NOVANTA INC
Form 10-Q
August 08, 2018

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 June 29, 2018

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 No. 001-35083

Novanta Inc.

(Exact name of registrant as specified in its charter)

New Brunswick, Canada (State or other jurisdiction of incorporation or organization)	98-0110412 (I.R.S. Employer Identification No.)
125 Middlesex Turnpike	
Bedford, Massachusetts, USA (Address of principal executive offices)	01730 (Zip Code)

(781) 266-5700

(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 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 (Section 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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
		Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 August 3, 2018, there were 34,656,870 of the Registrant's common shares, no par value, issued and outstanding.

NOVANTA INC.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

NOVANTA INC.

CONSOLIDATED BALANCE SHEETS

(In thousands of U.S. dollars or shares)

(Unaudited)

	June 29, 2018	December 31, 2017
ASSETS		
Current assets		
Cash and cash equivalents	$107,261	$ 100,057
Accounts receivable, net of allowance of $347 and $554, respectively	76,747	81,482
Inventories	96,377	91,278
Prepaid income taxes and income taxes receivable	6,478	4,387
Prepaid expenses and other current assets	8,878	10,675
Total current assets	295,741	287,879
Property, plant and equipment, net	64,660	61,718
Deferred tax assets	6,747	7,052
Other assets	1,575	4,018
Intangible assets, net	154,714	155,048
Goodwill	218,324	210,988
Total assets	$741,761	$ 726,703
LIABILITIES, NONCONTROLLING INTEREST AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current portion of long-term debt	$9,127	$ 9,119
Accounts payable	42,505	39,793
Income taxes payable	2,191	5,942
Accrued expenses and other current liabilities	39,175	43,314
Total current liabilities	92,998	98,168
Long-term debt	228,306	225,500
Deferred tax liabilities	25,541	25,672
Income taxes payable	3,948	3,754
Other liabilities	14,996	15,141
Total liabilities	365,789	368,235
Commitments and contingencies (Note 14)		
Redeemable noncontrolling interest	51,606	46,923
Stockholders' equity:		
Common shares, no par value; Authorized shares: unlimited;	423,856	423,856

Issued and outstanding: 34,671 and 34,595, respectively		
Additional paid-in capital	31,794	33,309
Accumulated deficit	(112,167)	(127,740)
Accumulated other comprehensive loss	(19,117)	(17,880)
Total stockholders' equity	324,366	311,545
Total liabilities, noncontrolling interest and stockholders’ equity	$741,761	$ 726,703

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

NOVANTA INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands of U.S. dollars or shares, except per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017
Revenue	$150,400	$119,102	$297,365	$228,076
Cost of revenue	85,171	65,613	169,977	128,493
Gross profit	65,229	53,489	127,388	99,583
Operating expenses:				
Research and development and engineering	12,551	9,004	24,540	18,219
Selling, general and administrative	29,231	23,810	58,451	46,684
Amortization of purchased intangible assets	3,893	3,347	7,591	6,196
Restructuring, acquisition and divestiture related costs	2,439	1,581	2,464	2,398
Total operating expenses	48,114	37,742	93,046	73,497
Operating income	17,115	15,747	34,342	26,086
Interest income (expense), net	(2,561)	(1,435)	(4,919)	(2,763)
Foreign exchange transaction gains (losses), net	177	486	(230)	485
Other income (expense), net	(46)	(119)	(87)	(150)
Gain on acquisition of business	—	—	—	26,409
Income before income taxes	14,685	14,679	29,106	50,067
Income tax provision	3,060	4,689	4,644	5,803
Consolidated net income	11,625	9,990	24,462	44,264
Less: Net income attributable to noncontrolling interest	(625)	(588)	(1,551)	(610)
Net income attributable to Novanta Inc.	$11,000	$9,402	$22,911	$43,654
Earnings per common share attributable to Novanta Inc. (Note 5):				
Basic	$0.32	$0.16	$0.51	$1.15
Diluted	$0.32	$0.16	$0.50	$1.13
Weighted average common shares outstanding—basic	34,949	34,827	34,919	34,796
Weighted average common shares outstanding—diluted	35,474	35,463	35,451	35,294

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

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NOVANTA INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands of U.S. dollars)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017
Consolidated net income	$ 11,625	$ 9,990	$ 24,462	$ 44,264
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax (1)	(5,663)	3,589	(1,992)	5,029
Pension liability adjustments, net of tax (2)	871	(117)	755	88
Total other comprehensive income	(4,792)	3,472	(1,237)	5,117
Total consolidated comprehensive income	6,833	13,462	23,225	49,381
Less: Comprehensive income attributable to noncontrolling interest	(625)	(588)	(1,551)	(610)
Comprehensive income attributable to Novanta Inc.	$ 6,208	$ 12,874	$ 21,674	$ 48,771

(1) The tax effect on this component of comprehensive income was nominal for all periods presented.

(2) The tax effect on this component of comprehensive income was nominal for all periods presented. See Note 4 for the total amount of pension liability adjustments reclassified out of accumulated other comprehensive income (loss).

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

NOVANTA INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)

(Unaudited)

	Six Months Ended	
	June 29, 2018	June 30, 2017
Cash flows from operating activities:		
Consolidated net income	$24,462	$44,264
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Depreciation and amortization	18,187	13,576
Provision for inventory excess and obsolescence	1,165	1,439
Share-based compensation	3,780	2,787
Deferred income taxes	(1,221)	(2,495)
Earnings from equity-method investment	—	(104)
Gain on acquisition of business	—	(26,409)
Inventory acquisition fair value adjustment	—	1,035
Other	278	1,128
Changes in assets and liabilities which (used)/provided cash, excluding effects from businesses acquired:		
Accounts receivable	6,526	(2,360)
Inventories	(6,544)	(10,909)
Prepaid income taxes, income taxes receivable, prepaid expenses and other current assets	(619)	(2,026)
Accounts payable, income taxes payable, accrued expenses and other current liabilities	(5,094)	9,411
Other non-current assets and liabilities	(555)	185
Cash provided by operating activities	40,365	29,522
Cash flows from investing activities:		
Purchases of property, plant and equipment	(7,259)	(3,117)
Acquisition of businesses, net of cash acquired and working capital adjustments	(27,445)	(34,798)
Other investing activities	72	10
Cash used in investing activities	(34,632)	(37,905)
Cash flows from financing activities:		
Borrowings under revolving credit facility	30,272	42,000
Repayments of long-term debt and revolving credit facility	(21,832)	(8,750)
Payments of contingent considerations	—	(2,398)
Repurchase of common stock	(1,929)	(370)

Payments of withholding taxes from stock-based awards	(3,367)	(1,794)
Capital lease payments	(284)	(400)
Other financing activities	(148)	—
Cash provided by financing activities	2,712	28,288
Effect of exchange rates on cash and cash equivalents	(1,241)	1,113
Increase in cash and cash equivalents	7,204	21,018
Cash and cash equivalents, beginning of period	100,057	68,108
Cash and cash equivalents, end of period	$107,261	$89,126
Supplemental disclosure of cash flow information:		
Cash paid for interest	$4,424	$1,857
Cash paid for income taxes	$12,041	$9,750
Income tax refunds received	$599	$185

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

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF JUNE 29, 2018

(Unaudited)

1. Basis of Presentation

Novanta Inc. and its subsidiaries (collectively referred to as “Novanta”, the “Company”, “we”, “us”, “our”) is a leading global supplier of core technology solutions that give medical and advanced industrial original equipment manufacturers (“OEMs”) a competitive advantage. We combine deep proprietary technology expertise and competencies in photonics, vision and precision motion with a proven ability to solve complex technical challenges. This enables Novanta to engineer core components and sub-systems that deliver extreme precision and performance, tailored to our customers’ demanding applications.

The accompanying unaudited interim consolidated financial statements have been prepared by the Company in U.S. dollars and pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”), the instructions to Form 10-Q and the provisions of Regulation S-X pertaining to interim financial statements. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the U.S. have been condensed or omitted pursuant to such rules and regulations. The interim consolidated financial statements and notes included in this report should be read in conjunction with the financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. In the opinion of management, these interim consolidated financial statements include all adjustments and accruals of a normal and recurring nature necessary to fairly state the results of the interim periods presented. The results for interim periods are not necessarily indicative of results to be expected for the full year or for any future periods.

Prior to January 10, 2017, the Company had an approximately 41% ownership interest in Laser Quantum Limited (“Laser Quantum”), a privately held company located in the United Kingdom, which was accounted for under the equity method of accounting. On January 10, 2017, the Company acquired an additional approximately 35% of the outstanding shares of Laser Quantum. As a result of this transaction, the Company’s ownership position in Laser Quantum increased from approximately 41% to approximately 76%. Since January 10, 2017, Laser Quantum has been consolidated in the Company’s consolidated financial statements.

The Company’s unaudited interim financial statements are prepared for each quarterly period ending on the Friday closest to the end of the calendar quarter, with the exception of the fourth quarter which always ends on December 31.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting periods. Estimates and assumptions are reviewed on an on-going basis and the effects of revisions are reflected in the period in which they are deemed to be necessary. The Company evaluates its estimates based on historical experience, current conditions and various other assumptions that it believes are reasonable under the circumstances. Actual results could differ significantly from those estimates.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JUNE 29, 2018

(Unaudited)

Recent Accounting Pronouncements

The following table provides a brief description of recent Accounting Standard Updates ("ASU") issued by the Financial Accounting Standards Board ("FASB"):

Standard	Description	Effective Date	Effect on the Financial Statements or Other Significant Matters
In March 2018, the FASB issued ASU 2018-05, "Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118."	ASU 2018-05 allows SEC registrants to record provisional amounts in earnings for the year ended December 31, 2017 due to the complexities involved in accounting for the income tax effects of the U.S. Tax Cuts and Jobs Act (the "Tax Reform Act"). Companies have up to one year from the enactment of the Tax Reform Act (the "measurement period") to obtain, prepare, and analyze the information that is needed in order to complete the accounting under Accounting Standards Codification ("ASC") Topic 740. Any provisional amounts or adjustments to provisional amounts during the measurement period should be included in income from continuing operations as an adjustment to tax provision (benefit) in the reporting period in which the amounts are determined.	January 1, 2018.	The Company adopted ASU 2018-05 during the first quarter of 2018. See Note 12.
In February 2018, the FASB issued ASU 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income."	ASU 2018-02 allows an entity to reclassify the income tax effects of the Tax Reform Act on items within accumulated other comprehensive income to retained earnings. ASU 2018-02 shall be applied either in the period of adoption or retrospectively to each period (or periods) in which the effects of the change in the U.S. federal corporate income tax rate in the Tax Reform Act is recognized.	January 1, 2019. Early adoption is permitted.	The Company is currently evaluating the impact of ASU 2018-02 on its consolidated financial statements.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JUNE 29, 2018

(Unaudited)

Standard	Description	Effective Date	Effect on the Financial Statements or Other Significant Matters
In May 2017, the FASB issued ASU 2017-09, “Compensation – Stock Compensation (Topic 718).”	ASU 2017-09 requires that an entity account for the effects of a modification unless (i) the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; (ii) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (iii) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. ASU 2017-09 should be applied prospectively to an award modified on or after the adoption date.	January 1, 2018. Early adoption is permitted.	The Company adopted ASU 2017-09 during the first quarter of 2018. The adoption of ASU 2017-09 did not have a material impact on the Company’s consolidated financial statements.
In March 2017, the FASB issued ASU 2017-07, “Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.”	ASU 2017-07 requires employers that offer or maintain defined benefit plans to disaggregate the service component from the other components of net periodic benefit cost and provides guidance on the presentation of the service component and the other components of net periodic benefit cost in the statement of operations. ASU 2017-07 should be applied retrospectively for the presentation of net periodic benefit cost in the statement of operations.	January 1, 2018. Early adoption is permitted.	The Company retrospectively adopted ASU 2017-07 during the first quarter of 2018. The adoption of ASU 2017-07 resulted in the reclassification of $0.1 million and $0.3 million of the Company’s net periodic benefit cost related to its frozen U.K. pension plan from Selling, general and administrative expenses into Other income (expense) in the consolidated statement of operations for the three and six months ended June 30, 2017, respectively.
In October 2016, the FASB issued ASU 2016-16, “Income Taxes	ASU 2016-16 requires that an entity recognize the income tax consequences of an intra-entity	January 1, 2018. Early adoption is	The Company adopted ASU 2016-16 during the first quarter of 2018 using the modified retrospective approach.

(Topic 740): Intra-Entity Transfers of Assets Other Than Inventory."	transfer of an asset other than inventory in the period in which the transfer occurs. ASU 2016-16 shall 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.	permitted.	The adoption resulted in the reclassification of $2.5 million of prepaid income taxes and income taxes receivable, of which $2.2 million was recorded to Accumulated deficit and $0.3 million was recognized as net deferred tax assets, for the three months ended March 30, 2018. The Company will recognize incremental deferred income tax expense thereafter as these net deferred tax assets are utilized.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JUNE 29, 2018

(Unaudited)

Standard	Description	Effective Date	Effect on the Financial Statements or Other Significant Matters
In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers – Deferral of the Effective Date."	ASU 2014-09 supersedes the revenue recognition requirements in ASC Topic 605, "Revenue Recognition," and requires entities to recognize revenue in a way that depicts the transfer of goods or services to customers at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgements and changes in judgements and assets recognized from costs incurred to fulfill a contract. ASU 2015-14 deferred the effective date of ASU 2014-09 by one year.	January 1, 2018.	The Company adopted ASU 2014-09 during the first quarter of 2018 using the modified retrospective method. ASU 2014-09 has been applied to those contracts which were not completed as of January 1, 2018 and all new contracts entered into by the Company subsequent to January 1, 2018. All prior period financial statements and disclosures are presented in accordance with Topic 605. The adoption of ASU 2014-09 did not have an impact on the Company's Accumulated deficit. See Note 2.
In January 2017, the FASB issued ASU 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment."	ASU 2017-04 simplifies the accounting for goodwill impairment by removing Step-two of the goodwill impairment test, which requires a hypothetical purchase price allocation. ASU 2017-04 should be applied on a prospective basis.	January 1, 2020. Early adoption is permitted.	The Company adopted ASU 2017-04 during the second quarter of 2018. The adoption of ASU 2017-04 had no impact on the Company's consolidated financial statements.
In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities."	ASU 2017-12 amends and simplifies existing guidance in order to better align a company's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results in the financial statements. ASU 2017-12 should	January 1, 2019. Early adoption is permitted.	The Company does not expect the adoption of ASU 2017-12 to have a material impact on its consolidated financial statements.

	be applied to hedging relationships existing on the date of adoption. The effect of the adoption should be reflected as of the beginning of the fiscal year of adoption.		
In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." In July 2018, the FASB issued ASU 2018-11, "Leases (Topic 842) – Targeted Improvements."	ASU 2016-02 requires a lessee to recognize on the balance sheet a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term for both finance and operating leases and to disclose key information about leasing arrangements. ASU 2016-02 should be applied as of the beginning of the earliest period presented in the financial statements using a modified retrospective approach. ASU 2018-11 provides an additional (and optional) transition method which allows entities to apply ASU 2016-02 as of the adoption date and recognize a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption.	January 1, 2019. Early adoption is permitted.	As a result of the new standard, all of the Company's leases longer than one year in duration will be recognized on the consolidated balance sheet as right-of-use assets with offsetting lease liabilities upon adoption of the standard. The Company has completed a qualitative assessment of its lease portfolio and is in the process of implementing a lease accounting software tool, collecting data and designing processes and controls to account for leases in accordance with the new standard. The Company plans to adopt the standard effective January 1, 2019 but has not yet selected a transition method.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JUNE 29, 2018

(Unaudited)

2. Revenue

The Company recognizes revenue when control of promised goods or services is transferred to customers. The transfer of control generally occurs upon shipment, which is when title and risk of loss pass to the customer. The vast majority of the Company's revenue is generated from the sale of distinct products. Revenue is measured as the amount of consideration the Company expects to receive in exchange for such products, which is generally at contractually stated prices. Sales taxes and value added taxes collected concurrently with revenue generating activities are excluded from revenue.

Performance Obligations

Substantially all of the Company's revenue is recognized at a point in time, upon shipment, rather than over time.

At the request of its customers, the Company may perform professional services, generally for the maintenance and repair of products previously sold to those customers and engineering services. Professional services are typically short in duration, mostly less than one month, and total less than 3% of the Company's consolidated revenue. Revenue is typically recognized at a point in time when control transfers to the customer upon completion of professional services. These services generally involve a single distinct performance obligation. The consideration expected to be received in exchange for such services is normally the contractually stated amount.

The Company occasionally sells separately priced non-standard/extended warranty services or preventative maintenance plans with the sale of products. The transfer of control over the service plans is over time. The Company recognizes the related revenue ratably over the terms of the service plans. The transaction price of a contract is allocated to each performance obligation based on its relative standalone selling price. Standalone selling prices are generally determined based on the prices charged to customers or using the expected cost plus a margin.

The Company accounts for shipping and handling activities that occur after the transfer of control over the related goods as fulfillment activities rather than performance obligations. The shipping and handling fees charged to customers are recognized as revenue and the related costs are recorded in cost of revenue at the time of transfer of control.

Accounts Receivable

Credit is extended based upon an evaluation of the customer's financial condition. Accounts receivable are stated at their estimated net realizable value. The allowance for doubtful accounts is based on a variety of factors, including the age of amounts outstanding relative to their contractual due date, specific customer factors, and other known risks and economic trends. Standard payment terms are typically 30 days after shipment and may vary by the type and geographic location of the customer.

Warranties

The Company generally provides warranties for its products. The standard warranty period is typically 12 months to 24 months for the Photonics and Precision Motion segments and 12 months to 36 months for the Vision segment. The standard warranty period for product sales is accounted for under the provisions of ASC 450, "Contingencies," as the Company has the ability to ascertain the likelihood of the liability and can reasonably estimate the amount of the liability. A provision for the estimated cost related to warranty is recorded to cost of revenue at the time revenue is recognized. The Company's estimate of costs to service the warranty obligations is based on historical experience and expectations of future conditions. To the extent that the Company's experience in warranty claims or costs associated with servicing those claims differ from the original estimates, revisions to the estimated warranty liability are recorded at that time, with an offsetting adjustment to cost of revenue.

Practical Expedients and Exemptions

The Company expenses incremental direct costs of obtaining a contract when incurred if the expected amortization period is one year or less. These costs are recorded within selling, general and administrative expenses in the consolidated statement of operations.

The Company does not adjust the promised amount of consideration for the effects of a financing component because the transfer of a promised good to a customer and the customer's payment for that good are typically one year or less.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JUNE 29, 2018

(Unaudited)

The Company does not disclose the value of the remaining performance obligation for contracts with an original expected length of one year or less.

Contract Liabilities

Contract liabilities consist of deferred revenue and advance payments from customers, including amounts that are refundable. These contract liabilities are classified as either current or long-term in the consolidated balance sheet based on the timing of when the Company expects to recognize revenue. As of June 29, 2018 and January 1, 2018 (the date of adoption of Topic 606), contract liabilities were $5.1 million and $5.4 million, respectively, and are included in accrued expenses and other current liabilities and other liabilities in the accompanying consolidated balance sheets. The decrease in the contract liability balance during the six months ended June 29, 2018 is primarily due to $2.4 million of revenue recognized during the period that was included in the contract liability balance at the date of adoption, partially offset by cash payments received in advance of satisfying performance obligations.

Disaggregated Revenue

See Note 17 for the Company’s disaggregation of revenue by segment, geography and end market.

3. Business Combinations

Zettlex

On May 1, 2018, the Company acquired 100% of the outstanding stock of Zettlex Holdings Limited (“Zettlex”), a Cambridge, United Kingdom-based provider of inductive encoder products that can provide absolute and accurate positioning, even in extreme operating environments, to OEMs in the medical and advanced industrial markets. The purchase price of £22.7 million ($31.2 million), subject to customary working capital adjustments, was financed with cash on hand and the Company’s revolving credit facility. The addition of Zettlex is expected to broaden the range of components and solutions that the Company can provide to customers by combining its commercial resources and application-specific competencies with Zettlex's technologies and strong team. Zettlex is included in the Company’s Precision Motion reportable segment.

The acquisition of Zettlex has been accounted for as a business combination. The allocation of the purchase price is based upon a valuation of assets acquired and liabilities assumed. Assets acquired and liabilities assumed have been recorded at their estimated fair values as of the acquisition date. The fair values of intangible assets were based on valuations using an income approach, with estimates and assumptions provided by management of Zettlex and the

Company. The process for estimating the fair values of identifiable intangible assets requires the use of significant estimates and assumptions, including estimating future cash flows and developing appropriate discount rates. The excess of the purchase price over the tangible assets, identifiable intangible assets and assumed liabilities was recorded as goodwill. The Company’s estimates and assumptions in determining the estimated fair values of certain assets and liabilities are subject to change within the measurement period (up to one year from the acquisition date) as a result of additional information obtained with regards to facts and circumstances that existed as of the acquisition date. The purchase price allocation is preliminary as the Company is in the process of collecting additional information for the valuation of property, plant and equipment, intangible assets, other liabilities and unrecognized tax benefits.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JUNE 29, 2018

(Unaudited)

Based upon a preliminary valuation, the total purchase price was allocated as follows (in thousands):

	Purchase Price Allocation
Cash	$ 3,776
Accounts receivable	2,237
Inventories	928
Property, plant and equipment	2,590
Intangible assets	14,585
Goodwill	10,844
Other assets	145
Total assets acquired	35,105
Accounts payable	509
Accrued expenses and other liabilities	894
Deferred tax liabilities	2,481
Total liabilities assumed	3,884
Total assets acquired, net of liabilities assumed	31,221
Less: cash acquired	3,776
Total purchase price, net of cash acquired	$ 27,445

The fair value of intangible assets is comprised of the following (dollar amounts in thousands):

	Estimated Fair Value	Weighted Average Amortization Period
Developed technologies	$ 3,027	10 years
Customer relationships	9,494	15 years
Trademarks and trade names	550	10 years
Backlog	1,514	1 year
Total	$ 14,585	

The purchase price allocation resulted in $14.6 million of identifiable intangible assets and $10.8 million of goodwill. As the Zettlex acquisition is an acquisition of outstanding common shares, none of the resulting goodwill is deductible for tax purposes. Intangible assets are being amortized over their weighted average useful lives primarily based upon the pattern in which anticipated economic benefits from such assets are expected to be realized. The goodwill recorded represents the anticipated incremental value of future cash flows potentially attributable to: (i) Zettlex’s ability to grow its business with existing and new customers, including leveraging the Company’s customer base; and (ii) cost improvements due to the integration of Zettlex operations into the Company’s existing infrastructure.

The operating results of Zettlex were included in the Company’s results of operations beginning on May 1, 2018. Zettlex contributed revenues of $1.8 million and a loss before income taxes of $0.6 million for the six months ended June 29, 2018. Loss before income taxes for the six months ended June 29, 2018 included amortization of purchased intangible assets of $0.3 million and compensation expense of $1.1 million recognized under earn-out agreements.

The pro forma financial information reflecting the operating results of Zettlex, as if it had been acquired as of January 1, 2017, would not differ materially from the operating results of the Company as reported for the year ended December 31, 2017.

Acquisition Costs

Acquisition-related costs are included in restructuring, acquisition and divestiture related costs in the consolidated statements of operations. Acquisition-related costs for Zettlex were $0.2 million for the six months ended June 29, 2018.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JUNE 29, 2018

(Unaudited)

4. Accumulated Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) was as follows (in thousands):

	Total Accumulated Other Comprehensive Income (Loss)	Cumulative Translation Adjustments	Pension Liability Adjustments
Balance at December 31, 2017	$ (17,880)	$ (8,313)	$ (9,567)
Other comprehensive income (loss)	(1,726)	(1,992)	266
Amounts reclassified from accumulated other comprehensive income (loss) (1)	489	—	489
Balance at June 29, 2018	$ (19,117)	$ (10,305)	$ (8,812)

(1) The amounts reclassified from other comprehensive income (loss) were included in other income (expense), net in the consolidated statements of operations.

5. Earnings per Common Share

Earnings per common share is computed by dividing net income attributable to Novanta Inc., after adjustment of redeemable noncontrolling interest to estimated redemption value, by the weighted average number of common shares outstanding during the period. The Company recognizes changes in the redeemable noncontrolling interest redemption value by adjusting the carrying amount of the redeemable noncontrolling interest as of the end of the period to the higher of: (i) the estimated redemption value assuming the end of the period is also the redemption date or (ii) the carrying value without any redemption value adjustments. Such adjustments are recorded in retained earnings in stockholders' equity instead of net income attributable to Novanta Inc. For both basic and diluted earnings per common share, such redemption value adjustments are included in the calculation of the numerator. For diluted earnings per common share, the denominator also includes the dilutive effect of outstanding restricted stock units, stock options, non-GAAP EPS performance-based restricted stock units and total shareholder return performance-based restricted stock units determined using the treasury stock method. Dilutive effects of contingently issuable shares are included in the weighted average dilutive share calculation using the treasury stock method when the contingencies have been resolved. For periods in which net losses are generated, the dilutive potential common shares are excluded from the calculation of diluted earnings per common share as the effect would be anti-dilutive.

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NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JUNE 29, 2018

(Unaudited)

The following table sets forth the computation of basic and diluted earnings per common share (amounts in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017
Numerators:				
Consolidated net income	$ 11,625	$ 9,990	$ 24,462	$ 44,264
Less: Net income attributable to noncontrolling interest	(625)	(588)	(1,551)	(610)
Net income attributable to Novanta Inc.	11,000	9,402	22,911	43,654
Decrease (increase) in estimated redemption value of redeemable noncontrolling interest (see Note 15)	303	(3,718)	(5,096)	(3,718)
Net income attributable to Novanta Inc. after adjustment of redeemable noncontrolling interest to estimated redemption value	$ 11,303	$ 5,684	$ 17,815	$ 39,936
Denominators:				
Weighted average common shares outstanding— basic	34,949	34,827	34,919	34,796
Dilutive potential common shares	525	636	532	498
Weighted average common shares outstanding— diluted	35,474	35,463	35,451	35,294
Antidilutive common shares excluded from above	—	—	6	—
Earnings per Common Share Attributable to Novanta Inc.:				
Basic	$ 0.32	$ 0.16	$ 0.51	$ 1.15
Diluted	$ 0.32	$ 0.16	$ 0.50	$ 1.13

Common Share Repurchases

During the six months ended June 29, 2018, the Company repurchased 30 thousand of its common shares in the open market for an aggregate purchase price of $1.9 million at an average price of $63.88 per share.

6. Fair Value Measurements

ASC 820, “Fair Value Measurements,” establishes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the third is considered unobservable:

- Level 1: Quoted prices for identical assets or liabilities in active markets which the Company can access.
- Level 2: Observable inputs other than those described in Level 1.
- Level 3: Unobservable inputs.

Cash Equivalents

The Company’s cash equivalents are highly liquid investments with original maturities of three months or less, which represent an asset the Company measures at fair value on a recurring basis. The Company determines the fair value of cash equivalents using a market approach based on quoted prices in active markets. The fair values of cash, accounts receivable, income taxes receivable, accounts payable, income taxes payable and accrued expenses and other current liabilities approximate their carrying values because of their short-term nature.

Foreign Currency Contracts

The Company addresses market risks from changes in foreign currency exchange rates through a risk management program that includes the use of derivative financial instruments to mitigate certain balance sheet foreign currency transaction exposures. The

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JUNE 29, 2018

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Company uses foreign currency forward contracts as a part of its strategy to manage exposures related to foreign currency denominated monetary assets and liabilities.

Contingent Consideration

On December 14, 2016, the Company acquired certain video signal processing and management technologies used in medical visualization solutions. Under the purchase and sale agreement, the owners are eligible to receive contingent consideration based on the achievement of certain revenue targets from 2018 to 2021. The undiscounted range of possible contingent consideration is zero to €5.5 million ($6.6 million). If such targets are achieved, the contingent consideration would be payable in cash in four installments from 2019 to 2022. As the acquired assets did not meet the definition of a business, the fair value of the contingent consideration is recognized when probable and estimable and is capitalized as part of the cost of the acquired assets. In December 2017, the Company recorded an estimated fair value of $1.3 million in contingent consideration, which is reported as a long-term liability in other liabilities on the consolidated balance sheet as of December 31, 2017. Based on the most recent projected revenues for fiscal years 2018 to 2021, the fair value of the contingent consideration was adjusted to $2.4 million, which is reported as a long-term liability in other liabilities on the consolidated balance sheet as of June 29, 2018.

On February 19, 2015, the Company acquired Applimotion Inc. (“Applimotion”). Under the purchase and sale agreement for the Applimotion acquisition, the shareholders of Applimotion were eligible to receive contingent consideration based on the achievement of certain revenue targets for fiscal years 2015 to 2017. If such targets were achieved, the contingent consideration would be payable in cash in two installments in 2017 and 2018, respectively. The estimated fair value of the contingent consideration of $1.0 million was determined based on the Monte Carlo valuation method and was recorded as part of the purchase price as of the acquisition date. As a result of Applimotion’s fiscal year 2015 and 2016 revenue results, $1.2 million in contingent consideration was paid in the first quarter of 2017. Based on Applimotion’s fiscal year 2016 and 2017 revenue results, the fair value for the remaining contingent consideration was adjusted to $2.8 million as of December 31, 2017. The Company paid $2.8 million as the final Applimotion contingent consideration payment in January 2018.

The following table summarizes the fair values of the Company’s financial assets and liabilities as of June 29, 2018 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash equivalents	$ 2,987	$ 2,987	$ —	$ —
Prepaid expenses and other current assets:				
Foreign currency forward contracts	9	—	9	—

	$ 2,996	$ 2,987	$ 9	$ —
Liabilities				
Accrued expenses and other current liabilities:				
Foreign currency forward contracts	$ 36	$ —	$ 36	$ —
Other liabilities:				
Contingent consideration - Long-term	2,438	—	—	2,438
	$ 2,474	$ —	$ 36	$ 2,438

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JUNE 29, 2018

(Unaudited)

The following table summarizes the fair values of the Company’s financial assets and liabilities as of December 31, 2017 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash equivalents	$ 2,665	$ 2,665	$ —	$ —
Prepaid expenses and other current assets:				
Foreign currency forward contracts	150	—	150	—
	$ 2,815	$ 2,665	$ 150	$ —
Liabilities				
Accrued expenses and other current liabilities:				
Contingent consideration - Current	$ 2,800	$ —	$ —	$ 2,800
Foreign currency forward contracts [1]	—	—	—	—
Other liabilities:				
Contingent consideration - Long-term	1,304	—		