

VICOR CORP
Form 10-Q
August 11, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 June 30, 2008

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

For the
transition
period from

Commission File Number
0-18277

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

Delaware
(State of Incorporation)
25 Frontage Road, Andover, Massachusetts 01810
(Address of Principal Executive Office)
(978) 470-2900
(Registrant's telephone number)
04-2742817
(I.R.S. Employer Identification No.)

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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller Reporting Company ☐
(Do not check if a 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 ☒

The number of shares outstanding of each of the issuer's classes of common stock as of July 31, 2008 was:

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Common Stock, \$.01 par value	29,885,746
Class B Common Stock, \$.01 par value	11,767,052

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Item 1 Financial Statements

VICOR CORPORATION
Condensed Consolidated Balance Sheets
(In thousands)
(Unaudited)

Assets	<u>June 30, 2008</u>	<u>December 31, 2007</u>
Current assets:		
Cash and cash equivalents	\$ 33,000	\$ 20,017
Short-term investments	2,663	57,490
Accounts receivable, less allowance of \$296 in 2008 and \$398 in 2007	27,181	32,054
Inventories, net	26,025	23,078
Deferred tax assets	741	741
Other current assets	3,121	2,539
Total current assets	92,731	135,919
Restricted cash and cash equivalents	919	952
Long-term investments, net	36,250	
Property, plant and equipment, net	49,322	50,257
Other assets	5,397	5,330
	\$ 184,619	\$ 192,458
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 8,260	\$ 10,062
Accrued compensation and benefits	7,082	6,003
Accrued expenses	2,925	3,471
Accrual for litigation settlement	162	240
Income taxes payable	696	278
Deferred revenue	534	941
Total current liabilities	19,659	20,995
Long-term deferred revenue	924	42
Long-term income taxes payable	1,399	1,344
Deferred income taxes	1,649	1,597

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Minority interests	4,991	4,040
Stockholders' equity:		
Class B Common Stock	118	118
Common Stock	384	384
Additional paid-in capital	160,013	159,332
Retained earnings	119,315	126,263
Accumulated other comprehensive (loss) income	(2,006)	170
Treasury stock, at cost	(121,827)	(121,827)
Total stockholders' equity	155,997	164,440
	\$ 184,619	\$ 192,458

See accompanying notes.

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VICOR CORPORATION
Condensed Consolidated Statements of Operations
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Net revenues	\$ 49,297	\$ 47,206	\$ 102,766	\$ 94,187
Cost of revenues	28,184	27,607	59,193	54,361
Gross margin	21,113	19,599	43,573	39,826
Operating expenses:				
Selling, general and administrative	13,975	12,163	28,027	24,176
Research and development	8,080	7,667	15,591	15,067
Gain from litigation-related settlements, net	(177)	(1,353)	(177)	(1,353)
Total operating expenses	21,878	18,477	43,441	37,890
Income (loss) from operations	(765)	1,122	132	1,936
Other income (expense), net	(36)	906	719	2,483
Income (loss) before income taxes	(801)	2,028	851	4,419
Provision for income taxes	350	298	592	287
Loss from equity method investment, net of tax	172	756	962	837
Net income (loss)	\$ (1,323)	\$ 974	\$ (703)	\$ 3,295
Net income (loss) per common share:				
Basic	\$ (0.03)	\$ 0.02	\$ (0.02)	\$ 0.08
Diluted	\$ (0.03)	\$ 0.02	\$ (0.02)	\$ 0.08

Shares used to compute net income (loss) per share:

Basic	41,643	41,576	41,640	41,570
Diluted	41,643	41,641	41,640	41,628

Cash dividends per share	\$ 0.00	\$ 0.00	\$ 0.15	\$ 0.15
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See accompanying notes.

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VICOR CORPORATION
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six Months Ended	
	<u>June 30,</u> <u>2008</u>	<u>June 30, 2007</u>
Operating activities:		
Net income (loss)	\$ (703)	\$ 3,295
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,211	6,185
Loss from equity method investment, net of tax	962	837
Minority interest in net income of subsidiaries	951	89
Long-term deferred revenue	882	87
Stock compensation expense	588	321
Amortization of bond premium		(321)
Gain on disposal of equipment	(22)	(23)
Change in current assets and liabilities, net	233	(36,440)
Net cash provided by (used in) operating activities	8,102	(25,970)
Investing activities:		
Purchases of investments	(9,812)	(72,408)
Sales and maturities of investments	26,139	103,030
Additions to property, plant and equipment	(4,169)	(3,140)
Purchase of equity method investment	(1,000)	(1,000)
Proceeds from sale of equipment	22	23
Change in restricted cash and cash equivalents	33	
Increase in other assets	(119)	(58)
Net cash provided by investing activities	11,094	26,447
Financing activities:		
Proceeds from issuance of Common Stock	93	227
Common Stock dividends paid	(6,245)	(6,327)
Net cash used in financing activities	(6,152)	(6,100)

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Effect of foreign exchange rates on cash	(61)	12
Net increase (decrease) in cash and cash equivalents	12,983	(5,611)
Cash and cash equivalents at beginning of period	20,017	35,860
Cash and cash equivalents at end of period	\$ 33,000	\$ 30,249

See accompanying notes.

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VICOR CORPORATION
Notes to Condensed Consolidated Financial Statements
June 30, 2008
(Unaudited)

1. **Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2008, are not necessarily indicative of the results that may be expected for any other interim period or the year ending December 31, 2008. Operating results for the six months ended June 30, 2008 includes compensation-related accruals of \$320,000 for certain of the Company's international subsidiaries and additional stock compensation expense of \$90,000 identified and recorded in the first quarter of 2008. Management has concluded the impact of accounting for these previously unidentified accruals in the first quarter of 2008 is not material for the first quarter or the six months ended June 30, 2008, the Company's estimated 2008 financial results, or prior periods. Certain amounts in the 2007 condensed consolidated financial statements have been reclassified to conform to the 2008 presentation. The balance sheet at December 31, 2007, presented herein has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, (File No. 0-18277) filed by the Company with the Securities and Exchange Commission.

2. **Short-Term and Long-Term Investments**

The Company's principal sources of liquidity are its existing balances of cash, cash equivalents and short-term investments, as well as cash generated from operations. Consistent with the Company's investment policy guidelines, the Company can and has historically invested its substantial cash balances in demand deposit accounts, money market funds meeting certain quality criteria, and highly-liquid auction rate securities meeting certain quality criteria. All of the Company's investments are subject to credit, liquidity, market, and interest rate risk.

As of June 30, 2008, the Company held \$38,500,000 of auction rate securities, consisting of debt obligations of municipal and corporate issuers. The interest rates for these securities are reset at auction at regular intervals ranging from seven to 90 days. The auction rate securities held by the Company have historically traded at par and are callable at par at the option of the issuer. At June 30, 2008, the majority of the auction rate securities held by the Company were AAA/Aaa rated by the major credit rating agencies, with most collateralized by student loans guaranteed by the U.S. Department of Education under the Federal Family Education Loan Program.

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2. Short-Term and Long-Term Investments (continued)

Until February 2008, the auction rate securities market was highly liquid. Starting the week of February 11, 2008, a substantial number of auctions failed, meaning there was not enough demand to sell all of the securities that holders offered for sale. The consequences of a failed auction are (a) an investor must hold the specific security until the next scheduled auction (unless that investor chooses to sell the security to a third party outside of the auction process) and (b) the interest rate on the security generally resets to an interest rate set forth in the security's indenture. The principal associated with these failed auctions will not be accessible to the Company until a successful auction occurs, a buyer is found outside of the auction process, the security is called by the issuer, or the underlying securities have matured. As of June 30, 2008, the Company held auction rate securities that had experienced failed auctions totaling \$38,500,000 at par value (the "Failed Auction Securities").

Management is not aware of any reason to believe any of the issuers of the Failed Auction Securities held by the Company are presently at risk of default. Through June 30, 2008, the Company has continued to receive interest payments on the Failed Auction Securities in accordance with their terms. Management believes the Company ultimately should be able to liquidate all of its auction rate security investments without significant loss primarily due to the collateral securing the substantial majority of the underlying obligations. However, current conditions in the auction rate securities market have lead management to conclude the recovery period for the Failed Auction Securities exceeds 12 months. As a result, the Company continued to classify the Failed Auction Securities as long-term as of June 30, 2008, having classified them as long-term as of March 31, 2008.

Based on the fair value measurements described in Note 3, the fair value of the Failed Auction Securities at June 30, 2008, was estimated by the Company to be approximately \$36,250,000, compared with a par value of \$38,500,000. Management considers this \$2,250,000 difference to be temporary and has recorded this amount as an unrealized loss, net of taxes, in Accumulated other comprehensive (loss) income on the consolidated balance sheet. In making this determination, management considered the financial condition and near-term prospects of the issuers, the magnitude of the losses compared to the investments' cost, the length of time the investments have been in an unrealized loss position, the assumed low probability that the Company will be unable to collect all amounts due according to the contractual terms of the security, whether the security has been downgraded by a rating agency, and the Company's ability and intent to hold these investments until the anticipated recovery in market value occurs. If current market conditions deteriorate further, the Company may be required to record additional unrealized losses. If the credit rating of the security issuers deteriorates, or the anticipated recovery in the market values does not occur, the Company may be required to adjust the carrying value of these investments through impairment charges recorded in the consolidated statement of operations, and any such impairment adjustments may be material.

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June 30, 2008
(Unaudited)

2. Short-Term and Long-Term Investments (continued)

Based on the Company's ability to access cash and other short-term investments and its expected operating cash flows, management does not anticipate the current lack of liquidity will affect the Company's ability to execute its current operating plan.

3. Fair Value Measurements

The Company purchases marketable securities that have been designated as available-for-sale in accordance with Statement of Financial Accounting Standards (SFAS) 115, *Accounting for Certain Investments in Debt and Equity Securities*. SFAS 115 addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. Consistent with SFAS 115, such available-for-sale securities are carried at fair value, with unrealized gains and losses reported in Accumulated other comprehensive (loss) income, a component of stockholders' equity.

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS 157, *Fair Value Measurements*, expanding upon SFAS 115 and providing guidance on how to measure assets and liabilities recorded at fair value. SFAS 157 does not expand the use of fair value to any new circumstances, but does require additional disclosures in both annual and quarterly reports. The Company adopted SFAS 157 and its related amendments for financial assets and liabilities effective as of January 1, 2008. In accordance with FASB Staff Position No. FAS 157-2 (FSP FAS 157-2), SFAS 157 will be effective for non-financial assets and liabilities in financial statements issued for fiscal years beginning after November 15, 2008. FSP FAS 157-2 will impact the disclosures related to the Company's investment in Great Wall Semiconductor Corporation (GWS) and goodwill related to the operations of one of the Company's subsidiaries, Vicor Japan Company, Ltd.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (i.e., an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. SFAS 157 establishes a three-level hierarchy for disclosure to show the extent and level of judgment used to estimate fair value measurements:

Level 1 Inputs used to measure fair value are unadjusted quoted prices available in active markets for the identical assets or liabilities as of the reporting date.

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June 30, 2008
(Unaudited)

3. Fair Value Measurements (continued)

Level 2 Inputs used to measure fair value, other than quoted prices included in Level 1, are either directly or indirectly observable as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in inactive markets. Level 2 also includes assets and liabilities valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data from actively quoted markets for substantially the full term of the financial instrument.

Level 3 Inputs used to measure fair value are unobservable inputs supported by little or no market activity and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions.

As of June 30, 2008, there was insufficient observable auction rate security market information available to determine the fair value of the Failed Auction Securities. As such, the Company's investments in Failed Auction Securities were deemed to require valuation using Level 3 inputs. Consistent with SFAS 157, management, after consulting with outside experts, valued the Failed Auction Securities using analyses and pricing models similar to those used by market participants (i.e., buyers, sellers, and the broker-dealers responsible for execution of the Dutch auction pricing mechanism by which each issue's interest rate was set). Management utilized a probability weighted discounted cash flow (DCF) model to determine the estimated fair value of these securities as of June 30, 2008. The assumptions used in preparing the DCF model included estimates for the amount and timing of future interest, principal payments and the rate of return required by investors to own these securities in the current environment, and the estimated timeframe during which successful auctions for these securities will occur. In making these assumptions, management considered relevant factors including: the formula applicable to each security defining the interest rate paid to investors in the event of a failed auction; forward projections of the interest rate benchmarks specified in such formulas; the likely timing of principal repayments; the probability of full repayment considering the guarantees by the U.S. Department of Education of the underlying student loans, guarantees by other third parties, and additional credit enhancements provided through other means; and publicly available pricing data for recently issued student loan asset-backed securities not subject to auctions. The estimate of the rate of return required by investors to own these securities also considered the currently reduced liquidity for auction-rate securities. An increase or decrease in the liquidity risk premium (i.e., the discount rate) of 100 basis points as used in the model would decrease or increase, respectively, the fair value of the Failed Auction Securities by approximately \$600,000.

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June 30, 2008
(Unaudited)

3. Fair Value Measurements (continued)

Assets measured at fair value on a recurring basis, consistent with SFAS 157, include the following as of June 30, 2008 (in thousands):

	Fair Value Measurements at June 30, 2008 Using Significant			
	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value as of June 30, 2008
Cash equivalents:				
Money market funds	\$ 20,913	\$	\$	\$ 20,913
Short term investments	2,663			2,663
Auction rate securities:				
Long term investments			36,250	36,250

The following table summarizes the change in the fair values for those assets valued on a recurring basis utilizing Level 3 inputs for the six months ended June 30, 2008 (in thousands):

	Level 3
Balance at the beginning of the period (1)	\$
Transfers into Level 3 categorization:	38,500
Unrealized loss included in Accumulated other comprehensive (loss) income	(2,250)
Balance at the end of the period	\$ 36,250

- (1) The Company adopted SFAS 157 in January 2008 and, as such, had no beginning balance of such assets. All short-term and long-term investments measured at fair value are classified as available-for-sale securities, consistent with SFAS 115. Adjustments to fair value of these investments are recorded as an increase or decrease, net of taxes, in Accumulated other comprehensive (loss) income, except when losses are considered to be other-than-temporary, in which case the losses are recorded in Other income (expense), net.

Effective January 1, 2008, the Company adopted SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS 159 allows an entity the irrevocable option to elect fair value for the initial and

subsequent measurement for specified financial assets and liabilities on a contract-by-contract basis. The Company did not elect the fair value option as set forth by SFAS 159.

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VICOR CORPORATION
Notes to Condensed Consolidated Financial Statements (Continued)
June 30, 2008
(Unaudited)

4. Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with SFAS 123 (revised 2004), *Share-Based Payment*. Stock compensation expense for the three and six months ended June 30 was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Cost of revenues	\$ 30	\$ 14	\$ 45	\$ 24
Selling, general and administrative (1)	206	46	431	164
Research and development	50	67	112	133
 Total stock based compensation	 \$ 286	 \$ 127	 \$ 588	 \$ 321

(1) The increase in selling, general and administrative stock-based compensation expense is primarily the result of acceleration of the service periods used to amortize the cost of V*I Chip stock options granted to the Company's Chief Executive Officer in 2007.

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June 30, 2008
(Unaudited)

5. Net Income (Loss) per Share

The following table sets forth the computation of basic and diluted income per share for the three and six months ended June 30 (in thousands, except per share amounts):

Three Months Ended