

TERADYNE, INC
Form 10-Q
August 10, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 1, 2018

OR

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

For the transition period from to

Commission File No. 001-06462

TERADYNE, INC.

(Exact name of registrant as specified in its charter)

Massachusetts
(State or Other Jurisdiction of

04-2272148
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

600 Riverpark Drive, North Reading,

Massachusetts
(Address of Principal Executive Offices)

01864
(Zip Code)

978-370-2700

(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 the 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 (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, smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

(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

The number of shares outstanding of the registrant's only class of Common Stock as of August 6, 2018 was 186,437,930 shares.

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Table of Contents**PART I****Item 1: Financial Statements****TERADYNE, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

	July 1, 2018	December 31, 2017
	(in thousands, except per share amount)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 480,384	\$ 429,843
Marketable securities	712,309	1,347,979
Accounts receivable, less allowance for doubtful accounts of \$2,216 and \$2,219 at July 1, 2018 and December 31, 2017, respectively	454,122	272,783
Inventories, net	135,550	107,525
Prepayments and other current assets	111,820	112,151
Total current assets	1,894,185	2,270,281
Property, plant and equipment, net	285,302	268,447
Marketable securities	111,417	125,926
Deferred tax assets	73,574	84,026
Retirement plans assets	18,252	17,491
Other assets	12,192	12,275
Acquired intangible assets, net	148,173	79,088
Goodwill	388,625	252,011
Total assets	\$ 2,931,720	\$ 3,109,545
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 102,737	\$ 86,393
Accrued employees' compensation and withholdings	115,264	141,694
Deferred revenue and customer advances	82,491	83,614
Other accrued liabilities	83,681	59,083
Contingent consideration	35,911	24,497
Income taxes payable	32,226	59,055
Total current liabilities	452,310	454,336

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Retirement plans liabilities	124,258	119,776
Long-term deferred revenue and customer advances	25,375	30,127
Deferred tax liabilities	22,281	6,720
Long-term other accrued liabilities	22,296	10,273
Long-term contingent consideration	25,003	20,605
Long-term incomes taxes payable	147,360	148,075
Long-term debt	372,897	365,987
Total liabilities	1,191,780	1,155,899

Commitments and contingencies (See Note Q)

SHAREHOLDERS EQUITY

Common stock, \$0.125 par value, 1,000,000 shares authorized; 187,962 and 195,548 shares issued and outstanding at July 1, 2018 and December 31, 2017, respectively	23,495	24,444
Additional paid-in capital	1,645,679	1,638,413
Accumulated other comprehensive (loss) income	(3,504)	18,776
Retained earnings	74,270	272,013
Total shareholders equity	1,739,940	1,953,646
Total liabilities and shareholders equity	\$ 2,931,720	\$ 3,109,545

The accompanying notes, together with the Notes to Consolidated Financial Statements included in Teradyne's Annual Report on Form 10-K for the year ended December 31, 2017, are an integral part of the condensed consolidated financial statements.

Table of Contents**TERADYNE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

	For the Three Months Ended		For the Six Months Ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
	(in thousands, except per share amount)			
Revenues:				
Products	\$ 434,051	\$ 610,356	\$ 837,976	\$ 983,560
Services	92,878	86,545	176,420	170,254
Total revenues	526,929	696,901	1,014,396	1,153,814
Cost of revenues:				
Cost of products	180,777	267,752	361,735	422,634
Cost of services	38,818	38,511	75,495	75,525
Total cost of revenues (exclusive of acquired intangible assets amortization shown separately below)	219,595	306,263	437,230	498,159
Gross profit	307,334	390,638	577,166	655,655
Operating expenses:				
Selling and administrative	99,410	90,111	189,916	174,903
Engineering and development	75,342	82,270	149,750	158,248
Acquired intangible assets amortization	9,793	8,166	17,491	16,118
Restructuring and other	2,389	2,288	2,076	4,799
Total operating expenses	186,934	182,835	359,233	354,068
Income from operations	120,400	207,803	217,933	301,587
Non-operating (income) expense:				
Interest income	(5,427)	(3,292)	(11,407)	(6,812)
Interest expense	5,639	5,509	12,530	10,911
Other (income) expense, net	176	(1,291)	979	(1,405)
Income before income taxes	120,012	206,877	215,831	298,893
Income tax provision	18,975	31,901	27,821	38,696
Net income	\$ 101,037	\$ 174,976	\$ 188,010	\$ 260,197
Net income per common share:				
Basic	\$ 0.53	\$ 0.88	\$ 0.97	\$ 1.30

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Diluted	\$ 0.52	\$ 0.87	\$ 0.94	\$ 1.29
Weighted average common shares basic	190,730	198,774	192,992	199,390
Weighted average common shares diluted	194,909	201,529	199,197	201,732
Cash dividend declared per common share	\$ 0.09	\$ 0.07	\$ 0.18	\$ 0.14

The accompanying notes, together with the Notes to Consolidated Financial Statements included in Teradyne's Annual Report on Form 10-K for the year ended December 31, 2017, are an integral part of the condensed consolidated financial statements.

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TERADYNE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	For the Three Months Ended		For the Six Months Ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
	(in thousands)			
Net income	\$ 101,037	\$ 174,976	\$ 188,010	\$ 260,197
Other comprehensive income, net of tax:				
Foreign currency translation adjustment	(29,322)	15,981	(18,781)	24,944
Available-for-sale marketable securities:				
Unrealized gains (losses) on marketable securities arising during period, net of tax of \$(25), \$765, \$(744), \$1,185, respectively	198	985	(2,489)	1,498
Less: Reclassification adjustment for (gains) losses included in net income, net of tax of \$(68), \$(42), \$11, \$(106) respectively	(199)	(83)	1,469	(177)
	(1)	902	(1,020)	1,321
Defined benefit pension and post-retirement plans:				
Amortization of prior service benefit included in net periodic pension and post-retirement benefit, net of tax of \$(18), \$(38), \$(35), \$(77), respectively	(61)	(68)	(123)	(136)
Other comprehensive (loss) income	(29,384)	16,815	(19,924)	26,129
Comprehensive income	\$ 71,653	\$ 191,791	\$ 168,086	\$ 286,326

The accompanying notes, together with the Notes to Consolidated Financial Statements included in Teradyne's

Annual Report on Form 10-K for the year ended December 31, 2017, are an integral part of the condensed

consolidated financial statements.

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TERADYNE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Six Months Ended	
	July 1, 2018	July 2, 2017
	(in thousands)	
Cash flows from operating activities:		
Net income	\$ 188,010	\$ 260,197
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	33,156	32,474
Amortization	20,177	22,412
Stock-based compensation	17,625	17,312
Deferred taxes	17,312	(3,563)
Provision for excess and obsolete inventory	6,175	5,295
Contingent consideration adjustment	(8,468)	2,133
Retirement plan actuarial gains	(71)	(2,504)
Other	1,168	1,153
Changes in operating assets and liabilities, net of businesses acquired:		
Accounts receivable	(179,403)	(214,189)
Inventories	(21,283)	(8,149)
Prepayments and other assets	1,641	4,425
Accounts payable and other accrued expenses	(8,155)	34,504
Deferred revenue and customer advances	10,518	5,312
Retirement plans contributions	(2,173)	(1,983)
Income taxes	(26,308)	14,363
Net cash provided by operating activities	49,921	169,192
Cash flows from investing activities:		
Purchases of property, plant and equipment	(62,663)	(45,967)
Purchases of marketable securities	(647,071)	(334,819)
Proceeds from sales of marketable securities	829,053	313,254
Proceeds from maturities of marketable securities	469,862	307,607
Acquisition of businesses, net of cash acquired	(170,632)	
Net cash provided by investing activities	418,549	240,075
Cash flows from financing activities:		
Issuance of common stock under stock purchase and stock option plans	10,681	15,215
Repurchase of common stock	(360,795)	(94,328)
Dividend payments	(34,682)	(27,925)

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Payments related to net settlement of employee stock compensation awards	(19,751)	(12,438)
Payments of contingent consideration	(13,571)	(1,050)
Net cash used for financing activities	(418,118)	(120,526)
Effects of exchange rate changes on cash and cash equivalents	189	1,724
Increase in cash and cash equivalents	50,541	290,465
Cash and cash equivalents at beginning of period	429,843	307,884
Cash and cash equivalents at end of period	\$ 480,384	\$ 598,349

The accompanying notes, together with the Notes to Consolidated Financial Statements included in Teradyne's Annual Report on Form 10-K for the year ended December 31, 2017, are an integral part of the condensed consolidated financial statements.

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TERADYNE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

A. THE COMPANY

Teradyne, Inc. (Teradyne) is a leading global supplier of automation equipment for test and industrial applications. Teradyne designs, develops, manufactures and sells automatic test systems used to test semiconductors, wireless products, data storage and complex electronics systems in the consumer electronics, wireless, automotive, industrial, computing, communications, and aerospace and defense industries. Teradyne s industrial automation products include collaborative robotic arms, autonomous mobile robots, and advanced robotic control software used by global manufacturing and light industrial customers to improve quality, increase manufacturing and material handling efficiency and decrease manufacturing costs. Teradyne s automatic test equipment and industrial automation products and services include:

semiconductor test (Semiconductor Test) systems;

defense/aerospace (Defense/Aerospace) test instrumentation and systems, storage test (Storage Test) systems, and circuit-board test and inspection (Production Board Test) systems (collectively these products represent System Test);

industrial automation (Industrial Automation) products; and

wireless test (Wireless Test) systems.

B. ACCOUNTING POLICIES

Basis of Presentation

The consolidated interim financial statements include the accounts of Teradyne and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated. These interim financial statements are unaudited and reflect all normal recurring adjustments that are, in the opinion of management, necessary for the fair statement of such interim financial statements. Certain prior year amounts were reclassified to conform to the current year presentation. The December 31, 2017 condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The accompanying financial information should be read in conjunction with the consolidated financial statements and notes thereto contained in Teradyne s Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission (SEC) on March 1, 2018, for the year ended December 31, 2017.

Preparation of Financial Statements and Use of Estimates

The preparation of consolidated financial statements requires management to make estimates and judgments that affect the amounts reported in the financial statements. Actual results may differ significantly from these estimates.

Revenue from Contracts with Customers

Teradyne adopted Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (ASC 606) on January 1, 2018 using the modified retrospective method for all contracts not completed as of the date of adoption. The reported results for 2018 reflect the application of ASC 606 while the reported results for 2017 were prepared under the guidance of ASC 605, *Revenue Recognition* (ASC 605), which is also referred to herein as Legacy GAAP or the previous guidance. Teradyne recorded a net increase

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to retained earnings of \$12.7 million as of January 1, 2018 due to the cumulative impact of adopting ASC 606. Refer to Note B: Accounting Policies in Teradyne's 2017 Annual Report on Form 10-K for the policies in effect for revenue prior to January 1, 2018. The adoption of ASC 606 represents a change in accounting principle that will more closely align revenue recognition with the delivery of Teradyne's hardware and services and will provide financial statement readers with enhanced disclosures. In accordance with ASC 606, revenue is recognized when or as a customer obtains control of promised goods or services. The amount of revenue recognized reflects the consideration to which Teradyne expects to be entitled to receive in exchange for fulfillment of the performance obligation. Teradyne's primary source of revenue will continue to be from the sale of systems, instruments, robots, and the delivery of services.

In accordance with ASC 606, Teradyne recognizes revenues, when or as control is transferred to a customer. Teradyne's determination of revenue is dependent upon a five step process outlined below.

Step 1: Identify the contract with the customer

Teradyne accounts for a contract with a customer when there is written approval, the contract is committed, the rights of the parties, including payment terms, are identified, the contract has commercial substance and consideration is probable of collection.

Step 2: Identify the performance obligations in the contract

Teradyne periodically enters into contracts with its customers in which a customer may purchase a combination of goods and or services, such as products with extended warranty obligations. Teradyne determines performance obligations by assessing whether the products or services are distinct from the other elements of the contract. In order to be distinct, the product or service must perform either on its own or with readily available resources and must be separate within the context of the contract.

Step 3: Determine the transaction price

Teradyne considers the amount stated on the face of the purchase order to be the transaction price. Teradyne does not have material variable consideration, which could impact the stated purchase price agreed to by Teradyne and the customer.

Step 4: Allocate the transaction price to the performance obligations in the contract

Transaction price is allocated to each individual performance obligation based on the standalone selling price of that performance obligation. Teradyne uses standalone transactions when available to value each performance obligation. If standalone transactions are not available, Teradyne will estimate the standalone selling price through market assessments or cost plus a reasonable margin analysis. Any discounts from standalone selling price are spread proportionally to each performance obligation.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation

In order to determine the appropriate timing for revenue recognition, Teradyne first determines if the transaction meets any of three criteria for over time recognition. If the transaction meets the criteria for over time recognition, Teradyne recognizes revenue as the good or service is delivered. Teradyne uses input variables such as hours or months utilized or costs incurred to determine the amount of revenue to recognize in a given period. Input variables are used as they best align consumption with benefit to the customer. For transactions that do not meet the criteria for

over time recognition, Teradyne will recognize revenue at a point in time based on an assessment of the five criteria for transfer of control. Teradyne has concluded that revenue should be recognized when shipped or delivered based on contractual terms. Typically acceptance of Teradyne's products and services is a formality as Teradyne delivers similar systems, instruments and robots to standard specifications. In cases where acceptance is not deemed a formality, Teradyne will defer revenue recognition until customer acceptance.

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Revenue recognized in accordance with ASC 606 was \$523.3 million and \$1,006.5 million for the three and six months ended July 1, 2018, respectively. For the three and six months ended July 1, 2018, Teradyne also recognized \$3.6 million and \$7.9 million, respectively, in revenue on leases of Teradyne systems, which are accounted for outside of ASC 606.

Disaggregation of Revenue

The following table provides information about disaggregated revenue by primary geographical market, major product line and timing of revenue recognition.

For the Three Months Ended July 1, 2018

	Semiconductor Test System on a chip (SOC)		System Test Defense/Aerospace Storage Test		Production Board Test		Industrial Automation Universal Robots	Wireless Test Elimination	Corporate and Consolidated	
	Memory						Mobile Industrial Robots			
<i>Americas</i>										
Point in time	\$ 12,111	\$ 2,827	\$ 15,256	\$ 5	\$ 1,429	\$ 16,053	\$ 1,199	\$ 4,716	\$ (110)	\$ 53,486
Over time	8,934	710	6,237		795	327		122		17,125
<i>Europe, Middle East and Africa</i>										
Point in time	10,227	847	447		4,849	26,616	2,000	26		45,012
Over time	5,689	254	539		1,713	526		257		8,978
<i>Asia Pacific</i>										
Point in time	218,352	59,633	385	31,824	3,741	13,895	1,310	27,663		356,803
Over time	34,951	2,285	258	1,428	744	131		2,103		41,900
Lease revenue	3,268				32			325		3,625
Total	\$ 293,532	\$ 66,556	\$ 23,122	\$ 33,257	\$ 13,303	\$ 57,548	\$ 4,509	\$ 35,212	\$ (110)	\$ 526,929

For the Six Months Ended July 1, 2018

	Semiconductor Test SOC		System Test Defense/Aerospace Storage Test		Production Board Test		Industrial Automation Universal Robots	Wireless Test Elimination	Corporate and Consolidated
	Memory						Mobile Industrial Robots		

(in thousands)

Americas										
Point in										
time	\$ 21,711	\$ 5,691	\$ 26,853	\$ 284	\$ 3,189	\$ 30,190	\$ 1,199	\$ 9,695	\$ (332)	\$ 98,480
Over time	17,517	1,406	12,425		1,552	652		233		33,785
Europe, Middle East and Africa										
Point in										
time	22,352	986	1,943		8,886	49,190	2,000	1,066		86,423
Over time	10,888	523	1,090		3,272	668		484		16,925
Asia Pacific										
Point in										
time	446,543	125,904	487	41,946	5,603	25,478	1,310	41,329		688,600
Over time	68,173	4,607	466	2,961	1,479	204		4,399		82,289
Lease revenue	7,115				266			513		7,894
Total	\$ 594,299	\$ 139,117	\$ 43,264	\$ 45,191	\$ 24,247	\$ 106,382	\$ 4,509	\$ 57,719	\$ (332)	\$ 1,014,396

*Performance Obligations**Hardware*

Teradyne hardware consists primarily of semiconductor test systems and instruments, defense/aerospace test instrumentation and systems, storage test systems and instruments, circuit-board test and inspection systems and instruments, collaborative robots, autonomous mobile robots and wireless test systems. The hardware includes a standard 12-month warranty. This warranty is not considered a distinct performance obligation because it does

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not obligate Teradyne to provide a separate service to the customer and it cannot be purchased separately. Teradyne's hardware is recognized at a point in time upon transfer of control to the customer.

Extended Warranty

Customers have the option to purchase an extended warranty, which extends the warranty period for systems and robots beyond the one-year standard warranty. The extended warranty is purchased in the same transaction as the system or robot purchase and is classified as a separate performance obligation, which meets the criteria for over time recognition. The relative standalone selling price of the extended warranty is recognized ratably over the course of the extended warranty based on months completed.

Training and Applications Support

Teradyne sells training and applications support to customers either in standalone transactions or included with system purchases. The training and support allow the customer to use Teradyne's systems efficiently and effectively. Training and applications support included in system orders are valued based on their standalone selling price and all training and applications support is recognized over time as the customer receives and consumes the benefit associated with each. Both are recognized using an input method of hours consumed as this best depicts the transfer of services to the customer.

Service Agreements

Service agreements are recognized ratably over the period of agreement based on months completed.

Post-Contract Customer Support (PCS)

Teradyne provides support services for certain systems and robots outside of warranty. These services include telephone support, bug fixes, and when-and-if available upgrades. Standalone selling price for PCS is not directly observable as Teradyne does not sell these services separately. Teradyne has estimated the standalone selling price for these services based on adjusted market assessments. Revenue for PCS is recognized ratably over the performance period.

Teradyne does not allow customer returns or provide refunds to customers for any products or services.

Contract Balances

The following table provides information about contract liabilities. Teradyne does not have material contract assets on the balance sheet.

	July 1, 2018	January 1, 2018 (as adjusted) (in thousands)	Increase/ (Decrease)
Deferred revenue and customer advances	\$ 82,491	\$ 76,638	\$ 5,853
Long-term deferred revenue and customer advances	25,375	20,848	4,527

The amount of revenue recognized during the three and six months ended July 1, 2018 that was included within the deferred revenue and customer advances balance at January 1, 2018 was \$24.7 million and \$46.5 million, respectively, and primarily relates to extended warranties, training, application support, and PCS. Each of these represents a distinct performance obligation. Customers typically pay for these services net 30 to 60 days from the date that transfer of control of the associated system or product occurs.

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Teradyne does not have material remaining performance obligations from contracts with an original expected duration of greater than one year.

Significant Judgments

Teradyne makes no significant judgements in determining the amount or timing of revenue recognition.

Practical Expedients

Teradyne has adopted the practical expedients available within ASC 340 *Other Assets and Deferred Costs* for contract assets, specifically in relation to incremental costs of obtaining a contract. Teradyne generally expenses sales commissions when incurred because the amortization period would be less than one year. Teradyne records these costs within selling and administrative expenses.

Teradyne has adopted the practical expedient, which states an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to the customer and when the customer pays for that good or service will be one year or less. Teradyne does not have material payments associated with performance obligations outside this one-year time frame.

Impacts

The following tables summarize the impact of ASC 606 to Teradyne's consolidated financial statements. Differences are the result of timing differences between the recognition of revenue under ASC 606 and ASC 605 primarily with respect to software transactions deferred due to lack of vendor specific objective evidence of price under ASC 605 and Teradyne's assessment of acceptance under ASC 606. Under Legacy GAAP, Teradyne did not recognize revenue prior to acceptance if payment, title, or risk of loss was tied to acceptance. Under ASC 606, Teradyne recognizes revenue prior to receipt of acceptance if acceptance is deemed a formality.

Condensed Consolidated Balance Sheet:

	As Reported	July 1, 2018 Adjustments to Recognize Under Legacy GAAP	Legacy GAAP
(in thousands, except per share amount)			
ASSETS			
Accounts receivable, less allowance for doubtful accounts	\$ 454,122	\$ (95,102)	\$ 359,020
Inventories, net	135,550	33,830	169,380
Deferred tax assets	73,574	(3,494)	70,080
LIABILITIES			
Deferred revenue and customer advances	\$ 82,491	\$ (7,254)	\$ 75,237
Income taxes payable	32,226	(9,002)	23,224

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Long-term deferred revenue and customer advances	25,375	(9,836)	15,539
SHAREHOLDERS EQUITY			
Retained earnings	\$ 74,270	\$ (38,674)	\$ 35,596

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Condensed Consolidated Statement of Operation:

	For the Three Months ended July 1, 2018		
	As Reported	Adjustments to Recognize Under Legacy GAAP	Legacy GAAP
	(in thousands, except per share amount)		
Total revenues	\$ 526,929	\$ (28,626)	\$ 498,303
Total cost of revenues	219,595	(6,081)	213,514
Income tax provision	18,975	(4,569)	14,406
Net income	101,037	(17,976)	83,061
Net income per common share:			
Basic	\$ 0.53	\$ (0.09)	\$ 0.44
Diluted	\$ 0.52	\$ (0.09)	\$ 0.43

	For the Six Months ended July 1, 2018		
	As Reported	Adjustments to Recognize Under Legacy GAAP	Legacy GAAP
	(in thousands, except per share amount)		
Total revenues	\$ 1,014,396	\$ (94,268)	\$ 920,128
Total cost of revenues	437,230	(33,830)	403,400
Income tax provision	27,821	(9,084)	18,737
Net income	188,010	(51,354)	136,656
Net income per common share:			
Basic	\$ 0.97	\$ (0.27)	\$ 0.71
Diluted	\$ 0.94	\$ (0.26)	\$ 0.69

Retirement Benefits

In March 2017, the Financial Accounting Standards Board (FASB) issued ASU 2017-07, *Compensation Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. Teradyne retrospectively adopted the new accounting guidance on presentation of net periodic pension costs and net periodic postretirement benefit costs in the first quarter of 2018. This guidance requires the service cost component of net benefit costs to be reported in the same line item in the consolidated statement of operations as other employee compensation costs. The non-service components of net benefit costs such as interest cost, expected return on assets, amortization of prior service cost, and actuarial gains or losses, are required to be reported separately outside of income or loss from operations. Following the adoption of this guidance, Teradyne continues to record the service cost component in the same line item as other employee compensation costs and the non-service components of net benefit costs such as interest cost, expected return on assets, amortization of prior service cost, and actuarial gains or losses are reported within other (income) expense, net. The retrospective adoption of this standard decreased income from operations by \$2.1 million and \$1.7 million in the three and six months ended July 2, 2017, respectively,

due to the removal of net actuarial pension gains and increased non-operating (income) expense by the same amount with no impact to net income.

Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. Teradyne adopted the new accounting guidance in the first quarter of 2018 using the modified retrospective approach. This guidance requires that changes in fair value of equity securities be accounted for directly in earnings. Previously, the

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changes in fair value were recorded in accumulated other comprehensive income on the balance sheet. Teradyne continues to record realized gains in interest income and realized losses in interest expense. The adoption of this new accounting guidance increased the January 1, 2018 retained earnings balance by \$3.1 million and decreased the accumulated other comprehensive income balance by the same amount.

Contingencies and Litigation

Teradyne may be subject to certain legal proceedings, lawsuits and other claims as discussed in Note Q: Commitments and Contingencies. Teradyne accrues for a loss contingency, including legal proceedings, lawsuits, pending claims and other legal matters, when the likelihood of a loss is probable and the amount of the loss can be reasonably estimated. When the reasonable estimate of the loss is within a range of amounts, and no amount in the range constitutes a better estimate than any other amount, Teradyne accrues the amount at the low end of the range. Teradyne adjusts the accruals from time to time as additional information is received, but the loss incurred may be significantly greater than or less than the amount accrued. Loss contingencies are disclosed when they are material and there is at least a reasonable possibility that a loss has been incurred. Attorney fees related to legal matters are expensed as incurred.

C. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

On January 26, 2017, the FASB issued ASU 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment*. The new guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. Goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. All other goodwill impairment guidance will remain largely unchanged. Entities will continue to have the option to perform a qualitative assessment to determine if a quantitative impairment test is necessary. The same one-step impairment test will be applied to goodwill at all reporting units, even those with zero or negative carrying amounts. Entities will be required to disclose the amount of goodwill at reporting units with zero or negative carrying amounts. The revised guidance will be applied prospectively, and is effective in 2020. Early adoption is permitted for any impairment tests performed after January 1, 2017. Teradyne is currently evaluating the impact of this ASU on its financial position, results of operations and statements of cash flows.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The guidance in this ASU supersedes the lease recognition requirements in Accounting Standards Codification (ASC) Topic 840, *Leases*. The new standard establishes a right-of-use (ROU) model that requires a lessee to record an ROU asset and a lease liability on the balance sheet for all leases with terms longer than twelve months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the statements of operations. The new standard is effective for annual periods beginning after December 15, 2018 with early adoption permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Teradyne is still assessing the potential changes from this ASU, but expects it to have a material impact on its financial position and immaterial impact on its results of operations.

D. ACQUISITIONS*Mobile Industrial Robots*

On April 25, 2018, Teradyne acquired all the issued and outstanding shares of Mobile Industrial Robots ApS (MiR), a Danish limited liability company located in Odense, Denmark. MiR is the leading maker of collaborative autonomous

mobile robots for industrial applications. MiR is part of Teradyne's Industrial Automation segment.

The total preliminary purchase price of \$196.6 million consisted of \$145.2 million of cash paid and \$51.4 million of contingent consideration, measured at fair value. The contingent consideration is payable in

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Euros upon the achievement of certain thresholds and targets for revenue and earnings before interest and taxes for periods from January 1, 2018 to December 31, 2018; January 1, 2018 to December 31, 2019; and January 1, 2018 to December 31, 2020. At July 1, 2018, the maximum amount of contingent consideration that could be paid is \$117 million.

The valuation of the contingent consideration utilized the following assumptions: (1) probability of meeting each target; (2) expected timing of meeting each target; and (3) discount rate reflecting the risk associated with the expected payments. The probabilities and timing for each target were estimated based on a review of the historical and projected results. A significant portion of the risk in achieving the contingent consideration was captured in the probabilities assigned to meeting each target.

The MiR acquisition was accounted for as a business combination and, accordingly, the results have been included in Teradyne's consolidated results of operations from the date of acquisition. The allocation of the preliminary total purchase price to MiR's net tangible liabilities and identifiable intangible assets was based on their estimated fair values as of the acquisition date. The excess of the purchase price over the identifiable intangible assets and net tangible liabilities in the amount of \$135.7 million was allocated to goodwill, which is not deductible for tax purposes. The purchase price and purchase price allocation are preliminary pending the final determination of the fair value of contingent consideration, acquired assets and assumed liabilities. MiR's results have been included in Teradyne's Industrial Automation segment from the date of acquisition.

The following table represents the allocation of the preliminary purchase price:

	Purchase Price Allocation	
	(in thousands)	
Goodwill	\$	135,747
Intangible assets		79,660
Tangible assets acquired and liabilities assumed:		
Current assets		6,039
Non-current assets		299
Accounts payable and current liabilities		(7,336)
Long-term deferred tax liabilities		(17,779)
Total purchase price	\$	196,630

Teradyne estimated the fair value of intangible assets using the income and cost approaches. Acquired intangible assets are amortized on a straight-line basis over their estimated useful lives. Components of these intangible assets and their estimated useful lives at the acquisition date are as follows:

	Fair Value	Estimated Useful Life
	(in thousands)	(in years)
Developed technology	\$ 63,820	7.0
Trademarks and tradenames	12,060	11.0
Customer relationships	3,770	2.5

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Backlog	10	0.2
Total intangible assets	\$ 79,660	7.4

For the period from April 25, 2018 to July 1, 2018, MiR contributed \$4.5 million of revenues and had a \$(1.5) million loss from operations before income taxes.

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The following unaudited pro forma information gives effect to the acquisition of MiR as if the acquisition occurred on January 1, 2017. The unaudited pro forma results are not necessarily indicative of what actually would have occurred had the acquisition been in effect for the periods presented:

	For the Three Months Ended		For the Six Months Ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
	(in thousands)			
Revenue	\$ 528,238	\$ 699,790	\$ 1,021,194	\$ 1,158,228
Net income	101,780	172,238	186,787	251,728
Net income per common share:				
Basic	\$ 0.53	\$ 0.87	\$ 0.97	\$ 1.26
Diluted	\$ 0.52	\$ 0.85	\$ 0.94	\$ 1.25

Pro forma results for the three and six months ended July 1, 2018 were adjusted to exclude \$2.3 million and \$2.9 million, respectively, of acquisition related costs, and \$0.4 million of non-recurring expense related to fair value adjustment to acquisition-date inventory.

Pro forma results for the six months ended July 2, 2017 were adjusted to include \$2.9 million of acquisition related costs, and \$0.4 million of non-recurring expense related to fair value adjustment to acquisition-date inventory.

Energid Technologies Corporation

On February 26, 2018, Teradyne acquired all of the issued and outstanding shares of Energid Technologies Corporation (Energid) for a total purchase price of approximately \$27.6 million. Energid s technology enables and simplifies the programming of complex robotic motions used in a wide variety of end markets, ranging from heavy industry to healthcare, utilizing both traditional robots and collaborative robots. The Energid acquisition was accounted for as a business combination and, accordingly, Energid s results have been included in Teradyne s Industrial Automation segment from the date of acquisition. As of the acquisition date, Teradyne s purchase price allocation was goodwill of \$14.4 million, acquired intangible assets of \$12.3 million with an average estimated useful life of 7.7 years, and \$1.0 million of net tangible assets. The acquisition was not material to Teradyne s condensed consolidated financial statements.

E. INVENTORIES

Inventories, net consisted of the following at July 1, 2018 and December 31, 2017:

	July 1, 2018	December 31, 2017
	(in thousands)	
Raw material	\$ 76,888	\$ 62,668
Work-in-process	26,378	19,464

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Finished goods	32,284	25,393
	\$ 135,550	\$ 107,525

Inventory reserves at July 1, 2018 and December 31, 2017 were \$103.2 million and \$102.9 million, respectively.

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F. FINANCIAL INSTRUMENTS

Cash Equivalents

Teradyne considers all highly liquid investments with maturities of three months or less at the date of acquisition to be cash equivalents.

Marketable Securities

Effective January 1, 2018, Teradyne adopted ASU 2016-01, *Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* using the modified retrospective approach. This guidance requires that changes in fair value of equity securities be accounted for directly in earnings. Prior to 2018, the changes in fair value of equity securities were recorded in accumulated other comprehensive income on the balance sheet.

On a quarterly basis, Teradyne reviews its investments to identify and evaluate those that have an indication of a potential other-than-temporary impairment. Factors considered in determining whether a loss is other-than-temporary include:

The length of time and the extent to which the market value has been less than cost;

The financial condition and near-term prospects of the issuer; and

The intent and ability to retain the investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.

Teradyne uses the market and income approach techniques to value its financial instruments and there were no changes in valuation techniques during the three and six months ended July 1, 2018 and July 2, 2017. As defined in ASC 820-10, *Fair Value Measurements and Disclosures*, fair value is the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. ASC 820-10 requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Quoted prices in active markets for identical assets as of the reporting date;

Level 2: Inputs other than Level 1, that are observable either directly or indirectly as of the reporting date. For example, a common approach for valuing fixed income securities is the use of matrix pricing. Matrix pricing is a mathematical technique used to value securities by relying on the securities' relationship to other benchmark quoted prices, and is considered a Level 2 input; or

Level 3: Unobservable inputs that are not supported by market data. Unobservable inputs are developed based on the best information available, which might include Teradyne's own data.

Teradyne's available-for-sale debt securities are classified as Level 2, and equity securities are classified as Level 1. Acquisition-related contingent consideration is classified as Level 3. Teradyne determines the fair value of acquisition-related contingent consideration using a Monte Carlo simulation model. Assumptions utilized in the model

include forecasted revenues, revenue volatility, earnings before interest and taxes, and discount rate. The vast majority of Level 2 securities are fixed income securities priced by third party pricing vendors. These pricing vendors utilize the most recent observable market information in pricing these securities or, if specific prices are not available, use other observable inputs like market transactions involving identical or comparable securities.

Realized gains recorded in the three and six months ended July 1, 2018 were \$0.1 million and \$0.4 million, respectively. Realized losses recorded in the three and six months ended July 1, 2018 were \$0.0 million and \$1.5 million, respectively. Realized gains recorded in the three and six months ended July 2, 2017 were

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\$0.2 million and \$0.5 million, respectively. Realized losses recorded in the three and six months ended July 2, 2017 were \$0.1 million and \$0.2 million, respectively. Realized gains are included in interest income and realized losses are included in interest expense.

Unrealized gains and losses on available-for-sale debt securities are included in accumulated other comprehensive income (loss). Changes in fair value of equity securities are included in other (income) expense, net. The cost of securities sold is based on the specific identification method.

During the three and six months ended July 1, 2018 and July 2, 2017, there were no transfers in or out of Level 1, Level 2 or Level 3 financial instruments.

The following table sets forth by fair value hierarchy Teradyne's financial assets and liabilities that were measured at fair value on a recurring basis as of July 1, 2018 and December 31, 2017.

	July 1, 2018			Total
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Assets				
Cash	\$ 209,827	\$	\$	\$ 209,827
Cash equivalents	247,525	23,032		270,557
Available-for-sale securities:				
U.S. Treasury securities		528,857		528,857
Commercial paper		218,520		218,520
Corporate debt securities		38,372		38,372
U.S. government agency securities		10,009		10,009
Certificates of deposit and time deposits		1,318		1,318
Debt mutual funds	2,810			2,810
Non-U.S. government securities		551		551
Equity securities:				
Mutual funds	23,289			23,289
	\$ 483,451	\$ 820,659	\$	\$ 1,304,110
Derivative assets		7		7
Total	\$ 483,451	\$ 820,666	\$	\$ 1,304,117
Liabilities				
Contingent consideration	\$	\$	\$ 60,914	\$ 60,914
Derivative liabilities		253		253

Total	\$	\$	253	\$	60,914	\$	61,167
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Reported as follows:

	(Level 1)	(Level 2)	(Level 3)	Total
	(in thousands)			
Assets				
Cash and cash equivalents	\$ 457,352	\$ 23,032	\$	\$ 480,384
Marketable securities		712,309		712,309
Long-term marketable securities	26,099	85,318		111,417
Prepayments		7		7
Total	\$ 483,451	\$ 820,666	\$	\$ 1,304,117
Liabilities				
Other current liabilities	\$	\$ 253	\$	\$ 253
Contingent consideration			35,911	35,911
Long-term contingent consideration			25,003	25,003
Total	\$	\$ 253	\$ 60,914	\$ 61,167

	December 31, 2017			Total
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	(in thousands)			
Assets				
Cash	\$ 197,955	\$	\$	\$ 197,955
Cash equivalents	206,335	25,553		231,888
Available for sale securities:				
U.S. Treasury securities		855,795		855,795
Commercial paper		282,840		282,840
Certificates of deposit and time deposits		167,342		167,342
Corporate debt securities		133,186		133,186
Equity and debt mutual funds	23,430			23,430
U.S. government agency securities		10,726		10,726
Non-U.S. government securities		586		586
	\$ 427,720	\$ 1,476,028	\$	\$ 1,903,748
Derivative assets		389		389

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Total	\$ 427,720	\$ 1,476,417	\$	\$ 1,904,137
Liabilities				
Contingent consideration	\$	\$	\$ 45,102	\$ 45,102
Derivative liabilities		446		446
Total	\$	\$ 446	\$ 45,102	\$ 45,548

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Reported as follows:

	(Level 1)	(Level 2)	(Level 3)	Total
	(in thousands)			
Assets				
Cash and cash equivalents	\$ 404,290	\$ 25,553	\$	\$ 429,843
Marketable securities		1,347,979		1,347,979
Long-term marketable securities	23,430	102,496		125,926
Prepayments		389		389
Total	\$ 427,720	\$ 1,476,417	\$	\$ 1,904,137
Liabilities				
Other accrued liabilities	\$	\$ 446	\$	\$ 446
Contingent consideration			24,497	24,497
Long-term contingent consideration			20,605	20,605
Total	\$	\$ 446	\$ 45,102	\$ 45,548