AVNET INC
Form 10-Q
November 08, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 29, 2018

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

For the transition period from _____ to _____

Commission File #1-4224

AVNET, INC.

(Exact name of registrant as specified in its charter)

New York	11-1890605
(State or other jurisdiction Of incorporation)	(IRS Employer Identification No.)

2211 South 47th Street, Phoenix, Arizona	85034
(Address of principal executive offices)	(Zip Code)

(480) 643-2000

(Registrant’s telephone number, including area code.)

N/A

(Former name and former address, if changed since last report.)

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 and posted pursuant to Rule 405 of Regulation S-T 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, 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.

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 in Rule 12b-2 of the Exchange Act). Yes No

As of November 1, 2018, the total number of shares outstanding of the registrant’s Common Stock was 111,226,195 shares, net of treasury shares.

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AVNET, INC. AND SUBSIDIARIES

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PART I

FINANCIAL INFORMATION

Item 1.Financial Statements

AVNET, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 29, 2018	June 30, 2018
	(Thousands, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 365,852	$ 621,125
Receivables, less allowances of $49,645 and $48,959, respectively	3,682,512	3,641,139
Inventories	3,395,194	3,141,822
Prepaid and other current assets	114,432	206,513
Total current assets	7,557,990	7,610,599
Property, plant and equipment, net	525,873	522,909
Goodwill	982,306	980,872
Intangible assets, net	199,379	219,913
Other assets	188,226	262,552
Total assets	$ 9,453,774	$ 9,596,845
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current liabilities:		
Short-term debt	$ 10,626	$ 165,380
Accounts payable	2,352,771	2,269,478
Accrued expenses and other	501,435	534,603
Total current liabilities	2,864,832	2,969,461
Long-term debt	1,554,722	1,489,219
Other liabilities	413,147	453,084
Total liabilities	4,832,701	4,911,764
Commitments and contingencies (Note 7)		
Shareholders’ equity:		
Common stock $1.00 par; authorized 300,000,000 shares; issued 113,030,625 shares and 115,825,062 shares, respectively	113,031	115,825
Additional paid-in capital	1,554,564	1,528,713
Retained earnings	3,139,272	3,235,894
Accumulated other comprehensive loss	(185,794)	(195,351)

Total shareholders’ equity	4,621,073	4,685,081
Total liabilities and shareholders’ equity	$ 9,453,774	$ 9,596,845

See notes to consolidated financial statements.

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AVNET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	First Quarters Ended	
	September 29, 2018	September 30, 2017
	(Thousands, except per share amounts)	
Sales	$ 5,089,879	$ 4,660,943
Cost of sales	4,453,129	4,048,388
Gross profit	636,750	612,555
Selling, general and administrative expenses	475,146	501,593
Restructuring, integration and other expenses	14,788	46,394
Operating income	146,816	64,568
Other income (expense), net	(1,892)	18,921
Interest and other financing expenses, net	(30,093)	(22,015)
Income from continuing operations before taxes	114,831	61,474
Income tax expense	31,302	3,292
Income from continuing operations, net of tax	83,529	58,182
Income from discontinued operations, net of tax	195	121
Net income	83,724	58,303
Earnings per share - basic:		
Continuing operations	$ 0.73	$ 0.48
Discontinued operations	0.00	0.00
Net income per share basic	0.73	0.48
Earnings per share - diluted:		
Continuing operations	$ 0.72	$ 0.47
Discontinued operations	0.00	0.00
Net income per share diluted	0.72	0.47
Shares used to compute earnings per share:		
Basic	115,260	122,685
Diluted	116,471	123,984
Cash dividends paid per common share	$ 0.20	$ 0.18

See notes to consolidated financial statements.

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AVNET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	First Quarters Ended	
	September 29, 2018	September 30, 2017
	(Thousands)	
Net income	$ 83,724	$ 58,303
Other comprehensive income, net of tax:		
Foreign currency translation and other	8,801	88,843
Pension adjustments, net	756	939
Total comprehensive income	$ 93,281	$ 148,085

See notes to consolidated financial statements.

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AVNET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended September 29, 2018	September 30, 2017
	(Thousands)	
Cash flows from operating activities:		
Net income	$ 83,724	$ 58,303
Less: Income from discontinued operations, net of tax	195	121
Income from continuing operations	83,529	58,182
Non-cash and other reconciling items:		
Depreciation	25,389	38,263
Amortization	20,810	25,506
Deferred income taxes	36,830	(23,436)
Stock-based compensation	9,044	8,609
Other, net	14,994	4,902
Changes in (net of effects from businesses acquired and divested):		
Receivables	(19,292)	(32,409)
Inventories	(269,649)	(266,998)
Accounts payable	95,119	37,252
Accrued expenses and other, net	(81,753)	22,140
Net cash flows used for operating activities - continuing operations	(84,979)	(127,989)
Net cash flows used for operating activities - discontinued operations	—	—
Net cash flows used for operating activities	(84,979)	(127,989)
Cash flows from financing activities:		
Borrowings (repayments) under accounts receivable securitization, net	(40,000)	28,000
Repayments under senior unsecured credit facility, net	(50,330)	(92,471)
Repayments under bank credit facilities and other debt, net	(1,217)	(24,888)
Repurchases of common stock	(149,094)	(68,113)
Dividends paid on common stock	(22,932)	(22,012)
Other, net	17,328	(579)
Net cash flows used for financing activities - continuing operations	(246,245)	(180,063)
Net cash flows used for financing activities - discontinued operations	—	—
Net cash flows used for financing activities	(246,245)	(180,063)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(41,007)	(26,659)
Acquisitions of businesses, net of cash acquired	—	(14,661)
Other, net	65	1,211

Net cash flows used for investing activities - continuing operations	(40,942)	(40,109)
Net cash flows provided by investing activities - discontinued operations	120,000	45,391
Net cash flows provided by investing activities	79,058	5,282
Effect of currency exchange rate changes on cash and cash equivalents	(3,107)	6,065
Cash and cash equivalents:		
— decrease	(255,273)	(296,705)
— at beginning of period	621,125	836,384
— at end of period	$ 365,852	$ 539,679

See notes to consolidated financial statements.

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AVNET, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of presentation and new accounting pronouncements

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments necessary to present fairly Avnet, Inc.'s and its consolidated subsidiaries' (collectively, the "Company" or "Avnet") financial position, results of operations, comprehensive income and cash flows. All such adjustments are of a normal recurring nature.

The preparation of financial statements in accordance with generally accepted accounting principles in the U.S. ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Actual results may differ from these estimates.

Interim results of operations are not necessarily indicative of the results to be expected for the full fiscal year. The information included in this Form 10-Q should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2018.

Certain reclassifications have been made in prior periods to conform to the current period presentation including reclassifications as a result of recently adopted accounting pronouncements.

Recently adopted accounting pronouncements

In May 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09", and collectively with its related subsequent amendments, "Topic 606"). Topic 606 supersedes previous revenue recognition guidance and requires the Company to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for such goods or services. The Company adopted Topic 606 on July 1, 2018 using the modified retrospective transition method applied to those contracts which were not completed as of July 1, 2018. Under this transition method, the Company's results in the consolidated statements of operations for the three months ended September 29, 2018 are presented under Topic 606, while the comparative results for the three months ended September 30, 2017 were not retrospectively adjusted, as such results were recognized in accordance with the revenue recognition policy discussed under Summary of Significant Accounting Policies in Note 1 of the Company's Fiscal 2018 Annual Report on Form 10-K.

The adoption of Topic 606 did not have a material impact on the Company's consolidated financial statements as of the adoption date and as of and for the three months ended September 29, 2018. Substantially all of the Company's sales continue to be recognized when products are shipped from the Company's facilities or delivered to customers, depending on the respective contractual terms. For a nominal portion of the Company's contracts where the accounting did change, the adoption of Topic 606 resulted in an increase to the opening balance of retained earnings of $2.0 million as of July 1, 2018. This impact was primarily due to the acceleration of recognition of net sales and associated gross profit related to certain uncompleted contracts for the manufacture of goods with no alternative use and for which the Company has an enforceable right to payment, including a reasonable profit margin, from the customer for performance completed to date. For these contracts, the Company now recognizes revenue over time as control of the goods transfers through the manufacturing process, rather than when the goods are delivered, and title, risk and reward of ownership are passed to the customer, as under previous revenue recognition guidance.

Refer to Note 2 herein for further discussion regarding revenue recognition and related policies.

In March 2017, the FASB issued Accounting Standards Update No. 2017-07, Compensation - Retirement Benefits (Topic 715)- Improving the Presentation of Net Periodic Cost and Net Periodic Postretirement Benefit Cost ("ASU No. 2017-07"). ASU No. 2017-07 requires that the service cost component of net periodic pension costs be included in the same line item as other compensation costs arising from services rendered by employees during the period, with the other components of the net periodic pension costs reported separately from the service cost component and below operating income. The Company adopted this standard effective the first quarter of fiscal year 2019, which required changes to the classification of net periodic pension costs in the consolidated statements of operations for all periods presented. The service cost component of the net periodic pension cost is now included in “Selling, general and administrative expenses” with all other components of net periodic pension costs within “Other income (expense), net” in the consolidated statements of operations. The adoption of ASU No. 2017-07 did not have any impact on the Company’s reported amount of income from continuing operations before taxes.

During the first quarter of fiscal 2019, the Company adopted ASU 2016-16 - Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. This update addresses the recognition of current and deferred income taxes resulting from an intra-entity transfer of any asset other than inventory. This update has been applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings. The adoption of this update resulted in a cumulative reduction to the opening balance of retained earnings of $5.8 million and a reduction to other assets of $5.8 million.

Recently issued accounting pronouncements

In August 2018, the FASB issued Accounting Standards Update No. 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (a consensus of the FASB Emerging Issues Task Force) ("ASU No. 2018-15"). ASU No. 2018-15 aligns 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 internal-use software. ASU No. 2018-15 is effective for the Company in the first quarter of fiscal 2021, with early adoption permitted, and is to be applied either retrospectively or prospectively. The Company is currently evaluating the potential effects of adopting the provisions of ASU No. 2018-15.

In February 2018, the FASB issued Accounting Standards Update 2018-02, Income Statement–Reporting Comprehensive Income (Topic 220):-Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (“ASU 2018-02”), which allows entities to reclassify accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the tax legislation enacted by the U.S. federal governments on December 22, 2017 (the “Act”). This update is effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. The update should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the income tax rate change resulting from the Act is recognized. The Company is currently evaluating the impact of the adoption of ASU 2018-02 on its consolidated financial statements.

In August 2017, the FASB issued Accounting Standards Update 2017-12, Derivatives and Hedging (Topic 815) - Targeted Improvements to Accounting for Hedging Activities (“ASU 2017-12”), which improves the financial reporting of hedging relationships to better portray the economic results of an entity’s risk management activities in its financial statements and makes certain targeted improvements to simplify the qualification and application of the hedge accounting compared to current GAAP. This update is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the impact of the adoption of ASU 2017-12 on its consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (“ASU 2016-02”) and issued subsequent amendments to the initial guidance in September 2017 within ASU 2017-13 (collectively, Topic 842). Topic 842 requires companies to generally recognize operating and financing lease liabilities on the balance sheet and corresponding right-of-use assets created by those leases with lease terms of more than 12 months. The Company intends to adopt Topic 842 when it becomes effective in the first quarter of fiscal 2020 using a modified retrospective approach. The Company is currently evaluating the impact of its pending adoption of Topic 842 on its consolidated financial statements and expects that most of its operating lease commitments related to the Company’s real estate portfolio will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon adoption, which will materially increase total assets and total liabilities relative to such amounts prior to adoption.

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AVNET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

2. Revenue recognition

Prior to the adoption of Topic 606, the Company’s revenue recognition policy was in accordance with ASC Topic 605, Revenue Recognition. Effective July 1, 2018, the Company adopted Topic 606 using the modified retrospective transition method, resulting in accounting policy changes surrounding revenue recognition which replace revenue recognition policies discussed in the Summary of Significant Accounting Policies in Note 1 of the Company’s Fiscal 2018 Annual Report on Form 10-K. The adoption of Topic 606 did not have a material impact on the Company’s consolidated financial statements.

The Company’s revenues are generated from the distribution and sale of electronic components including semiconductors, interconnect, passive and electromechanical (“IP&E”) devices and other integrated electronic components from the world’s leading electronic component manufacturers. The Company’s expertise in design, supply chain and logistics enable it to sell to customers of all sizes from startups and mid-sized businesses to enterprise-level original equipment manufacturers (“OEMs”), electronic manufacturing services (“EMS”) providers and original design manufacturers (“ODMs”). The Company sells to a variety of markets ranging from automotive to medical to defense and aerospace. The Company also sells integrated solutions including the assembly or manufacture of embedded electronic component products and systems, touch and passive displays, and standard or specialized boards. The Company’s revenue arrangements primarily consist of performance obligations related to the transfer of promised products. The Company considers customer purchase orders, which in some cases are governed by master agreements, to be the contracts with a customer. All revenue is generated from contracts with customers.

Revenue is recognized at the point at which control of the underlying products are transferred to the customer, which includes determining whether products are distinct and separate performance obligations. For electronic component and related product sales, this generally occurs upon shipment of the products, however, this may occur at a later date depending on the agreed upon sales terms, such as delivery at the customer's designated location, or when products that are consigned at customer locations are consumed. In limited instances, where products are not in stock and delivery times are critical, product is purchased from the supplier and drop-shipped to the customer. The Company typically takes control of the products when shipped by the manufacturer and then recognizes revenue when control of the product transfers to the customer. The Company does not have material product warranty obligations as the assurance type product warranties provided by the component manufacturers are passed through to the Company’s customers.

For contracts related to the specialized manufacture of products for customers with no alternative use and for which the Company has an enforceable right to payment, including a reasonable profit margin, the Company recognizes revenue over time as control of the products transfer through the manufacturing process. The contract assets associated with such specialized manufacturing products are not material as these contracts represent less than 2% of the Company’s total sales.

Revenue is measured as the amount of consideration the Company expects to receive in exchange for transferring products. The Company estimates different forms of variable consideration at the time of sale based on historical experience, current conditions and contractual obligations. Revenue is recorded net of customer discounts and rebates. When the Company offers the right or has a history of accepting returns of product, historical experience is utilized to establish a liability for the estimate of expected returns and an asset for the right to recover the product expected to be returned. These adjustments are made in the same period as the underlying sales transactions.

The Company considers the following indicators amongst others when determining whether it is acting as a principal in the contract and recording revenue on a gross basis: (i) the Company is primarily responsible for fulfilling the promise to provide the specified products or services, (ii) the Company has inventory risk before the specified products have been transferred to a customer or after transfer of control to the customer and (iii) the Company has discretion in establishing the price for the specified products or services. If a transaction does not meet the Company's indicators of being a principal in the transaction, then the Company is acting as an agent in the transaction and the associated revenues are recognized on a net basis.

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AVNET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Sales and other tax amounts collected from customers for remittance to governmental authorities are excluded from revenue. The Company has elected to treat shipping and handling of product as a fulfillment activity. The practical expedient not to disclose information about remaining performance obligations has also been elected as these contacts have an original duration of one year or less. The Company does not have any payment terms that exceed one year from the point it has satisfied the related performance obligations.

3. Discontinued operations

In February 2017, the Company completed the sale of its Technology Solutions business (“TS business”) to Tech Data Corporation (the “Buyer”). The TS business and the financial impacts of the divestiture are classified as discontinued operations in all periods presented. In August 2018, the Company executed a settlement agreement with the Buyer resulting in a final adjustment of $120.0 million and a final geographic allocation of the TS business sales price for tax reporting purposes. The incremental consideration received from the sale of the TS business has been classified as cash flow from discontinued operations investing activities.

In connection with the sale of the TS business, the Company entered into a Transition Services Agreement (“TSA”), pursuant to which the Buyer will pay the Company to provide certain information technology, distribution, facilities, finance and human resources related services for various periods of time depending upon the services not to exceed approximately two years from the closing date. Expenses incurred by the Company to provide such services under the TSA are classified within selling, general and administrative expenses and amounts billed to the Buyer to provide such services are classified as a reduction of such expenses. In fiscal 2018, the Buyer formally terminated substantially all TSA services outside of certain minor information technology services and all remaining TSA services are expected to be terminated during the first half of fiscal 2019.

4. Goodwill and long-lived assets

Goodwill

The following table presents the change in goodwill by reportable segment for the three months ended September 29, 2018.

	Electronic Components	Premier Farnell	Total
	(Thousands)		
Carrying value at June 30, 2018 (1)	$ 479,699	$ 501,173	$ 980,872
Additions from acquisitions	—	—	—
Foreign currency translation	704	730	1,434
Carrying value at September 29, 2018 (1)	$ 480,403	$ 501,903	$ 982,306

(1) Includes accumulated impairment of $1,045,110 from fiscal 2009 and $181,440 from fiscal 2018

The Company evaluates each quarter if facts and circumstances indicate that it is more likely than not that the fair value of reporting units is less than its carrying value, which would require the Company to perform an interim goodwill impairment test. Indicators the Company evaluates to determine whether an interim goodwill impairment test is necessary include, but are not limited to (i) a sustained decrease in share price or market capitalization as of any fiscal quarter end, (ii) changes in the macroeconomic or industry environments, (iii) the results of and the amount of time passed since the last goodwill impairment test and (iv) the long-term expected financial performance of its reporting units. During the first quarter of fiscal 2019, the Company concluded that an interim goodwill impairment test was not required.

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AVNET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Intangible Assets

The following table presents the Company's acquired intangible assets at September 29, 2018, and June 30, 2018, respectively.

	September 29, 2018	June 30, 2018