NOVANTA INC
Form 10-Q
November 02, 2016

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 September 30, 2016

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 No. 001-35083

Novanta Inc.

(Exact name of registrant as specified in its charter)

New Brunswick, Canada (State or other jurisdiction of	98-0110412 (I.R.S. Employer
incorporation or organization)	Identification No.)
125 Middlesex Turnpike	
Bedford, Massachusetts, USA	01730

(Address of principal executive offices) (Zip Code)

(781) 266-5700

(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 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 (Section 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 (Do not check if a smaller reporting company)	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 October 28, 2016, there were 34,443,526 of the Registrant's common shares, no par value, issued and outstanding.

NOVANTA INC.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

NOVANTA INC.

CONSOLIDATED BALANCE SHEETS

(In thousands of U.S. dollars or shares)

(Unaudited)

	September 30, 2016	December 31, 2015
ASSETS		
Current Assets		
Cash and cash equivalents	$64,739	$ 59,959
Accounts receivable, net of allowance of $536 and $500, respectively	61,787	57,188
Inventories	59,614	59,566
Income taxes receivable	4,505	2,510
Prepaid expenses and other current assets	5,621	5,989
Total current assets	196,266	185,212
Property, plant and equipment, net	34,911	40,550
Deferred tax assets	5,886	7,885
Other assets	10,466	12,673
Intangible assets, net	60,871	66,269
Goodwill	108,337	103,456
Total assets	$416,737	$ 416,045
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Current portion of long-term debt	$7,365	$ 7,385
Accounts payable	28,179	24,401
Income taxes payable	1,274	3,985
Accrued expenses and other current liabilities	30,074	21,182
Total current liabilities	66,892	56,953
Long-term debt	72,267	88,426
Deferred tax liabilities	42	449
Income taxes payable	5,855	6,071
Other liabilities	14,481	19,445
Total liabilities	159,537	171,344
Commitments and Contingencies (Note 13)		
Stockholders' Equity:		
Common shares, no par value; Authorized shares: unlimited; Issued and outstanding: 34,439 and 34,345, respectively	423,856	423,856
Additional paid-in capital	29,257	29,225

Accumulated deficit	(175,303)	(189,550)
Accumulated other comprehensive loss	(20,610)	(18,830)
Total stockholders’ equity	257,200	244,701
Total liabilities and stockholders’ equity	$416,737	$ 416,045

The accompanying notes are an integral part of these consolidated financial statements.

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NOVANTA INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands of U.S. dollars or shares, except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2016	October 2, 2015	September 30, 2016	October 2, 2015
Revenue	$ 97,829	$ 92,271	$ 285,879	$ 283,379
Cost of revenue	56,617	52,361	166,279	162,118
Gross profit	41,212	39,910	119,600	121,261
Operating expenses:				
Research and development and engineering	7,961	7,693	24,029	23,748
Selling, general and administrative	20,972	19,979	62,357	62,969
Amortization of purchased intangible assets	2,066	1,852	6,153	5,593
Restructuring, acquisition and divestiture related costs (gain)	(835)	1,379	5,828	4,232
Total operating expenses	30,164	30,903	98,367	96,542
Operating income from continuing operations	11,048	9,007	21,233	24,719
Interest income (expense), net	(1,081)	(1,248)	(3,471)	(4,020)
Foreign exchange transaction gains (losses), net	188	383	978	(2,253)
Other income (expense), net	686	878	1,699	21,641
Income from continuing operations before income taxes	10,841	9,020	20,439	40,087
Income tax provision	3,371	2,452	6,192	10,562
Income from continuing operations	7,470	6,568	14,247	29,525
Loss from discontinued operations, net of tax	—	—	—	(13)
Consolidated net income	$ 7,470	$ 6,568	$ 14,247	$ 29,512
Earnings per common share from continuing operations:				
Basic	$ 0.22	$ 0.19	$ 0.41	$ 0.85
Diluted	$ 0.21	$ 0.19	$ 0.41	$ 0.84
Loss per common share from discontinued operations:				
Basic	$ —	$ —	$ —	$ (0.00)
Diluted	$ —	$ —	$ —	$ (0.00)
Earnings per common share:				
Basic	$ 0.22	$ 0.19	$ 0.41	$ 0.85
Diluted	$ 0.21	$ 0.19	$ 0.41	$ 0.84
Weighted average common shares outstanding—basic	34,677	34,599	34,689	34,578
Weighted average common shares outstanding—diluted	34,928	35,055	34,889	35,027

The accompanying notes are an integral part of these consolidated financial statements.

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NOVANTA INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands of U.S. dollars)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2016	October 2, 2015	September 30, 2016	October 2, 2015
Consolidated net income	$ 7,470	$ 6,568	$ 14,247	$ 29,512
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax (1)	(563)	(1,624)	(3,413)	(2,172)
Pension liability adjustments, net of tax (2)	338	517	1,633	937
Total other comprehensive income (loss)	(225)	(1,107)	(1,780)	(1,235)
Total consolidated comprehensive income (loss)	$ 7,245	$ 5,461	$ 12,467	$ 28,277

(1) The tax effect on this component of comprehensive income was nominal for the three and nine months ended September 30, 2016 and $0.2 million for the three and nine months ended October 2, 2015.

(2) The tax effect on this component of comprehensive income was not material for all periods presented. See Note 4 for the total amount of pension liability adjustments reclassified out of accumulated other comprehensive income (loss).

The accompanying notes are an integral part of these consolidated financial statements.

NOVANTA INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)

(Unaudited)

	Nine Months Ended	
	September 30, 2016	October 2, 2015
Cash flows from operating activities:		
Consolidated net income	$14,247	$29,512
Less: Loss from discontinued operations, net of tax	—	13
Income from continuing operations	14,247	29,525
Adjustments to reconcile income from continuing operations to net cash provided by operating activities of continuing operations:		
Depreciation and amortization	15,317	14,088
Provision for inventory excess and obsolescence	2,387	1,303
Share-based compensation	3,385	3,494
Deferred income taxes	162	3,782
Earnings from equity-method investment	(1,698)	(2,007)
Gain on disposal of business	—	(19,633)
Gain on sale of fixed assets	(1,736)	(24)
Dividend from equity-method investment	2,341	—
Non-cash restructuring and acquisition related charges	616	511
Earn-out adjustments	1,427	—
Other	974	921
Changes in assets and liabilities which (used)/provided cash, excluding effects from businesses purchased or classified as discontinued operations:		
Accounts receivable	(3,683)	(6,996)
Inventories	(1,470)	(5,352)
Income taxes receivable, prepaid expenses and other current assets	(3,594)	1,244
Accounts payable, income taxes payable, accrued expenses and other current liabilities	6,110	6,602
Other non-current assets and liabilities	(78)	(1,982)
Cash provided by operating activities of continuing operations	34,707	25,476
Cash used in operating activities of discontinued operations	—	(13)
Cash provided by operating activities	34,707	25,463
Cash flows from investing activities:		
Purchases of property, plant and equipment	(7,005)	(4,111)
Acquisition of businesses, net of cash acquired and working capital adjustments	(8,952)	(13,048)
Proceeds from the sale of property, plant and equipment	7,037	123

Proceeds from the sale of business, net of transaction costs	—	29,570
Cash provided by (used in) investing activities of continuing operations	(8,920)	12,534
Cash provided by investing activities of discontinued operations	1,498	—
Cash provided by (used in) investing activities	(7,422)	12,534
Cash flows from financing activities:		
Borrowings under revolving credit facility	—	13,000
Repayments of long-term debt and revolving credit facility	(14,375)	(18,625)
Payments for debt issuance costs	(2,496)	—
Payments of withholding taxes from stock-based compensation awards	(1,719)	(1,431)
Repurchase of common stock	(1,634)	(997)
Capital lease payments	(905)	(414)
Other financing activities	(1)	23
Cash used in financing activities of continuing operations	(21,130)	(8,444)
Cash used in financing activities of discontinued operations	—	—
Cash used in financing activities	(21,130)	(8,444)
Effect of exchange rates on cash and cash equivalents	(1,375)	(610)
Increase in cash and cash equivalents	4,780	28,943
Cash and cash equivalents, beginning of period	59,959	51,146
Cash and cash equivalents, end of period	$64,739	$80,089
Supplemental disclosure of cash flow information:		
Cash paid for interest	$2,167	$2,939
Cash paid for income taxes	$10,870	$6,071
Income tax refunds received	$359	$63

The accompanying notes are an integral part of these consolidated financial statements.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 30, 2016

(Unaudited)

1. Basis of Presentation

Novanta Inc. and its subsidiaries (collectively referred to as the "Company", "we", "us", "our") design, develop, manufacture and sell precision photonic and motion control components and subsystems to Original Equipment Manufacturers ("OEMs") in the medical and advanced industrial markets. We combine deep expertise at the intersection of photonics and motion to solve complex technical challenges. This enables us to engineer core components and subsystems that deliver extreme precision and performance, tailored to our customers' demanding applications. We deliver highly engineered photonics, vision and precision motion solutions to customers around the world.

The accompanying unaudited interim consolidated financial statements have been prepared in U.S. dollars and pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC"), the instructions to Form 10-Q and the provisions of Regulation S-X pertaining to interim financial statements. Accordingly, certain information and footnote disclosures normally included in the financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. The interim consolidated financial statements and notes included in this report should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. In the opinion of management, these interim consolidated financial statements include all adjustments and accruals of a normal and recurring nature necessary to fairly state the results of the interim periods presented. The results for interim periods are not necessarily indicative of results to be expected for the full year or for any future periods.

The Company has a 41% ownership interest in Laser Quantum Ltd. ("Laser Quantum"), a privately held company located in the United Kingdom. The Company records the results of this entity under the equity method as it does not have a controlling interest in the entity.

The Company's unaudited interim financial statements are prepared for each quarterly period ending on the Friday closest to the end of the calendar quarter, with the exception of the fourth quarter which always ends on December 31.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. The Company evaluates its estimates based on historical experience, current conditions and various other assumptions that it believes are reasonable under the circumstances. Estimates and assumptions are reviewed on an on-going basis and the effects of revisions are reflected in the period in which they are deemed to be necessary. Actual results could differ significantly from those estimates.

Recent Accounting Pronouncements

Statement of Cash Flows Classification of Certain Cash Receipts and Cash Payments

In August 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments,” which provides further clarification on eight cash flow classification issues. The standard further clarifies the classification of the following: (i) debt prepayment or debt extinguishment costs; (ii) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; (iii) contingent consideration payments made after a business combination; (iv) proceeds from the settlement of insurance claims; (v) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; (vi) distributions received from equity method investees; (vii) beneficial interests in securitization transactions; and (viii) separately identifiable cash flows and application of the predominance principle. ASU 2016-15 will become effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. ASU 2016-15 should be applied using a retrospective transition method for each period presented. The Company is currently evaluating the impact of the new standard on our consolidated financial statements.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 30, 2016

(Unaudited)

Share-Based Compensation

In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting,” which amends the accounting for employee share-based payment transactions to require recognition of the income tax effects resulting from the settlement of stock-based awards as income tax provision or benefit in the income statement in the reporting period in which they occur. In addition, ASU 2016-09 requires that all tax-related cash flows resulting from share-based payments, including the excess tax benefits related to the settlement of stock-based awards, be classified as cash flows from operating activities in the statement of cash flows. ASU 2016-09 also requires that cash paid through directly withholding shares for tax-withholding purposes be classified as a financing activity in the statement of cash flows. In addition, ASU 2016-09 allows companies to make an accounting policy election to either estimate the number of awards that are expected to vest, consistent with existing U.S. GAAP, or account for forfeitures when they occur. The new standard is effective for annual reporting periods beginning after December 15, 2016, with early adoption permitted. The Company adopted ASU 2016-09 during the second quarter of 2016, which required no retrospective adjustments to the consolidated financial statements. The adoption of ASU 2016-09 had an impact of less than $0.1 million on income from continuing operation on the Company’s consolidated statements of operations for the three months ended July 1, 2016. The adoption of ASU 2016-09 had no impact on the prior year consolidated financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842),” which provides comprehensive lease accounting guidance. The standard requires entities to recognize lease assets and liabilities on the balance sheet and to disclose key information about leasing arrangements. ASU 2016-02 will become effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the impact of the new standard on our consolidated financial statements.

Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern

In August 2014, the FASB issued ASU 2014-15, “Presentation of Financial Statements - Going Concern (Subtopic 205-40),” which requires management to assess a company’s ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. ASU 2014-15 will be effective for annual reporting periods ending after December 15, 2016. Early application is permitted. The Company does not expect the adoption of ASU 2014-15 to have an impact on our consolidated financial statements.

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers,” which provides guidance for revenue recognition. ASU 2014-09 supersedes the revenue recognition requirements in ASC 605, “Revenue Recognition,” and requires entities to recognize revenue in a way that depicts the transfer of goods or services to customers at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 will be effective for annual and interim reporting periods beginning after December

15, 2016. Early adoption is not permitted. Upon adoption, an entity may apply the new guidance either retrospectively to each prior reporting period presented or retrospectively only to customer contracts not yet completed as of the date of adoption with the cumulative effect of initially applying the standard recognized in beginning retained earnings at the date of the initial application. In August 2015, the FASB issued ASU 2015-14, “Revenue from Contracts with Customers – Deferral of the Effective Date,” which defers the effective date of ASU 2014-09 by one year, with the option of early adoption as of the original effective date. The amendment in ASU 2015-14 will result in ASU 2014-09 being effective for annual and interim reporting periods beginning after December 15, 2017. The Company is currently evaluating the impact of the new standard on our consolidated financial statements and plans to adopt the standard beginning in the first quarter of 2018.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 30, 2016

(Unaudited)

2. Business Combinations

On May 24, 2016, the Company acquired 100% of the outstanding stock of Reach Technology Inc. (“Reach”), a Fremont, California-based provider of embedded touch screen technology solutions for OEMs in the medical and advanced industrial markets, for a total purchase price of $9.4 million, subject to customary working capital adjustments. The Company expects that the addition of Reach will enable the Company to enhance its value proposition with medical OEM customers by adding Reach’s high-performance touch screen solutions to its product offerings. The Company recognized acquisition costs of $0.2 million during the nine months ended September 30, 2016. Acquisition-related costs are included in restructuring, acquisition and divestiture related costs in the consolidated statements of operations.

The acquisition of Reach has been accounted for as a business combination. The allocation of the purchase price is based upon a valuation of assets and liabilities acquired. Assets acquired and liabilities assumed have been recorded at their estimated fair values as of the acquisition date. The fair values of intangible assets were based on valuations using an income approach, with estimates and assumptions provided by management of Reach and the Company. The process for estimating the fair values of identifiable intangible assets requires the use of significant estimates and assumptions, including estimating future cash flows and developing appropriate discount rates. The excess of the purchase price over the tangible assets, identifiable intangible assets and assumed liabilities was recorded as goodwill. The Company’s estimates and assumptions in determining the estimated fair values of certain assets and liabilities are subject to change within the measurement period (up to one year from the acquisition date) as a result of additional information obtained with regards to facts and circumstances that existed as of the acquisition date. The purchase price allocation is preliminary. The primary areas of the purchase price allocation that are not yet finalized relate to the final settlement of working capital and the amount of the residual goodwill.

Based upon a preliminary valuation, the total purchase price was allocated as follows (in thousands):

	Purchase Price Allocation
Cash	$ 238
Accounts receivable	991
Inventories	1,611
Prepaid expenses and other current assets	12
Intangible assets	3,953
Goodwill	4,924
Total assets acquired	11,729
Accounts payable	280
Other liabilities	148
Deferred tax liabilities	1,504

Total liabilities assumed		1,932
Total assets acquired, net of liabilities assumed		9,797
Less: cash acquired		238
Plus: working capital adjustments		(185)
Total purchase price, net of cash acquired	$	9,374

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 30, 2016

(Unaudited)

As of September 30, 2016, the working capital adjustments had not been finalized and were estimated to be an additional cash payment of $0.2 million which has been included in accrued expenses and other current liabilities in the consolidated balance sheet.

The fair value of intangible assets is comprised of the following (dollar amounts in thousands):

	Estimated Fair Value	Weighted Average Amortization Period
Customer relationships	$ 2,770	15 years
Developed technology	500	7 years
Trademarks and trade names	258	10 years
Backlog	425	1 year
Total	$ 3,953	

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 30, 2016

(Unaudited)

The purchase price allocation resulted in $4.9 million of goodwill and $4.0 million of identifiable intangible assets, none of which is expected to be deductible for tax purposes. Intangible assets are being amortized over their weighted average useful lives primarily based upon the pattern in which anticipated economic benefits from such assets are expected to be realized. The goodwill recorded represents the anticipated incremental value of future cash flow potential attributable to: (i) Reach's ability to grow their business with existing and new customers, including leveraging the Company's customer base, and (ii) cost improvements due to scale and more efficient operations.

The operating results of Reach were included in the Company's results of operations beginning on May 24, 2016. Reach contributed revenues of $3.2 million and a loss from continuing operations before income taxes of $0.4 million for the nine months ended September 30, 2016. Operating loss from continuing operations before income taxes for the nine months ended September 30, 2016 included transition costs of $0.6 million recognized under earn-out agreements. The pro forma financial information reflecting the operating results of Reach, as if it had been acquired as of January 1, 2015, would not differ materially from the operating results of the Company as reported for the year ended December 31, 2015. Reach is included in the Company's Vision reportable segment.

On November 9, 2015, the Company acquired certain assets and liabilities of Lincoln Laser Company ("Lincoln Laser"), a Phoenix, Arizona-based provider of ultrafast precision polygon scanners and other optical scanning solutions for the medical, food processing, and advanced industrial markets, for a total purchase price of $12.1 million, net of working capital adjustments. During the first quarter of 2016, the Company finalized the working capital adjustments with the sellers of Lincoln Laser and received a payment of $0.4 million.

3. Discontinued Operations and Divestitures

In April 2015, the Company completed the sale of certain assets and liabilities of its JK Lasers business, previously included in the Photonics (formerly known as "Laser Products") reportable segment, for approximately $29.6 million in cash, net of final working capital adjustments and transaction costs. The Company recognized a pre-tax gain on sale of $19.6 million in the consolidated statement of operations for the nine months ended October 2, 2015 under the caption "other income (expense), net." The JK Lasers business divestiture did not qualify for discontinued operations accounting treatment.

In July 2014, the Company completed the sale of certain assets and liabilities of its Scientific Lasers business for approximately $6.5 million in cash, net of working capital adjustments. In accordance with the purchase and sale agreement, $1.5 million of the sales proceeds was held in escrow until January 2016. The Company reported the $1.5 million escrow in other current assets on the balance sheet as of December 31, 2015. In January 2016, the $1.5 million escrow was released to the Company in full and is reported as cash flow from investing activities of discontinued operations.

4. Accumulated Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) were as follows (in thousands):

	Total accumulated other comprehensive income (loss)	Foreign currency translation adjustments	Pension liability
Balance at December 31, 2015	$ (18,830)	$ (9,698)	$ (9,132)
Other comprehensive income (loss)	(2,352)	(3,413)	1,061
Amounts reclassified from other comprehensive income (loss) (1)	572	—	572
Balance at September 30, 2016	$ (20,610)	$ (13,111)	$ (7,499)

(1) The amounts reclassified from other comprehensive income (loss) were included in selling, general and administrative expenses in the consolidated statements of operations.

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NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 30, 2016

(Unaudited)

5. Earnings per Share

Basic earnings per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. For diluted earnings per common share, the denominator also includes the dilutive effect of outstanding restricted stock units and stock options determined using the treasury stock method. Dilutive effects of contingently issuable shares are included in the weighted average dilutive share calculation when the contingencies have been resolved. For periods in which net losses are generated, the dilutive potential common shares are excluded from the calculation of diluted earnings per share as the effect would be anti-dilutive.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 30, 2016	October 2, 2015	September 30, 2016	October 2, 2015
Numerators:				
Income from continuing operations	$ 7,470	$ 6,568	$ 14,247	$ 29,525
Loss from discontinued operations	—	—	—	(13)
Consolidated net income	$ 7,470	$ 6,568	$ 14,247	$ 29,512
Denominators:				
Weighted average common shares outstanding— basic	34,677	34,599	34,689	34,578
Dilutive potential common shares	251	456	200	449
Weighted average common shares outstanding— diluted	34,928	35,055	34,889	35,027
Antidilutive common shares excluded from above	144	—	112	—
Basic Earnings (Loss) per Common Share:				
From continuing operations	$ 0.22	$ 0.19	$ 0.41	$ 0.85
From discontinued operations	$ —	$ —	$ —	$ (0.00)
Basic earnings per share	$ 0.22	$ 0.19	$ 0.41	$ 0.85
Diluted Earnings (Loss) per Common Share:				
From continuing operations	$ 0.21	$ 0.19	$ 0.41	$ 0.84
From discontinued operations	$ —	$ —	$ —	$ (0.00)
Diluted earnings per share	$ 0.21	$ 0.19	$ 0.41	$ 0.84

Common Stock Repurchases

In October 2013, the Company's Board of Directors authorized a share repurchase plan under which the Company may repurchase outstanding shares of the Company's common stock up to an aggregate amount of $10.0 million. The shares may be repurchased from time to time, at the Company's discretion, based on ongoing assessment of the capital needs of the business, the market price of the Company's common stock, and general market conditions. Shares may also be repurchased through an accelerated stock purchase agreement, on the open market or in privately negotiated transactions in accordance with applicable federal securities laws. Repurchases may be made under certain SEC regulations, which would permit common stock to be purchased when the Company would otherwise be prohibited from doing so under insider trading laws. The share repurchase plan does not obligate the Company to acquire any particular amount of common stock. No time limit was set for the completion of the share repurchase program, and the program may be suspended or discontinued at any time. As of December 31, 2015, the Company had repurchased an aggregate of 172 thousand shares for an aggregate purchase price of $2.2 million at an average price of $12.48 per share. During the nine months ended September 30, 2016, the Company repurchased 109 thousand shares in the open market for an aggregate purchase price of $1.6 million at an average price of $14.93 per share.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 30, 2016

(Unaudited)

6. Fair Value Measurements

ASC 820, “Fair Value Measurements,” establishes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the third is considered unobservable:

- Level 1: Quoted prices for identical assets or liabilities in active markets which the Company can access.
- Level 2: Observable inputs other than those described in Level 1.
- Level 3: Unobservable inputs.

The Company’s cash equivalents are investments in money market accounts, which represent the only asset the Company measures at fair value on a recurring basis. The Company determines the fair value of our cash equivalents using a market approach based on quoted prices in active markets. The fair values of cash, accounts receivable, income taxes receivable, accounts payable, income taxes payable and accrued expenses and other current liabilities (excluding contingent considerations) approximate their carrying values because of their short-term nature.

Contingent consideration

On December 18, 2015, the Company acquired all assets and certain liabilities of Skyetek Inc. (“Skyetek”). Under the purchase and sale agreement for the Skyetek acquisition, the owners of Skyetek are eligible to receive contingent consideration based on the achievement of certain sales order commitment targets from October 2015 through June 2017. The undiscounted range of possible contingent consideration is zero to $0.3 million. If such targets are achieved, the contingent consideration will be payable in 2017. The Company recognized an estimated fair value of $0.2 million as part of the purchase price as of the acquisition date. The estimated fair value of the contingent consideration is reported as an other current liability and a long-term liability in the consolidated balance sheet as of September 30, 2016 and December 31, 2015, respectively.

Under the purchase and sale agreement for the Lincoln Laser acquisition, the shareholders of Lincoln Laser are eligible to receive contingent consideration based on the achievement of certain revenue targets for fiscal year 2016. The undiscounted range of contingent consideration is zero to $6.0 million. If such targets are achieved, the contingent consideration will be payable in cash in 2017. The estimated fair value of $2.3 million was determined based on the Monte Carlo valuation method and was recorded as part of the purchase price as of the acquisition date. In June 2016, a $0.3 million increase in the estimated fair value was recorded in the consolidated statement of operations in restructuring, acquisition and divestiture related costs. The estimated fair value of $2.6 million for the contingent consideration was reported as an other current liability in the consolidated balance sheet as of September 30, 2016. The estimated fair value of $2.3 million for the contingent consideration was reported as a long-term liability in the consolidated balance sheet as of December 31, 2015.

On February 19, 2015, the Company acquired Applimotion Inc. (“Applimotion”). The former shareholders of Applimotion are eligible to receive contingent consideration based on the achievement of certain revenue targets for fiscal years 2015 to 2017. The undiscounted range of contingent considerations is zero to $4.0 million. If such targets are achieved, the contingent consideration will be payable in cash in two installments in 2017 and 2018, respectively. The estimated fair value of $1.0 million was determined based on the Monte Carlo valuation method and was recorded as part of the purchase price as of the acquisition date. In December 2015 and June 2016, respectively, the Company recorded a $0.4 million and $1.1 million increase in the estimated fair value in the consolidated statement of operations. These adjustments are included in restructuring, acquisition and divestiture related costs. The estimated fair value of $2.5 million for the contingent consideration was reported as an other current liability and a long-term liability in the consolidated balance sheet as of September 30, 2016 in accordance with the timing of the estimated payments. The estimated fair value of $1.4 million for the contingent consideration was reported as a long-term liability in the consolidated balance sheet as of December 31, 2015.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 30, 2016

(Unaudited)

The following table summarizes the fair values of our financial assets and liabilities as of September 30, 2016 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash equivalents	$ 3,450	$ 3,450	$ —	$ —
Liabilities				
Contingent consideration	$ 5,316	$ —	$ —	$ 5,316

The following table summarizes the fair values of our financial assets and liabilities as of December 31, 2015 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash equivalents	$ 4,657	$ 4,657	$ —	$ —
Liabilities				
Contingent consideration	$ 3,889	$ —	$ —	$ 3,889

Changes in the fair value of Level 3 contingent consideration during the nine months ended September 30, 2016 were as follows (in thousands):

	Contingent Consideration
Balance at December 31, 2015	$ 3,889
Fair value adjustments (1)	1,427
Balance at September 30, 2016	$ 5,316

(1) In the nine months ended September 30, 2016, the fair value of the contingent considerations in connection with the acquisitions of Lincoln Laser and Applimotion were increased by $0.3 million and $1.1 million, respectively, primarily due to increased actual and projected revenue performance.

See Note 9 to Consolidated Financial Statements for a discussion of the estimated fair value of the Company's outstanding debt.

7. Goodwill and Intangible Assets

Goodwill

Goodwill is recorded when the consideration for a business combination exceeds the fair value of net tangible and identifiable intangible assets acquired. The Company tests its goodwill balances annually for impairment as of the beginning of the second quarter or more frequently if indicators are present or changes in circumstances suggest that impairment may exist. The Company performed its annual goodwill impairment test at the beginning of the second quarter of 2016 and noted no impairment of goodwill. The implied fair value of all the reporting units exceeded their carrying values by at least 20%.

The following table summarizes changes in goodwill during the nine months ended September 30, 2016 (in thousands):

Balance at beginning of the period	$103,456
Net working capital adjustment of Lincoln Laser acquisition	(43)
Goodwill acquired from Reach acquisition	4,924
Balance at end of the period	$108,337

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NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 30, 2016

(Unaudited)

Goodwill by reportable segment as of September 30, 2016 was as follows (in thousands):

	Reportable Segment			
	Photonics	Vision	Precision Motion	Total
Goodwill	$136,278	$89,325	$33,963	$259,566
Accumulated impairment of goodwill	(102,461)	(31,722)	(17,046)	(151,229)
Total	$33,817	$57,603	$16,917	$108,337

Goodwill by reportable segment as of December 31, 2015 was as follows (in thousands):

	Reportable Segment			
	Photonics	Vision	Precision Motion	Total
Goodwill	$136,321	$84,401	$33,963	$254,685
Accumulated impairment of goodwill	(102,461)	(31,722)	(17,046)	(151,229)
Total	$33,860	$52,679	$16,917	$103,456

Intangible Assets

Intangible assets as of September 30, 2016 and December 31, 2015, respectively, are summarized as follows (in thousands):

	September 30, 2016			December 31, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortizable intangible assets:						
Patents and acquired technologies	$80,981	$ (67,120)	$ 13,861	$82,821	$ (66,297)	$ 16,524

Customer relationships	69,651	(41,400)	28,251	67,168	(36,914)	30,254
Customer backlog	622	(379)	243	2,644	(2,589)	55
Non-compete covenant	2,514	(1,284)	1,230	2,514	(882)	1,632
Trademarks and trade names	10,774	(6,515)	4,259	10,711	(5,934)	4,777
Amortizable intangible assets	164,542	(116,698)	47,844	165,858	(112,616)	53,242
Non-amortizable intangible assets:						
Trade names	13,027	—	13,027	13,027	—	13,027
Totals	$177,569	$ (116,698)	$ 60,871	$178,885	$ (112,616)	$ 66,269

All definite-lived intangible assets are amortized either on a straight-line basis or an economic benefit basis over their remaining useful life. Amortization expense for customer relationships and definite-lived trademarks, trade names and other intangibles is included in operating expenses in the accompanying consolidated statements of operations. Amortization expense for patents and acquired technologies is included in cost of revenue in the accompanying consolidated statements of operations. Amortization expense is as follows (in thousands):

Three Months Ended