NANOMETRICS INC
Form 10-Q
October 31, 2018

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 September 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: 000-13470

NANOMETRICS INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	94-2276314 (I.R.S. Employer Identification Number)
1550 Buckeye Drive	
Milpitas, California (Address of principal executive offices)	95035 (Zip Code)

Registrant’s telephone number, including area code: (408) 545-6000

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 every Interactive Data File required to be submitted 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 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	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 by Rule 12b-2 of the Exchange Act) Yes No

As of October 26, 2018, there were 24,215,562 shares of common stock, $0.001 par value, issued and outstanding.

NANOMETRICS INCORPORATED

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FOR THE QUARTER ENDED SEPTEMBER 29, 2018

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
NANOMETRICS INCORPORATED

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands except share and per share amounts)

(Unaudited)

	September 29, 2018	December 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 96,103	$ 34,899
Marketable securities	76,835	82,130
Accounts receivable, net of allowances of $58 and $126, respectively	50,349	62,457
Inventories	58,884	52,860
Inventories-delivered systems	1,858	1,534
Prepaid expenses and other	7,070	6,234
Total current assets	291,099	240,114
Property, plant and equipment, net	43,135	44,810
Goodwill	10,611	10,232
Intangible assets, net	4,101	2,206
Deferred income tax assets	7,050	11,924
Other assets	456	413
Total assets	$ 356,452	$ 309,699
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 20,870	$ 13,857
Accrued payroll and related expenses	14,895	12,901
Deferred revenue	11,698	7,408
Other current liabilities	8,470	7,249
Income taxes payable	3,183	2,680
Total current liabilities	59,116	44,095
Deferred revenue	1,575	1,661
Income taxes payable	1,003	860
Deferred tax liability	172	179
Other long-term liabilities	511	521
Total liabilities	62,377	47,316
Commitments and contingencies (Note 9)		
Stockholders' equity:		

Preferred stock, $0.001 par value; 3,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, $0.001 par value, 47,000,000 shares authorized: 24,215,562 and 24,628,722, respectively, issued and outstanding	24	26
Additional paid-in capital	241,318	255,368
Retained earnings	55,380	9,113
Accumulated other comprehensive loss	(2,647)	(2,124)
Total stockholders' equity	294,075	262,383
Total liabilities and stockholders' equity	$ 356,452	$ 309,699

See Notes to Condensed Consolidated Financial Statements

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NANOMETRICS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Net revenues:				
Products	$63,798	$ 45,571	$211,521	$ 147,322
Service	12,792	11,104	35,986	33,094
Total net revenues	76,590	56,675	247,507	180,416
Costs of net revenues:				
Cost of products	25,589	21,349	85,417	72,164
Cost of service	7,332	4,614	19,929	15,368
Amortization of intangible assets	35	52	105	156
Total costs of net revenues	32,956	26,015	105,451	87,688
Gross profit	43,634	30,660	142,056	92,728
Operating expenses:				
Research and development	12,717	8,825	35,410	26,658
Selling	8,902	7,553	28,077	22,730
General and administrative	7,744	6,798	22,950	19,696
Total operating expenses	29,363	23,176	86,437	69,084
Income from operations	14,271	7,484	55,619	23,644
Other income (expense):				
Interest income	4	2	8	6
Interest expense	(108)	(25)	(253)	(84)
Other income, net	322	59	508	330
Total other income, net	218	36	263	252
Income before income taxes	14,489	7,520	55,882	23,896
Provision for income taxes	2,921	1,756	10,258	4,492
Net income	$11,568	$ 5,764	$45,624	$ 19,404
Net income per share:				
Basic	$0.48	$ 0.23	$1.90	$ 0.77
Diluted	$0.47	$ 0.22	$1.86	$ 0.75
Weighted average shares used in per share calculation:				
Basic	24,059	25,494	24,065	25,320
Diluted	24,466	25,932	24,551	25,933

See Notes to Condensed Consolidated Financial Statements

NANOMETRICS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Net income	$11,568	$ 5,764	$45,624	$ 19,404
Other comprehensive income:				
Change in foreign currency translation adjustment	38	764	(530)	3,470
Net change in unrealized gains (losses) on available-for-sale investments	44	15	7	(2)
Other comprehensive income (loss):	82	779	(523)	3,468
Comprehensive income	$11,650	$ 6,543	$45,101	$ 22,872

See Notes to Condensed Consolidated Financial Statements

NANOMETRICS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 29, 2018	Nine Months Ended September 30, 2017
Cash flows from operating activities:		
Net income	$45,624	$ 19,404
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	4,962	5,219
Stock-based compensation	8,229	6,775
Disposal of fixed assets	38	98
Inventory write-down	870	1,412
Deferred income taxes	4,668	2,153
Changes in assets and liabilities:		
Accounts receivable	11,520	1,418
Inventories	(6,351)	(16,828)
Inventories-delivered systems	(324)	(864)
Prepaid expenses and other	(1,224)	(3,850)
Accounts payable, accrued and other liabilities	9,623	709
Deferred revenue	5,126	(1,204)
Income taxes payable	647	942
Net cash provided by operating activities	83,408	15,384
Cash flows from investing activities:		
Payments to acquire certain assets	(2,000)	(2,000)
Sales of marketable securities	19,776	28,624
Maturities of marketable securities	32,195	62,923
Purchases of marketable securities	(46,604)	(104,984)
Purchases of property, plant and equipment	(2,942)	(2,342)
Net cash provided by (used in) investing activities	425	(17,779)
Cash flows from financing activities:		
Proceeds from sale of shares under employee stock option plans and purchase plan	3,826	3,678
Taxes paid on net issuance of stock awards	(3,122)	(3,838)
Repurchases of common stock under share repurchase plans	(22,987)	-
Net cash used in financing activities	(22,283)	(160)
Effect of exchange rate changes on cash and cash equivalents	(346)	(466)
Net increase (decrease) in cash and cash equivalents	61,204	(3,021)
Cash and cash equivalents, beginning of period	34,899	47,062

Cash and cash equivalents, end of period	$96,103	$ 44,041
Supplemental disclosure of non-cash investing activities:		
Transfer of property, plant and equipment to inventory	$893	$ 205
Transfer of inventory to property, plant and equipment	$291	$ —
Property, plant and equipment included in accounts payable, accrued and other liabilities	$1,684	$ —

See Notes to Condensed Consolidated Financial Statements

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NANOMETRICS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Nature of Business, Basis of Presentation and Significant Accounting Policies

Description of Business – Nanometrics Incorporated ("Nanometrics" or the "Company") and its wholly-owned subsidiaries design, manufacture, market, sell and support optical critical dimension ("OCD"), thin film and overlay dimension metrology and inspection systems used primarily in the manufacturing of semiconductors, solar photovoltaics ("solar PV") and high-brightness LEDs ("HB-LED"), as well as by customers in the silicon wafer and data storage industries. Nanometrics' metrology systems precisely measure a wide range of film types deposited on substrates during manufacturing to control manufacturing processes and increase production yields in the fabrication of integrated circuits. The Company's OCD technology is a patented critical dimension measurement technology that is used to precisely determine the dimensions on the semiconductor wafer that directly control the resulting performance of the integrated circuit devices. The thin film metrology systems use a broad spectrum of wavelengths, high-sensitivity optics, proprietary software, and patented technology to measure the thickness and uniformity of films deposited on silicon and other substrates as well as their chemical composition. The overlay metrology systems are used to measure the overlay accuracy of successive layers of semiconductor patterns on wafers in the photolithography process. Nanometrics' inspection systems are used to find defects on patterned and unpatterned wafers at nearly every stage of the semiconductor production flow. The corporate headquarters of Nanometrics is located in Milpitas, California.

Basis of Presentation – The accompanying condensed consolidated financial statements ("financial statements") have been prepared on a consistent basis with the audited consolidated financial statements as of December 30, 2017 and include all normal recurring adjustments necessary to fairly state the information set forth therein. All significant intercompany accounts and transactions have been eliminated in consolidation.

The financial statements have been prepared in accordance with the regulations of the United States Securities and Exchange Commission ("SEC") for interim periods in accordance with S-X Article 10, and, therefore, omit certain information and footnote disclosure necessary to present the statements in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). The operating results for interim periods are not necessarily indicative of the operating results that may be expected for the entire year. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended December 30, 2017, which were included in the Company's Annual Report on Form 10-K filed with the SEC on February 26, 2018.

Fiscal Period – The Company uses a 52/53 week fiscal year ending on the last Saturday of the calendar year. All references to the quarter refer to Nanometrics' fiscal quarter. The fiscal quarters reported herein are 13 week periods.

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 the reported amounts of revenues and expenses during the reported period. Actual results could differ materially from those estimates. Estimates are used for, but not limited to, revenue recognition, the provision for doubtful accounts, the provision for excess, obsolete, or slow-moving inventories, valuation of intangible and long-lived assets, warranty accruals, income taxes, valuation of stock-based compensation, and contingencies.

Changes to Significant Accounting Policies

Except for the changes below, the Company has consistently applied the accounting policies to all periods presented in these financial statements.

The Company adopted the new accounting standard Topic 606, Revenue from Contracts with Customers and all the related amendments using the modified retrospective method of transition. As a result, the Company has changed its accounting policy for revenue recognition as detailed below. The Company adopted the new standard during the first quarter of 2018 for all contracts not substantially completed at the date of adoption, and the Company expects all new contracts will be governed by the new standard.

Revenue Recognition – The Company derives revenue from the sale of process control metrology and inspection systems and related upgrades ("product revenue") as well as spare part sales, billable service and service contracts (together "service revenue"). Upgrades are system software and hardware performance upgrades that extend the features and functionality of a product. Upgrades are included in product revenue, which consists of sales of complete, advanced process control metrology and inspection systems (the "system(s)"). Nanometrics' systems consist of hardware and software components that function together to deliver the essential functionality of the system. Arrangements for sales of systems and upgrades often include defined customer-specified acceptance criteria.

The Company recognizes revenue when control of a good or service has transferred to a customer. The amount of revenue recognized reflects the amount which Nanometrics expects to be entitled to in exchange for the transfer of the goods or services in a contract with a customer. Revenue excludes amounts collected on behalf of third parties including taxes assessed by governmental authorities that are both imposed on and concurrent with a specific revenue producing transaction. Shipping and handling costs associated with outbound freight both before and after control over a product has transferred to a customer are accounted for as a fulfillment cost and are included in cost of revenues. Nanometrics records revenue on a gross basis, rather than net, as it acts as the principal in all of its contractual arrangements and not as an agent.

Nanometrics follows a 5-Step process to evaluate its contracts with customers to determine the amount and timing of revenue recognition.

Nanometrics first identifies whether a legally enforceable contract with a customer exists. A legally enforceable contract creates enforceable rights and obligations on both parties. Nanometrics evaluates the following criteria in its evaluation and if all criteria are not met, a contract does not exist and any revenue that otherwise would be recorded because a good or service had been transferred to a customer is deferred until such time that a contract exists: (1) both Nanometrics and the customer have approved the contract and are committed to perform, (2) Nanometrics can identify each party's rights regarding the goods or services to be transferred, (3) Nanometrics can identify the payment terms for the goods or services to be delivered, (4) the contract has commercial substance, and (5) it is probable that Nanometrics will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. Historically, the Company has not experienced Customer payment defaults that would lead it to conclude that it does not have a contract under the new standard. Nanometrics evidences all its contracts in writing and the identification of the contract may include (1) reference to a master agreement that governs for multiple years, (2) a Volume Purchase Agreement that generally governs for 12 months and is negotiated with the larger customers to establish pricing for a committed volume of business, or (3) purchase orders which often govern the purchase of a single system or service item.

Once the contract has been identified, Nanometrics evaluates the promises in the contract to identify performance obligations. Many of the contracts include more than one performance obligation – for example the delivery of a system generally includes the promise to install the system in the customer's facility. Additionally, a contract could include the purchase of multiple systems or the purchase of a system and an upgrade. Promises in contracts which do not result in the transfer of a good or service are not performance obligations, as well as those promises that are administrative in nature, or are immaterial in the context of the contract. Generally, Nanometrics performance obligations can be categorized as (1) systems – including refurbished systems, (2) installation obligations, (3) hardware upgrades, (4) non-operating system software options / upgrades, (5) spare parts, (6) service contracts, (7) billable services and (8) other miscellaneous service items.

Once the performance obligations in the contract have been identified, Nanometrics estimates the transaction price of the contract. The estimate includes amounts that are fixed as well as those that can vary based on contractual terms (e.g., performance bonuses/penalties, amounts payable to customers, rebates, prompt payment discounts, etc.) These variable consideration items are rare as most Nanometrics contracts include only fixed amounts. It is expected that estimates of variable consideration will be immaterial for Nanometrics and would occur if customers did not meet their contractual purchase commitments and Nanometrics is entitled to recover additional contract consideration.

Once the transaction price of the contract has been identified, Nanometrics allocates the transaction price to the identified performance obligations. This is done on a relative selling price basis using standalone selling prices ("SSP"). For most performance obligations, Nanometrics does not have observable SSP's as they are not regularly sold on a standalone basis however if a performance obligation does have an observable SSP it is used for allocation purposes (e.g. spares parts are sold using a standard price list and often sold separately). Without observable SSP's, Nanometrics estimates the SSP using a methodology which maximizes the use of observable inputs – namely a cost plus gross margin approach.

Lastly, Nanometrics records the amount allocated to each performance obligation as revenue when control of that good or service has transferred to the customer. Nanometrics first evaluates whether a good or service is transferred over time, and if it is not, then it is recorded at a point in time. For service contracts, Nanometrics records revenue based on its measurement of progress, and the best method to determine this is the percentage of the stand-ready obligation that is completed to date as this best reflects the value of the service transferred to the customer. All other items at Nanometrics are recorded at a point in time other than the service contracts with customers. The timing of satisfaction of the performance obligation to payment is dependent upon the negotiated payment terms but generally occurs within 30 to 60 days. Nanometrics evaluates the following indicators to determine the point in time at which control transfers to the Customer, and may apply judgment in this evaluation: (1) whether Nanometrics has a present right to payment, (2) whether the customer has legal title, (3) whether the customer has physical possession, (4) whether the customer has significant risks and rewards of ownership, and (5) whether customer acceptance is a formality (i.e., whether customer acceptance of the tool is reasonably assured). Typically, for new product introductions, Nanometrics defers revenue recognition until formal customer acceptance is received from the customer. In almost all other situations, there is little or no significant judgment applied by Nanometrics in determining if control of a good or service has transferred to a customer. Additionally, for system shipments to Japan, revenue is deferred because typical contractual terms indicate that payment is not due, and title does not transfer until customer acceptance occurs.

The Company warrants its products against defects in manufacturing. Upon recognition of product revenue, this assurance-type warranty is recorded as a liability for anticipated warranty costs. On occasion, customers request a warranty period longer than the Company's standard warranty. In those instances, in which extended warranty services are separately quoted to the customer or if the warranty includes services beyond just an assurance that the product will work as intended, an additional performance obligation is created, and the associated revenue is deferred and recognized as service revenue ratably over the term of the extended warranty period. The portion of service contracts and extended warranty services agreements that are uncompleted at the end of any reporting period are included in deferred revenue.

Frequently, the Company delivers products and various services in a single transaction. The Company's deliverables consist of tools, installation, upgrades, billable services, spare parts, and service contracts. The Company's typical multi-element arrangements include a sale of one or multiple tools that include installation and standard warranty. Other arrangements consist of a sale of tools bundled with service elements or delivery of different types of services. The Company's tools, upgrades, and spare parts are generally delivered to customers within a period of up to six months from order date. Installation is usually performed soon after delivery of the tool. The portion of revenue associated with installation is deferred based on relative selling price and that revenue is recognized upon completion of the installation and receipt of final acceptance. Billable services are billed on a time and materials basis and performed as requested by customers. Under service contract arrangements, services are provided as needed over the fixed arrangement term, with terms normally up to twelve months. The Company does not grant its customers a general right of return or any refund terms and may impose a penalty on orders cancelled prior to the scheduled shipment date. Consideration received from customers for cancelled orders is rare as orders are typically not cancelled once placed.

When performance obligations are not transferred to a customer at the end of a reporting period, the amount allocated to those performance obligations is deferred until control of these performance obligations is transferred to the customer. If performance obligations cannot be accounted for as separate units of accounting, the entire arrangement is accounted for as a single unit of accounting and revenue is deferred until all elements are delivered and all revenue recognition requirements are met. These liabilities arising from contracts with customers are reported as Deferred Revenue in the consolidated balance sheet. The amount of revenue recognized in the three months ended September 29, 2018 that was included in the contract liability balance as of the beginning of the quarter was $3.1 million. Generally, all contracts have expected durations of one year or less. Accordingly, Nanometrics applies the practical expedient allowed for in U.S. GAAP and does not disclose information about remaining performance obligations that have original expected durations of one year or less.

Nanometrics incurs costs related to the acquisition of its contract with customers in the form of sales commissions. Sales commissions are paid to the internal direct sales team as well as to third-party representatives, and distributors. Contractual agreements, with each of these parties, outline commissions structures and rates to be paid. Generally, the contracts are all individual procurement decisions by the customers and are not for significant periods of time, nor do they include renewal provisions. As such, most of the contracts have an economic life of significantly less than a year, although some volume purchase agreements might extend beyond 12 months (the capitalization and amortization of commission costs for contracts that extend beyond one year is immaterial for Nanometrics). Accordingly, the Company expense these contract acquisition costs in accordance with the practical expedient outlined in U.S. GAAP when the underlying contract asset is less than one year.

Nanometrics does not incur any costs to fulfill the contracts with customers that is not already reported in compliance with another applicable standard (for example, inventory or plant, property and equipment). Given the nature of the systems, the Company does not have costs which are separately identifiable to just a particular contract (for example, dedicated labs).

Nanometrics records accounts receivable when revenue has been recorded and the amount due from the customer is reasonably assured and unconditionally due. In certain situations, Nanometrics may record revenue because goods or services have been transferred to the customer, but the amount is not unconditionally due. In these situations, a contract asset is reflected in the consolidated balance sheet (Unbilled A/R). This amount is subsequently reported as accounts receivable when the condition that made the amount conditional is resolved (for example, when the final installation obligation is completed, and Nanometrics has recorded revenue for the delivery of the system in an amount larger than what has been invoiced). The balance of contract assets included in the Accounts Receivable at September 29, 2018 was $3.0 million. The opening balance of contract assets was $4.5 million and $4.3 million for the three and nine months ended September 29, 2018, respectively, reflecting no significant change during either period.

The following tables summarize the impacts of Topic 606 adoption on the Company's financial statements for the three and nine months ended September 29, 2018 (in thousands, except per share data):

	Three Months Ended September 29, 2018			Nine Months Ended September 29, 2018		
	As Reported	Balances Without Adoption of ASC 606	Effect of Change Higher/(Lower)	As Reported	Balances Without Adoption of ASC 606	Effect of Change Higher/(Lower)
Net Revenue	$76,590	$77,478	$ (888)	$247,507	$244,668	$ 2,839
Net Income	$11,568	$12,169	$ (601)	$45,624	$43,779	$ 1,845
Net income per share:						
Basic	$0.48	$0.51	$ (0.03)	$1.90	$1.82	$ 0.08
Diluted	$0.47	$0.50	$ (0.03)	$1.86	$1.78	$ 0.08

Note 2. New Accounting Pronouncements

Recently Adopted Accounting Standards

In October 2016, the Financial Accounting Standards Board (the "FASB") issued an accounting standard update which requires the recognition of the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. The Company adopted this standard in the first quarter of fiscal 2018 using a modified retrospective approach. The adoption did not have a material impact on the financial statements.

In August 2016, the FASB issued an accounting standard which addresses eight specific cash flow classification issues. This update is effective for public companies for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. Early adoption is permitted, including in an interim period. The standard is to be applied through a retrospective transition method to each period presented. If it is impracticable to apply retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The adoption of this guidance did not have an impact on the Company's consolidated statement of cash flows.

In May 2014, the FASB issued an accounting standard update which requires an entity to recognize the amount of revenue to which it expects to be entitled to for transferring promised goods or services to customers. The Company adopted Topic 606 Revenue from Contracts with Customers with a date of initial application of December 31, 2017. The Company applied Topic 606 using the modified retrospective method by recognizing the cumulative effect of initially applying Topic 606 as an adjustment to the opening balance of equity at December 31, 2017. This method was chosen due to the Company's inability to review all necessary contract information to adopt the standard using the full retrospective method. Both methods are allowed per U.S. GAAP. Therefore, the comparative information has not been adjusted and continues to be reported under Topic 605.

Recently Issued Accounting Standards

In August 2018, the FASB issued an accounting standard update to provide additional guidance on the accounting for costs of implementation activities performed in a cloud computing arrangement. The amendments in this update align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software and hosting arrangements that include an internal-use software license. The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this update. The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. The amendments in this update should be applied retrospectively or prospectively to all implementation costs incurred after the date of adoption. The Company is currently evaluating the effect of this update on its consolidated financial condition and results of operations.

In August 2018, the FASB issued an accounting standard update which improves the effectiveness of fair value measurement disclosures in the notes to the financial statements. The update is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Certain amendments within the update should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted. Entities are permitted to early adopt any removed or modified disclosures upon issuance of this Update and delay adoption of the additional disclosures until their effective date. The adoption of this guidance is not expected to have a significant impact on the Company's consolidated results of operations or consolidated statement of cash flows.

In June 2018, the FASB issued an accounting standard update which simplifies the accounting for nonemployee share-based payment transactions. The accounting for share-based payments to nonemployees and employees will be substantially aligned because of this update. The standard is effective for public companies for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. Early adoption is permitted, but no earlier than an entity's adoption date of Topic 606. The adoption of this guidance is not expected to have a significant impact on the Company's consolidated results of operations or consolidated statement of cash flows.

In January 2017, the FASB issued an accounting standard update which simplifies the subsequent measurement of goodwill and removes step 2 from the goodwill impairment test. Instead, an entity should record an impairment charge based on excess of a reporting unit's carrying amount over its fair value. The standard is effective for public companies for fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of this guidance is not expected to have a significant impact on the Company's consolidated financial condition and results of operations.

In June 2016, the FASB issued an accounting standard which requires measurement and timely recognition of expected credit losses for financial assets. The update is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The standard is to be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. The Company is currently evaluating the effect of this update on its consolidated financial condition and results of operations.

In February 2016, the FASB issued an accounting standard update which requires lessees to record a right-of-use asset and a corresponding lease liability on the balance sheet (with the exception of short-term leases). For lessees, leases will continue to be classified as either operating or financing in the income statement. The standard is effective for public companies for annual reporting periods beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. This standard is required to be applied with a modified retrospective transition approach. The Company generally does not finance purchases of equipment or other capital but does lease some equipment and facilities. The Company has established a cross-functional implementation team to evaluate and identify the impact of this update on its financial position, results of operations and cash flows. Based on the preliminary work completed, the Company is considering the possible implications of the update, including the discount rate to be used in valuing new and existing leases, procedural and operational changes that may be necessary to comply with the provisions of the guidance and all applicable financial statement disclosures required by the new guidance. The Company is also in the process of identifying changes to its business processes, systems and controls to support adoption of the new standard. The Company expects to adopt this standard on December 30, 2018 and anticipates most its existing operating lease commitments will be recognized as operating lease liabilities and right-of-use assets.

In July 2018, the FASB issued an accounting standard update which provided certain transition relief on the comparative reporting requirement for lessees. Under this update, the FASB provided an additional transition method in addition to the existing transition method by allowing entities to initially apply Topic 842 at the adoption date (such as January 1, 2019, for calendar-year-end public business entities) and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The amendments in this update change only when the Company is required to initially apply Topic 842 Leases, it does not change how such Topic will be applied. Since the Company has not yet adopted Topic 842 Leases, the amendments in this update will be effective for the Company when Topic 842 becomes effective for the Company. The Company expects to adopt Topic 842 Leases on December 30, 2018.

Note 3. Fair Value Measurements and Disclosures

The Company determines the fair values of its financial instruments based on the fair value hierarchy established in FASB Accounting Standards Codification ("ASC") 820, Fair Value Measurement, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The classification of a financial asset or liability within the hierarchy is based upon the lowest level input that is significant to the fair value measurement. The fair value hierarchy prioritizes the inputs into the following three levels that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities.

Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument.

Level 3 — Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Such unobservable inputs include an estimated discount rate used in the Company's discounted present value analysis of future cash flows, which reflects the Company's estimate of debt with similar terms in the current credit markets. As there is currently minimal activity in such markets, the actual rate could be materially different.

Fair value is defined as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The standard assumes that the transaction to sell the asset or transfer the liability occurs in the principal or most advantageous market for the asset or liability and establishes that the fair value of an asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability.

The following tables present the Company's assets and liabilities measured at estimated fair value on a recurring basis, excluding accrued interest components, categorized in accordance with the fair value hierarchy (in thousands), as of the following dates:

	September 29, 2018 Fair Value Measurements Using Input Types				December 30, 2017 Fair Value Measurements Using Input Types			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents:								
Money market funds	$1,684	$—	$ —	$1,684	$256	$—	$ —	$256
Marketable securities:								
U.S. Government agency debt securities	—	—	—	—	—	1,495	—	1,495
Certificates of deposits	—	14,502	—	14,502	—	14,497	—	14,497
Commercial paper	—	11,185	—	11,185	—	7,949	—	7,949
Corporate debt securities	—	36,950	—	36,950	—	47,968	—	47,968
Asset-backed Securities	—	14,198	—	14,198	—	10,221	—	10,221

Total marketable securities	$—	$76,835	$ —	$76,835	$—	$82,130	$ —	$82,130
Total[1]	$1,684	$76,835	$ —	$78,519	$256	$82,130	$ —	$82,386

[1] Excludes $94.4 million and $34.6 million held in operating accounts as of September 29, 2018 and December 30, 2017, respectively. See “Note 4. Cash and Investments” of the Notes to Condensed Consolidated Financial Statements for more information.

The fair values of the marketable securities that are classified as Level 1 in the table above were derived from quoted market prices for identical assets or liabilities in active markets that the Company can access. The fair value of marketable securities that are classified as Level 2 in the table above were derived from non-binding market consensus prices that were corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques with all significant inputs derived from or corroborated by observable market data. There were no transfers of instruments between Level 1, Level 2 and Level 3 during the financial periods presented.

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Derivatives

The Company uses foreign currency exchange forward contracts to mitigate variability in gains and losses generated from the re-measurement of certain monetary assets and liabilities denominated in foreign currencies. These derivatives are carried at fair value with changes recorded in other income (expense), net in the condensed consolidated statements of operations. Changes in the fair value of these derivatives are largely offset by re-measurement of the underlying assets and liabilities. The derivatives have maturities of approximately 30 days.

The settlement of forward foreign currency contracts included in the three months ended September 29, 2018 and September 30, 2017 was a gain of $0.2 million and $0.3 million, respectively. The settlement of forward exchange contracts included in the nine months ended September 29, 2018 and September 30, 2017 was a loss of $1.5 million and a gain of $1.0 million, respectively. These are included in other income (expense), net, in the condensed consolidated statements of operations.

The following table presents the notional amounts and fair values of the Company's outstanding derivative instruments in U.S. Dollar equivalent as of the following dates (in millions):

	September 29, 2018			December 30, 2017		
		Fair Value			Fair Value	
	Notional Amount	Asset	Liability	Notional Amount	Asset	Liability
Undesignated Hedges:						
Forward Foreign Currency Contracts						
Purchase	$20.8	$—	$ 0.1	$27.5	$—	$ 0.1
Sell	$27.3	$0.1	$ —	$16.8	$0.1	$ —

Note 4. Cash and Investments

The following tables present cash, cash equivalents, and available-for-sale investments as of the following dates (in thousands):

	September 29, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
Cash	$94,419	$ —	$ —	$94,419
Cash equivalents:				
Money market funds	1,684	—	—	1,684

Marketable securities:				
Certificates of deposit	14,496	6	—	14,502
Commercial paper	11,185	—	—	11,185
Corporate debt securities	37,038	—	(88)	36,950
Asset-backed securities	14,224	—	(26)	14,198
Total cash, cash equivalents, and marketable securities	$173,046	$ 6	$ (114)	$172,938

	December 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
Cash	$34,643	$ —	$ —	$34,643
Cash equivalents:				
Money market funds	256	—	—	256
Marketable securities:				
U.S. Government agency securities	1,500	—	(5)	1,495
Certificates of deposits	14,498	—	(1)	14,497
Commercial paper	7,952	—	(3)	7,949
Corporate debt securities	48,073	—	(105)	47,968
Asset-backed securities	10,240	—	(19)	10,221
Total cash, cash equivalents, and marketable securities	$117,162	$ —	$ (133)	$117,029

Available-for-sale marketable securities, readily convertible to cash, with maturity dates of 90 days or less are classified as cash equivalents, while those with maturity dates greater than 90 days are classified as marketable securities within short-term assets. All marketable securities as of September 29, 2018 and December 30, 2017, were available-for-sale and reported at fair value based on the estimated or quoted market prices as of the balance sheet date.

Realized gains and losses on sale of securities are recorded in other income (expense), net, in the Company's condensed consolidated statement of operations. For the three and nine months ended September 29, 2018 and September 30, 2017, net realized gains and losses were not material.

Unrealized gains or losses, net of tax effect, are recorded in accumulated other comprehensive income (loss) within stockholders' equity. Both the gross unrealized gains and gross unrealized losses for the three and nine months ended September 29, 2018 and September 30, 2017 were not material, and no marketable securities had other than temporary impairment.

All marketable securities as of September 29, 2018 and December 30, 2017, had maturity dates of less than 36 and 24 months, respectively.

Note 5. Accounts Receivable

The Company maintains arrangements under which eligible accounts receivable in Japan are sold without recourse to unrelated third-party financial institutions. These receivables were not included in the condensed consolidated balance sheets as the criteria for sale treatment had been met. The Company pays administrative fees as well as interest, which ranged 0.62% to 1.68% during the nine months ended September 29, 2018, based on the anticipated length of time between the date the sale is consummated, and the expected collection date of the receivables sold.

The Company sold $12.8 million and $6.1 million of receivables during the three months ended September 29, 2018 and September 30, 2017, respectively, and $47.5 million and $15.5 million of receivables during the nine months ended September 29, 2018 and September 30, 2017, respectively. There were no amounts due from such third party financial institutions at September 29, 2018 and December 30, 2017.

Note 6. Financial Statement Components

The following tables provide details of selected financial statement components as of the following dates (in thousands):

	At September 29, 2018	December 30, 2017
Inventories:		
Raw materials and sub-assemblies	$31,619	$ 32,187
Work in process	20,590	13,498
Finished goods	6,675	7,175
Inventories	58,884	52,860
Inventories-delivered systems	1,858	1,534
Total inventories	$60,742	$ 54,394
Property, plant and equipment, net:[1]		
Land	$15,571	$ 15,573
Building and improvements	21,226	20,880
Machinery and equipment	39,652	36,380
Furniture and fixtures	2,494	2,420
Software	9,915	9,558
Capital in progress	2,919	4,418
Total property, plant and equipment, gross	91,777	89,229
Accumulated depreciation and amortization	(48,642)	(44,419)
Total property, plant and equipment, net	$43,135	$ 44,810

[1] Total depreciation and amortization expense was $1.6 million and $1.6 million for the three months ended September 29, 2018 and September 30, 2017, respectively, and $4.9 million and $5.1 million for the nine months ended September 29, 2018 and September 30, 2017, respectively.

Other Current Liabilities:		
Accrued warranty	$4,258	$ 4,863
Accrued taxes	1,201	813
Third party commissions	837	76
Accrued professional services	537	534
Other	1,637	963
Total other current liabilities	$8,470	$ 7,249

Components of Accumulated Other Comprehensive Income (Loss)

	Foreign	Defined	Unrealized	Accumulated

	Currency Translations	Benefit Pension Plans	Income (Loss) on Investment	Other Comprehensive Income (Loss)
Balance as of December 30, 2017	$ (1,647)	$ (387)	$ (90)	$ (2,124)
Current period change	(530)	—	7	(523)
Balance as of September 29, 2018	$ (2,177)	$ (387)	$ (83)	$ (2,647)

The items above, except for unrealized income (loss) on investment, did not impact the Company's income tax provision. The amounts reclassified from each component of accumulated other comprehensive income (loss) into income statement line items were insignificant.

Note 7. Goodwill and Intangible Assets

The following table summarizes the activity in the Company’s goodwill during the nine months ended September 29, 2018:

	(in thousands)
Balance as of December 30, 2017	$ 10,232
Foreign currency movements	379
Balance as of September 29, 2018	$ 10,611

Finite-lived intangible assets are recorded at cost, less accumulated amortization. Finite-lived intangible assets as of September 29, 2018 and December 30, 2017 consisted of the following (in thousands):

	September 29, 2018		
	Adjusted cost	Accumulated amortization	Net carrying amount
Developed technology	$20,917	$ (16,816)	$ 4,101
Customer relationships	9,445	(9,445)	—
Brand names	1,927	(1,927)	—
Patented technology	2,252	(2,252)	—
Trademark	80	(80)	—
Total	$34,621	$ (30,520)	$ 4,101

	December 30, 2017		
	Adjusted cost	Accumulated amortization	Net carrying amount
Developed technology	$18,887	$ (16,681)	$ 2,206
Customer relationships	9,438	(9,438)	—
Brand names	1,927	(1,927)	—
Patented technology	2,252	(2,252)	—
Trademark	80	(80)	—
Total	$32,584		