removed the restriction on cash related to the Advance Payment during the third quarter ended December 31, 2014.

A bank guarantee in the amount of €1.5 million ($1.8 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.

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Accordingly, a deposit was placed with the European bank for €1.7 million ($2.0 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.

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2014 and March 31, 2014 are as follows (amounts in thousands):

| | Carrying Value December 31, 2014 | Fair Value December 31, 2014 | Fair Value Measurement Using | | | Carrying Value March 31, 2014 | Fair Value March 31, 2014 | Fair Value Measurement Using | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Level 1 | Level 2 (2) | Level 3 | | | Level 1 | Level 2 (2) | Level 3 |
| Assets: | | | | | | | | | | |
| Money markets (1) | $ 738 | $ 738 | $ 738 | $ — | $ — | $ 714 | $ 714 | $ 714 | $ — | $ — |
| Total debt | 404,603 | 403,086 | 362,100 | 40,986 | — | 398,589 | 409,284 | 371,863 | 37,421 | — |
| NEC TOKIN options, net (3) | 16,800 | 16,800 | — | — | 16,800 | 3,600 | 3,600 | — | — | 3,600 |

(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.

(3) See Note 6, Investment in NEC TOKIN, for a description of the NEC TOKIN options. The value of the options is interrelated and depends
on the enterprise value of NEC TOKIN Corporation and its forecasted EBITDA over the duration of the instruments. 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, 2014 | $3,600 |
| Change in value of NEC TOKIN options | 13,200 |
| December 31, 2014 | $16,800 |

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Inventories

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

| | December 31, 2014 | March 31, 2014 |
|---|---|---|
| Raw materials and supplies | $89,924 | $90,968 |
| Work in process | 52,981 | 61,310 |
| Finished goods | 64,300 | 62,522 |
| | 207,205 | 214,800 |
| Inventory reserves (1) | (19,591) | (26,826) |
| | $187,614 | $187,974 |

(1) During the quarter ended June 30, 2013, the Company recorded a $3.9 million reserve for inventory held by a third party. In the quarter ended June 30, 2014, this $3.9 million of inventory and the related reserve was written off. In the quarter ended December 31, 2014, the Company scrapped $1.8 million of fully reserved finished goods inventory to reclaim and recycle the tantalum raw material contained therein.

Warrant

As of December 31, 2014 and March 31, 2014, 8.4 million shares were subject to the warrant 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.

A portion of sales is related to products designed to meet customer specific requirements. These products typically have stricter tolerances making them useful to the specific customer requesting the product and to customers with similar or less stringent requirements. 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 from their local KEMET sales representative and apply only to a specific customer, part, specified special price amount, specified quantity, and is 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

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than 1.0% for the quarters and nine month periods ended December 31, 2014 and 2013. 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 $5.6 million on the sale of the business (after income tax expense) offset by a loss from machinery operations of $0.3 million during the nine month period ended December 31, 2014 resulting in net income from discontinued operations of $5.4 million.

Net sales and operating income (loss) from the Company's discontinued operation for the quarters and nine month periods ended December 31, 2014 and 2013 were (amounts in thousands):

| | Quarters Ended December 31, | | Nine Month Periods Ended December 31, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Net sales | $— | $1,711 | $104 | $6,668 |
| Operating income (loss) | — | (1,009) | (265) | (4,030) |

Note 3. Debt

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

| | December 31, 2014 | March 31, 2014 |
|---|---|---|
| 10.5% Senior Notes, net of premium of $2,634 and $3,144 as of December 31, 2014 and March 31, 2014, respectively | $357,634 | $358,144 |
| Advanced payment from OEM, net of discount of $323 as of March 31, 2014 | — | 20,095 |
| Revolving line of credit | 46,448 | 18,449 |
| Other | 521 | 1,901 |
| Total debt | 404,603 | 398,589 |
| Current maturities | (12,521) | (7,297) |
| Total long-term debt | $392,082 | $391,292 |