

MATERION Corp
Form 10-Q
July 31, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

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

For the quarterly period ended July 3, 2015

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

For the transition period from _____ to _____
Commission file number 001-15885

MATERION CORPORATION
(Exact name of Registrant as specified in charter)

Ohio
(State or other jurisdiction of incorporation or
organization)

34-1919973
(I.R.S. Employer
Identification No.)

6070 Parkland Blvd., Mayfield Hts., Ohio
(Address of principal executive offices)

44124
(Zip Code)

Registrant's telephone number, including area code:
216-486-4200

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

As of July 23, 2015, there were 20,124,806 common shares, no par value, outstanding.

PART I FINANCIAL INFORMATION
MATERION CORPORATION AND SUBSIDIARIES

Item 1. Financial Statements

The consolidated financial statements of Materion Corporation and its subsidiaries for the second quarter and six months ended July 3, 2015 are as follows:

<u>Consolidated Statements of Income -</u> Second quarter and six months ended July 3, 2015 and June 27, 2014	<u>2</u>
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Materion Corporation and Subsidiaries
Consolidated Statements of Income
(Unaudited)

(Thousands, except per share amounts)	Second Quarter Ended		Six Months Ended	
	Jul. 3, 2015	Jun. 27, 2014	Jul. 3, 2015	Jun. 27, 2014
Net sales	\$276,855	\$287,965	\$566,879	\$546,894
Cost of sales	225,528	238,164	463,197	451,631
Gross margin	51,327	49,801	103,682	95,263
Selling, general, and administrative expense	34,884	34,685	71,825	65,945
Research and development expense	3,586	3,443	6,934	6,230
Other—net	36	(2,895)	(2,122)	(2,533)
Operating profit	12,821	14,568	27,045	25,621
Interest expense—net	650	672	1,307	1,367
Income before income taxes	12,171	13,896	25,738	24,254
Income tax expense	3,293	3,922	7,231	6,949
Net income	\$8,878	\$9,974	\$18,507	\$17,305
Basic earnings per share:				
Net income per share of common stock	\$0.44	\$0.48	\$0.92	\$0.84
Diluted earnings per share:				
Net income per share of common stock	\$0.43	\$0.47	\$0.90	\$0.82
Cash dividends per share	\$0.090	\$0.085	\$0.175	\$0.165
Weighted-average number of shares of common stock outstanding:				
Basic	20,153	20,642	20,149	20,625
Diluted	20,461	21,001	20,453	20,983

Refer to Notes to Consolidated Financial Statements.

Materion Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income
(Unaudited)

(Thousands)	Second Quarter Ended		Six Months Ended	
	Jul. 3, 2015	Jun. 27, 2014	Jul. 3, 2015	Jun. 27, 2014
Net income	\$8,878	\$9,974	\$18,507	\$17,305
Other comprehensive income:				
Foreign currency translation adjustment	316	126	(1,254) 715
Derivative and hedging activity, net of tax	(1,104) 80	(601) 87
Pension and post-employment benefit adjustment, net of tax	902	542	1,804	9,925
Net change in accumulated other comprehensive income	114	748	(51) 10,727
Comprehensive income	\$8,992	\$10,722	\$18,456	\$28,032

Refer to Notes to Consolidated Financial Statements.

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Materion Corporation and Subsidiaries
Consolidated Balance Sheets
(Unaudited)

(Thousands)	Jul. 3, 2015	Dec. 31, 2014
Assets		
Current assets		
Cash and cash equivalents	\$20,629	\$13,150
Accounts receivable	117,178	112,780
Inventories	229,232	232,409
Prepaid expenses	18,992	14,953
Deferred income taxes	13,806	13,402
Total current assets	399,837	386,694
Long-term deferred income taxes	17,722	17,722
Property, plant, and equipment	811,645	800,671
Less allowances for depreciation, depletion, and amortization	(557,369)	(553,083)
Property, plant, and equipment—net	254,276	247,588
Intangible assets	15,717	18,559
Other assets	4,985	4,781
Goodwill	86,725	86,725
Total Assets	\$779,262	\$762,069
Liabilities and Shareholders' Equity		
Current liabilities		
Short-term debt	\$3,427	\$653
Accounts payable	31,508	36,239
Other liabilities and accrued items	48,687	59,151
Income taxes	5,875	3,144
Unearned revenue	4,597	4,879
Total current liabilities	94,094	104,066
Other long-term liabilities	18,060	18,203
Retirement and post-employment benefits	100,782	103,891
Unearned income	48,523	51,796
Long-term income taxes	1,750	1,750
Deferred income taxes	3,377	617
Long-term debt	41,213	23,613
Shareholders' equity		
Serial preferred stock	—	—
Common stock	203,125	202,104
Retained earnings	491,262	476,277
Common stock in treasury	(144,185)	(140,938)
Other comprehensive income (loss)	(82,288)	(82,237)
Other equity transactions	3,549	2,927
Total shareholders' equity	471,463	458,133
Total Liabilities and Shareholders' Equity	\$779,262	\$762,069

Refer to Notes to Consolidated Financial Statements.

Materion Corporation and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

(Thousands)	Six Months Ended	
	Jul. 3, 2015	Jun. 27, 2014
Cash flows from operating activities:		
Net income	\$18,507	\$17,305
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation, depletion, and amortization	20,117	22,093
Amortization of deferred financing costs in interest expense	331	356
Stock-based compensation expense (non-cash)	2,655	3,027
Changes in assets and liabilities net of acquired assets and liabilities:		
Decrease (increase) in accounts receivable	(4,622)	(8,680)
Decrease (increase) in inventory	2,150	(16,559)
Decrease (increase) in prepaid and other current assets	(4,037)	(2,658)
Decrease (increase) in deferred income taxes	2,177	58
Increase (decrease) in accounts payable and accrued expenses	(16,882)	(8,965)
Increase (decrease) in unearned revenue	(283)	1,637
Increase (decrease) in interest and taxes payable	3,240	5,432
Increase (decrease) in long-term liabilities	(1,801)	(11,419)
Other-net	(509)	(3,111)
Net cash provided by (used in) operating activities	21,043	(1,484)
Cash flows from investing activities:		
Payments for purchase of property, plant, and equipment	(16,564)	(12,859)
Payments for mine development	(10,100)	(337)
Proceeds from sale of property, plant, and equipment	18	3,009
Other investments-net	—	(2)
Net cash (used in) investing activities	(26,646)	(10,189)
Cash flows from financing activities:		
Proceeds from issuance (repayment) of short-term debt	2,346	(4,886)
Proceeds from issuance of long-term debt	51,000	33,170
Repayment of long-term debt	(33,110)	(15,492)
Principal payments under capital lease obligations	(404)	(328)
Cash dividends paid	(3,523)	(3,405)
Repurchase of common stock	(2,748)	(2,672)
Issuance of common stock under stock option plans	—	360
Tax benefit from stock compensation realization	—	109
Net cash provided by financing activities	13,561	6,856
Effects of exchange rate changes	(479)	105
Net change in cash and cash equivalents	7,479	(4,712)
Cash and cash equivalents at beginning of period	13,150	22,774
Cash and cash equivalents at end of period	\$20,629	\$18,062

Refer to Notes to Consolidated Financial Statements.

Materion Corporation and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

Note A — Accounting Policies

In management's opinion, the accompanying consolidated financial statements of Materion Corporation and its subsidiaries (Company) contain all adjustments necessary to present fairly the financial position as of July 3, 2015 and December 31, 2014, and the results of operations for the three months and six months ended July 3, 2015 and June 27, 2014. All adjustments were of a normal and recurring nature. Certain amounts in prior years have been reclassified to conform to the 2015 consolidated financial statement presentation.

In May 2014, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU), Revenue from Contracts with Customers, which supersedes previous revenue recognition guidance. The new standard requires that a company recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those goods or services. Companies will need to use more judgment and estimates than under the guidance currently in effect, including estimating the amount of variable revenue to recognize over each identified performance obligation. Additional disclosures will be required to help users of financial statements understand the nature, amount, and timing of revenue and cash flows arising from contracts. This ASU is effective beginning in fiscal year 2018 with a provision for early adoption in 2017. The standard can be adopted either retrospectively or as a cumulative-effect adjustment as of the date of adoption. The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements.

On April 1, 2015, the Financial Accounting Standards Board issued ASU No. 2015-03, Simplifying the Presentation of Debt Issuance Costs, which requires companies to present debt issuance costs associated with a debt liability as a deduction from the carrying amount of that debt liability on the balance sheet rather than being capitalized as an asset. The standard is effective for interim and annual periods beginning after December 15, 2015, and retrospective presentation is required. The Company will adopt ASU No. 2015-03 as required. The ASU will not have a material effect on the Company's results of operations, financial condition, or liquidity.

Note B — Inventories

Inventories on the Consolidated Balance Sheets are summarized as follows:

(Thousands)	Jul. 3, 2015	Dec. 31, 2014
Principally average cost:		
Raw materials and supplies	\$35,536	\$39,559
Work in process	153,200	155,377
Finished goods	40,496	37,473
Net inventories	\$229,232	\$232,409

The Company recognized last-in, first-out (LIFO) liquidation benefits of \$0.8 million and \$1.9 million in the second quarter and first six months of 2015, respectively, due to a forecasted reduction in year-end inventory.

Materion Corporation and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

Note C — Pensions and Other Post-employment Benefits

The following is a summary of the net periodic benefit cost for the second quarter and first six months of 2015 and 2014 for the domestic pension plans (which include the defined benefit pension plan and the supplemental retirement plans) and the domestic retiree medical plan.

(Thousands)	Pension Benefits		Other Benefits	
	Second Quarter Ended		Second Quarter Ended	
	Jul. 3, 2015	Jun. 27, 2014	Jul. 3, 2015	Jun. 27, 2014
Components of net periodic benefit cost				
Service cost	\$2,231	\$1,936	\$29	\$34
Interest cost	2,500	2,444	138	169
Expected return on plan assets	(3,354)	(3,013)	—	—
Amortization of prior service cost (benefit)	(112)	(109)	(374)	(374)
Amortization of net loss	1,819	1,275	—	—
Net periodic benefit cost (benefit)	\$3,084	\$2,533	\$(207)	\$(171)

(Thousands)	Pension Benefits		Other Benefits	
	Six Months Ended		Six Months Ended	
	Jul. 3, 2015	Jun. 27, 2014	Jul. 3, 2015	Jun. 27, 2014
Components of net periodic benefit cost				
Service cost	\$4,461	\$3,872	\$58	\$69
Interest cost	5,000	4,888	276	337
Expected return on plan assets	(6,708)	(6,025)	—	—
Amortization of prior service cost (benefit)	(224)	(218)	(748)	(749)
Amortization of net loss	3,639	2,550	—	—
Net periodic benefit cost (benefit)	\$6,168	\$5,067	\$(414)	\$(343)

The Company made contributions to the domestic defined benefit pension plans of \$4.0 million in the first six months of 2015.

In 2014, the Company amended its domestic retiree medical plan, including changing the benefit formula for participants covered by the plan. The revised benefit formula is designed to lower costs for the Company and the majority of plan participants. As a result of this change, the plan liability on the Company's Consolidated Balance Sheet was reduced by \$14.0 million in the first quarter of 2014, with the offset increasing other comprehensive income, a component of shareholders' equity. The liability reduction will be recognized in earnings over the average remaining service life of participants.

Note D — Contingencies

Materion Brush Inc., one of the Company's wholly owned subsidiaries, is a defendant from time to time in proceedings where the plaintiffs allege they have contracted chronic beryllium disease (CBD) or related ailments as a result of exposure to beryllium. The Company will record a reserve for CBD or other litigation when a loss from either settlement or verdict is probable and estimable. Claims filed by third-party plaintiffs may be covered by insurance subject to deductibles which vary based on when the exposure occurred. Reserves are recorded for asserted claims only and defense costs are expensed as incurred. There were two CBD cases outstanding as of the end of the second quarter of 2015, and the Company does not expect the resolution of these matters to have a material impact on the consolidated financial statements.

The Company has an active environmental compliance program and records reserves for the probable cost of identified environmental remediation projects. The reserves are established based upon analyses conducted by the Company's engineers and outside consultants and are adjusted from time to time based upon ongoing studies, the difference between actual and estimated costs, and other factors. The reserves may also be affected by rulings and negotiations with regulatory agencies. The

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Materion Corporation and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

undiscounted reserve balance was \$4.9 million at July 3, 2015 and \$4.9 million at December 31, 2014. Environmental projects tend to be long term, and the final actual remediation costs may differ from the amounts currently recorded. During the second quarter and first six months of 2015, the Company recognized gains of \$1.3 million and \$5.1 million, respectively, from settlement agreements on insurance claims regarding construction of the Company's beryllium pebble facility located in Elmore, Ohio. The Company recognized this benefit in Other-net in the Consolidated Statement of Income.

Note E — Segment Reporting

(Thousands)	Performance Alloys and Composites	Advanced Materials	Other		Subtotal	Total
			Other ⁽¹⁾	Corporate ⁽²⁾		
Second Quarter 2015						
Net sales	\$ 107,682	\$ 131,370	\$ 38,265	\$ (462)	\$ 37,803	\$ 276,855
Intersegment sales ⁽³⁾	365	16,129	—	—	—	16,494
Value-added sales	91,511	46,705	25,203	(1,060)	24,143	162,359
Operating profit (loss)	9,327	7,436	564	(4,506)	(3,942)	12,821
Second Quarter 2014						
Net sales	\$ 109,647	\$ 145,025	\$ 34,088	\$ (795)	\$ 33,293	\$ 287,965
Intersegment sales ⁽³⁾	181	11,040	—	—	—	11,221
Value-added sales	89,864	44,984	24,916	(198)	24,718	159,566
Operating profit (loss)	6,293	12,534	490	(4,749)	(4,259)	14,568