II-VI INC
Form 10-Q
February 08, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended December 31, 2015

¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the transition period from   to   .

Commission File Number: 0-16195

II-VI INCORPORATED

(Exact name of registrant as specified in its charter)

PENNSYLVANIA	25-1214948
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
375 Saxonburg Boulevard Saxonburg, PA	16056
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: 724-352-4455

N/A

(Former name, former address and former fiscal year, 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 x 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	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 x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

At February 4, 2016, 61,259,112 shares of Common Stock, no par value, of the registrant were outstanding.

II-VI INCORPORATED

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

II-VI Incorporated and Subsidiaries

Condensed Consolidated Balance Sheets (Unaudited)

($000)

	December 31, 2015	June 30, 2015
Assets		
Current Assets		
Cash and cash equivalents	$177,084	$173,634
Accounts receivable - less allowance for doubtful accounts of $1,766 at December 31, 2015 and $1,048 at June 30, 2015	128,260	140,772
Inventories	167,928	164,388
Deferred income taxes	-	13,260
Prepaid and refundable income taxes	8,355	6,881
Prepaid and other current assets	13,999	14,033
Total Current Assets	495,626	512,968
Property, plant & equipment, net	200,563	203,812
Goodwill	193,874	195,894
Other intangible assets, net	115,939	122,462
Investment	12,343	11,914
Deferred income taxes	16,099	2,210
Other assets	9,001	8,904
Total Assets	$1,043,445	$1,058,164
Liabilities and Shareholders' Equity		
Current Liabilities		
Current portion of long-term debt	$20,000	$20,000
Accounts payable	38,824	45,275
Accrued compensation and benefits	37,457	39,310
Accrued income taxes payable	10,783	9,310
Deferred income taxes	-	685
Other accrued liabilities	23,829	24,576
Total Current Liabilities	130,893	139,156
Long-term debt	126,491	155,957
Deferred income taxes	6,303	7,105
Other liabilities	27,732	26,865
Total Liabilities	291,419	329,083
Shareholders' Equity		
Preferred stock, no par value; authorized - 5,000,000 shares; none issued	-	-
Common stock, no par value; authorized - 300,000,000 shares; issued - 72,289,968 shares at December 31, 2015; 71,779,704 shares at June 30, 2015	235,342	226,609
Accumulated other comprehensive income (loss)	(4,848)	8,665

Retained earnings	623,507	587,302
	854,001	822,576
Treasury stock, at cost - 11,069,110 shares at December 31, 2015 and 10,565,209 shares at June 30, 2015	(101,975)	(93,495)
Total Shareholders' Equity	752,026	729,081
Total Liabilities and Shareholders' Equity	$1,043,445	$1,058,164

- See notes to condensed consolidated financial statements.

II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Earnings (Unaudited)

($000 except per share data)

	Three Months Ended December 31,	
	2015	2014
Revenues		
Domestic	$74,177	$68,695
International	117,257	108,041
Total Revenues	191,434	176,736
Costs, Expenses and Other Expense (Income)		
Cost of goods sold	120,090	113,718
Internal research and development	12,155	12,845
Selling, general and administrative	37,408	33,642
Interest expense	597	1,038
Other expense (income), net	(994)	(9,295)
Total Costs, Expenses and Other Expense (Income)	169,256	151,948
Earnings Before Income Taxes	22,178	24,788
Income Taxes	3,187	2,692
Net Earnings	$18,991	$22,096
Basic Earnings Per Share:	$0.31	$0.36
Diluted Earnings Per Share:	$0.30	$0.35

- See notes to condensed consolidated financial statements.

II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Earnings (Unaudited)

($000 except per share data)

	Six Months Ended December 31,	
	2015	2014
Revenues		
Domestic	$144,928	$130,676
International	235,713	231,893
Total Revenues	380,641	362,569
Costs, Expenses and Other Expense (Income)		
Cost of goods sold	238,108	231,692
Internal research and development	25,306	25,788
Selling, general and administrative	73,718	69,162
Interest expense	1,246	2,242
Other expense (income), net	(2,051)	(7,613)
Total Costs, Expenses and Other Expense (Income)	336,327	321,271
Earnings Before Income Taxes	44,314	41,298
Income Taxes	8,109	6,900
Net Earnings	$36,205	$34,398
Basic Earnings Per Share:	$0.59	$0.56
Diluted Earnings Per Share:	$0.58	$0.55

- See notes to condensed consolidated financial statements.

II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

($000)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2015	2014	2015	2014
Net earnings	$18,991	$22,096	$36,205	$34,398
Other comprehensive income (loss):				
Foreign currency translation adjustments	(5,411)	(1,491)	(13,562)	(4,166)
Pension adjustment, net of taxes of $4 and $14 for the three and six months ended December 31, 2015, respectively, and $50 and $107 for the three and six months ended December 31, 2014, respectively	13	(98)	49	(402)
Comprehensive income	$13,593	$20,507	$22,692	$29,830

- See notes to condensed consolidated financial statements.

II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

($000)

	Six Months Ended December 31,	
	2015	2014
Cash Flows from Operating Activities		
Net earnings	$36,205	$34,398
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	21,166	20,642
Amortization	5,958	5,990
Share-based compensation expense	6,949	5,955
(Gain) loss on foreign currency remeasurements and transactions	(951)	1,611
Earnings from equity investment	(429)	(516)
Deferred income taxes	(3,788)	(621)
Excess tax benefits from share-based compensation expense	(112)	(103)
Increase (decrease) in cash from changes in:		
Accounts receivable	10,520	(4,675)
Inventories	(7,833)	(4,892)
Accounts payable	(5,167)	(5,662)
Income taxes	2,540	1,456
Other operating net assets	(2,758)	(4,139)
Net cash provided by operating activities	62,300	49,444
Cash Flows from Investing Activities		
Additions to property, plant & equipment	(19,156)	(31,609)
Proceeds from sale of property, plant & equipment	39	101
Net cash used in investing activities	(19,117)	(31,508)
Cash Flows from Financing Activities		
Proceeds from borrowings	4,000	3,000
Payments on borrowings	(33,500)	(32,000)
Purchases of treasury stock	(6,284)	(11,301)
Proceeds from exercises of stock options	1,794	2,042
Other financing activities	(1,861)	(894)
Net cash used in financing activities	(35,851)	(39,153)
Effect of exchange rate changes on cash and cash equivalents	(3,882)	1,506
Net increase (decrease) in cash and cash equivalents	3,450	(19,711)
Cash and Cash Equivalents at Beginning of Period	173,634	174,660
Cash and Cash Equivalents at End of Period	$177,084	$154,949
Cash paid for interest	$1,226	$2,229
Cash paid for income taxes	$8,497	$6,239

- See notes to condensed consolidated financial statements.

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e II-VI Incorporated and Subsidiaries

Condensed Consolidated Statement of Shareholders' Equity (Unaudited)

(000)

	Common Stock		Accumulated Other Comprehensive	Retained	Treasury Stock		
	Shares	Amount	Income (Loss)	Earnings	Shares	Amount	Total
Balance - June 30, 2015	71,780	$226,609	$ 8,665	$587,302	(10,565)	$(93,495)	$729,081
Shares issued under share-based compensation plans	497	1,794	-	-	-	-	1,794
Shares acquired in satisfaction of minimum tax withholding obligations	-	-	-	-	(110)	(1,981)	(1,981)
Net earnings	-	-	-	36,205	-	-	36,205
Purchases of treasury stock	-	-	-	-	(381)	(6,284)	(6,284)
Treasury stock under deferred compensation arrangements	13	215	-	-	(13)	(215)	-
Foreign currency translation adjustments	-	-	(13,562)	-	-	-	(13,562)
Share-based compensation expense	-	6,949	-	-	-	-	6,949
Pension adjustment, net of taxes of $14	-	-	49	-	-	-	49
Tax deficiency from share-based compensation expense	-	(225)	-	-	-	-	(225)
Balance - December 31, 2015	72,290	$235,342	$ (4,848)	$623,507	(11,069)	$(101,975)	$752,026

- See notes to condensed consolidated financial statements.

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II-VI Incorporated and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1. Basis of Presentation

The condensed consolidated financial statements of II-VI Incorporated ("II-VI" or the "Company") for the three and six months ended December 31, 2015 and 2014 are unaudited. In the opinion of management, all adjustments considered necessary for a fair presentation for the periods presented have been included. All adjustments are of a normal recurring nature unless disclosed otherwise. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2015. The consolidated results of operations for the three and six months ended December 31, 2015 are not necessarily indicative of the results to be expected for the full fiscal year. The June 30, 2015 Condensed Consolidated Balance Sheet information was derived from the Company's audited financial statements.

Note 2. Recent Accounting Pronouncements

Adopted Pronouncements

In November 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. This update requires all deferred tax assets and liabilities, and any related valuation allowance, to be classified as noncurrent on the balance sheet. The classification change for all deferred taxes as noncurrent simplifies the Company's processes as it eliminates the need to separately identify the net current and net noncurrent deferred tax asset or liability in each jurisdiction and allocate valuation allowances. The Company has elected to prospectively adopt the accounting standard in the quarter ended December 31, 2015. The adoption of this standard resulted in the reclassification of $13.3 million from current Deferred income tax assets in the Consolidated Balance Sheet as of December 31, 2015 to noncurrent Deferred income tax assets and $1.0 million from current Deferred income tax liabilities to noncurrent Deferred income tax liabilities. Prior periods in the Company's Consolidated Financial Statements were not retrospectively adjusted.

Pronouncements Currently Under Evaluation

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. This update requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The standard will be effective for the Company's 2017 fiscal year. Early adoption is permitted. The adoption of this ASU is not expected to have a material effect on the Company's Consolidated Financial Statements.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. This update simplifies the measurement of inventory valuation at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The new inventory measurement requirements will be effective for the Company's 2018 fiscal year and will replace the current inventory valuation guidance that requires the use of a lower of cost or market framework. The adoption of this ASU is not expected to have a material effect on the Company's Consolidated

Financial Statements.

In April 2015, the FASB issued ASU 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement. This update provides guidance about whether a cloud computing arrangement includes a software license. The update will be effective for annual reporting periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. The update allows for the use of either a prospective or retrospective adoption approach. The adoption of this ASU is not expected to have a material effect on the Company's Consolidated Financial Statements.

In April 2015, the FASB issued ASU 2015-03, Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. This ASU requires entities to present debt issuance costs in the balance sheet as a direct deduction from the carrying amount of the corresponding debt liability, consistent with debt discounts. The guidance does not address situations in which debt issuance costs do not have an associated debt liability or exceed the carrying amount of the associated debt liability. The update will be effective for annual reporting periods, including interim periods within those annual periods, beginning after December 15, 2015. The adoption of this ASU is not expected to have a material effect on the Company's Consolidated Financial Statements.

In February 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis, which affects reporting organizations that are required to evaluate whether they should consolidate certain legal entities. The update will be effective for interim and annual reporting periods in fiscal years beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. The update allows for the use of either a full retrospective or a modified retrospective adoption approach. The adoption of this ASU is not expected to have a material effect on the Company's Consolidated Financial Statements.

In May 2014, the FASB issued ASU 2014-09: Revenue from Contracts with Customers (Topic 606) which supersedes virtually all existing revenue recognition guidance under U.S. GAAP. The update's core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The update allows for the use of either the retrospective or modified retrospective approach of adoption. On July 9, 2015 the FASB approved a one year deferral of the effective date of the update. The update will be effective for fiscal years, and interim periods within those years, beginning after December 15, 2017 (the first quarter of our fiscal year 2019). We have not yet selected a transition method and are currently evaluating the impact of this guidance on the Company's Consolidated Financial Statements.

Note 3. Investment

The Company has an equity investment of 20.2% in Guangdong Fuxin Electronic Technology ("Fuxin") based in Guangdong Province, China, which is accounted for under the equity method of accounting. The total carrying value of the investment recorded at December 31, 2015 and June 30, 2015 was $12.3 million and $11.9 million, respectively. During each of the three months ended December 31, 2015 and 2014, the Company's pro-rata share of earnings from this investment was $0.2 million, and was $0.4 million and $0.5 million during the six months ended December 31, 2015 and 2014, respectively, and was recorded in Other expense (income), net in the Condensed Consolidated Statements of Earnings.

Note 4. Inventories

The components of inventories were as follows ($000):

	December 31, 2015	June 30, 2015
Raw materials	$67,795	$71,210
Work in progress	55,805	52,726
Finished goods	44,328	40,452
	$167,928	$164,388

Note 5. Property, Plant and Equipment

Property, plant and equipment consists of the following ($000):

	December 31, 2015	June 30, 2015
Land and improvements	$4,619	$4,566
Buildings and improvements	91,620	91,171
Machinery and equipment	371,378	366,560
Construction in progress	24,333	17,749
	491,950	480,046
Less accumulated depreciation	(291,387)	(276,234)
	$200,563	$203,812

During the quarter ended March 31, 2015, as part of the Company's restructuring of its military related businesses in the Performance Products segment, the Company implemented a plan to sell one of its manufacturing facilities located in New Port Richey, Florida. The Company anticipates completing the sale within twelve months of the plan implementation, has reclassified the carrying value of the land and building of approximately $1.2 million as assets held for sale and has included the carrying value in Prepaid and other current assets in the Condensed Consolidated Balance Sheets for the periods presented.

Note 6. Goodwill and Other Intangible Assets

Changes in the carrying amount of goodwill were as follows ($000):

	Six Months Ended December 31, 2015			
	II-VI Laser Solutions	II-VI Photonics	II- VI Performance Products	Total
Balance-beginning of period	$43,578	$99,426	$ 52,890	$195,894
Foreign currency translation	(63)	(1,957)	-	(2,020)
Balance-end of period	$43,515	$97,469	$ 52,890	$193,874

Note 1 of the Notes to Consolidated Financial Statements in the Company's most recent Annual Report on Form 10-K describes the significant accounting policies and methods used in the preparation of the Company's Consolidated Financial Statements. Management has evaluated goodwill for indicators of impairment and has concluded that there are no indicators of impairment as of December 31, 2015.

The gross carrying amount and accumulated amortization of the Company's intangible assets other than goodwill as of December 31, 2015 and June 30, 2015 were as follows ($000):

	December 31, 2015			June 30, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Technology and Patents	$49,933	$ (20,556)	$29,377	$50,520	$ (18,838)	$31,682
Trademarks	15,663	(1,148)	14,515	15,869	(1,111)	14,758
Customer Lists	101,988	(30,039)	71,949	102,489	(26,583)	75,906
Other	1,570	(1,472)	98	1,572	(1,456)	116
Total	$169,154	$ (53,215)	$115,939	$170,450	$ (47,988)	$122,462

Amortization expense recorded on the Company's intangible assets was $3.0 million and $6.0 million for the three and six months ended December 31, 2015, respectively, and was $2.9 million and $6.0 million for the three and six months ended December 31, 2014, respectively. The technology and patents are being amortized over a range of 60 to 240 months, with a weighted average remaining life of approximately 104 months. The customer lists are being amortized over a range of approximately 120 to 240 months with a weighted average remaining life of approximately 135 months. The gross carrying amount of trademarks includes $14.2 million of acquired trade names with indefinite lives that are not amortized but tested annually for impairment or more frequently if a triggering event occurs. Included in the gross carrying amount and accumulated amortization of the Company's intangible assets is the effect of foreign currency translation on that portion of the intangible assets relating to the Company's German and Chinese subsidiaries.

At December 31, 2015, the estimated amortization expense for existing intangible assets for each of the five succeeding fiscal years is as follows ($000):

Year Ending June 30,	
Remaining 2016	$5,804
2017	11,607
2018	11,067
2019	10,706
2020	10,313

Note 7. Debt

The components of debt for the periods indicated were as follows ($000):

	December 31, 2015	June 30, 2015
Line of credit, interest at LIBOR, as defined, plus 1.25%	$ 89,000	$ 108,500
Term loan, interest at LIBOR, as defined, plus 1.25%	55,000	65,000
Yen denominated line of credit, interest at LIBOR, as defined, plus 0.625%	2,491	2,457
Total debt	146,491	175,957
Current portion of long-term debt	(20,000)	(20,000)
Long-term debt, less current portion	$ 126,491	$ 155,957

The Company’s Second Amended and Restated Credit Agreement (the “Credit Facility”) provides for a revolving credit facility of $225 million, as well as a $100 million Term Loan. The Term Loan is being repaid in consecutive quarterly principal payments on the first business day of each January, April, July and October, with the first payment having commenced on October 1, 2013, as follows: (i) twenty consecutive quarterly installments of $5 million and (ii) a final installment of all remaining principal due and payable on the maturity date of September 10, 2018. Amounts borrowed under the revolving credit facility are due and payable on the maturity date. The Credit Facility is unsecured, but is guaranteed by each existing and subsequently acquired or organized wholly-owned domestic subsidiary of the Company. The Company has the option to request an increase to the size of the Credit Facility in an aggregate additional amount not to exceed $100 million. The Credit Facility has a five-year term through September 10, 2018 and has an interest rate of either a Base Rate Option or a Euro-Rate Option, plus an Applicable Margin, as defined in the agreement governing the Credit Facility. If the Base Rate option is selected for a borrowing, the Applicable Margin is 0.00% to 0.075% and if the Euro-Rate Option is selected for a borrowing, the Applicable Margin is 0.75% to 1.75%. The Applicable Margin is based on the Company’s ratio of consolidated indebtedness to consolidated EBITDA. Additionally, the Credit Facility is subject to certain covenants, including those relating to minimum interest coverage and maximum leverage ratios. As of December 31, 2015, the Company was in compliance with all financial covenants under its Credit Facility.

The Company’s Yen denominated line of credit is a 500 million Yen (approximately $4.1 million) facility. The Yen line of credit was extended in September 2015 through August 2020 on substantially the same terms. The interest rate is equal to LIBOR, as defined in the loan agreement, plus 0.625% to 1.50%. At each of December 31, 2015 and June 30, 2015, the Company had 300 million Yen borrowed. Additionally, the facility is subject to certain covenants, including those relating to minimum interest coverage and maximum leverage ratios. As of December 31, 2015, the Company was in compliance with all financial covenants under its Yen facility.

The Company had aggregate availability of $136.1 million and $116.6 million under its lines of credit as of December 31, 2015 and June 30, 2015, respectively. The amounts available under the Company’s lines of credit are reduced by outstanding letters of credit. As of December 31, 2015 and June 30, 2015, total outstanding letters of credit supported by these credit facilities were $1.5 million.

The weighted average interest rate of total borrowings was 1.5% and 1.9% for the six months ended December 31, 2015 and 2014, respectively.

Remaining annual principal payments under the Company's existing credit facilities as of December 31, 2015 were as follows:

Period	Term Loan	Yen Line of Credit	U.S. Dollar Line of Credit	Total
Year 1	$20,000	$-	$-	$20,000
Year 2	20,000	-	-	20,000
Year 3	15,000	-	89,000	104,000
Year 4	-	-	-	-
Year 5	-	2,491	-	2,491
Total	$55,000	$2,491	$89,000	$146,491

Note 8. Income Taxes

The Company's year-to-date effective income tax rate at December 31, 2015 and 2014 was 18.3% and 16.4%, respectively. The variations between the Company's effective tax rate and the U.S. statutory rate of 35.0% were primarily due to the consolidation of the Company's foreign operations, which are subject to income taxes at lower statutory rates.

U.S. GAAP clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. As of December 31, 2015 and June 30, 2015, the Company's gross unrecognized income tax benefit was $5.1 million and $4.0 million, respectively. The Company has classified the uncertain tax positions as noncurrent income tax liabilities, as the amounts are not expected to be paid within one year. If recognized, substantially all of the gross unrecognized tax benefits at December 31, 2015 would impact the effective tax rate. The Company recognizes interest and penalties related to uncertain tax positions in the income tax provision on the Condensed Consolidated Statements of Earnings. The amount of accrued interest and penalties included in the $5.1 million and $4.0 million of gross unrecognized income tax benefit at December 31, 2015 and June 30, 2015, respectively, was immaterial. Fiscal years 2012 to 2015 remain open to examination by the United States Internal Revenue Service, fiscal years 2011 to 2015 remain open to examination by certain state jurisdictions, and fiscal years 2008 to 2015 remain open to examination by certain foreign taxing jurisdictions. The Company's fiscal year 2011 and 2012 California state income tax returns are currently under examination by the state of California's Franchise Tax Board. The Company's fiscal year 2012 and 2013 German income tax returns are currently under examination by the Federal Central Tax Office in Germany.

Note 9. Earnings Per Share

The following table sets forth the computation of earnings per share for the periods indicated. Weighted average shares issuable upon the exercises of stock options and the release of performance and restricted shares not included in the calculation because they were anti-dilutive totaled approximately 193,000 and 212,000 for the three and six months ended December 31, 2015, respectively, and 976,000 and 927,000 for the three and six months ended December 31, 2014, respectively ($000 except per share data):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2015	2014	2015	2014
Net earnings	$18,991	$22,096	$36,205	$34,398
Divided by:				
Weighted average shares	61,165	61,129	61,194	61,319
Basic earnings per common share:	$0.31	$0.36	$0.59	$0.56
Net earnings	$18,991	$22,096	$36,205	$34,398
Divided by:				
Weighted average shares	61,165	61,129	61,194	61,319
Dilutive effect of common stock equivalents	1,508	1,147	1,507	1,213

Diluted weighted average common shares	62,673	62,276	62,701	62,532
Diluted earnings per common share:	$0.30	$0.35	$0.58	$0.55

Note 10. Segment Reporting

The Company reports its business segments using the “management approach” model for segment reporting. This means that the Company determines its reportable business segments based on the way the chief operating decision maker organizes business segments within the Company for making operating decisions and assessing performance.

The Company reports its financial results in the following three segments: (i) II-VI Laser Solutions, (ii) II-VI Photonics, and (iii) II-VI Performance Products, and the Company’s chief operating decision maker receives and reviews financial information based on these segments. The Company evaluates business segment performance based upon segment operating income, which is defined as earnings before income taxes, interest and other income or expense. The segments are managed separately due to the market, production requirements and facilities unique to each segment.

The II-VI Laser Solutions segment is located in the U.S., Singapore, China, Germany, Switzerland, Japan, Belgium, the U.K., Italy, South Korea and the Philippines. II-VI Laser Solutions is directed by the President of II-VI Laser Solutions, while each geographic location is directed by a general manager, and is further divided into production and administrative units that are directed by managers. II-VI Laser Solutions designs, manufactures and markets optical and electro-optical components and materials sold under the II-VI Infrared brand name and used primarily in high-power CO_2 lasers. II-VI Laser Solutions also manufactures fiber-delivered beam delivery systems and processing tools and direct diode lasers for industrial lasers sold under the II-VI HIGHYAG and II-VI Laser Enterprise brand names.

The II-VI Photonics segment is located in the U.S., China, Vietnam, Germany, Japan, the U.K., Italy and Hong Kong. II-VI Photonics is directed by the President of II-VI Photonics and is further divided into production and administrative units that are directed by managers. II-VI Photonics manufactures crystal materials, optics, microchip lasers and opto-electronic modules for use in optical communication networks and other diverse consumer and commercial applications. In addition, the segment also manufactures pump lasers, and optical amplifiers and micro-optics for optical amplifiers for both terrestrial and submarine applications within the optical communications market.

The II-VI Performance Products segment is located in the U.S., Vietnam, Japan, China, Germany and the Philippines. II-VI Performance Products is directed by a Corporate Executive Vice President, while each geographic location is directed by a general manager. II-VI Performance Products is further divided into production and administrative units that are directed by managers. II-VI Performance Products designs, manufactures and markets infrared optical components and high-precision optical assemblies for military, medical and commercial laser imaging applications. In addition, the segment designs, manufactures and markets unique engineered materials for thermo-electric and silicon carbide applications servicing the semiconductor, military and medical markets.

The accounting policies of the segments are the same as those of the Company. The Company’s corporate expenses are allocated to the segments. The Company evaluates segment performance based upon reported segment operating income, which is defined as earnings from continuing operations before income taxes, interest and other income or expense. Inter-segment sales and transfers are eliminated.

The following tables summarize selected financial information of the Company’s operations by segment ($000):

	Three Months Ended December 31, 2015				
	II-VI Laser Solutions	II-VI Photonics	II-VI Performance Products	Eliminations	Total
Revenues	$70,191	$74,264	$ 46,979	$ -	$191,434
Inter-segment revenues	4,850	2,766	1,543	(9,159)	-
Operating income	11,251	7,455	3,076	-	21,781
Interest expense	-	-	-	-	(597)
Other income (expense), net	-	-	-	-	994
Income taxes	-	-	-	-	(3,187)
Net earnings	-	-	-	-	18,991
Depreciation and amortization	3,691	4,980	5,148	-	13,819
Segment assets	331,797	435,297	276,351	-	1,043,445
Expenditures for property, plant and equipment	3,475	4,471	1,786	-	9,732
Investment	-	-	12,343	-	12,343

Goodwill	43,515	97,469	52,890	-	193,874

	Three Months Ended December 31, 2014				
	II-VI Laser Solutions	II-VI Photonics	II-VI Performance Products	Eliminations	Total
Revenues	$67,655	$ 60,853	$ 48,228	$ -	$176,736
Inter-segment revenues	5,498	3,800	1,880	(11,178)	-
Operating income	12,226	413	3,892	-	16,531
Interest expense	-	-	-	-	(1,038)
Other income (expense), net	-	-	-	-	9,295
Income taxes	-	-	-	-	(2,692)
Net earnings	-	-	-	-	22,096
Depreciation and amortization	3,368	5,229	4,474	-	13,071
Expenditures for property, plant and equipment	3,372	3,076	3,631	-	10,079

	Six Months Ended December 31, 2015				
	II-VI Laser Solutions	II-VI Photonics	II-VI Performance Products	Eliminations	Total
Revenues	$141,774	$146,159	$ 92,708	$ -	$380,641
Inter-segment revenues	9,380	5,797	3,938	(19,115)	-
Operating income	23,426	13,739	6,345	-	43,509
Interest expense	-	-	-	-	(1,246)
Other income (expense), net	-	-	-	-	2,051
Income taxes	-	-	-	-	(8,109)
Net earnings	-	-	-	-	36,205
Depreciation and amortization	7,395	10,073	9,656	-	27,124
Expenditures for property, plant and equipment	9,355	6,623	3,178	-	19,156

	Six Months Ended December 31, 2014				
	II-VI Laser Solutions	II-VI Photonics	II-VI Performance Products	Eliminations	Total
Revenues	$140,454	$124,491	$ 97,624	$ -	$362,569
Inter-segment revenues	10,562	6,620	4,108	(21,290)	-
Operating income	25,149	2,485	8,293	-	35,927
Interest expense	-	-	-	-	(2,242)
Other income (expense), net	-	-	-	-	7,613
Income taxes	-	-	-	-	(6,900)
Net earnings	-	-	-	-	34,398
Depreciation and amortization	6,901	10,751	8,980	-	26,632
Expenditures for property, plant and equipment	19,438	5,969	6,202	-	31,609

Note 11. Share-Based Compensation

The Board of Directors adopted the II-VI Incorporated Second Amended and Restated 2012 Omnibus Incentive Plan (the “Plan”) which was approved by the shareholders at the Annual Meeting in November 2015. The Plan provides for the grant of performance-based cash incentive awards, non-qualified stock options, stock appreciation rights, restricted share awards, restricted share units, deferred share awards, performance share awards and performance share units to employees, officers and directors of the Company. The maximum number of shares of the Company’s common stock authorized for issuance under the Plan is limited to 4,900,000 shares of common stock, not including any remaining shares forfeited under the predecessor plans that may be rolled into the Plan. The Company records share-based compensation expense for these awards in accordance with U.S. GAAP, which requires the recognition of grant-date fair value of share-based compensation in net earnings and over the requisite service period of the individual grantees, which generally equals the vesting period. The Company accounts for cash-based stock appreciation rights, cash-based restricted share unit awards and cash-based performance share unit awards as liability awards, in accordance with applicable accounting standards.

Share-based compensation expense is allocated approximately 15% to cost of goods sold and 85% to selling, general and administrative expense, based on the employee classification of the grantees. Share-based compensation expense for the periods indicated was as follows ($000):

	Three Months Ended		Six Months Ended	
December 31,	2015	2014	2015	2014
Stock Options and Cash-Based Stock Appreciation Rights	$751	$1,096	$3,137	$3,215
Restricted Share Awards and Cash-Based Restricted Share Unit Awards	1,554	1,063	2,785	2,159
Performance Share Awards and Cash-Based Performance Share Unit Awards	1,428	580	1,676	990
	$3,733	$2,739	$7,598	$6,364

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Note 12. Fair Value of Financial Instruments

The FASB defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous markets for the asset and liability in an orderly transaction between market participants at the measurement date. The Company estimates fair value of its financial instruments utilizing an established three-level hierarchy in accordance with U.S. GAAP. The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date as follows:

- Level 1 – Valuation is based upon unadjusted quoted prices for identical assets or liabilities in active markets.
- Level 2 – Valuation is based upon quoted prices for similar assets and liabilities in active markets, or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instruments.
- Level 3 – Valuation is based upon other unobservable inputs that are significant to the fair value measurements.

The classification of fair value measurements within the hierarchy is based upon the lowest level of input that is significant to the measurement. At December 31, 2015, the Company had foreign currency forward contracts recorded at fair value. The fair values of these instruments were measured using valuations based upon quoted prices for similar assets and liabilities in active markets (Level 2) and are valued by reference to similar financial instruments, adjusted for credit risk and restrictions and other terms specific to the contracts. Foreign currency gain related to these contracts was immaterial for the three and six months ended December 31, 2015.

The Company had Level 2 foreign currency forward contract liabilities of $35,000 as of December 31, 2015 and assets of $130,000 as of June 30, 2015, respectively.

The Company’s policy is to report transfers into and out of Levels 1 and 2 of the fair value hierarchy at fair values as of the beginning of the period in which the transfers occur. There were no transfers in and out of Levels 1 and 2 of the fair value hierarchy during the three and six months ended December 31, 2015.

The fair values of cash and cash equivalents are considered Level 1 among the fair value hierarchy and approximate fair value because of the short-term maturity of those instruments. The Company’s borrowings are considered Level 2 among the fair value hierarchy and are variable interest rates and accordingly their carrying amounts approximate fair value.

Note 13. Derivative Instruments

The Company, from time to time, purchases foreign currency forward exchange contracts, primarily in Japanese Yen, that permit it to sell specified amounts of these foreign currencies expected to be received from its export sales for pre-established U.S. dollar amounts at specified dates. The Company enters into these contracts to limit transactional exposure to changes in currency exchange rates of export sales transactions in which settlement will occur in future periods and which otherwise would expose the Company, on the basis of its aggregate net cash flows in respective currencies, to foreign currency risk.

The Company has recorded the fair market value of these contracts in the Company's Condensed Consolidated Financial Statements. These contracts had a total notional amount of $8.7 million and $10.8 million at December 31, 2015 and June 30, 2015, respectively. As of December 31, 2015, these forward contracts had expiration dates ranging from January 2016 through April 2016, with Japanese Yen denominations individually ranging from 100 million Yen to 350 million Yen. The Company does not account for these contracts as hedges as defined by U.S. GAAP, and records the change in the fair value of these contracts in Other expense (income), net in the Condensed Consolidated Statements of Earnings as they occur. The fair value measurement takes into consideration foreign currency rates and the current creditworthiness of the counterparties to these contracts, as applicable, and is based upon quoted prices for similar assets and liabilities in active markets, or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instruments and thus represents a Level 2 measurement. These contracts are recorded in Other liabilities in the Company's Condensed Consolidated Balance Sheets. The change in the fair value of these contracts for each of the three and six months ended December 31, 2015 and 2014 was insignificant.

Note 14. Commitments and Contingencies

The Company records a warranty reserve as a charge against earnings based on a percentage of sales utilizing actual warranty claims over the last twelve months. The following table summarizes the change in the carrying value of the Company's warranty reserve, which is a component of Other accrued liabilities in the Company's Condensed Consolidated Balance Sheets ($000):

	Six Months Ended December 31, 2015
Balance-beginning of period	$ 3,251
Payments made during the period	(1,536)
Additional warranty liability recorded during the period	1,525
Balance-end of period	$ 3,240

Note 15. Post-Retirement Benefits

The Company has a pension plan (the "Swiss Plan") covering employees of the Zurich, Switzerland subsidiary. The unfunded pension liability of $9.8 million is recorded in Other liabilities in the Condensed Consolidated Balance Sheet at December 31, 2015. Net periodic pension costs associated with the Swiss Plan included the following ($000):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2015	2014	2015	2014
Service cost	$637	$673	$1,320	$1,353
Interest cost	103	179	214	360
Expected return on plan assets	(261)	(267)	(541)	(537)
Net amortization	17	(148)	63	(509)
Net periodic pension costs	$496	$437	$1,056	$667

The Company contributed $0.5 million and $1.0 million to the Swiss Plan during the three and six months ended December 31, 2015, respectively, and $0.6 million and $1.2 million during the three and six months ended December 31, 2014, respectively. The Company currently anticipates contributing an additional estimated amount of approximately $1.0 million to the Swiss Plan during the remainder of fiscal year 2016.

Note 16. Share Repurchase Program

In August 2014, the Company's Board of Directors authorized the Company to purchase up to $50 million of its Common Stock through a share repurchase program (the "Program") that calls for shares to be purchased in the open market or in private transactions from time to time. The Program has no expiration and may be suspended or discontinued at any time. Shares purchased by the Company are retained as treasury stock and available for general corporate purposes. As of December 31, 2015, the Company has purchased 1,318,987 shares of its Common Stock pursuant to the Program for approximately $19.0 million.

Note 17. Accumulated Other Comprehensive Income (Loss)

The changes in accumulated other comprehensive income ("AOCI") by component, net of tax, for the six months ended December 31, 2015 were as follows ($000):

	Foreign Currency Translation Adjustment	Defined Benefit Pension Plan	Total Accumulated Other Comprehensive Income (Loss)
AOCI - June 30, 2015	$ 9,466	$ (801)	$ 8,665
Other comprehensive income (loss) before reclassifications	(13,562)	-	(13,562)
Amounts reclassified from AOCI	-	49	49
Net current-period other comprehensive income (loss)	(13,562)	49	(13,513)
AOCI - December 31, 2015	$ (4,096)	$ (752)	$ (4,848)

Note 18. Subsequent Event

On January 19, 2016, the Company announced that it signed agreements to acquire two businesses, EpiWorks, Inc. (“EpiWorks”) and ANADIGICS, Inc. (“Anadigics”), in two separate transactions. These businesses are expected to expand the Company’s technology platforms and production capacity for semiconductor lasers with a scalable 6-inch epitaxial growth and wafer fabrication platform.

On February 1, 2016, the Company completed its acquisition of EpiWorks, which now operates as a wholly owned subsidiary of the Company. The merger agreement between the Company and EpiWorks provides for the payment by the Company of an aggregate of approximately $43 million in cash at closing with up to an additional $6 million in potential earn-out payments over the next three years, subject to certain adjustments. Due to the close proximity of this acquisition to the filing date of this Form 10-Q, the Company was unable to make certain financial statement disclosures related to the purchase price allocation of EpiWorks.

On January 15, 2016, the Company entered into a merger agreement with Anadigics. On February 2, 2016 a wholly owned subsidiary of the Company commenced a tender offer for all of the outstanding common stock of Anadigics at a price of $0.66 per share in cash, without interest. The tender offer will expire on March 1, 2016, unless extended. Assuming sufficient shares of Anadigics are tendered in the tender offer, the Company is expected to complete the acquisition of Anadigics via a second-step merger promptly following the expiration of the tender offer. The aggregate consideration for the transaction is approximately $61.0 million. Assuming the satisfaction of all applicable conditions to the tender offer and the merger, the acquisition of Anadigics is currently expected to close in March 2016

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This Quarterly Report on Form 10-Q, including Management's Discussion and Analysis of Financial Condition and Results of Operations ("Management's Discussion and Analysis"), contains forward-looking statements as defined by Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding projected growth rates, markets, product development, financial position, capital expenditures and foreign currency exposure. Forward-looking statements are also identified by words such as "expects," "anticipates," "intends," "plans," "projects" or similar expressions.

Although our management considers these expectations and assumptions to be reasonable, actual results could differ materially from any such forward-looking statements included in this Quarterly Report on Form 10-Q or otherwise made by our management due to the following factors, among others: dependency on international sales and successful management of global operations, the development and use of new technology, the timely release of new products and acceptance of such new products by the market, our ability to devise and execute strategies to respond to market conditions, the impact of acquisitions on our business and our ability to assimilate recently acquired businesses, the impact of impairment in goodwill and indefinite-lived intangible assets in one or more of our segments, adverse changes in economic or industry conditions generally (including capital markets) or in the markets served by the Company, our ability to protect our intellectual property, domestic and foreign governmental regulation, including that related to the environment, the impact of a data breach incident on our operations, supply chain issues, the actions of competitors, the purchasing patterns of customers and end-users, the occurrence of natural disasters and other catastrophic events outside of our control, and changes in local market laws and practices. There are additional risk factors that could materially affect the Company's business, results of operations or financial condition as set forth in Part I, Item 1A of the Company's most recent Annual Report on Form 10-K as filed with the Securities and Exchange Commission on August 28, 2015.

In addition, we operate in a highly competitive and rapidly changing environment; therefore, new risk factors can arise, and it is not possible for management to predict all such risk factors, nor to assess the impact of all such risk factors on our business or the extent to which any individual risk factor, or combination of risk factors, may cause results to differ materially from those contained in any forward-looking statement. The forward-looking statements included in this Quarterly Report on Form 10-Q are based only on information currently available to us and speak only as of the date of this Report. We do not assume any obligation, and do not intend to, update any forward-looking statements, whether as a result of new information, future developments or otherwise, except as may be required by the securities laws. Investors should, however, consult any further disclosures of a forward-looking nature that the Company may make in its subsequent Annual Reports