ACETO CORP
Form 10-Q
November 03, 2017

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, 2017

Commission file number 000-04217

ACETO CORPORATION
(Exact name of registrant as specified in its charter)

New York	11-1720520
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

4 Tri Harbor Court, Port Washington, NY 11050
(Address of principal executive offices) (Zip Code)

(516) 627-6000

(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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 x 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 x		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 x

The registrant had 30,641,254 shares of common stock outstanding as of October 31, 2017.

ACETO CORPORATION AND SUBSIDIARIES

QUARTERLY REPORT FOR THE PERIOD ENDED SEPTEMBER 30, 2017

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Item 1. Financial Statements

ACETO CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per-share amounts)

	September 30, 2017 (unaudited)	**June 30, 2017**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 72,100	$ 55,680
Investments	3,048	2,046
Trade receivables, less allowance for doubtful accounts (September 30, 2017, $476; June 30, 2017, $485)	240,620	260,889
Other receivables	11,897	12,066
Inventory	135,119	136,387
Prepaid expenses and other current assets	4,916	3,941
Deferred income tax asset, net	-	546
Total current assets	467,700	471,555
Property and equipment, net	11,569	10,428
Property held for sale	6,250	7,152
Goodwill	237,004	236,970
Intangible assets, net	277,247	285,081
Deferred income tax asset, net	10,991	19,453
Other assets	7,212	7,546
TOTAL ASSETS	$ 1,017,973	$ 1,038,185
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 14,482	$ 14,466
Accounts payable	98,013	90,011
Accrued expenses	114,654	118,328
Total current liabilities	227,149	222,805
Long-term debt, net	317,097	339,200
Long-term liabilities	62,743	61,449

Environmental remediation liability	1,754	2,339
Deferred income tax liability	-	7,325
Total liabilities	608,743	633,118
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Preferred stock, 2,000 shares authorized; no shares issued and outstanding	-	-
Common stock, $.01 par value, 75,000 shares authorized; 30,581 and 30,094 shares issued and outstanding at September 30, 2017 and June 30, 2017, respectively	306	301
Capital in excess of par value	217,439	214,198
Retained earnings	194,171	195,680
Accumulated other comprehensive loss	(2,686)	(5,112)
Total shareholders' equity	409,230	405,067
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,017,973	$ 1,038,185

See accompanying notes to condensed consolidated financial statements and accountants' review report.

ACETO CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited and in thousands, except per-share amounts)

	Three months Ended September 30	
	2017	2016
Net sales	$185,255	$128,018
Cost of sales	145,272	97,179
Gross profit	39,983	30,839
Selling, general and administrative expenses	31,149	21,024
Research and development expenses	1,615	1,050
Operating income	7,219	8,765
Other (expense) income:		
Interest expense	(5,355)	(2,233)
Interest and other income, net	274	248
	(5,081)	(1,985)
Income before income taxes	2,138	6,780
Income tax provision	1,684	2,395
Net income	$454	$4,385
Basic income per common share	$0.01	$0.15
Diluted income per common share	$0.01	$0.15
Weighted average shares outstanding:		
Basic	34,975	29,518
Diluted	35,259	29,840

See accompanying notes to condensed consolidated financial statements and accountants' review report.

ACETO CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited and in thousands)

	Three months Ended September 30,	
	2017	2016
Net income	$ 454	$ 4,385
Other comprehensive income:		
Foreign currency translation adjustments	2,320	560
Change in fair value of interest rate swaps	106	-
Comprehensive income	$ 2,880	$ 4,945

See accompanying notes to condensed consolidated financial statements and accountants' review report.

ACETO CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited and in thousands)

	Three months Ended September 30,	
	2017	2016
Operating activities:		
Net income	$ 454	$ 4,385
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,301	3,168
Amortization of debt issuance costs and debt discount	1,513	1,432
Amortization of deferred financing costs	270	-
Provision for doubtful accounts	(15)	(58)
Non-cash stock compensation	3,146	1,664
Deferred income taxes	(1,099)	1,405
Environmental charge	902	170
Earnings on equity investment in joint venture	(231)	(325)
Changes in assets and liabilities:		
Trade accounts receivable	21,137	9,141
Other receivables	149	464
Inventory	2,225	(6,105)
Prepaid expenses and other current assets	(944)	(978)
Other assets	(334)	(305)
Accounts payable	7,699	3,135
Accrued expenses and other liabilities	792	(6,543)
Net cash provided by operating activities	43,965	10,650
Investing activities:		
Purchases of investments	(2,655)	(1,017)
Sales of investments	1,646	-
Payments for intangible assets	(54)	(1,594)
Purchases of property and equipment, net	(1,506)	(541)
Net cash used in investing activities	(2,569)	(3,152)
Financing activities:		
Payment of cash dividends	(1,935)	(1,954)
Proceeds from exercise of stock options	73	185
Excess tax benefit on stock option exercises and restricted stock	-	437
Repayment of bank loans	(23,783)	(49)
Net cash used in financing activities	(25,645)	(1,381)

Effect of exchange rate changes on cash	669	197
Net increase in cash	16,420	6,314
Cash and cash equivalents at beginning of period	55,680	66,828
Cash and cash equivalents at end of period	$ 72,100	$ 73,142

See accompanying notes to condensed consolidated financial statements and accountants' review report

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ACETO CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited and in thousands, except per-share amounts)

(1) Basis of Presentation

The condensed consolidated financial statements of Aceto Corporation and subsidiaries ("Aceto" or the "Company") included herein have been prepared by the Company and reflect all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows for all periods presented. Interim results are not necessarily indicative of results which may be achieved for the full year.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses reported in those financial statements and the disclosure of contingent assets and liabilities at the date of the financial statements. These judgments can be subjective and complex, and consequently actual results could differ from those estimates and assumptions. The Company's most critical accounting policies relate to revenue recognition; allowance for doubtful accounts; inventory; goodwill and other indefinite-life intangible assets; long-lived assets; environmental matters and other contingencies; income taxes; stock-based compensation; and purchase price allocation.

These condensed consolidated financial statements do not include all disclosures associated with consolidated financial statements prepared in accordance with GAAP. Accordingly, these statements should be read in conjunction with the Company's consolidated financial statements and notes thereto contained in the Company's Form 10-K for the year ended June 30, 2017.

(2) Business Combinations

On December 21, 2016, wholly owned subsidiaries of Rising Pharmaceuticals, Inc. ("Rising"), a wholly owned subsidiary of Aceto, completed the acquisition of certain generic products and related assets of entities formerly known as Citron Pharma LLC ("Citron") and its affiliate Lucid Pharma LLC ("Lucid"). Citron was a privately-held New Jersey-based pharmaceutical company focused on developing and marketing generic pharmaceutical products in partnership with leading generic pharmaceutical manufacturers based in India and the United States. Lucid was a privately-held New Jersey-based generic pharmaceutical distributor specializing in providing cost-effective products to various agencies of the U.S. Federal Government including the Veterans Administration and the Defense Logistics Agency. Lucid serviced 18 national contracts with the Federal Government, nearly all of which have 5-year terms.

Aceto and Citron possess complementary asset-light business models, drug development and manufacturing partnerships and product portfolios. The Company believes consistent with its strategy of expanding Rising's portfolio of finished dosage form generic products through product development partnerships and acquisitions of late stage assets, abbreviated new drug applications ("ANDAs") and complementary generic drug businesses, this transaction significantly expanded its roster of commercialized products and pipeline of products under development. In addition, the Company believes that this product acquisition greatly enhanced its size and stature within the generic pharmaceutical industry, expanded its partnership network and offers the Company opportunities to realize meaningful cost and tax efficiencies.

At closing, Aceto paid the sellers $270,000 in cash, committed to make a $50,000 unsecured deferred payment that will bear interest at a rate of 5% per annum to the sellers on December 21, 2021 and agreed to issue 5,122 shares of Aceto common stock beginning on December 21, 2019. The product purchase agreement also provides the sellers with a 5-year potential earn-out of up to an additional $50,000 in cash, based on the financial performance of four pre-specified pipeline products that are currently in development. As of September 30, 2017, the Company accrued $2,924 related to this contingent consideration.

ACETO CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited and in thousands, except per-share amounts)

Rising formed two subsidiaries to consummate the product acquisition – Rising Health, LLC (which acquired certain products and related assets of Citron) and Acetris Health, LLC (which acquired certain products and related assets of Lucid).

(3) Stock-Based Compensation

Under the Aceto Corporation 2015 Equity Participation Plan (the “2015 Plan”), grants of stock options, stock appreciation rights, restricted stock, restricted stock units and other stock-based awards (“Stock Awards”) may be offered to employees, non-employee directors, consultants and advisors of the Company, including the chief executive officer, chief financial officer and other named executive officers. The maximum number of shares of common stock of the Company that may be issued pursuant to Stock Awards granted under the 2015 Plan will not exceed, in the aggregate, 4,250 shares. Stock Awards that are intended to qualify as “performance-based compensation” for purposes of Section 162(m) of the Internal Revenue Code of 1986, as amended, may be granted. Performance-based awards may be granted, vested and paid based on the attainment of specified performance goals.

Under the Aceto Corporation 2010 Equity Participation Plan (as amended and restated in 2012, the “2010 Plan”), grants of stock options, restricted stock, restricted stock units, stock appreciation rights, and stock bonuses may be made to employees, non-employee directors and consultants of the Company. The maximum number of shares of common stock of the Company that may be issued pursuant to awards granted under the 2010 Plan will not exceed, in the aggregate, 5,250 shares. In addition, restricted stock may be granted to an eligible participant in lieu of a portion of any annual cash bonus earned by such participant. Such award may include additional shares of restricted stock (premium shares) greater than the portion of bonus paid in restricted stock. The restricted stock award is vested at issuance and the restrictions lapse ratably over a period of years as determined by the Board of Directors, generally three years. The premium shares vest when all the restrictions lapse, provided that the participant remains employed by the Company at that time.

During the three months ended September 30, 2017, the Company granted 337 shares of restricted common stock to its employees that vest over three years. In addition, the Company also issued a target grant of 168 performance-vested restricted stock units, which grant could be as much as 294 units if certain performance criteria and market conditions are met. These performance-vested restricted stock units will cliff vest 100% at the end of the third year following grant in accordance with the performance metrics set forth in the applicable employee performance-vested restricted stock unit grant.

During the year ended June 30, 2017, the Company granted 277 shares of restricted common stock to its employees that vest over three years and 22 shares of restricted common stock to its non-employee directors, which vest over approximately one year as well as 42 restricted stock units that have varying vest dates through July 2017. In addition, the Company also issued a target grant of 160 performance-vested restricted stock units, which grant could be as much as 280 if certain performance criteria and market conditions are met. These performance-vested restricted stock units will cliff vest 100% at the end of the third year following grant in accordance with the performance metrics set forth in the applicable employee performance-vested restricted stock unit grant.

For the three months ended September 30, 2017 and 2016, the Company recorded stock-based compensation expense of approximately $3,132 and $1,659, respectively, related to restricted common stock and restricted stock units. Included in the $3,132 for the three months ended September 30, 2017 is $2,017 in stock-based compensation expense associated with the separation of the Company’s former Chief Executive Officer in September 2017. As of September 30, 2017, the total unrecognized stock-based compensation cost is approximately $10,168.

(4) Capital Stock

On August 24, 2017, the Company's Board of Directors declared a regular quarterly dividend of $0.065 per share which was paid on September 21, 2017 to shareholders of record as of September 8, 2017.

On May 4, 2017, the Board of Directors of the Company authorized the continuation of the Company’s stock repurchase program, expiring in May 2020. Under the stock repurchase program, the Company is authorized to purchase up to 5,000 shares of common stock in open market or private transactions, at prices not to exceed the market value of the common stock at the time of such purchase.

ACETO CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited and in thousands, except per-share amounts)

The Company is authorized to issue 75,000 shares of Common Stock and 2,000 shares of Preferred Stock. The Board of Directors has authority under the Company's Restated Certificate of Incorporation to issue shares of preferred stock with voting and other relative rights to be determined by the Board of Directors.

(5) Net Income Per Common Share

Basic income per common share is based on the weighted average number of common shares outstanding during the period. Diluted income per common share includes the dilutive effect of potential common shares outstanding. The following table sets forth the reconciliation of weighted average shares outstanding and diluted weighted average shares outstanding:

	Three Months Ended September 30,	
	2017	2016
Weighted average shares outstanding	34,975	29,518
Dilutive effect of stock options and restricted stock awards and units	284	322
Diluted weighted average shares outstanding	35,259	29,840

The weighted average shares outstanding for the three months ended September 30, 2017 includes the effect of 5,122 shares to be issued in connection with the acquisition of certain products and related assets from Citron and Lucid (see Note 2).The Convertible Senior Notes (see Note 6) will only be included in the dilutive net income per share calculations using the treasury stock method during periods in which the average market price of Aceto's common stock is above the applicable conversion price of the Convertible Senior Notes, or $33.215 per share, and the impact would not be anti-dilutive.

There were 61 common equivalent shares outstanding as of September 30, 2017 that were not included in the calculation of diluted net income per common share for the three months ended September 30, 2017 because their effect would have been anti-dilutive.

(6) Debt

Long-term debt

	September 30, 2017	June 30, 2017
Convertible Senior Notes, net	$ 123,189	$ 121,676
Revolving Bank Loans	70,000	90,000
Term Bank Loans	135,660	139,227
Mortgage	2,730	2,763
	331,579	353,666
Less current portion	14,482	14,466
	$ 317,097	$ 339,200

ACETO CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited and in thousands, except per-share amounts)

Convertible Senior Notes

In November 2015, Aceto offered $125,000 aggregate principal amount of Convertible Senior Notes due 2020 (the "Notes") in a private offering to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. In addition, Aceto granted the initial purchasers for the offering an option to purchase up to an additional $18,750 aggregate principal amount pursuant to the initial purchasers' option to purchase additional Notes, which was exercised in November 2015. Therefore the total offering was $143,750 aggregate principal amount. The Notes are unsecured obligations of Aceto and rank senior in right of payment to any of Aceto's subordinated indebtedness, equal in right of payment to all of Aceto's unsecured indebtedness that is not subordinated, effectively junior in right of payment to any of Aceto's secured indebtedness to the extent of the value of the assets securing such indebtedness and structurally junior in right of payment to all indebtedness and other liabilities (including trade payables) of Aceto's subsidiaries. The Notes will be convertible into cash, shares of Aceto common stock or a combination thereof, at Aceto's election, upon the satisfaction of specified conditions and during certain periods. The Notes will mature in November 2020. The Notes pay 2.0% interest semi-annually in arrears on May 1 and November 1 of each year, which commenced on May 1, 2016. The Notes are convertible into 4,328 shares of common stock, based on an initial conversion price of $33.215 per share.

Holders may convert all or any portion of their notes, in multiples of one thousand dollar principal amount, at their option at any time prior to the close of business on the business day immediately preceding May 1, 2020 only under the following circumstances: (i) during any calendar quarter (and only during such calendar quarter), if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day, (ii) during the five consecutive business day period after any five consecutive trading day period (which is referred to as the "measurement period") in which the trading price per one thousand dollar principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of Aceto's common stock and the conversion rate on each such trading day; or (iii) upon the occurrence of specified corporate events.

Upon conversion by the holders, the Company may elect to settle such conversion in shares of its common stock, cash, or a combination thereof. As a result of its cash conversion option, the Company separately accounted for the value of the embedded conversion option as a debt discount (with an offset to capital in excess of par value). The debt discount is being amortized as additional non-cash interest expense using the effective interest method over the term of the Notes. Debt issuance costs are being amortized as additional non-cash interest expense. The Company presents debt issuance costs as a direct deduction from the carrying value of the debt liability rather than showing the debt issuance costs as a deferred charge on the balance sheet.

In connection with the offering of the Notes, Aceto entered into privately negotiated convertible note hedge transactions with option counterparties, which are affiliates of certain of the initial purchasers. The convertible note hedge transactions are expected generally to reduce the potential dilution to Aceto's common stock and/or offset any cash payments Aceto is required to make in excess of the principal amount of converted Notes upon any conversion of Notes. Aceto also entered into privately negotiated warrant transactions with the option counterparties. The warrant transactions could separately have a dilutive effect to the extent that the market price per share of Aceto's common stock as measured over the applicable valuation period at the maturity of the warrants exceeds the applicable strike price of the warrants. By entering into these transactions with the option counterparties, the Company issued convertible debt and a freestanding "call-spread."

The carrying value of the Notes is as follows:

	September 30, 2017	**June 30, 2017**
Principal amount	$ 143,750	$ 143,750
Unamortized debt discount	(17,951)	(19,255)
Unamortized debt issuance costs	(2,610)	(2,819)
Net carrying value	$ 123,189	$ 121,676

ACETO CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited and in thousands, except per-share amounts)

The following table sets forth the components of total “interest expense” related to the Notes recognized in the accompanying consolidated statements of income for the three months ended September 30:

	2017	2016
Contractual coupon	$	