

MERIX CORP

FORM 10-K (Annual Report)

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

FORM 10-K

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended May 27, 2006
OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 0-23818

MERIX CORPORATION

(Exact name of registrant as specified in its charter)

Oregon
(State or other jurisdiction of
incorporation or organization)

1521 Poplar Lane, Forest Grove, Oregon
(Address of principal executive offices)

93-1135197
(I.R.S. Employer
Identification Number)

97116
(Zip Code)

(503) 359-9300
(Registrant's telephone number)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, no par value	Nasdaq Global Market
Series A Preferred Stock Purchase Rights	Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act:

None

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or in any amendment to this Form 10-K.

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the last sales price as reported by the Nasdaq Global Market as of the last business day of the registrant's most recently completed second fiscal quarter (November 26, 2005) was \$124,820,417. For the purposes of this computation, only executive officers and directors of the registrant have been deemed affiliates. However, this shall not be deemed an admission that such persons are affiliates or an assertion that there may not be other persons who may be deemed to be affiliates of the registrant.

The number of shares of the Registrant's Common Stock outstanding as of August 1, 2006 was 20,026,890 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement in connection with its 2006 Annual Meeting of Shareholders are incorporated by reference into Part III.

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MERIX CORPORATION FORM 10-K

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PART I

A Warning About Forward-Looking Statements

This Annual Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, including statements regarding industry prospects and future results of operations or financial position, made in this Annual Report are forward-looking. We use words such as “anticipates,” “believes,” “expects,” “future” and “intends” and other similar expressions to identify forward-looking statements. Forward-looking statements reflect management’s current expectations, plans or projections and are inherently uncertain. Actual results could differ materially from management’s expectations, plans or projections. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. Certain risks and uncertainties that could cause our actual results to differ significantly from management’s expectations, plans and projections are described in Item 1A, “Risk Factors” under the subheading “Risk Factors Affecting Business and Results of Operations.” This section, along with other sections of this Annual Report, describes some, but not all, of the factors that could cause actual results to differ significantly from management’s expectations, plans and projections. We do not intend to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers are urged, however, to review the factors set forth in reports that we file from time to time with the Securities and Exchange Commission.

ITEM 1. BUSINESS

Recent Developments

The Company filed a Notification of Late Filing on Form 12b-25 with the Securities and Exchange Commission (SEC) on August 10, 2006 due to the Company’s inability to file this Annual Report on Form 10-K on a timely basis due to the following:

SEC Inquiry The Company pursued resolution on the Company’s application of Statement of Financial Accounting Standards No. 131, “Derivatives about Segments of an Enterprise and Related Information” (SFAS 131) through the SEC Office of Chief Accountant.

Material Weaknesses The Company’s review and evaluation of internal control over financial reporting have identified a number of material weaknesses. As a result, management’s assessment of internal control over financial reporting concluded that we did not maintain effective internal control over financial reporting as of May 27, 2006. For additional information regarding the material weaknesses, see Item 9A, “Controls and Procedures.”

General

Merix Corporation is an Oregon corporation formed in March 1994. In this report, the terms “Merix,” “Company,” “we,” “us,” and “our” refer to Merix Corporation and its wholly and majority-owned subsidiaries. We are a leading global manufacturer of technologically advanced printed circuit boards for use in electronic equipment. Our principal products are complex multi-layer rigid printed circuit boards, which are the platforms used to interconnect microprocessors, integrated circuits and other components that are essential to the operation of electronic products and systems. We provide our products to original equipment manufacturer (OEM) customers, and their electronic manufacturing service (EMS) providers, that use them primarily in commercial equipment in the communications, automotive, high-end computing and storage, and test and measurement markets. Our markets are generally characterized by rapid technological change, high levels of complexity and short product life-cycles, as new and technologically superior electronic equipment is continually being developed. We have focused our efforts on shortened lead time delivery, technology and volume production. We believe we are well positioned to serve our customer base as a result of our quick-turn service capabilities, our technology leadership, high-technology production capacity and our lower-cost, volume production capabilities in Asia.

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In December 2004, we acquired Data Circuit Systems, now referred to as “Merix San Jose.” Located in San Jose, California, Merix San Jose is a quick-turn services manufacturer of complex, multilayer printed circuit boards and provider of related engineering assistance. Merix San Jose’s experienced management team and strong technical capabilities have provided us additional capabilities to manufacture complex printed circuit boards in very compressed time frames. The majority of its sales are for prototypes. Merix San Jose has approximately 40,000 square feet of manufacturing space and 10,000 square feet of administration facilities.

In September 2005, we acquired the business operations of Eastern Pacific Circuits Holdings Limited, and certain of its subsidiaries, a Hong Kong-based lower-cost, high-volume supplier of printed circuit boards, now referred to as “Merix Asia.” Merix Asia supplies a global customer base of OEMs and contract manufacturers in the automotive, high-end computing, communications, consumer and industrial markets. Merix Asia provides us with a strategic combination of well located manufacturing operations, a strong new customer base and significant market diversification.

Merix Asia has approximately 869,000 square feet of manufacturing space, consisting of four facilities in Southern China and one facility in Hong Kong. Two of the facilities in the People’s Republic of China as well as the Hong Kong facility produce multi-layer printed circuit board products. Two smaller facilities in the People’s Republic of China produce single-sided printed circuit board products.

With our platform in Asia, we believe that we are better positioned to provide a full range of products and services to our existing customers, as well as to establish Merix as a viable supplier to Asian-based OEMs and contract manufacturers. Combined with our facilities in Oregon and San Jose, we can offer a combination of quick-turn service, advanced technology and lower-cost, high volume production capabilities that we believe should enable us to have significant cross-selling opportunities as we leverage our combined global sales forces.

Operating Segments

We define our business by three operating segments that are evidence of the internal structure of our organization. Our three operating segments, as defined by SFAS No. 131 “Disclosures about Segments of an Enterprise and Related Information” (“SFAS 131”) include: (1) Merix Oregon, (2) Merix San Jose and (3) Merix Asia. Operating segments are defined as components of an enterprise for which separate financial information is available and regularly reviewed by senior management. Each operating segment operates predominately in the same industry with production facilities that produce similar customized products for our global customers. The production facilities, sales management and chief decision-makers for all of our operating segments are managed by the same executive team. The Company’s chief operating decision maker (CODM) is the Company’s Chief Executive Officer.

Refer to Note 18 of the consolidated financial statements for disaggregated financial information relating to our operating segments.

Industry Overview

Printed circuit boards consist of patterns of electrical circuitry etched from copper that have been laminated on a board of insulating material. A finished multi-layer printed circuit board consists of a number of layers of circuitry laminated together using intense heat and pressure under vacuum. The electrical circuitry connects components, such as microprocessors, that are essential to the operation of electronic products and systems.

Printed circuit boards are used in virtually all electronic equipment from consumer products, such as personal computers, cellular telephones, automobiles and televisions, to high-end commercial electronic equipment, such as data communication routers and switches, computer workstations and network servers. Printed circuit boards used in consumer electronic products typically employ lower layer counts and lower performance materials and require less manufacturing capability than printed circuit boards used in high-end commercial equipment. High-end commercial equipment manufacturers require more complex multi-layer printed circuit boards, often

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constructed with advanced materials. Manufacturing printed circuit boards for these high-end products requires substantial investment in advanced production facilities and process technology as well as engineering and manufacturing expertise.

We believe the following are significant trends within the printed circuit board manufacturing industry:

Increasing complexity of electronic equipment OEMs are continually designing more complex and high performance electronic equipment, which requires sophisticated printed circuit boards that accommodate higher speeds and frequencies and increased component densities and operating temperatures. The increasing complexity of electronic equipment continues to drive technological advancements in printed circuit boards and requires manufacturers of these printed circuit boards to continually invest in technology and advanced manufacturing processes.

Increased customer demand for quick-turn services production and integrated solutions We believe OEMs are increasingly looking to high-end printed circuit board manufacturers that can offer engineering support in the design phase, quick turn-around of prototypes and manufacturing scalability throughout the product life-cycle. Many OEMs, looking to increase the efficiency of their electronic supply chains, are also working with a smaller number of technically qualified suppliers that have sophisticated manufacturing expertise and are able to offer a broad range of printed circuit board products and services. Rapid advances in technology have significantly shortened product life-cycles and placed increased pressure on OEMs to develop new products in shorter periods of time. In response to these pressures, OEMs have increased their demand for engineering support in the design phase of their products and quick-turn services production of small unit volumes of printed circuit boards in the prototype development stage.

Expanding markets The global demand for wireless communication products and the expansion of data networking infrastructure, including those supporting products such as voice-over IP (VOIP) and network security, are increasingly driving the demand for more complex multi-layer printed circuit boards. We believe that increased demand in these markets will result in technological changes, demanding a wider variety of electronic products, greater bandwidth and increasingly powerful electronic components.

Increased Asian production of printed circuit boards Asian manufacturers of printed circuit boards have increased their production and market share of less sophisticated, lower layer count printed circuit boards used in high-volume consumer electronics applications, such as personal computers and cell phones, as well as in high-volume automotive applications. Generally, Asian manufacturers to date have not produced printed circuit boards in significant quantities that require complex technologies, advanced manufacturing processes, quick turn-around times or high-mix production. We believe that the technological expertise and process know-how to manufacture complex multi-layered printed circuit boards and the resource commitments to maintain state-of-the-art capabilities have to date tended to serve as barriers to entry into the high-end segments of the printed circuit board industry. However, we believe that, over time, OEMs and electronic manufacturing service providers will increase their production of high-end commercial electronic equipment in Asia to meet growing Asian demand for those products and that printed circuit board manufacturers in Asia will become increasingly competitive in these areas of the market. In addition, we expect that increased competition from Asian printed circuit board companies will result as electronic manufacturing service providers increase high-end commercial electronic equipment assembly and manufacturing in Asia to capitalize on lower-cost labor.

Products and Services

Our principal products are complex multi-layer printed circuit boards, which are the platforms used to interconnect microprocessors, integrated circuits and other components that are essential to the operation of electronic products and systems. We help our customers throughout the life-cycle of their products, from product conception through volume production. The products and services we provide include:

Design and engineering assistance We provide design and engineering assistance in the early stages of product development to ensure that mechanical and electrical elements are integrated to achieve a high

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quality and cost-effective product for our customers. We also evaluate customer designs for manufacturability and recommend design changes. We believe this collaborative process helps our customers improve the systems they are designing, reduce manufacturing costs and increase manufacturing yields and the quality of finished printed circuit boards. We also believe this speeds the transition from development of the prototype design to volume manufacturing and facilitates the timely delivery of high quality products. In addition, by working closely with our customers throughout the design and manufacturing process, we gain insight into their product plans and production requirements.

Quick-turn services and premium revenues We can rapidly manufacture custom printed circuit boards allowing our customers to more quickly develop and market sophisticated electronic products. We manufacture quick-turn services prototypes with lead times of 24 hours to 10 days and pre-production quantities with lead times of 10 to 20 days. We also offer compressed lead time volume orders. We generally receive a premium over our standard volume pricing for each of these services. Consolidated net sales of quick-turn services and premium revenues comprised approximately 34% and 40% of consolidated net sales during the fiscal years ended May 28, 2005 and May 29, 2004, respectively. With the addition of our Merix Asia volume sales, our quick-turn services and premium revenues comprised approximately 30% of consolidated net sales during the fiscal year ended May 27, 2006.

Volume production Volume production of printed circuit boards is generally characterized by standard lead times of five to eight weeks, as printed circuit boards move to full-scale commercial production. At this stage of production, quality, on-time delivery, process capability and price are the factors most important to our customers.

Our Asian facilities provide lower cost, high volume manufacturing capabilities to serve a global customer base. In addition, our engineering capability has enabled us to produce commercial volumes of technologically sophisticated printed circuit boards of up to 40 layers from our Oregon facilities, utilizing high performance materials and leading edge fabrication techniques. Our manufacturing process controls enable us to meet accelerated time-to-market and time-to-volume requirements of our customers.

We also have expertise in advanced manufacturing techniques for products utilizing high performance materials and offer specialty products, including:

RF/Microwave application products We manufacture printed circuit boards using a variety of advanced insulating materials, primarily for RF/Microwave applications in the wireless infrastructure market. Although typically included in printed circuit boards with lower layer counts, these advanced materials offer electrical, thermal and long-term reliability advantages over conventional materials, however, are more difficult to process through manufacturing.

Thermal management solutions We offer solutions to help our customers manage heat in high performance applications, such as RF/Microwave, and address thermal and signal integrity requirements in high power wireless products. Our manufacturing facilities support the integration of metal heat sinks with printed circuit boards as well as other processes for managing thermal issues.

Backplanes, oversized and standard Backplanes are generally larger and thicker interconnection panels into or onto which printed circuit boards, integrated circuits and other panels or electronic components can be plugged or mounted.

Markets and Customers

We have a broad customer base and our customers include leading OEMs in the electronics and automotive industries. Our five largest OEM customers, which vary from year to year, comprised 39%, 59%, and 68% of our consolidated net sales during the fiscal years ended May 27, 2006, May 28, 2005 and May 29, 2004, respectively. Net sales to one customer individually represented 20% of consolidated net sales during the fiscal year ended

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May 27, 2006. Comparatively, net sales to two OEM customers individually represented 29% and 16% of consolidated net sales during the fiscal year ended May 28, 2005 and 35% and 15% of consolidated net sales during the fiscal year ended May 29, 2004. The reduced concentration of and shift in our major customers is largely the result of a more diverse customer base resulting from the acquisition of Merix Asia. However, we expect to continue to depend upon a small number of customers for a significant portion of our consolidated net sales for the foreseeable future.

The following are our significant end customers by operating segment:

Merix Oregon – Merix Oregon’s five largest customers during the fiscal year 2006, in alphabetic order, were Cisco Systems Inc., Juniper Networks Inc., Motorola Inc., Nokia Corporation, and Nortel Networks Inc. During the fiscal year ended May 27, 2006, Merix Oregon’s net sales to Cisco Systems and Motorola represented 32% and 13%, respectively, of Merix Oregon’s net sales.

Merix Asia – Merix Asia’s five largest customers during the fiscal year 2006, in alphabetic order, were Astec Power, Lear Corporation, Robert Bosch Corporation, TRW Automotive, Inc. and Visteon Corporation. During the fiscal year ended May 27, 2006, Merix Asia’s net sales to TRW Automotive, Visteon and Robert Bosch Corporation represented 21%, 12% and 10%, respectively, of Merix Asia’s net sales.

Merix San Jose – Merix San Jose’s five largest customers during the fiscal year 2006, in alphabetic order, were Aeroflex, Medtronic Inc., Paramit Corporation, Sauer Danfoss Inc. and Solectron USA Inc. During the fiscal year ended May 27, 2006, none of Merix San Jose’s customers represented 10% or more of Merix San Jose’s net sales.

Sales attributed to OEMs include sales made through their electronic manufacturing service providers. Approximately 59%, 65% and 68% of our consolidated net sales were through electronic manufacturing service providers during the fiscal years 2006, 2005 and 2004, respectively.

Although our contractual relationship is with the electronic manufacturing service provider, most of our shipments to electronic manufacturing service providers are directed by OEMs that negotiate product pricing and volumes directly with us. In addition, we are on the approved vendor list of several electronic manufacturing service providers and are awarded incremental discretionary orders directly from some of them. We expect these discretionary orders to increase in the future as we strengthen our direct relationships with these electronic manufacturing service providers.

The following table shows, for the periods indicated, the percentage of our consolidated net sales to the principal end markets we serve in the electronics industry:

	Fiscal Years		
	2006	2005	2004
End markets:			
Communications	52%	78%	82%
Automotive	13	0	0
High-end Computing and Storage	9	7	7
Test and Measurement	6	4	6
Aerospace and Defense	2	1	0
Other*	18	10	5
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

* Other includes medical, industrial and other.

Sales in the communications end market represented a lower percentage of sales during the fiscal years 2006 and 2005, as compared to fiscal 2004, due to a more diverse customer base largely due to the December 2004 acquisition of Merix San Jose and the September 2005 acquisition of Merix Asia. The increase in other end markets is the result of the addition of Merix Asia’s sales, which include additional sales to EMS’s and other

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