ARC Group Worldwide, Inc.
Form 10-Q
November 05, 2015
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 - Q

x QUARTERLY REPORT PURSUANT SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 27, 2015

OR

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

For the transition period from to

ARC Group Worldwide, Inc.

(Exact name of registrant as specified in its charter)

Utah

(State or other jurisdiction of incorporation or organization)

001-33400	**87-0454148**
(Commission File Number)	(IRS Employer Identification Number)

810 Flightline Blvd.

Deland, FL 32724

(Address of principal executive offices including zip code)

(303) 467-5236

(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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Date File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes x No 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 small reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	Smaller reporting company x

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

As of November 2, 2015, the Registrant had 19,029,297 shares outstanding of its $.0005 par value common stock.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ARC Group Worldwide, Inc.

Unaudited Condensed Consolidated Statements of Operations

(in thousands, except for share and per share amounts)

	For the three months ended			
		September 27, 2015		September 28, 2014
Sales	$	24,489	$	28,698
Cost of sales		20,005		21,715
Gross profit		4,484		6,983
Selling, general and administrative		4,213		5,499
Merger expense				176
Income from operations		271		1,308
Other income (expense), net		3		(2)
Interest expense, net		(1,141)		(921)
(Loss) income before income taxes		(867)		385
Income tax benefit (expense)		426		(153)
Net (loss) income		(441)		232
Less: Net income attributable to non-controlling interest		(29)		(56)
Net (loss) income attributable to ARC Group Worldwide, Inc.	$	(470)	$	176
Net (loss) income per common share:				
Basic and diluted (loss) income per share	$	(0.03)	$	0.01
Weighted average common shares outstanding:				
Basic and diluted		18,123,883		14,673,205

See accompanying notes to the unaudited condensed consolidated financial statements.

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ARC Group Worldwide, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except for share and per share amounts)

	September 27, 2015 (unaudited)	June 30, 2015
ASSETS		
Current assets:		
Cash	$ 4,146	$ 4,821
Accounts receivable, net	14,406	15,385
Inventories, net	16,982	16,386
Deferred tax assets	637	672
Prepaid and other current assets	3,263	2,330
Total current assets	39,434	39,594
Property and equipment, net	42,925	43,813
Goodwill	14,801	14,801
Intangible assets, net	25,597	26,441
Other	1,346	1,374
Total assets	$ 124,103	$ 126,023
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 8,350	$ 7,338
Accrued expenses	2,149	3,026
Deferred revenue	847	991
Bank borrowings, current portion of long-term debt	6,348	5,995
Capital lease obligations, current portion	882	857
Accrued escrow obligation	4,291	4,291
Total current liabilities	22,867	22,498
Long-term debt, net of current portion	50,207	51,971
Deferred taxes	2,217	2,029
Capital lease obligations, net of current portion	2,670	2,784
Total liabilities	77,961	79,282
Commitments and contingencies (Note 11)		
Stockholders equity:		
Preferred stock, $0.001 par value, 2,000,000 authorized, no shares issued and outstanding		
Common stock, $0.0005 par value, 250,000,000 shares authorized; 19,037,698 shares issued and 19,029,297 shares issued and outstanding at September 27, 2015, and 18,538,522 shares issued and 18,530,121 shares issued and outstanding at June 30, 2015	5	5
Treasury stock, at cost; 8,401 shares at September 27, 2015 and June 30, 2015	(94)	(94)
Additional paid-in capital	29,658	29,751
Retained earnings	15,461	15,931
Accumulated other comprehensive loss	(21)	(58)
ARC Group Worldwide, Inc. total stockholder equity	45,009	45,535
Non-controlling interest	1,133	1,206
Total stockholders equity	46,142	46,741
Total liabilities and stockholders equity	$ 124,103	$ 126,023

See accompanying notes to the unaudited condensed consolidated financial statements

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ARC Group Worldwide, Inc.

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)

	For the three months ended September 27, 2015	September 28, 2014
Cash flows from operating activities:		
Net (loss) income	$ (441)	$ 232
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,362	2,311
Bad debt expense and other	5	29
Deferred income taxes	150	23
Changes in working capital:		
Accounts receivable	974	(277)
Inventory	(596)	(1,068)
Prepaid expenses and other assets	(815)	(600)
Accounts payable	962	(2,474)
Other accrued expenses	(950)	(558)
Deferred revenue	(145)	(164)
Net cash provided by (used in) operating activities	1,506	(2,546)
Cash flows from investing activities:		
Purchase of plant and equipment	(629)	(2,457)
Net cash used in investing activities	(629)	(2,457)
Cash flows from financing activities:		
Proceeds from debt issuance		3,500
Repayments of long-term debt and capital lease obligations	(1,589)	(569)
Net cash (used in) provided by financing activities	(1,589)	2,931
Effect of exchange rates on cash	37	
Net decrease in cash	(675)	(2,072)
Cash, beginning of period	4,821	9,384
Cash, end of period	$ 4,146	$ 7,312
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 1,050	$ 843
Cash paid for income taxes	$ 123	$ 25

See accompanying notes to the unaudited condensed consolidated financial statements.

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Notes to Unaudited Condensed Consolidated Financial Statements

NOTE 1 General Information

Organization and Nature of Business

ARC Group Worldwide, Inc. (referred to herein as the Company or ARC) was organized under the laws of the State of Utah on September 30, 1987.

On August 8, 2012, ARC completed the acquisition of Quadrant Metals Technology, LLC (referred to herein as QMT or the Predecessor) and Advanced Forming Technology (AFT). QMT was formed in March 2011, to function as a holding company for a group of diversified manufacturing and distribution companies. Upon formation, QMT acquired controlling interests in TeknaSeal LLC (TeknaSeal) as of May 1, 2011 and in FloMet LLC (FloMet) as of June 30, 2011. In addition, QMT acquired General Flange & Forge (GF&F) as of April 18, 2011 and has held controlling interests in GF&F since that date. While QMT was formed in 2011 as a holding company, affiliated companies have held controlling interests in FloMet and TeknaSeal for over 10 years.

AFT is comprised of two operating units, AFT-U.S. and AFT Hungary. AFT-U.S. was founded in 1987. From 1991 until its acquisition by ARC on August 8, 2012, AFT was operated as a division of Precision Castparts Corp., a publicly traded company. In April 2014, ARC acquired in separate transactions Advance Tooling Concepts, LLC (ATC) and Thixoforming LLC (Thixoforming). In June 2014, ARC acquired substantially all of the assets of Kecy Corporation and 411 Munson Holding (collectively referred to as Kecy).

Everest Hill Group Inc. (Everest Hill Group) has been our major stockholder since 2008. ARC, Everest Hill Group, Quadrant Management Inc. (QMI), and QMT are under common control.

Basis of Presentation and Principles of Consolidation

The Company s fiscal year begins July 1 and ends June 30, and the quarters for interim reporting consist of thirteen weeks, therefore, the quarter end will not always coincide with the date of the calendar month-end.

The Consolidated Financial Statements include the amounts of ARC and its controlled subsidiaries. All material intercompany transactions have been eliminated in consolidation. The Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

NOTE 2 Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenue and expenses during the reporting period. Estimates are used for, among other things: allowances for doubtful accounts; inventory write-downs; valuation allowances for deferred tax assets; uncertain tax positions; valuation and useful lives of long-term assets including property, equipment, intangible assets, and goodwill; contingencies; and the fair value of assets and liabilities obtained in business combinations. Due to the inherent uncertainties in making estimates, actual results could differ from those estimates and such differences may be material to the consolidated financial statements.

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Cash

The Company places its cash with high-credit-quality financial institutions and does not believe it is exposed to any significant credit risk on cash. However, cash in the bank may, at times, exceed FDIC insurable limits.

Cash is held in financial institutions outside the United States to support existing operations and planned growth totaled $1.0 million and $1.5 million as of September 27, 2015 and June 30, 2015, respectively. The Company s Hungarian subsidiary, where these funds are held, is taxed in a similar manner to its domestic subsidiaries. Thus, the Company would not incur a tax obligation should it decide to repatriate these funds.

Inventories

Inventories are stated at the lower of average cost using the first-in, first-out (FIFO) method or market. It is the Company s practice to provide a valuation allowance for inventories to account for actual market pricing deflation and inventory shrinkage. Management actively reviews this inventory to determine that all materials are for products still in production to determine any potential obsolescence issues.

Plant and Equipment

Plant and equipment are stated at cost or acquisition date fair value less accumulated depreciation. Depreciation is recognized on a straight-line basis over the estimated useful lives of the related assets. Major additions and improvements are capitalized, while replacements, maintenance, and repairs, which do not improve or extend the life of the respective assets, are expensed as incurred.

Goodwill, Intangibles, and Other Long-lived Assets

Goodwill and indefinite-lived intangible assets are reviewed for impairment at least annually in June of each fiscal year, or more frequently if a triggering event occurs between impairment testing dates. The Company s impairment assessment begins with a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. The qualitative assessment includes comparing the overall financial performance of the reporting units against historical financial results. Additionally, each reporting unit s fair value is assessed in light of certain events and circumstances, including macroeconomic conditions, industry and market considerations, and other relevant entity- and reporting unit-specific events. If it is determined under the qualitative assessment that it is more likely than not that the fair value of a reporting unit is less than its carrying value, then a two-step quantitative impairment test is performed. Under the first step, the estimated fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. If the estimated fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit s goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation in acquisition accounting. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit under the two-step assessment is determined using a discounted cash flow analysis. The

selection and assessment of qualitative factors used to determine whether it is more likely than not that the fair value of a reporting unit exceeds the carrying value involves significant judgments and estimates. There were no impairments of goodwill during the quarters ended September 27, 2015 or September 28, 2014.

Intangible assets (identified as patents, trademarks, customer relationships, non-compete agreements and other) are recorded at fair value at the time of acquisition. Finite-lived intangibles are stated at cost less accumulated amortization. Amortization is recorded using the straight-line method, which approximates the expected pattern of economic benefit, over the estimated lives of the assets.

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The Company reviews the carrying value of its long-lived tangible and finite-lived intangible assets whenever events or changes in circumstances indicate that the carrying amount of the asset group may not be recoverable. Factors that would require an impairment assessment include, among other things, a significant change in the extent or manner in which an asset is used, a continual decline in the Company s operating performance, or as a result of fundamental changes in a subsidiary s business condition.

Recoverability of long-lived assets is measured by comparing their carrying amount to the projected cash flows the assets are expected to generate. If such assets are considered to be impaired, the impairment loss recognized, if any, is the amount by which the carrying amount of the finite-lived intangible assets exceeds fair value. There were no impairments of long-lived assets during the quarters ended September 27, 2015 or September 28, 2014.

Escrow Payable

On April 7, 2014, the Company acquired the member interests of Advance Tooling Concepts (ATC) for approximately $24.3 million, of which: (i) $21.9 million was paid in cash; and (ii) $2.4 million, consisting of 233,788 newly issued shares of the Company, was to be held in escrow for a period of 12 months (referred to herein as the ATC Escrow) to satisfy certain working capital adjustments and/or indemnification obligations. In July 2014, the ATC Escrow was reduced by $0.7 million following the completion of a working capital adjustment. The common stock issued for purposes of the ATC Escrow was deemed to be mandatorily redeemable and the Company therefore recorded $1.7 million as a current liability in the accompanying balance sheet as of September 27, 2015. Subsequent to the period covered by this report, the Company entered into an agreement to settle and terminate the ATC Escrow in cash pursuant to which the ATC Escrow shares will be returned to the Company and placed into treasury.

On June 25, 2014, the Company acquired substantially all of the assets of Kecy Corporation and 411 Munson Holding (referred to herein as the Kecy) for approximately $26.8 million, of which: (i) $24.2 million was paid in cash; and (ii) $2.6 million, consisting of 172,450 newly issued shares of the Company was placed into escrow for a period of 18 months (referred to herein as the Kecy Escrow) to satisfy certain working capital adjustments and/or indemnification obligations. The Company has determined the common stock issued is mandatorily redeemable and has therefore recorded $2.6 million as a current liability in the accompanying balance sheet as of September 27, 2015. In August 2015 and in connection with the change in the Company s stock price since the date of inception of the escrow, the Company issued 499,176 additional shares for security of the escrow. Subsequent to the period covered by this report, the Company has initiated procedures to settle and terminate the Kecy Escrow.

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Revenue Recognition

Revenue is measured at the fair value of the consideration received or receivable net of sales tax, trade discounts and customer returns. The Company recognizes revenue when the earnings process is complete. This generally occurs when products are shipped to the customer in accordance with the contract or purchase order, ownership and risk of loss have passed to the customer, collectability is reasonably assured, and pricing is fixed and determinable. In instances where title does not pass to the customer upon shipment, the Company recognizes revenue upon delivery or customer acceptance, depending on terms of the sales agreement. Service sales, representing maintenance and engineering activities, are recognized as services are performed. Products are generally shipped free-on-board from our facilities, the customer pays freight costs and assumes all liability.

Research and Development Costs

Research and development costs are expensed as incurred. The majority of these expenditures consist of salaries for engineering and manufacturing personnel, and outside services. For the quarters ended September 27, 2015 and September 28 2014, the Company incurred $60 thousand and $360 thousand, respectively, for research and development, which is included in selling, general and administrative expenses on the accompanying statements of operations.

Non-Controlling Interest

In connection with the acquisitions of FloMet and TeknaSeal, the Company obtained a majority interest in the subsidiaries and control of the subsidiaries boards of directors. Effective July 1, 2015, the Company purchased approximately 1.9% of the outstanding non-controlling shares of Tekna Seal. At September 27, 2015, third party investors owned approximately 3.8% of the outstanding shares of FloMet and approximately 4.3% of the outstanding shares of TeknaSeal. At September 28, 2014, third party investors owned approximately 3.8% of the outstanding shares of FloMet and approximately 6.2% of the outstanding shares of Tekna Seal. Accordingly, the Consolidated Financial Statements include the financial position of these subsidiaries as of September 27, 2015 and June 30, 2015, and the results of operations of these subsidiaries since the dates of acquisitions. The Company has recognized the carrying value of the non-controlling interests as a component of stockholders equity.

Comprehensive Income

For each of the quarters ended September 27, 2015 and September 28, 2014, there were no material differences between net income (loss) and comprehensive income (loss).

Recent Accounting Pronouncements

From time to time, the FASB or other standard setting bodies issue new accounting pronouncements. Updates to the ASC are communicated through issuance of an *Accounting Standards Update* (ASU).

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers: Topic* 606 (ASU 2014-09), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In August 2015, the FASB issued ASU 2015-14 which defers the effective date for one year beyond the originally specified effective date. ASU 2014-09 is effective in the Company s first quarter of fiscal 2018 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (ii) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial

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application and providing certain additional disclosures as defined per ASU 2014-09. The Company is currently evaluating the impact, if any, of its pending adoption of ASU 2014-09 on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs.* The standard requires debt issuance costs to be presented in the balance sheet as a direct deduction from the associated debt liability, consistent with the presentation for debt discounts. The standard must be applied on a retrospective basis and is effective for the Company beginning on January 1, 2016. Early adoption is permitted. The adoption of this standard is a change in financial statement presentation only and will not have a material impact on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, *Customers Accounting for Fees Paid in a Cloud Computing Arrangement.* The standard amends internal use software guidance to clarify how customers in cloud computing arrangements should determine whether the arrangement includes a software license. It also eliminates the requirement to analogize to the lease guidance when determining the asset acquired in a software licensing arrangement. The standard may be applied retrospectively or prospectively and is effective for the Company beginning on January 1, 2016. Early adoption is permitted. The Company is evaluating the impact, if any, of adopting this standard on its consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, *Simplifying the Measurement of Inventory*. This ASU applies to inventory that is measured using first-in, first-out (FIFO) or average cost. Under the updated guidance, an entity should measure inventory that is within scope at the lower of cost and net realizable value, which is the estimated selling prices in the ordinary course of business, less reasonably predicable costs of completion, disposal and transportation. This ASU is effective for annual and interim periods beginning after December 15, 2016, and should be applied prospectively with early adoption permitted at the beginning of an interim and annual reporting period. The Company is evaluating the impact, if any, of adopting this standard on its consolidated financial statements.

NOTE 3 - Fair Value Measurements

The fair value guidance establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels of inputs are defined as follows:

- Level 1 - quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 - quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

- Level 3 - unobservable inputs when little or no market data is available.

A financial instrument s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

There were no transfers of assets or liabilities between levels in the valuation hierarchy during the periods ended September 27, 2015 and June 30, 2015.

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NOTE 4 Inventory

Inventories consisted of the following (in thousands):

	September 27, 2015	June 30, 2015
Raw materials and supplies	$ 6,118	$ 5,723
Work-in-process	6,802	7,335
Finished goods	4,825	4,224
	17,745	17,282
Less: Reserve for obsolescence	(763)	(896)
	$ 16,982	$ 16,386

NOTE 5 Plant and Equipment

Plant and equipment consisted of the following (in thousands):

	Depreciable Life (in years)	September 27, 2015	June 30, 2015
Land		$ 1,264	$ 1,264
Building and improvements	7 - 40	18,822	18,811
Machinery and equipment	3 - 12	41,552	39,422
Office furniture and equipment	3 - 10	741	931
Construction-in-process		557	1,934
		62,936	62,362
Less: Accumulated depreciation		(20,011)	(18,549)
		$ 42,925	$ 43,813

Depreciation expense totaled $1.5 million and $1.4 million in the three month periods ended September 27, 2015 and September 28, 2014, respectively.

NOTE 6 Intangible Assets

The following table summarizes the Company s intangible assets as follows (in thousands):

As of September 27, 2015	As of June 30, 2015

Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization