ARC Group Worldwide, Inc.
Form 10-Q
February 09, 2018
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 - Q

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

For the quarterly period ended December 31, 2017

OR

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)	(I.R.S. 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 No

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 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. (Check one):

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 February 5, 2018, the Registrant had 18,305,982 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		For the six months ended	
	December 31, 2017	January 1, 2017	December 31, 2017	January 1, 2017
Sales	$ 18,354	$ 27,009	$ 38,304	$ 52,722
Cost of sales	18,724	22,505	37,251	43,539
Gross profit	(370)	4,504	1,053	9,183
Selling, general and administrative	3,552	4,660	7,038	9,517
Loss from operations	(3,922)	(156)	(5,985)	(334)
Other income, net	167	837	130	804
Interest expense, net	(927)	(1,030)	(1,939)	(2,137)
Loss on extinguishment of debt	—	—	—	(723)
Loss before income taxes	(4,682)	(349)	(7,794)	(2,390)
Income tax benefit (expense)	366	(30)	194	1,301
Net loss from continuing operations	(4,316)	(379)	(7,600)	(1,089)
(Loss) gain on sale of subsidiaries and income (loss) from discontinued operations, net of tax	(6)	(331)	(276)	3,986
Net (loss) income	(4,322)	(710)	(7,876)	2,897
Net income attributable to non-controlling interest				
Continuing operations	—	—	—	(22)
Discontinued operations	—	—	—	(4)
Net income attributable to non-controlling interest	—	—	—	(26)
Net (loss) income attributable to ARC Group Worldwide, Inc.	$ (4,322)	$ (710)	$ (7,876)	$ 2,871
Net (loss) income per common share, basic and diluted:				
Continuing operations	$ (0.24)	$ (0.02)	$ (0.42)	$ (0.06)

Discontinued operations	$ —	$ (0.02)	$ (0.01)	$ 0.22
Attributable to ARC Group Worldwide, Inc.	$ (0.24)	$ (0.04)	$ (0.43)	$ 0.16
Weighted average common shares outstanding:				
Basic and diluted	18,265,323	18,123,883	18,229,320	18,123,883

See accompanying notes to the unaudited condensed consolidated financial statements.

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ARC Group Worldwide, Inc.

Unaudited Condensed Consolidated Balance Sheets

(in thousands, except share data)

	December 31, 2017	June 30, 2017
ASSETS		
Current assets:		
Cash	$ 387	$ 593
Accounts receivable, net	10,769	10,488
Inventories, net	14,342	14,369
Prepaid expenses and other current assets	2,382	3,152
Current assets of discontinued operations	—	1,452
Total current assets	27,880	30,054
Property and equipment, net	39,417	41,349
Goodwill	6,412	6,412
Intangible assets, net	17,942	19,624
Other	356	291
Long-term assets of discontinued operations	—	1,893
Total assets	$ 92,007	$ 99,623
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 10,160	$ 8,681
Accrued expenses and other current liabilities	2,153	3,273
Deferred revenue	1,387	1,165
Bank borrowings, current portion of long-term debt	1,747	1,701
Capital lease obligations, current portion	1,455	1,470
Accrued escrow obligations, current portion	1,212	1,212
Current liabilities of discontinued operations	—	283
Total current liabilities	18,114	17,785
Long-term debt, net of current portion	43,358	42,822
Capital lease obligations, net of current portion	1,196	1,888
Accrued escrow obligations, net of current portion	942	1,184
Other long-term liabilities	927	1,017
Long-term liabilities of discontinued operations	—	260
Total liabilities	64,537	64,956
Commitments and contingencies (Note 11)		
Equity:		
Preferred stock, $0.001 par value, 2,000,000 shares authorized, no shares issued and outstanding	—	—

Common stock, $0.0005 par value, 250,000,000 shares authorized; 18,282,681 shares issued and 18,274,280 shares issued and outstanding at December 31, 2017, and 18,180,027 shares issued and 18,171,626 shares issued and outstanding at June 30, 2017	10	10
Treasury stock, at cost; 8,401 shares at December 31, 2017 and June 30, 2017	(94)	(94)
Additional paid-in capital	31,675	31,109
Retained earnings (accumulated deficit)	(4,321)	3,569
Accumulated other comprehensive income	200	73
Total equity	27,470	34,667
Total liabilities and equity	$ 92,007	$ 99,623

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 six months ended December 31, 2017	January 1, 2017
Cash flows from operating activities:		
Net (loss) income	$ (7,876)	$ 2,897
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Depreciation and amortization	5,051	4,889
Share-based compensation expense	397	375
Loss (gain) on sale of subsidiaries	109	(5,418)
Bad debt expense and other	84	49
Deferred income taxes	—	(286)
Changes in working capital:		
Accounts receivable	(137)	(621)
Inventory	(138)	(2,374)
Prepaid expenses and other assets	609	(306)
Accounts payable	1,486	1,628
Accrued expenses and other current liabilities	(1,472)	(700)
Deferred revenue	222	(629)
Net cash used in operating activities	(1,665)	(496)
Cash flows from investing activities:		
Purchases of property and equipment	(1,500)	(2,901)
Proceeds from sale of subsidiary	3,000	10,538
Net cash provided by investing activities	1,500	7,637
Cash flows from financing activities:		
Proceeds from debt issuance	49,533	48,773
Repayments of long-term debt and capital lease obligations	(50,040)	(57,397)
Payment of distributions to non-controlling membership interests from the sale of subsidiary	—	(438)
Purchase of non-controlling membership interests	—	(200)
Issuance of common stock under employee stock purchase plan and exercise of stock options	155	—
Net cash used in financing activities	(352)	(9,262)
Effect of exchange rates on cash	311	(284)
Net decrease in cash	(206)	(2,405)
Cash, beginning of period	593	3,620
Cash, end of period	$ 387	$ 1,215
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 1,244	$ 1,913

Cash paid for income taxes, net of refunds	$ 48	$ (877)

See accompanying notes to the unaudited condensed consolidated financial statements.

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ARC Group Worldwide, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

NOTE 1 – Nature of Operations and Basis of Presentation

Nature of Operations

ARC Group Worldwide, Inc. (the "Company" or "ARC") is a global advanced manufacturer offering a full suite of products and services to our customers, with specific expertise in metal injection molding ("MIM") and metal 3D printing (also referred to herein as additive manufacturing). To further advance and support these core capabilities, the Company also offers complementary services including: (i) precision metal stamping; (ii) traditional and clean room plastic injection molding; and (iii) advanced rapid and conformal tooling. Through its diverse product offering, the Company provides its customers with a holistic prototyping and full-run production solution for both precision metal and plastic fabrication. The Company further differentiates itself from its competitors by providing innovative, custom capabilities, which improve high-precision manufacturing efficiency and speed-to-market for its customers.

Basis of Presentation

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 accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial statements and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments consisting of normal recurring adjustments necessary for a fair presentation of its financial position and results of operations. Interim results of operations are not necessarily indicative of the results that may be achieved for the full year. The consolidated balance sheet as of June 30, 2017, was derived from the audited financial statements as of that date, but does not include all disclosures, including notes required by GAAP. As such, this quarterly report should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2017. The Company follows the same accounting policies for preparing quarterly and annual reports.

Principles of Consolidation

The unaudited condensed consolidated financial statements include the accounts of ARC and its controlled subsidiaries. All material intercompany transactions have been eliminated in consolidation.

NOTE 2 – Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with 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. 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.

Comprehensive Income (Loss)

For each of the quarters and six months ended December 31, 2017 and January 1, 2017, there were no material differences between net income (loss) and comprehensive income (loss).

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases: Topic 842 (“ASU 2016-02”), to supersede nearly all existing lease guidance under GAAP. ASU 2016-02 requires the recognition of lease assets and lease liabilities on the

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balance sheet by lessees for those leases currently classified as operating leases. ASU 2016-02 also requires qualitative disclosures along with specific quantitative disclosures and is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. Entities are required to apply the amendments at the beginning of the earliest period presented using a modified retrospective approach. The Company is evaluating the requirements of this guidance and has not yet determined the impact of the adoption on its consolidated financial position, results of operations and cash flows; however, the Company's operating lease commitments are disclosed in Note 13, Commitments and Contingencies, of the Company's Form 10-K for the fiscal year ended June 30, 2017.

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 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 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 2019 and may transition to the standard using either the full retrospective approach or retrospectively with a cumulative effect of initially applying the amendments recognized at the date of initial application. The Company has completed its initial assessment of the effect of adoption. Based on this initial assessment, the majority of the Company's revenues will not be affected upon adoption. The Company is still analyzing the disclosure requirements of this new standard.

NOTE 3 – Divestitures

General Flange & Forge LLC ("GF&F")

On September 15, 2017, the Company sold substantially all of the assets of GF&F to GFFC Holdings, LLC ("GFFC") for $3.0 million in cash. GFFC is owned, in part, by Quadrant Management Inc., which is an affiliate of the Company. The sale of GF&F is therefore a related party transaction. The GF&F sale was made pursuant to an industry-wide auction undertaken on behalf of the Company by a registered investment banking organization that managed the sale process with prospective bidders. GFFC entered into the bidding for the GF&F assets only after the first rounds of the auction indicated uncertainty both in respect to the timing for closing any prospective sale and achieving the Company's valuation objectives. Mr. Alan Quasha, CEO of Quadrant Management Inc. and Chairman of the Company's Board of Directors, recused himself from any deliberations or voting by the Board of Directors in respect of the sale of the GF&F assets to GFFC. The Board of Directors appointed a special committee consisting solely of independent directors to oversee and negotiate the sale process. The special committee engaged its own independent legal counsel to advise the special committee in respect of the drafting of the asset sale agreement and ancillary transaction documents in accordance with customary terms and conditions for transactions of this type. In this manner, the special committee was able to conclude that the sale price and the terms and conditions for the transaction were superior to any other offers, as well as fair and reasonable to the Company and its shareholders.

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Below is a summary of the loss on sale of discontinued operations (in thousands):

Gross proceeds	$ 3,000
Less:	
Property and equipment, net	181
Accounts receivable	561
Inventory	882
Other current assets	42
Accounts payable and accrued expenses	(269)
Total net assets disposed	1,397
Goodwill	1,712
Transaction costs	394
Loss on sale of discontinued operations, before income taxes	$ (503)

The condensed consolidated statement of operations for the six months ended December 31, 2017, includes the results of operations of GF&F through the sale date of September 15, 2017 and the loss on the sale of GF&F. Financial information for discontinued operations for the three and six months ended December 31, 2017 and January 1, 2017 is as follows (in thousands):

	For the three months ended		For the six months ended	
	December 31, 2017	January 1, 2017	December 31, 2017	January 1, 2017
Sales	$ —	$ 1,191	$ 726	$ 2,304
Cost of sales	—	(903)	(615)	(1,695)
Gross profit	—	288	111	609
Selling, general and administrative	—	(128)	(108)	(320)
Income from discontinued operations, before income taxes	—	160	3	289
Loss on sale of discontinued operations	(21)	—	(503)	—
Total income (loss) from discontinued operations, before income taxes	(21)	160	(500)	289
Income tax benefit on discontinued operations	15	—	224	—
Income (loss) from discontinued operations, net of tax	$ (6)	$ 160	$ (276)	$ 289

The following table presents the carrying amount as of June 30, 2017, of the major classes of assets and liabilities held for sale in the condensed consolidated balance sheet (in thousands):

	June 30, 2017
Current assets:	
Accounts receivable, net	$ 687
Inventories, net	717
Prepaid expenses and other current assets	48
Total current assets	1,452
Property and equipment, net	181
Goodwill	1,712
Total assets of discontinued operations	$ 3,345
Current liabilities:	
Accounts payable and accrued expenses	$ 283
Total current liabilities	283
Other long-term liabilities	260
Total liabilities of discontinued operations	$ 543

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The following table presents depreciation and purchases of property and equipment of the discontinued operations related to GF&F (in thousands):

	For the six months ended December 31, 2017	January 1, 2017
Depreciation of property and equipment	$ —	$ 34
Purchases of property and equipment	—	(47)

NOTE 4– Inventory

Inventories consisted of the following (in thousands):

	December 31, 2017	June 30, 2017
Raw materials and supplies	$ 5,331	$ 5,357
Work-in-process	7,325	7,767
Finished goods	3,534	4,113
	16,190	17,237
Reserve for obsolescence	(1,848)	(2,151)
Inventory of discontinued operations	—	(717)
	$ 14,342	$ 14,369

As part of the Company's plan to reduce selected inventory to match current market conditions, the Company decreased inventory within certain business units comprising the Precision Components Group segment by $1.3 million during the six months ended December 31, 2017. See Note 12, Segment Information, for a discussion about the Company's segments.

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NOTE 5 – Property and Equipment

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

	Depreciable Life (in years)	December 31, 2017	June 30, 2017
Land	—	$ 1,264	$ 1,264
Building and improvements	7 - 40	18,210	18,125
Machinery and equipment	3 - 12	41,871	40,715
Office furniture and equipment	3 - 10	1,249	1,280
Construction-in-process	—	2,016	2,462
Assets acquired under capital lease		7,274	7,235
		71,884	71,081
Accumulated depreciation		(29,678)	(27,201)
Accumulated amortization on capital leases		(2,789)	(2,350)
Property and equipment of discontinued operations		—	(181)
		$ 39,417	$ 41,349

Depreciation expense totaled $1.7 million for the three months ended December 31, 2017 and January 1, 2017, respectively, and $3.4 million and $3.2 million for the six months ended December 31, 2017 and January 1, 2017, respectively.

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NOTE 6 – Goodwill and Intangible Assets

Goodwill

Total goodwill of $6.4 million is assigned to the Company's Precision Components Group. The Company performs a goodwill impairment assessment on at least an annual basis. The Company conducts its annual goodwill impairment assessment during the fourth quarter, or more frequently, if indicators of impairment exist. During the fiscal quarter ended December 31, 2017, the Company assessed whether any such indicators of impairment existed and concluded there were none.

Intangible Assets

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

	As of December 31, 2017			As of June 30, 2017		
Intangible assets:	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Patents and tradenames	$ 3,418	(832)	$ 2,586	$ 3,418	$ (717)	$ 2,701
Customer relationships	24,077	(9,632)	14,445	24,077	(8,429)	15,648
Non-compete agreements	3,642	(2,731)	911	3,642	(2,367)	1,275
Total	$ 31,137	$ (13,195)	$ 17,942	$ 31,137	$ (11,513)	$