

PHOTRONICS INC
Form 10-Q
June 05, 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 April 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 number 0-15451

PHOTRONICS, INC.
(Exact name of registrant as specified in its charter)

Connecticut 06-0854886
(State or other jurisdiction of incorporation or organization) (IRS Employer Identification No.)

15 Secor Road, Brookfield, Connecticut 06804
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (203) 775-9000

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 periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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. (Check one):

Large Accelerated Filer	Accelerated Filer
Non-Accelerated Filer (Do not check if a smaller reporting company)	Smaller Reporting Company
	Emerging growth company

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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

The registrant had 69,934,196 shares of common stock outstanding as of May 31, 2018.

Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements made by or on behalf of Photronics, Inc. ("Photronics", the "Company", "we", "our", or "us"). These statements are based on management's beliefs, as well as assumptions made by, and information currently available to, management. Forward-looking statements may be identified by words like "expect," "anticipate," "believe," "plan," "project," "could," "should," "estimate," "intend," "may," "will" and similar expressions, or the negative of such terms, or other comparable terminology. All forward-looking statements involve risks and uncertainties that are difficult to predict. In particular, any statement contained in this quarterly report on Form 10-Q, or in other documents filed with the Securities and Exchange Commission in press releases or in the Company's communications and discussions with investors and analysts in the normal course of business through meetings, phone calls, or conference calls regarding, among other things, the consummation and benefits of transactions, joint ventures, business combinations, divestitures and acquisitions, expectations with respect to future sales, financial performance, operating efficiencies, or product expansion, are subject to known and unknown risks, uncertainties, and contingencies, many of which are beyond the control of the Company. Various factors may cause actual results, performance, or achievements to differ materially from anticipated results, performance, or achievements expressed or implied by forward-looking statements. Factors that might affect forward-looking statements include, but are not limited to, overall economic and business conditions; economic and political conditions in international markets; the demand for the Company's products; competitive factors in the industries and geographic markets in which the Company competes; the timing of orders received from customers; the gain or loss of significant customers; competition from other manufacturers; changes in accounting standards; federal, state and international tax requirements (including tax rate changes, new tax laws and revised tax law interpretations); changes in the jurisdictional mix of our earnings and changes in tax laws and rates; interest rate and other capital market conditions, including changes in the market price of the Company's securities; foreign currency exchange rate fluctuations; changes in technology; technology or intellectual property infringement, including cyber-security breaches, and other innovation risks; unsuccessful or unproductive research and development or capital expenditures; the timing, impact, and other uncertainties related to transactions and acquisitions, divestitures, business combinations, and joint ventures as well as decisions the Company may make in the future regarding the Company's business, capital and organizational structures and other matters; the seasonal and cyclical nature of the semiconductor and flat panel display industries; management changes; changes in laws and government regulation impacting our operations or our products; the occurrence of regulatory or legal violations, proceedings, claims or litigation; customer complaints or disputes; damage or destruction to the Company's facilities, or the facilities of its customers or suppliers, by natural disasters, labor strikes, political unrest, or terrorist activity; the ability of the Company to (i) place new equipment in service on a timely basis; (ii) obtain additional financing; (iii) achieve anticipated synergies and cost savings; (iv) fully utilize its tools; (v) achieve desired yields, pricing, product mix, and market acceptance of its products and, (vi) obtain necessary export licenses. Any forward-looking statements should be considered in light of these factors. Accordingly, there is no assurance that the Company's expectations will be realized. The Company does not assume responsibility for the accuracy and completeness of any forward-looking statements and does not assume an obligation to provide revisions to such forward-looking statements, except as otherwise required by securities and other applicable laws.

PHOTRONICS, INC.

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PART I. FINANCIAL INFORMATION

Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

PHOTRONICS, INC.

Condensed Consolidated Balance Sheets
(in thousands, except per share amounts)
(unaudited)

	April 29, 2018	October 29, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 321,246	\$ 308,021
Accounts receivable, net of allowance of \$2,449 in 2018 and \$2,319 in 2017	124,331	105,320
Inventories	31,936	23,703
Prepaid expenses	7,542	3,162
Other current assets	15,244	8,918
Total current assets	500,299	449,124
Property, plant and equipment, net	563,313	535,197
Intangible assets, net	14,708	17,122
Deferred income taxes	19,925	15,481
Other assets	4,036	3,870
Total assets	\$ 1,102,281	\$ 1,020,794
LIABILITIES AND EQUITY		
Current liabilities:		
Current portion of long-term borrowings	\$ 59,263	\$ 4,639
Accounts payable	64,944	50,834
Accrued liabilities	42,301	26,303
Total current liabilities	166,508	81,776
Long-term borrowings	-	57,337
Other liabilities	17,707	16,386
Total liabilities	184,215	155,499
Commitments and contingencies		
Equity:		
Preferred stock, \$0.01 par value, 2,000 shares authorized, none issued and outstanding	-	-
Common stock, \$0.01 par value, 150,000 shares authorized, 69,443 shares issued and outstanding at April 29, 2018 and 68,666 shares issued and outstanding at October 29, 2017	694	687
Additional paid-in capital	552,977	547,596
Retained earnings	205,953	189,390

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Accumulated other comprehensive income	23,756	6,891
Total Photronics, Inc. shareholders' equity	783,380	744,564
Noncontrolling interests	134,686	120,731
Total equity	918,066	865,295
Total liabilities and equity	\$1,102,281	\$1,020,794

See accompanying notes to condensed consolidated financial statements.

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PHOTRONICS, INC.

Condensed Consolidated Statements of Income

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Six Months Ended	
	April 29, 2018	April 30, 2017	April 29, 2018	April 30, 2017
Revenue	\$ 130,779	\$ 108,297	\$ 254,225	\$ 218,128
Cost of goods sold	(97,960)	(88,140)	(193,744)	(174,973)
Gross profit	32,819	20,157	60,481	43,155
Operating expenses:				
Selling, general and administrative	(13,637)	(10,894)	(25,387)	(21,764)
Research and development	(3,817)	(3,726)	(7,921)	(7,212)
Total operating expenses	(17,454)	(14,620)	(33,308)	(28,976)
Operating income	15,365	5,537	27,173	14,179
Other income (expense):				
Interest income and other income (expense), net	3,883	(3,073)	351	(4,596)
Interest expense	(551)	(549)	(1,125)	(1,108)
Income before income taxes	18,697	1,915	26,399	8,475
Income tax provision	(3,508)	(431)	(1,729)	(2,481)
Net income	15,189	1,484	24,670	5,994
Net (income) loss attributable to noncontrolling interests	(4,524)	313	(8,107)	(2,250)
Net income attributable to Photronics, Inc. shareholders	\$ 10,665	\$ 1,797	\$ 16,563	\$ 3,744
Earnings per share:				
Basic	\$0.15	\$0.03	\$0.24	\$0.05
Diluted	\$0.15	\$0.03	\$0.23	\$0.05
Weighted-average number of common shares outstanding:				
Basic	69,293	68,426	69,024	68,301
Diluted	75,190	69,385	75,052	69,277

See accompanying notes to condensed consolidated financial statements.

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PHOTRONICS, INC.

Condensed Consolidated Statements of Comprehensive Income

(in thousands)

(unaudited)

	Three Months Ended		Six Months Ended	
	April 29, 2018	April 30, 2017	April 29, 2018	April 30, 2017
Net income	\$ 15,189	\$ 1,484	\$ 24,670	\$ 5,994
Other comprehensive income (loss), net of tax of \$0:				
Foreign currency translation adjustments	(11,098)	18,382	18,989	17,769
Amortization of cash flow hedge	16	32	48	64
Other	54	(74)	22	(94)
Net other comprehensive income (loss)	(11,028)	18,340	19,059	17,739
Comprehensive income	4,161	19,824	43,729	23,733
Less: comprehensive income attributable to noncontrolling interests	1,841	4,326	10,301	8,147
Comprehensive income attributable to Photronics, Inc. shareholders	\$ 2,320	\$ 15,498	\$ 33,428	\$ 15,586

See accompanying notes to condensed consolidated financial statements.

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PHOTRONICS, INC.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended	
	April 29, 2018	April 30, 2017
Cash flows from operating activities:		
Net income	\$24,670	\$5,994
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	44,429	42,242
Changes in assets and liabilities:		
Accounts receivable	(16,976)	4,204
Inventories	(7,765)	(1,506)
Other current assets	(9,666)	2,103
Accounts payable, accrued liabilities, and other	3,216	(6,130)
Net cash provided by operating activities	37,908	46,907
Cash flows from investing activities:		
Purchases of property, plant and equipment	(44,129)	(14,152)
Acquisition of business	-	(5,400)
Proceeds from sale of investment	-	167
Other	436	(462)
Net cash used in investing activities	(43,693)	(19,847)
Cash flows from financing activities:		
Repayments of long-term borrowings	(2,771)	(2,695)
Contribution from noncontrolling interest	11,998	-
Proceeds from share-based arrangements	3,776	2,311
Other	(267)	(23)
Net cash provided by (used in) financing activities	12,736	(407)
Effect of exchange rate changes on cash and cash equivalents	6,274	4,997
Net increase in cash and cash equivalents	13,225	31,650
Cash and cash equivalents at beginning of period	308,021	314,074
Cash and cash equivalents at end of period	\$321,246	\$345,724
Supplemental disclosure information:		
Accrual for property, plant and equipment purchased during the period	\$10,317	\$11,409
Subsidiary dividend payable	\$8,196	\$8,383

See accompanying notes to condensed consolidated financial statements.

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PHOTRONICS, INC.

Notes to Condensed Consolidated Financial Statements

Three Months and Six Months Ended April 29, 2018 and April 30, 2017

(unaudited)

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

NOTE 1 - BASIS OF FINANCIAL STATEMENT PRESENTATION

Photronics, Inc. ("Photronics", "the Company", "we", "our", or "us") is one of the world's leading manufacturers of photomasks, which are high precision photographic quartz or glass plates containing microscopic images of electronic circuits. Photomasks are a key element in the manufacture of semiconductors and flat panel displays ("FPDs"), and are used as masters to transfer circuit patterns onto semiconductor wafers and flat panel display substrates during the fabrication of integrated circuits ("ICs" or "semiconductors") and a variety of FPDs and, to a lesser extent, other types of electrical and optical components. We currently operate principally from nine manufacturing facilities, two of which are located in Europe, three in Taiwan, one in Korea, and three in the United States. We have commenced construction of two manufacturing facilities in China and anticipate production to begin at these facilities during the first half of 2019.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information, and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for annual financial statements. In the opinion of management, adjustments, all of which are of a normal recurring nature, considered necessary for a fair presentation have been included. Our business is typically impacted during the first, and sometimes the second, quarter of our fiscal year by the North American, European, and Asian holiday periods, as some customers reduce their development and buying activities during those periods. Operating results for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ending October 28, 2018. For further information, refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended October 29, 2017.

NOTE 2 - CHANGES IN EQUITY

The following tables set forth our consolidated changes in equity for the three and six month periods ended April 29, 2018 and April 30, 2017:

	Three Months Ended April 29, 2018						
	Photronics, Inc. Shareholders						
	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Non- controlling Interests	Total Equity
Shares	Amount						
Balance at January 29, 2018	68,869	\$ 689	\$ 549,328	\$ 195,288	\$ 32,128	\$ 141,014	\$ 918,447
Net income	-	-	-	10,665	-	4,524	15,189
Other comprehensive loss	-	-	-	-	(8,372)	(2,656)	(11,028)
Sale of common stock through employee stock option and purchase plans	548	5	2,892	-	-	-	2,897

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Restricted stock awards vesting and expense	26	-	457	-	-	-	457
Share-based compensation expense	-	-	300	-	-	-	300
Subsidiary dividend payable	-	-	-	-	-	(8,196)	(8,196)
Balance at April 29, 2018	69,443	\$ 694	\$552,977	\$205,953	\$ 23,756	\$ 134,686	\$918,066

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Photronics, Inc. Shareholders

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Non- controlling Interests	Total Equity
	Shares	Amount					
Balance at January 30, 2017	68,333	\$ 683	\$ 543,116	\$ 178,207	\$ (9,530)	\$ 118,932	\$ 831,408
Net income (loss)	-	-	-	1,797	-	(313)	1,484
Other comprehensive income	-	-	-	-	13,701	4,639	18,340
Sale of common stock through employee stock option and purchase plans	148	2	982	-	-	-	984
Restricted stock awards vesting and expense	15	-	431	-	-	-	431
Share-based compensation expense	-	-	490	-	-	-	490
Subsidiary dividend payable	-	-	-	-	-	(8,383)	(8,383)
Balance at April 30, 2017	68,496	\$ 685	\$ 545,019	\$ 180,004	\$ 4,171	\$ 114,875	\$ 844,754

Six Months Ended April 29, 2018
Photronics, Inc. Shareholders

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Non- controlling Interests	Total Equity
	Shares	Amount					
Balance at October 30, 2017	68,666	\$ 687	\$ 547,596	\$ 189,390	\$ 6,891	\$ 120,731	\$ 865,295
Net income	-	-	-	16,563	-	8,107	24,670
Other comprehensive income	-	-	-	-	16,865	2,194	19,059
Sale of common stock through employee stock option and purchase plans	664	7	3,592	-	-	-	3,599
Restricted stock awards vesting and expense	113	-	843	-	-	-	843
Share-based compensation expense	-	-	798	-	-	-	798
Contribution from noncontrolling interest	-	-	148	-	-	11,850	11,998
Subsidiary dividend payable	-	-	-	-	-	(8,196)	(8,196)
Balance at April 29, 2018	69,443	\$ 694	\$ 552,977	\$ 205,953	\$ 23,756	\$ 134,686	\$ 918,066

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Photronics, Inc. Shareholders

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Non- controlling Interests	Total Equity
	Shares	Amount					
Balance at October 31, 2016	68,080	\$ 681	\$ 541,093	\$ 176,260	\$ (7,671)	\$ 115,111	\$ 825,474
Net income	-	-	-	3,744	-	2,250	5,994
Other comprehensive income	-	-	-	-	11,842	5,897	17,739
Sale of common stock through employee stock option and purchase plans	323	3	2,068	-	-	-	2,071
Restricted stock awards vesting and expense	93	1	728	-	-	-	729
Share-based compensation expense	-	-	1,130	-	-	-	1,130
Subsidiary dividend payable	-	-	-	-	-	(8,383)	(8,383)
Balance at April 30, 2017	68,496	\$ 685	\$ 545,019	\$ 180,004	\$ 4,171	\$ 114,875	\$ 844,754

NOTE 3 - INVENTORIES

Inventories are stated at the lower of cost, determined under the first-in, first-out ("FIFO") method, or net realizable value. Presented below are the components of inventory at the balance sheet dates:

	April 29, 2018	October 29, 2017
Finished goods	\$ 2,011	\$ 664
Work in process	4,901	2,957
Raw materials	25,024	20,082
	\$ 31,936	\$ 23,703

NOTE 4 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of the following:

	April 29, 2018	October 29, 2017
Land	\$ 11,697	\$ 9,959
Buildings and improvements	127,148	125,290
Machinery and equipment	1,609,456	1,547,870
Leasehold improvements	20,415	20,050
Furniture, fixtures and office equipment	13,816	12,989
Construction in progress	83,554	72,045

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	1,866,086	1,788,203
Accumulated depreciation and amortization	(1,302,773)	(1,253,006)
	\$563,313	\$535,197

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Equipment under capital leases is included in the property, plant and equipment amount, above, as follows:

	April 29, 2018	October 29, 2017
Machinery and equipment	\$34,917	\$ 34,917
Accumulated amortization	(19,328)	(13,843)
	\$15,589	\$ 21,074

Depreciation and amortization expense for property, plant and equipment was \$20.8 million and \$42.0 million for the three and six month periods ended April 29, 2018, respectively, and \$20.1 million and \$39.8 million for the three and six month periods ended April 30, 2017, respectively.

During the three month period ended January 29, 2017, we entered into noncash transactions with a customer for the acquisition of equipment, under which we acquired equipment with fair value of \$6.7 million in the six month period ended April 29, 2018, and \$2.8 million and \$5.0 million in the three and six month periods ended April 30, 2017, respectively. We did not acquire any equipment under this agreement during the three month period ended April 29, 2018.

NOTE 5 - PDMCX JOINT VENTURE

In January 2018, Photronics, through its wholly-owned Singapore subsidiary (hereinafter, within this Note “we”, or “Photronics”), and Dai Nippon Printing Co., Ltd., through its wholly owned subsidiary “DNP Asia Pacific PTE, Ltd.” (hereinafter, within this Note “DNP”) entered into a joint venture under which DNP obtained a 49.99% interest in our recently established IC business in Xiamen, China, which includes the facility currently under construction. The joint venture, known as “Photronics DNP Mask Corporation Xiamen” (hereinafter, “PDMCX”), was established to develop and manufacture photomasks for leading edge and advanced generation semiconductors. We entered into this joint venture to enable us to compete more effectively for the merchant photomask business in China and to benefit from the additional resources and investment that DNP will provide to enable us to offer advanced process technology to our customers. No gain or loss was recorded upon the formation of the joint venture.

As of April 29, 2018, Photronics and DNP have each contributed cash of approximately \$12 million to the joint venture. We estimate that, over the next several years and per the PDMCX joint venture operating agreement (“the Agreement”), DNP and Photronics will each contribute an additional \$43 million of cash and additional amounts to be obtained through local borrowings.

Under the Agreement, DNP is afforded, under certain circumstances, the right to put its interest in PDMCX to Photronics. These circumstances include disputes regarding the strategic direction of PDMCX that arise after the initial two year term of the Agreement and cannot be resolved between the two parties. In addition, both Photronics and DNP have the option to purchase, or put, their interest from, or to, the other party, should their ownership interest fall below 20% for a period of more than six consecutive months. Under all such circumstances, the sales of ownership interests would be at the exiting party’s ownership percentage of the joint venture’s net book value, with closing to take place within three business days of obtaining required approvals and clearance.

We recorded net losses from the operations of the PDMCX joint venture of approximately \$0.2 million, and \$0.7 million in the three and six month periods ended April 29, 2018. General creditors of PDMCX do not have recourse to the assets of Photronics, Inc., and the maximum exposure to loss for Photronics from PDMCX at April 29, 2018, was \$11.4 million.

As required by the guidance in Topic 810 - “Consolidation” of the Accounting Codification Standards, we evaluated our involvement in PDMCX for the purpose of determining whether we should consolidate its results in our financial statements. The initial step of our evaluation was to determine whether PDMCX was a variable interest entity (“VIE”). Due to its lack of sufficient equity at risk to finance its activities without additional subordinated financial support, we determined that it is a VIE. Having made this determination, we then assessed whether we were the primary beneficiary of the VIE, and concluded that we were the primary beneficiary during the current reporting period; thus, as required, the PDMCX financial results should be consolidated with Photronics, Inc. Our conclusion was based on the fact that we held a controlling financial interest in PDMCX, which resulted from our having the power to direct the activities that most significantly impacted its economic performance, the obligation to absorb losses, and the right to receive benefits that could potentially be significant to PDMCX. Our conclusion that we had the power to direct the activities that most significantly affected the economic performance of PDMCX during the current period was based on our right to appoint the majority of its board of directors, which has, among others, the powers to manage the business (through its rights to appoint and evaluate PDMCX’s management), incur indebtedness, enter into agreements and commitments, and acquire and dispose of PDMCX’s assets. In addition, as a result of the 50.01% variable interest we held during the current period, we had the obligation to absorb losses and the right to receive benefits that could potentially be significant to PDMCX.

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The carrying amounts of PDMCX assets and liabilities included in our condensed consolidated balance sheet as of April 29, 2018, are presented in the following table, together with the maximum exposure to loss of Photronics due to its interests in the net assets of this joint venture.

Classification	Carrying Amount	Photronics Interest
Current assets	\$ 11,226	\$ 5,614
Non-current assets	15,635	7,819
Total assets	26,861	13,433
Current liabilities	4,000	2,000
Non-current liabilities	16	8
Total liabilities	4,016	2,008
Net assets	\$ 22,845	\$ 11,425

NOTE 6 - LONG-TERM BORROWINGS

Long-term borrowings consist of the following:

	April 29, 2018	October 29, 2017
3.25% convertible senior notes due in April 2019	\$57,395	\$ 57,337
2.77% capital lease obligation payable through July 2018	1,868	4,639
Current portion	59,263 (59,263)	61,976 (4,639)
	\$-	\$ 57,337

In January 2015, we privately exchanged \$57.5 million in aggregate principal amount of our 3.25% convertible senior notes with a maturity date of April 1, 2016, for new 3.25% convertible senior notes with an aggregate principal amount of \$57.5 million with a maturity date of April 1, 2019. The conversion rate of the new notes is the same as that of the exchanged notes, which were issued in March 2011 with a conversion rate of approximately 96 shares of common stock per \$1,000 note principal, equivalent to a conversion price of \$10.37 per share of common stock, subject to adjustment upon the occurrence of certain events described in the indenture dated January 22, 2015. Note holders may convert each \$1,000 principal amount of notes at any time prior to the close of business on the second scheduled trading day immediately preceding April 1, 2019, and we are not required to redeem the notes prior to their maturity date. Interest on the notes accrues in arrears and is paid semiannually through the notes' maturity date.

Our credit facility, which expires in December 2018, has a \$50 million limit with an expansion capacity to \$75 million, and is secured by substantially all of our assets located in the United States and common stock we own in certain of our foreign subsidiaries. The credit facility stipulates that we may not pay cash dividends on Photronics, Inc. stock, and contains the following financial covenants: minimum interest coverage ratio, total leverage ratio and minimum unrestricted cash balance, all of which we were in compliance with at April 29, 2018. We had no

outstanding borrowings against the credit facility at April 29, 2018, and \$50 million was available for borrowing. The interest rate on the credit facility (3.62% at April 29, 2018) is based on our total leverage ratio at LIBOR plus a spread, as defined in the credit facility. In April 2018, our credit facility was amended to change the definition of “specified capital expenditures”, which is used to calculate the interest coverage ratio.

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In August 2013, we entered into a \$26.4 million principal amount, five year capital lease to fund the purchase of a high-end lithography tool. Payments under the capital lease, which bears interest at 2.77%, are \$0.5 million per month through July 2018. The lease is subject to a cross default with cross acceleration provision related to certain nonfinancial covenants incorporated into our credit facility. As of April 29, 2018, the total amount payable through August 2018 (the end of the lease term) was \$1.9 million, substantially all of which represented principal.

NOTE 7 - SHARE-BASED COMPENSATION

In March 2016, shareholders approved a new equity incentive compensation plan (the "Plan"), under which incentive stock options, non-qualified stock options, stock grants, stock-based awards, restricted stock, restricted stock units, stock appreciation rights, performance units, performance stock, and other stock or cash awards may be granted. Shares to be issued under the Plan may be authorized and unissued shares, issued shares that have been reacquired by us (in the open-market or in private transactions), shares that are being held in the treasury, or a combination thereof. The maximum number of shares of common stock approved that may be issued under the Plan is four million shares. Awards may be granted to officers, employees, directors, consultants, advisors, and independent contractors of Photronics. In the event of a change in control (as defined in the Plan), the vesting of awards may be accelerated. Total share-based compensation costs for the three and six month periods ended April 29, 2018, were \$0.8 million and \$1.6 million, respectively, and \$0.9 million and \$1.9 million for the three and six month periods ended April 30, 2017, respectively. The Company received cash from option exercises of \$2.9 million and \$3.6 million for the three and six month periods ended April 29, 2018, respectively, and \$1.0 million and \$2.1 million for the three and six month periods ended April 30, 2017, respectively. No share-based compensation cost was capitalized as part of an asset and no related income tax benefits were recorded during the periods presented.

Stock Options

Option awards generally vest in one-to-four years, and have a ten-year contractual term. All incentive and non-qualified stock option grants have an exercise price no less than the market value of the underlying common stock on the date of grant. The grant date fair values of options are based on closing prices of our common stock on the dates of grant using the Black-Scholes option pricing model. Expected volatility is based on the historical volatility of our common stock. We use historical option exercise behavior and employee termination data to estimate expected term, which represents the period of time that options are expected to remain outstanding. The risk-free rate of return for the estimated term of the option is based on the U.S. Treasury yield curve in effect at the date of grant.

There were no share options granted during the three month period ended April 29, 2018, and 10,000 share options granted during the three month period ended April 30, 2017, with a weighted-average grant date fair value of \$3.35 per share. There were 252,000 share options granted during the six month period ended April 29, 2018, with a weighted-average grant date fair value of \$2.74 per share, and 348,750 share options granted during the six month period ended April 30, 2017, with a weighted-average grant date fair value of \$3.59 per share. As of April 29, 2018, the total unrecognized compensation cost related to unvested option awards was approximately \$2.1 million. That cost is expected to be recognized over a weighted-average amortization period of 2.1 years.

The weighted-average inputs and risk-free rate of return ranges used to calculate the grant date fair value of options issued during the three and six month periods ended April 29, 2018 and April 30, 2017, are presented in the following table.

Three Months Ended		Six Months Ended	
		April	
April 29,	April 30,	29,	April 30,
2018	2017	2018	2017

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Volatility	N/A	31.6	%	31.6	%	32.2	%
Risk free rate of return	N/A	2.0	%	2.2	%	1.9-2.0	%
Dividend yield	N/A	0.0	%	0.0	%	0.0	%
Expected term	N/A	5.0 years		5.0 years		5.0 years	

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Information on outstanding and exercisable option awards as of April 29, 2018, is presented below.

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at April 29, 2018	2,613,640	\$ 8.47	6.2 years	\$ 2,054
Exercisable at April 29, 2018	1,744,975	\$ 7.62	5.0 years	\$ 2,054

Restricted Stock

We periodically grant restricted stock awards, the restrictions on which typically lapse over a service period of one-to-four years. The fair value of the awards is determined on the date of grant, based on the closing price of our common stock. There were 10,000 restricted stock awards granted during the three month period ended April 29, 2018, with a grant date fair value of \$8.40 and 290,000 restricted stock awards granted during the six month period ended April 29, 2018, with a weighted-average fair value of \$8.62 per share. There were 25,000 restricted stock awards granted during the three month period ended April 30, 2017, with a grant date fair value of \$10.75, and 285,000 restricted stock awards granted during the six month period ended April 30, 2017, with a weighted-average grant date fair value of \$11.30 per share. As of April 29, 2018, the total compensation cost not yet recognized related to unvested restricted stock awards was approximately \$3.7 million. That cost is expected to be recognized over a weighted-average amortization period of 2.8 years. As of April 29, 2018, there were 472,673 shares of restricted stock outstanding.

NOTE 8 - INCOME TAXES

The effective tax rate of 18.8% and 6.5% for the three and six month periods ended April 29, 2018, respectively, differ from the post U.S. Tax Reform blended statutory rate of 23.4%, primarily due to the benefit from U.S. Tax Reform (as discussed below), earnings being taxed at lower statutory rates in foreign jurisdictions, the benefit of various investment credits in a foreign jurisdiction, and a tax holiday in Taiwan.

On December 22, 2017, the U.S. Tax Cuts and Jobs Act (the “Act”), was signed into law, enacting significant changes to the United States Internal Revenue Code of 1986, as amended, that we expect to have a positive impact on our future after-tax earnings. Under ASC Topic 740 – “Income Taxes” (“ASC 740”), the effects of the new legislation are recognized in the interim and annual accounting periods that include the enactment date, which falls within our six month period ended April 29, 2018. In December 2017, the Securities and Exchange Commission released Staff Accounting Bulletin No. 118 (“SAB 118”) to address situations in which the accounting under ASC 740 is incomplete for certain income tax effects of the Act. We adopted SAB 118 in our first quarter of fiscal year 2018.

SAB 118 summarizes a three-step process to be applied at each reporting period to account for and qualitatively disclose: (1) the effects of the change in tax law for which accounting is complete; (2) provisional amounts (or adjustments to provisional amounts) for the effects of the tax law where accounting is not complete, but that a reasonable estimate has been determined; and (3) a reasonable estimate cannot yet be made and, therefore, taxes are reflected in accordance with law prior to the enactment of the Act.

We continue to analyze the provisions of the Act addressing the net deferred tax asset revaluation and its calculations, the deemed earnings repatriation, including the determination of undistributed non-U.S. earnings, and evaluate potential actions we may consider in light of the Act that could affect our fiscal year 2018 U.S. taxable income. As

such, our accounting for certain elements within the Act is preliminary, and subject to further clarification of the Act by the Internal Revenue Service. The following is a discussion of the major provisions of the Act that affect our financial statements, and our preliminary assessment of the impact of such provisions on our financial statements.

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The Act repeals the corporate alternative minimum tax (“AMT”) for tax years beginning after December 31, 2017, and provides that existing AMT credit carryforwards are fully refundable over a four year period, starting with the tax year beginning after December 31, 2017. We have approximately \$3.9 million of AMT credit carryforwards that we previously determined were not more likely than not going to be realized and, as such, established a valuation allowance for these carryforwards. The Act has changed our determination regarding the realization of the benefit of the carryforwards; accordingly, the related valuation allowance has been reversed, and the \$3.9 million tax benefit, excluding any impact of potential future sequestration reductions, was recorded in our tax provision for the period ended January 28, 2018.

As of January 1, 2018, the Act reduces the corporate income tax rate from a maximum 35% to a flat 21%. Our fiscal year 2018 blended statutory tax rate is approximately 23.4%, the weighted daily average rate between the pre-enactment U.S. federal statutory tax rate of 35% applicable to our 2018 fiscal year prior to the rate change effective January 1, 2018, and the post-enactment U.S. federal statutory tax rate of 21% applicable to the balance of our 2018 fiscal year. The 21% rate will be applicable to fiscal year 2019 and beyond. Under generally accepted accounting principles, we are required to revalue our deferred tax assets and liabilities utilizing the rate applicable to the period when a temporary difference will reverse. Our preliminary analysis of the two stepped revaluation indicates that our net deferred tax asset will be increased by \$2.5 million, with an offsetting change in the related valuation allowance resulting in a provisional net zero impact for the period.

The Act imposes a transition tax for a one-time deemed repatriation of the accumulated earnings of foreign subsidiaries. The transition tax effective rates are 15.5% on accumulated earnings held in cash (as defined by the Act), and 8% on any remaining balance. Our preliminary analysis indicates an estimated deemed repatriation transition tax of \$28.4 million, the entire amount of which will be fully offset by tax credits and/or available loss carryforwards resulting in a provisional net zero impact in the period, due in part to an offsetting change in the related valuation allowance. We anticipate that future earnings of foreign subsidiaries will not be subject to U.S. federal income tax. No change has been, or is, anticipated to be made with respect to the year-end fiscal year 2017 indefinite reinvestment assertion of foreign subsidiary earnings.

Our preliminary analysis of other provisions of the Act including, but not limited to, 100 percent bonus depreciation and changes to the limitations on the deductibility of meals and entertainment expenses, indicates that, under our current tax profile, there should be limited or no provisional impact on our current period financial statements. Based on the effective date of certain provisions, we will be subject to additional requirements of tax reform beginning in fiscal year 2019. Those provisions include a tax on global intangible low-taxed income (GILTI), a tax determined by base erosion tax benefits (BEAT) from certain payments between a U.S. corporation and foreign subsidiaries, a limitation of certain executive compensation, a deduction for foreign derived intangible income (FDII), and interest expense limitations. We have not completed our analysis of those provisions and the estimated impact.

On January 18, 2018, the Taiwan Legislature Yuan approved amendments to the Income Tax Act, enacting an increase in the corporate tax rate from 17% to 20%. Under generally accepted accounting principles, we are required to revalue our deferred tax assets and liabilities utilizing the rate applicable to the period when a temporary difference will reverse. Our analysis indicates that our Taiwan deferred tax asset will be increased and, accordingly, a net benefit of \$0.2 million was reflected in our January 28, 2018, tax provision.

The 22.5% and 29.3% effective tax rates for the respective three and six month periods ended April 30, 2017, differ from the U.S. statutory rate of 35%, primarily due to earnings being taxed at lower statutory rates in foreign jurisdictions, combined with the benefit of various investment credits in a foreign jurisdiction. Valuation allowances in jurisdictions with historic losses eliminate the tax benefit that would be recognized in these jurisdictions. We have two five-year tax holidays in Taiwan, one that expired in 2017 and the other that expires in 2019. The latter tax holiday reduced foreign taxes by \$0.7 million and \$0.8 million in the three and six month periods ended April 29, 2018, respectively, and had a \$0.01 effect on earnings per share in each period. For the three and six month periods ended April 30, 2017, the company realized benefits from the tax holidays of \$0.1 million and \$0.2 million, respectively, with de minimis per share effects for these periods.

There were unrecognized tax benefits related to uncertain tax positions of \$4.0 million at April 29, 2018, and \$3.4 million at October 29, 2017, all of which, if recognized, would favorably impact the Company's effective tax rate. Accrued interest and penalties related to unrecognized tax benefits were \$0.1 million at April 29, 2018 and October 29, 2017. Although the timing of the expirations of statutes of limitations may be uncertain, as they can be dependent upon the settlement of tax audits, we believe that it is reasonably possible that up to \$1.4 million of our uncertain tax positions (including accrued interest and penalties, and net of tax benefits) may be resolved over the next twelve months. Resolution of these uncertain tax positions may result from either or both the lapses of statutes of limitations and tax settlements.

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NOTE 9 - EARNINGS PER SHARE

The calculations of basic and diluted earnings per share is presented below.

Three Months Ended Six Months Ended