WATERS CORP /DE/
Form 10-Q
November 02, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 29, 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 Number: 01-14010

Waters Corporation

(Exact name of registrant as specified in its charter)

Delaware	**13-3668640**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

34 Maple Street

Milford, Massachusetts 01757

(Address, including zip code, of principal executive offices)

(508) 478-2000

(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 such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or 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	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 Act). Yes No

Indicate the number of shares outstanding of the registrant s common stock as of October 26, 2018: 75,745,720

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WATERS CORPORATION AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

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Item 1: ***Financial Statements***

WATERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(unaudited)

	September 29, 2018	December 31, 2017
	(In thousands, except per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 689,373	$ 642,319
Investments	1,394,887	2,751,382
Accounts receivable, net	489,193	533,825
Inventories	313,614	270,294
Other current assets	83,702	72,314
Total current assets	2,970,769	4,270,134
Property, plant and equipment, net	338,472	349,278
Intangible assets, net	252,834	228,395
Goodwill	357,869	359,819
Other assets	123,114	116,728
Total assets	$ 4,043,058	$ 5,324,354
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable and debt	$ 284	$ 100,273
Accounts payable	65,810	64,537
Accrued employee compensation	39,860	69,024
Deferred revenue and customer advances	186,485	166,840
Accrued income taxes	59,304	73,008
Accrued warranty	12,193	13,026
Other current liabilities	84,189	119,449
Total current liabilities	448,125	606,157
Long-term liabilities:		
Long-term debt	1,148,061	1,897,501
Long-term portion of retirement benefits	63,696	67,334
Long-term income tax liabilities	429,611	456,949
Other long-term liabilities	77,133	62,625
Total long-term liabilities	1,718,501	2,484,409

Total liabilities	2,166,626	3,090,566
Commitments and contingencies (Notes 6, 7 and 11)		
Stockholders equity:		
Preferred stock, par value $0.01 per share, 5,000 shares authorized, none issued at September 29, 2018 and December 31, 2017		
Common stock, par value $0.01 per share, 400,000 shares authorized, 160,368 and 159,845 shares issued, 75,730 and 79,337 shares outstanding at September 29, 2018 and December 31, 2017, respectively	1,604	1,598
Additional paid-in capital	1,815,428	1,745,088
Retained earnings	5,810,053	5,405,380
Treasury stock, at cost, 84,638 and 80,509 shares at September 29, 2018 and December 31, 2017, respectively	(5,624,860)	(4,808,211)
Accumulated other comprehensive loss	(125,793)	(110,067)
Total stockholders equity	1,876,432	2,233,788
Total liabilities and stockholders equity	$ 4,043,058	$ 5,324,354

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended	
	September 29, 2018	**September 30, 2017**
	(In thousands, except per share data)	
Revenues:		
Product sales	$ 378,522	$ 375,550
Service sales	199,499	190,034
Total net sales	578,021	565,584
Costs and operating expenses:		
Cost of product sales	155,825	155,621
Cost of service sales	85,314	80,271
Selling and administrative expenses	126,997	135,206
Research and development expenses	35,173	33,782
Litigation provision	924	
Purchased intangibles amortization	2,114	1,682
Total costs and operating expenses	406,347	406,562
Operating income	171,674	159,022
Other (expense) income	(811)	12
Interest expense	(11,435)	(14,750)
Interest income	9,802	9,516
Income before income taxes	169,230	153,800
Provision for income taxes	28,216	17,696
Net income	$ 141,014	$ 136,104
Net income per basic common share	$ 1.84	$ 1.71
Weighted-average number of basic common shares	76,575	79,712
Net income per diluted common share	$ 1.83	$ 1.69
Weighted-average number of diluted common shares and equivalents	77,136	80,521

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Nine Months Ended September 29, 2018	Nine Months Ended September 30, 2017
	(In thousands, except per share data)	
Revenues:		
Product sales	$ 1,106,508	$ 1,072,684
Service sales	598,402	549,119
Total net sales	1,704,910	1,621,803
Costs and operating expenses:		
Cost of product sales	456,270	436,800
Cost of service sales	249,425	239,814
Selling and administrative expenses	394,049	395,972
Research and development expenses	105,297	97,471
Litigation (settlement) provision	(748)	10,018
Purchased intangibles amortization	5,375	5,104
Acquired in-process research and development		5,000
Total costs and operating expenses	1,209,668	1,190,179
Operating income	495,242	431,624
Other (expense) income	(2,293)	64
Interest expense	(36,965)	(41,558)
Interest income	28,356	25,229
Income before income taxes	484,340	415,359
Provision for income taxes	75,698	41,876
Net income	$ 408,642	$ 373,483
Net income per basic common share	$ 5.26	$ 4.67
Weighted-average number of basic common shares	77,741	79,908
Net income per diluted common share	$ 5.21	$ 4.63
Weighted-average number of diluted common shares and equivalents	78,395	80,660

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
	(In thousands)		(In thousands)	
Net income	$ 141,014	$ 136,104	$ 408,642	$ 373,483
Other comprehensive income (loss):				
Foreign currency translation	5,309	26,827	(17,937)	94,209
Unrealized gains on investments before income taxes	1,631	318	108	1,700
Income tax expense	(382)	(9)	(125)	(108)
Unrealized gains (losses) on investments, net of tax	1,249	309	(17)	1,592
Retirement liability adjustment before reclassifications	(177)	(499)	107	(2,030)
Amounts reclassified to other income	904	894	2,720	2,652
Retirement liability adjustment before income taxes	727	395	2,827	622
Income tax expense	(177)	(183)	(599)	(570)
Retirement liability adjustment, net of tax	550	212	2,228	52
Other comprehensive income (loss)	7,108	27,348	(15,726)	95,853
Comprehensive income	$ 148,122	$ 163,452	$ 392,916	$ 469,336

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Nine Months Ended September 29, 2018	Nine Months Ended September 30, 2017
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 408,642	$ 373,483
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation	28,184	30,068
Deferred income taxes	278	3,046
Depreciation	44,710	45,454
Amortization of intangibles	38,101	32,795
In-process research and development		5,000
Change in operating assets and liabilities:		
Decrease in accounts receivable	36,893	53,358
Increase in inventories	(47,826)	(26,217)
Increase in other current assets	(21,091)	(12,944)
Increase in other assets	(235)	(2,370)
Decrease in accounts payable and other current liabilities	(84,203)	(23,066)
Increase in deferred revenue and customer advances	23,085	29,332
Decrease in other liabilities	(3,641)	(2,483)
Net cash provided by operating activities	422,897	505,456
Cash flows from investing activities:		
Additions to property, plant, equipment and software capitalization	(64,215)	(55,257)
Asset acquisitions	(31,486)	
Investment in unaffiliated companies	(7,615)	(7,000)
Payments for intellectual property licenses		(5,000)
Purchases of investments	(908,147)	(2,345,259)
Maturities and sales of investments	2,269,181	2,008,528
Net cash provided by (used in) investing activities	1,257,718	(403,988)
Cash flows from financing activities:		
Proceeds from debt issuances	10	130,190
Payments on debt	(850,000)	(64)
Proceeds from stock plans	42,377	72,821
Purchases of treasury shares	(816,649)	(245,742)
(Payments for) proceeds from derivative contracts	(2,181)	3,301
Net cash used in financing activities	(1,626,443)	(39,494)
Effect of exchange rate changes on cash and cash equivalents	(7,118)	36,202

Increase in cash and cash equivalents	47,054	98,176
Cash and cash equivalents at beginning of period	642,319	505,631
Cash and cash equivalents at end of period	$ 689,373	$ 603,807

The accompanying notes are an integral part of the interim consolidated financial statements.

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1 Basis of Presentation and Summary of Significant Accounting Policies

Waters Corporation (the Company) is a specialty measurement company that has pioneered analytical workflow solutions involving liquid chromatography, mass spectrometry and thermal analysis innovations serving the life, materials and food sciences for 60 years. The Company primarily designs, manufactures, sells and services high performance liquid chromatography (HPLC), ultra performance liquid chromatography (UPLC™ and together with HPLC, referred to as LC) and mass spectrometry (MS) technology systems and support products, including chromatography columns, other consumable products and comprehensive post-warranty service plans. These systems are complementary products that are frequently employed together (LC-MS) and sold as integrated instrument systems using common software platforms. LC is a standard technique and is utilized in a broad range of industries to detect, identify, monitor and measure the chemical, physical and biological composition of materials, and to purify a full range of compounds. MS technology, principally in conjunction with chromatography, is employed in drug discovery and development, including clinical trial testing, the analysis of proteins in disease processes (known as proteomics), nutritional safety analysis and environmental testing. LC-MS instruments combine a liquid phase sample introduction and separation system with mass spectrometric compound identification and quantification. In addition, the Company designs, manufactures, sells and services thermal analysis, rheometry and calorimetry instruments through its TA™ product line. These instruments are used in predicting the suitability and stability of fine chemicals, pharmaceuticals, water, polymers, metals and viscous liquids for various industrial, consumer goods and healthcare products, as well as for life science research. The Company is also a developer and supplier of advanced software-based products that interface with the Company s instruments, as well as other manufacturers instruments.

The Company s interim fiscal quarter typically ends on the thirteenth Saturday of each quarter. Since the Company s fiscal year end is December 31, the first and fourth fiscal quarters may have more or less than thirteen complete weeks. The Company s third fiscal quarters for 2018 and 2017 ended on September 29, 2018 and September 30, 2017, respectively.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with the instructions to the Quarterly Report on Form 10-Q and do not include all of the information and footnote disclosures required for annual financial statements prepared in accordance with generally accepted accounting principles (GAAP) in the United States of America. The consolidated financial statements include the accounts of the Company and its subsidiaries, which are wholly owned. All inter-company balances and transactions have been eliminated.

The preparation of consolidated financial statements in conformity with GAAP requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities at the dates of the financial statements. Actual amounts may differ from these estimates under different assumptions or conditions.

It is management s opinion that the accompanying interim consolidated financial statements reflect all adjustments (which are normal and recurring) that are necessary for a fair statement of the results for the interim periods. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the U.S. Securities and Exchange Commission (SEC) on February 27, 2018.

Translation of Foreign Currencies

The functional currency of each of the Company s foreign operating subsidiaries is the local currency of its country of domicile, except for the Company s subsidiaries in Hong Kong, Singapore and the Cayman Islands, where the underlying transactional cash flows are denominated in currencies other than the respective local currency of domicile. The functional currency of the Hong Kong, Singapore and Cayman Islands subsidiaries is the U.S. dollar, based on the respective entity s cash flows.

For most of the Company s foreign operations, assets and liabilities are translated into U.S. dollars at exchange rates prevailing on the balance sheet date, while revenues and expenses are translated at average exchange rates prevailing during the respective period. Any resulting translation gains or losses are included in accumulated other comprehensive income in the consolidated balance sheets.

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

Cash, Cash Equivalents and Investments

Cash equivalents represent highly liquid investments, with original maturities of 90 days or less, while investments with longer maturities are classified as investments. The Company maintains cash balances in various operating accounts in excess of federally insured limits, and in foreign subsidiary accounts in currencies other than the U.S. dollar. As of September 29, 2018 and December 31, 2017, $942 million out of $2,084 million and $3,326 million out of $3,394 million, respectively, of the Company s total cash, cash equivalents and investments were held by foreign subsidiaries. In addition, $341 million out of $2,084 million and $304 million out of $3,394 million of cash, cash equivalents and investments were held in currencies other than the U.S. dollar at September 29, 2018 and December 31, 2017, respectively.

Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The Company has very limited use of rebates and other cash considerations payable to customers and, as a result, the transaction price determination does not have any material variable consideration. The allowance for doubtful accounts is the best estimate of the amount of probable credit losses in the existing accounts receivable. The allowance is based on a number of factors, including historical experience and the customer s credit-worthiness. The allowance for doubtful accounts is reviewed on at least a quarterly basis. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. Account balances are charged against the allowance when the Company determines it is probable that the receivable will not be recovered. The Company does not have any off-balance sheet credit exposure related to its customers. Historically, the Company has not experienced significant bad debt losses.

The following is a summary of the activity of the Company s allowance for doubtful accounts for the nine months ended September 29, 2018 and September 30, 2017 (in thousands):

	Balance at Beginning of Period	Additions	Deduction	Balance at End of Period
Allowance for Doubtful Accounts				
September 29, 2018	$ 6,109	$ 2,752	$ (2,175)	$ 6,686
September 30, 2017	$ 5,140	$ 2,545	$ (1,586)	$ 6,099

Fair Value Measurements

In accordance with the accounting standards for fair value measurements and disclosures, certain of the Company s assets and liabilities are measured at fair value on a recurring basis as of September 29, 2018 and December 31, 2017. Fair values determined by Level 1 inputs utilize observable data, such as quoted prices in active markets. Fair values determined by Level 2 inputs utilize data points other than quoted prices in active markets that are observable either directly or indirectly. Fair values determined by Level 3 inputs utilize unobservable data points for which there is little or no market data, which require the reporting entity to develop its own assumptions.

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

The following table represents the Company s assets and liabilities measured at fair value on a recurring basis at September 29, 2018 (in thousands):

	Total at September 29, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Treasury securities	$ 271,918	$	$ 271,918	$
Foreign government securities	2,958		2,958	
Corporate debt securities	1,063,382		1,063,382	
Time deposits	179,271		179,271	
Waters 401(k) Restoration Plan assets	37,723	37,723		
Foreign currency exchange contracts	116		116	
Interest rate cross-currency swap agreements	767		767	
Total	$ 1,556,135	$ 37,723	$ 1,518,412	$
Liabilities:				
Contingent consideration	$ 3,701	$	$	$ 3,701
Foreign currency exchange contracts	828		828	
Total	$ 4,529	$	$ 828	$ 3,701

The following table represents the Company s assets and liabilities measured at fair value on a recurring basis at December 31, 2017 (in thousands):

	Total at December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Treasury securities	$ 591,988	$	$ 591,988	$
Foreign government securities	6,952		6,952	
Corporate debt securities	1,975,160		1,975,160	

Time deposits		371,511				371,511		
Equity securities		147				147		
Waters 401(k) Restoration Plan assets		35,645		35,645				
Foreign currency exchange contracts		566				566		
Total	$	2,981,969	$	35,645	$	2,946,324	$	
Liabilities:								
Contingent consideration	$	3,247	$		$		$	3,247
Foreign currency exchange contracts		182				182		
Total	$	3,429	$		$	182	$	3,247

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)   (Continued)

Fair Value of 401(k) Restoration Plan Assets

The 401(k) Restoration Plan is a nonqualified defined contribution plan and the assets were held in registered mutual funds and have been classified as Level 1. The fair values of the assets in the plan are determined through market and observable sources from daily quoted prices on nationally recognized securities exchanges.

Fair Value of Cash Equivalents, Investments, Foreign Currency Exchange Contracts and Interest Rate Cross-Currency Swap Agreements

The fair values of the Company s cash equivalents, investments and foreign currency exchange contracts are determined through market and observable sources and have been classified as Level 2. These assets and liabilities have been initially valued at the transaction price and subsequently valued, typically utilizing third-party pricing services. The pricing services use many inputs to determine value, including reportable trades, benchmark yields, credit spreads, broker/dealer quotes, current spot rates and other industry and economic events. The Company validates the prices provided by third-party pricing services by reviewing their pricing methods and obtaining market values from other pricing sources.

Fair Value of Contingent Consideration

The fair value of the Company s liability for contingent consideration relates to earnout payments in connection with the July 2014 acquisition of Medimass Research, Development and Service Kft. and is determined using a probability-weighted discounted cash flow model, which uses significant unobservable inputs, and has been classified as Level 3. Subsequent changes in the fair value of the contingent consideration liability are recorded in the results of operations. The fair value of the contingent consideration liability associated with future earnout payments is based on several factors, including the estimated future results and a discount rate that reflects both the likelihood of achieving the estimated future results and the Company s creditworthiness. A change in any of these unobservable inputs can significantly change the fair value of the contingent consideration. Although there is no contractual limit, the fair value of future contingent consideration payments was estimated to be $4 million and $3 million at September 29, 2018 and December 31, 2017, respectively, based on the Company s best estimate, as the earnout is based on future sales of certain products, some of which are currently in development, through 2034.

Fair Value of Other Financial Instruments

The Company s accounts receivable, accounts payable and variable interest rate debt are recorded at cost, which approximates fair value due to their short-term nature. The carrying value of the Company s fixed interest rate debt was $510 million and $610 million at September 29, 2018 and December 31, 2017, respectively. The fair value of the Company s fixed interest rate debt was estimated using discounted cash flow models, based on estimated current rates offered for similar debt under current market conditions for the Company. The fair value of the Company s fixed interest rate debt was estimated to be $495 million and $608 million at September 29, 2018 and December 31, 2017, respectively, using Level 2 inputs.

Derivative Transactions

The Company is a global company that operates in over 35 countries and, as a result, the Company s net sales, cost of sales, operating expenses and balance sheet amounts are significantly impacted by fluctuations in foreign currency exchange rates. The Company is exposed to currency price risk on foreign currency exchange rate fluctuations when it translates its non-U.S. dollar foreign subsidiaries financial statements into U.S. dollars, and when any of the Company s subsidiaries purchase or sell products or services in a currency other than its own currency.

The Company s principal strategies in managing exposures to changes in foreign currency exchange rates are to 1) naturally hedge the foreign-currency-denominated liabilities on the Company s balance sheet against corresponding assets of the same currency, such that any changes in liabilities due to fluctuations in foreign currency exchange rates are typically offset by corresponding changes in assets and 2) mitigate foreign exchange risk exposure of international operations by hedging the variability in the movement of foreign currency exchange rates on a portion of its Euro-denominated net asset investments. The Company presents the derivative transactions in financing activities in the statement of cash flows.

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

Foreign Currency Exchange Contracts

The Company does not specifically enter into any derivatives that hedge foreign-currency-denominated assets, liabilities or commitments on its balance sheet, other than a portion of certain third-party accounts receivable and accounts payable, and the Company s net worldwide intercompany receivables and payables, which are eliminated in consolidation. The Company periodically aggregates its net worldwide balances by currency and then enters into foreign currency exchange contracts that mature within 90 days to hedge a portion of the remaining balance to minimize some of the Company s currency price risk exposure. The foreign currency exchange contracts are not designated for hedge accounting treatment. Principal hedged currencies include the Euro, Japanese yen, British pound, Mexican peso and Brazilian real.

Interest Rate Cross-Currency Swap Agreements

In July 2018, the Company entered into a three-year interest rate cross-currency swap derivative agreement with a notional value of $150 million to hedge the variability in the movement of foreign currency exchange rates on a portion of its Euro-denominated net asset investments. Under hedge accounting, the change in fair value of the derivative that relates to changes in the foreign currency spot rate are recorded in the currency translation adjustment in other comprehensive income and remain in accumulated comprehensive income in stockholders equity until the sale or substantial liquidation of the foreign operation. The difference between the interest rate received and paid under the interest rate cross-currency swap derivative agreement is recorded in interest income in the statement of operations.

The Company s foreign currency exchange contracts and interest rate cross-currency swap agreements included in the consolidated balance sheets are classified as follows (in thousands):

	September 29, 2018		December 31, 2017	
	Notional Value	**Fair Value**	**Notional Value**	**Fair Value**
Foreign exchange contracts:				
Other current assets	$ 37,927	$ 116	$ 110,759	$ 566
Other current liabilities	$ 105,885	$ 828	$ 37,104	$ 182
Interest rate cross-currency swap agreements:				
Other assets	$ 150,000	$ 767	$	$
Accumulated other comprehensive income		$ (767)		$

The following is a summary of the activity included in the statements of comprehensive income related to the foreign currency exchange contracts (in thousands):

	Financial Statement Classification	Three Months Ended		Nine Months Ended	
		September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Foreign currency exchange contracts:					

Realized (losses) gains on closed contracts	Cost of sales	$ (23)	$ 2,871	$ (2,181)	$ 3,301
Unrealized (losses) gains on open contracts	Cost of sales	(5)	(1,258)	(1,097)	819
Cumulative net pre-tax (losses) gains	Cost of sales	$ (28)	$ 1,613	$ (3,278)	$ 4,120
Interest rate cross-currency swap agreements:					
Interest earned	Interest income	$ 927	$	$ 927	$
Unrealized gains on open contracts	Stockholders equity	$ 767	$	$ 767	$

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

Stockholders Equity

In April 2018, the Company s Board of Directors authorized the Company to repurchase up to $3 billion of its outstanding common stock over a three-year period. This new program adds the remaining $526 million from the pre-existing program, allowing for the purchase of a total of $3.5 billion of the Company s common stock over a three-year period. Upon commencement of the new authorization, the May 2017 authorization was terminated. During the nine months ended September 29, 2018 and September 30, 2017, the Company repurchased 4.1 million and 1.4 million shares of the Company s outstanding common stock at a cost of $809 million and $238 million, respectively, under the April 2018 authorization and other previously announced programs. As of September 29, 2018, the Company had repurchased an aggregate of 2.8 million shares at a cost of $534 million under the April 2018 repurchase program and had a total of $3.0 billion authorized for future repurchases. In addition, the Company repurchased $9 million and $8 million of common stock related to the vesting of restricted stock units during the nine months ended September 29, 2018 and September 30, 2017, respectively. The Company believes that it has the financial flexibility to fund these share repurchases given current cash levels and debt borrowing capacity, as well as to invest in research, technology and business acquisitions.

Product Warranty Costs

The Company accrues estimated product warranty costs at the time of sale, which are included in cost of sales in the consolidated statements of operations. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers, the Company s warranty obligation is affected by product failure rates, material usage and service delivery costs incurred in correcting a product failure. The amount of the accrued warranty liability is based on historical information, such as past experience, product failure rates, number of units repaired and estimated costs of material and labor. The liability is reviewed for reasonableness at least quarterly.

The following is a summary of the activity of the Company s accrued warranty liability for the nine months ended September 29, 2018 and September 30, 2017 (in thousands):

	Balance at Beginning of Period	Accruals for Warranties	Settlements Made	Balance at End of Period
Accrued warranty liability:				
September 29, 2018	$ 13,026	$ 6,068	$ (6,901)	$ 12,193
September 30, 2017	$ 13,391	$ 6,287	$ (6,823)	$ 12,855

Other Commitments

In February 2018, the Company s Board of Directors approved expanding its precision chemistry consumable manufacturing operations in the U.S. The Company anticipates spending an estimated $215 million to build and equip the new state-of-the-art manufacturing facility, which will be paid for with existing cash and investments.

2 Revenue Recognition

The Company adopted new accounting guidance regarding the recognition of revenue from contracts with customers as of January 1, 2018.

The Company recognizes revenue upon transfer of control of promised products and services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. The Company generally enters into contracts that include a combination of products and services. Revenue is allocated to distinct performance obligations and is recognized net of allowances for returns and discounts.

The Company recognizes revenue on product sales at the time control of the product transfers to the customer. In substantially all of the Company s arrangements, title of our products transfers at shipping point and, as a result, the Company determined control transfers at the point of shipment. In more limited cases, there are destination-based shipping terms and, thus, control is deemed to transfer when the products arrive at the customer site. Incremental costs of obtaining a contract are expensed as and when incurred if the expected amortization period of the asset that

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

would have been recognized is one year or less. Shipping and handling costs are included as a component of cost of sales. In situations where the control of the goods transfers prior to the completion of the Company s obligation to ship the products to its customers, the Company has elected the practical expedient to account for the shipping services as a fulfillment cost. Accordingly, such costs are recognized when control of the related goods is transferred to the customer. In more rare situations, the Company has revenue associated with products that contain specific customer acceptance criteria and the related revenue is not recognized before the customer acceptance criteria are satisfied. The Company elected to exclude from the measurement of the transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with specific revenue-producing transactions and collected by the Company from a customer.

Generally, the Company s contracts for products include a performance obligation related to installation. The Company has determined that the installation represents a distinct performance obligation and revenue is recognized separately upon the completion of installation. The Company determines the amount of the transaction price to allocate to the installation service based on the standalone selling price of the product and the service, which requires judgment. The Company determines relative standalone selling price of installation based upon a number of factors, including hourly service billing rates and estimated installation hours. In developing these estimates, the Company considers past history, competition, billing rates of current services and other factors.

The Company has sales from standalone software, which is included in instrument systems revenue. These arrangements typically include software licenses and maintenance contracts, both of which the Company has determined are distinct performance obligations. The Company determines the amount of the transaction price to allocate to the license and maintenance contract based on the relative standalone selling price of each performance obligation. Software license revenue is recognized at the point in time when control has been transferred to the customer. The revenue allocated to the software maintenance contract is recognized on a straight-line basis over the maintenance period, which is the contractual term of the contract, as a time-based measure of progress best reflects the Company s performance in satisfying this obligation. Unspecified rights to software upgrades are typically sold as part of the maintenance contract on a when-and-if-available basis.

Payment terms and conditions vary among the Company s revenue streams, although terms generally include a requirement of payment within 30 to 60 days of product shipment. Prior to providing payment terms to customers, an evaluation of the customer s credit risk is performed. Returns and customer credits are infrequent and insignificant and are recorded as a reduction to sales. Rights of return are not included in sales arrangements and, therefore, there is minimal variable consideration included in the transaction price of our products.

Service revenue includes (i) service and software maintenance contracts and (ii) service calls (time and materials). Instrument service contracts and software maintenance contracts are typically annual contracts, which are billed at the beginning of the contract or maintenance period. The amount of the service and software maintenance contract is recognized on a straight-line basis to revenue over the maintenance service period, which is the contractual term of the contract, as a time-based measure of progress best reflects the Company s performance in satisfying this obligation. There are no deferred costs associated with the service contract, as the cost of the service is recorded when the service is performed. Service calls are recognized to revenue at the time a service is performed.

The Company s deferred revenue liabilities on the consolidated balance sheets consists of the obligation on instrument service contracts and customer payments received in advance, prior to shipment of the instrument. The Company records deferred revenue primarily related to its service contracts, where consideration is billable at the beginning of the service period.

The following is a summary of the activity of the Company s deferred revenue and customer advances for the nine months ended September 29, 2018 and September 30, 2017 (in thousands):

	September 29, 2018	September 30, 2017
Balance at the beginning of the period	$ 192,590	$ 173,780
Recognition of revenue included in balance at beginning of the period	(147,310)	(132,435)
Revenue deferred during the period, net of revenue recognized	179,571	169,337
Balance at the end of the period	$ 224,851	$ 210,682

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

As of September 29, 2018 and December 31, 2017, $38 million and $26 million of deferred revenue and customer advances were classified in other long-term liabilities, respectively.

The estimated amount of deferred revenue and customer advances equals the transaction price allocated to unfulfilled performance obligations for the period presented. Such amounts are expected to be recognized in the future as follows (in thousands):

	September 29, 2018
Deferred revenue and customer advances expected to be recognized:	
In one year or less	$ 186,485
In 13-24 months	26,316
In 25 months and beyond	12,050
Total	$ 224,851

3 Marketable Securities

The Company s marketable securities within cash equivalents and investments included in the consolidated balance sheets are detailed as follows (in thousands):

	September 29, 2018			
	Amortized Cost	Unrealized Gain	Unrealized Loss	Fair Value
U.S. Treasury securities	$ 272,812	$	$ (894)	$ 271,918
Foreign government securities	2,994		(36)	2,958
Corporate debt securities	1,066,088	424	(3,130)	1,063,382
Time deposits	179,271			179,271
Total	$ 1,521,165	$ 424	$ (4,060)	$ 1,517,529
Amounts included in:				
Cash equivalents	$ 122,645	$	$ (3)	$ 122,642
Investments	1,398,520	424	(4,057)	1,394,887