

EMCORE CORP
Form 10-Q
August 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: June 30, 2006

Commission File Number: 0-22175

EMCORE Corporation

(Exact name of Registrant as specified in its charter)

New Jersey

(State or other jurisdiction of incorporation or organization)

22-2746503

(IRS Employer Identification No.)

145 Belmont Drive, Somerset, NJ 08873

(Address of principal executive offices)

(732) 271-9090

(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. **Yes** **No**

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (check one): Large accelerated filer **Accelerated filer** Non-accelerated filer

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 no par value common stock as of August 4, 2006 was 50,889,524.

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PART I. FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS.**

EMCORE CORPORATION
Condensed Consolidated Statements of Operations
For the three and nine months ended June 30, 2006 and 2005
(in thousands, except per share data)
(unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	2005	2006	2005
Revenue	\$ 41,954	\$ 33,234	\$ 123,007	\$ 90,628
Cost of revenue	33,336	26,503	98,864	76,293
Gross profit	8,618	6,731	24,143	14,335
Operating expenses:				
Selling, general and administrative	8,182	7,902	26,445	18,589
Research and development	5,152	4,061	14,550	13,189
Total operating expenses	13,334	11,963	40,995	31,778
Operating loss	(4,716)	(5,232)	(16,852)	(17,443)
Other (income) expenses:				
Interest income	(263)	(297)	(838)	(779)
Interest expense	1,331	1,202	3,987	3,606
Loss from convertible subordinated notes exchange offer	-	-	1,078	-
Equity in net loss of Velox investment	-	-	332	-
Equity in net loss (income) of GELcore investment	129	778	(21)	703
Total other expenses	1,197	1,683	4,538	3,530
Loss from continuing operations	(5,913)	(6,915)	(21,390)	(20,973)
Discontinued operations:				
Gain on disposal of discontinued operations	-	-	2,012	12,476
Income from discontinued operations	-	-	2,012	12,476
Net loss	\$ (5,913)	\$ (6,915)	\$ (19,378)	\$ (8,497)
Per share data:				
Basic and diluted per share data:				
Loss from continuing operations	\$ (0.12)	\$ (0.15)	\$ (0.43)	\$ (0.44)
Income from discontinued operations	-	-	0.04	0.26

Net loss	\$	(0.12)	\$	(0.15)	\$	(0.39)	\$	(0.18)
Weighted average number of shares outstanding used in basic and diluted per share calculations		50,430		47,426		49,336		47,228

The accompanying notes are an integral part of these condensed consolidated financial statements.

EMCORE CORPORATION
Condensed Consolidated Balance Sheets
As of June 30, 2006 and September 30, 2005
(in thousands)
(unaudited)

	As of June 30, 2006	As of September 30, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 16,138	\$ 19,525
Restricted cash	1,303	547
Marketable securities	7,900	20,650
Accounts receivable, net	27,388	22,633
Receivables, related parties	482	4,197
Inventory, net	24,940	18,348
Prepaid expenses and other current assets	3,224	3,638
Total current assets	81,375	89,538
Property, plant and equipment, net	56,997	56,957
Goodwill	40,476	34,643
Intangible assets, net	6,624	5,347
Investments in unconsolidated affiliates	12,388	12,698
Receivables, related parties	169	169
Other assets, net	5,526	6,935
Total assets	\$ 203,555	\$ 206,287
LIABILITIES and SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 20,692	\$ 15,587
Accrued expenses and other current liabilities	13,540	19,078
Notes payable, current portion	430	-
Convertible subordinated notes, current portion	-	1,350
Total current liabilities	34,662	36,015
Notes payable, long-term	277	-
Convertible subordinated notes, long-term	95,895	94,709
Total liabilities	130,834	130,724
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$0.0001 par, 5,882 shares authorized, no shares outstanding	-	-
Common stock, no par value, 100,000 shares authorized, 50,805 shares issued and 50,646 shares outstanding at June 30, 2006;	410,153	392,466

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48,023 shares issued and 48,003 shares outstanding at September 30, 2005		
Accumulated deficit	(335,349)	(315,971)
Treasury stock, at cost		
159 shares at June 30, 2006; 20 shares at September 30, 2005	(2,083)	(932)
Total shareholders' equity	72,721	75,563
Total liabilities and shareholders' equity		
	\$ 203,555	\$ 206,287

The accompanying notes are an integral part of these condensed consolidated financial statements.

EMCORE CORPORATION
Condensed Consolidated Statements of Cash Flows
For the nine months ended June 30, 2006 and 2005
(in thousands)
(unaudited)

	Nine Months Ended June 30,	
	2006	2005
Cash flows from operating activities:		
Net loss	\$ (19,378)	\$ (8,497)
Adjustments to reconcile net loss to net cash used for operating activities:		
Gain on disposal of discontinued operations	(2,012)	(12,476)
Stock option compensation expense	3,086	-
Depreciation and amortization expense	10,297	10,861
Accretion of loss from convertible subordinated notes exchange offer	116	-
Loss on convertible subordinated notes exchange offer	1,078	-
Provision for doubtful accounts	56	(170)
Equity in net (income) loss of GELcore	(21)	703
Equity in net loss of Velox	332	-
Compensatory stock issuances	591	579
Forgiveness of shareholders' notes receivable	2,613	34
Reduction of note receivable due for services received	390	390
Total non-cash adjustments	16,526	(79)
Changes in operating assets and liabilities:		
Accounts receivable	(4,072)	(6,328)
Receivables, related parties	(49)	(317)
Inventory	(5,931)	(2,761)
Prepaid expenses and other current assets	389	941
Other assets	(928)	(402)
Accounts payable	3,320	(2,070)
Accrued expenses and other current liabilities	(7,904)	(1,664)
Total change in operating assets and liabilities	(15,175)	(12,601)
Net cash used for operating activities	(18,027)	(21,177)
Cash flows from investing activities:		
Cash proceeds from disposition of discontinued operations	-	13,197
Investment in GELcore	-	(1,470)
Purchase of plant and equipment	(4,008)	(3,280)
Proceeds from (investment in) K2 Optronics	500	(1,000)
Cash purchase of businesses, net of cash acquired	610	(2,783)
Purchase of marketable securities	(350)	(11,225)
Funding of restricted cash	(703)	-
Sale of marketable securities	13,100	22,875
Net cash provided by investing activities	9,149	16,314
Cash flows from financing activities:		
Payments on debt obligations	(176)	(31)

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Proceeds from exercise of stock options	6,023	503
Proceeds from employee stock purchase plan	1,108	1,006
Convertible debt/equity issuance costs	(114)	-
Principal payment on convertible debt obligation	(1,350)	-
Net cash provided by financing activities	5,491	1,478
Net decrease in cash and cash equivalents	(3,387)	(3,385)
Cash and cash equivalents, beginning of period	19,525	19,422
Cash and cash equivalents, end of period	\$ 16,138	\$ 16,037

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash paid during the period for interest	\$ 5,067	\$ 4,806
Issuance of common stock in conjunction with acquisitions	\$ 6,460	\$ -

NON-CASH INVESTING AND FINANCING ACTIVITIES

Acquisition of property and equipment under capital leases	\$ 126	\$ -
Net decrease in liabilities for purchase of plant and equipment	\$ 670	\$ -
Manufacturing equipment received in lieu of earn-out proceeds from disposition of discontinued operations	\$ 2,012	\$ -

The accompanying notes are an integral part of these condensed consolidated financial statements.

EMCORE Corporation
Notes to Condensed Consolidated Financial Statements
As of June 30, 2006 and September 30, 2005 and
For the three and nine months ended June 30, 2006 and 2005
(unaudited)

NOTE 1. Basis of Presentation.

The accompanying unaudited condensed consolidated financial statements include the accounts of EMCORE Corporation and its subsidiaries (EMCORE). All intercompany accounts and transactions have been eliminated. Certain amounts in prior period financial statements have been reclassified to conform to the current year presentation. These reclassifications had no effect on previously reported shareholders' equity.

These statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) for interim information, and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by US GAAP for annual financial statements. In the opinion of management, all information considered necessary for a fair presentation of the financial statements has been included. Operating results for interim periods are not necessarily indicative of results that may be expected for an entire fiscal year. The condensed consolidated balance sheet as of September 30, 2005 has been derived from the audited financial statements as of such date. For a more complete understanding of EMCORE's financial position, operating results, risk factors and other matters, please refer to EMCORE's Annual Report on Form 10-K for the fiscal year ended September 30, 2005.

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Management bases estimates on historical experience and on various assumptions about the future that are believed to be reasonable based on available information. EMCORE's reported financial position or results of operations may be materially different under changed conditions or when using different estimates and assumptions. In the event that estimates or assumptions prove to differ from actual results, adjustments are made in subsequent periods to reflect more current information.

NOTE 2. Recent Accounting Pronouncements.

SFAS No. 123(R) - Effective October 1, 2005, EMCORE adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment (Revised 2004)*, on a modified prospective basis. As a result, EMCORE included stock-based compensation expense in its results of operations for all periods presented in fiscal 2006, as more fully described in Note 3 to EMCORE's condensed consolidated financial statements.

SFAS No. 151 - Effective October 1, 2005, EMCORE adopted SFAS No. 151, *Inventory Costs, an amendment of ARB No. 43, Chapter 4*. SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal". In addition, it requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The adoption of this pronouncement did not have a material impact on EMCORE's financial statements.

SFAS No. 154 - Effective October 1, 2005, EMCORE adopted SFAS No. 154, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes*, and Financial Accounting Standards Board (FASB) Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. The Statement applies to all voluntary changes in accounting principle, and changes the requirements for accounting for and reporting of a change in accounting principle. SFAS 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. SFAS 154 requires that a change in method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. Opinion 20 previously required that such a change be reported as a change in accounting principle. The adoption of this pronouncement did not have a material impact on EMCORE's financial statements.

FIN 47 - Effective October 1, 2005, EMCORE adopted FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143*. This interpretation clarifies the timing of liability recognition for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligations are conditional on a future event and where an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The adoption of this pronouncement did not have a material impact on EMCORE's financial statements.

FIN 48 - In June 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 applies to all tax positions related to income taxes subject to FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption should be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. EMCORE does not believe the adoption of FIN 48 on October 1, 2007 will have a material impact on its financial statements.

EITF No. 05-6 - In June 2005, the Emerging Issues Task Force (EITF) issued No. 05-6, *Determining the Amortization Period for Leasehold Improvements*. The pronouncement requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of the lease be amortized over the lesser of the useful life of the asset or the lease term that includes reasonably assured lease renewals as determined on the date of the acquisition of the leasehold improvement. This pronouncement should be applied prospectively and EMCORE adopted it during the first quarter of fiscal 2006. This pronouncement did not have a material impact on the financial statements.

FSP 115-1 - In November 2005, FASB issued Staff Position (FSP) 115-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, which provides guidance on determining when investments in certain debt and equity securities are considered impaired, whether that impairment is other-than-temporary, and on measuring such impairment loss. FSP 115-1 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosure about unrealized losses that have not been recognized as other-than-temporary impairments. FSP 115-1 is effective for annual reporting periods beginning after December 15, 2005. EMCORE does not believe the adoption of FSP 115-1 on October 1, 2006 will have a material impact on its financial statements.

NOTE 3. Stock-based Compensation.

Stock Options

EMCORE has stock option plans to provide long-term incentives to eligible employees, officers, and directors in the form of stock options. Most of the stock options vest and become exercisable over four to five years and have ten-year terms. EMCORE maintains two incentive stock option plans: the 2000 Stock Option Plan (2000 Plan), and the 1995 Incentive and Non-Statutory Stock Option Plan (1995 Plan and, together with the 2000 Plan, the Option Plans). The 1995 Plan authorizes the grant of options to purchase up to 2,744,118 shares of EMCORE's common stock. As of June 30, 2006, no options were available for issuance under the 1995 Plan. The 2000 Plan authorizes the grant of options to purchase up to 9,350,000 shares of EMCORE's common stock. As of June 30, 2006, 1,433,874 options were available for issuance under the 2000 Plan. Certain options under the Option Plans are intended to qualify as incentive stock options pursuant to Section 422A of the Internal Revenue Code.

During the three and nine months ended June 30, 2006, 211,750 and 1,740,707 options were granted pursuant to the 2000 Plan, respectively. All options were issued at the closing market price on the date of grant. The stock option issue prices for the three months ended June 30, 2006 ranged from \$7.97 to \$12.57 per share. The stock option issue prices for the nine months ended June 30, 2006 ranged from \$5.18 to \$12.57 per share. These options are subject to a five-year vesting period for new-hire grants and a four-year vesting period for retention grants, and have a contractual life of ten years. The weighted average grant date fair value for the options issued during the three and nine months ended June 30, 2006 was \$7.89 and \$6.33, respectively. No executive officers received any stock option grants during fiscal 2006. As of June 30, 2006, 2,408,896 options were exercisable. EMCORE issues new shares of common stock upon exercise of stock options.

The following table summarizes the activity under the Option Plans:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding as of September 30, 2005	6,166,226	\$ 4.16		
Granted	1,740,707	7.93		
Exercised	(1,524,542)	3.95		
Cancelled	(222,409)	3.46		
Outstanding as of June 30, 2006	6,159,982	\$ 5.30	7.46	\$ 29,345
Exercisable as of June 30, 2006	2,408,896	\$ 5.53	5.36	\$ 12,629
Non-vested as of June 30, 2006	3,751,086	\$ 5.16	8.81	\$ 16,716

As of June 30, 2006 there was \$12.7 million of total unrecognized compensation expense related to non-vested share-based compensation arrangements granted under the Option Plans. This expense is expected to be recognized over a weighted average life of 3.3 years. The total intrinsic value of options exercised during the three and nine months ended June 30, 2006 was \$1.6 million and \$7.4 million, respectively. The total fair value of shares vested during the three and nine months ended June 30, 2006 was \$0.9 million and \$2.6 million, respectively. EMCORE received \$0.6 million and \$6.0 million in cash from the exercise of stock options during the three and nine months ended June 30, 2006, respectively.

At June 30, 2006, stock options outstanding were as follows:

Exercise Price

	Options Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
<\$1	1,920	1.43	\$0.23
>\$1 to <\$5	3,572,590	7.39	2.70
>\$5 to <\$10	2,332,582	7.92	7.60
>\$10	252,890	4.42	20.88
	6,159,982	7.46	\$5.30

At June 30, 2006, stock options exercisable were as follows:

Exercise Price	Options Exercisable	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
<\$1	1,920	1.43	\$0.23
>\$1 to <\$5	1,504,644	6.34	2.37
>\$5 to <\$10	675,992	3.73	7.03
>\$10	226,340	3.79	22.07
	2,408,896	5.36	\$5.53

Employee Stock Purchase Plan

In fiscal 2000, EMCORE adopted an Employee Stock Purchase Plan (ESPP). The ESPP provides employees of EMCORE an opportunity to purchase common stock through payroll deductions. The ESPP is a 6-month duration plan, with new participation periods beginning the first business day of January and July of each year. The purchase price is set at 85% of the market price for EMCORE's common stock on either the first or last day of the participation period, whichever is lower and contributions are limited to 10% of an employee's compensation. The number of shares of common stock available for issuance under the ESPP is 2,000,000 shares. The amount of shares issued for the ESPP are as follows:

	Number of Shares
Amount of shares reserved for the ESPP	2,000,000
Number of shares issued in December 2000 for calendar year 2000	(16,534)
Number of shares issued in December 2001 for calendar year 2001	(48,279)
Number of shares issued in December 2002 for calendar year 2002	(89,180)
Number of shares issued in December 2003 for calendar year 2003	(244,166)
Number of shares issued in June 2004 for first half of calendar year 2004	(166,507)
Number of shares issued in December 2004 for second half of calendar year 2004	(167,546)
Number of shares issued in June 2005 for first half of calendar year 2005	(174,169)
Number of shares issued in December 2005 for second half of calendar year 2005	(93,619)
Number of shares issued in June 2006 for first half of calendar year 2006	(123,857)

Remaining shares reserved for the ESPP as of June 30, 2006

876,143

Future Issuances

As of June 30, 2006, EMCORE has reserved a total of 20,841,970 shares of its common stock for future issuances as follows:

	Number of Shares
For exercise of outstanding warrants to purchase common stock	31,535
For exercise of outstanding common stock options	6,159,982
For conversion of subordinated notes	12,016,930
For future issuances to employees under the ESPP plan	876,143
For future common stock option awards	1,433,874
Total reserved	20,518,464

Valuation of Stock-Based Compensation

Effective October 1, 2005, EMCORE adopted SFAS 123(R), using the modified prospective application transition method, which establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation expense is measured at grant date, based on the fair value of the award, over the requisite service period. EMCORE previously applied Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*.

Periods prior to the adoption of SFAS 123(R) - Prior to the adoption of SFAS 123(R), EMCORE provided the disclosures required under SFAS No. 123 as amended by SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosures*. EMCORE did not recognize stock-based compensation expense in its statement of operations for periods prior to the adoption of SFAS 123(R) since options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss and net loss per share as if EMCORE had applied the fair value recognition provisions of SFAS 123(R) to options granted under EMCORE's stock-based compensation plans prior to the adoption. For purposes of this pro forma disclosure, the value of the options was estimated using a Black-Scholes option pricing formula and amortized on a straight-line basis over the respective vesting periods of the awards. Disclosures for the three months and nine months ended June 30, 2006 are not presented because stock-based compensation was accounted for under SFAS 123(R)'s fair-value method during this period.

<i>(in thousands, except per share amounts)</i>	Three Months Ended June 30, 2005	Nine Months Ended June 30, 2005
Reported net loss	\$ (6,915)	\$ (8,497)
Less:		
Pro forma stock-based compensation expense determined under the fair value based method, net of tax	(788)	