TECHNITROL INC
Form 10-Q
May 07, 2008

**UNITED STATES**
**SECURITIES & EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

x The Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the three months ended March 28, 2008, or

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from ______________ to ______________.

Commission File No. 1-5375

**TECHNITROL, INC.**
(Exact name of registrant as specified in its Charter)

| | |
|---|---|
| PENNSYLVANIA<br>(State or other jurisdiction of incorporation or organization) | 23-1292472<br>(IRS Employer Identification Number) |
| 1210 Northbrook Drive, Suite 470<br>Trevose, Pennsylvania<br>(Address of principal executive offices) | 19053<br>(Zip Code) |

Registrant's telephone number, including area code: 215-355-2900

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 at least the past 90 days.

YES x NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Act)

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o NO x

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of May 2, 2008:
40,924,768

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## PART I. FINANCIAL INFORMATION

**Item 1: Financial Statements**

**Technitrol, Inc. and Subsidiaries**
**Consolidated Balance Sheets**

*In thousands*

| | March 28, 2008 | December 28, 2007 |
|---|---|---|
| | (unaudited) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 54,439 | $ 116,289 |
| Trade receivables, net | 202,264 | 164,859 |
| Inventories | 173,290 | 122,115 |
| Prepaid expenses and other current assets | 34,007 | 24,864 |
| Total current assets | 464,000 | 428,127 |
| Long-term assets: | | |
| Property, plant and equipment | 375,005 | 261,171 |
| Less accumulated depreciation | 174,226 | 163,404 |
| Net property, plant and equipment | 200,779 | 97,767 |
| Deferred income taxes | 23,423 | 22,753 |
| Goodwill, net | 533,752 | 224,656 |
| Other intangibles, net | 34,132 | 34,794 |
| Other assets | 16,589 | 13,256 |
| | $ 1,272,675 | $ 821,353 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | $ 129,187 | $ 104,214 |
| Accrued expenses and other current liabilities | 116,522 | 92,096 |
| Total current liabilities | 245,709 | 196,310 |
| Long-term liabilities: | | |
| Long-term debt, excluding current installments | 364,080 | 10,467 |
| Deferred income taxes | 11,677 | 12,528 |
| Other long-term liabilities | 31,917 | 31,022 |
| Minority interest | 10,029 | 9,947 |

| | | |
|---|---|---|
| Shareholders' equity: | | |
| Common stock and additional paid-in capital | 223,141 | 222,593 |
| Retained earnings | 300,206 | 289,048 |
| Other comprehensive income | 85,916 | 49,438 |
| Total shareholders' equity | 609,263 | 561,079 |
| | $ 1,272,675 | $ 821,353 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

**Technitrol, Inc. and Subsidiaries**
**Consolidated Statements of Operations**

(Unaudited)
*In thousands, except per share data*

| | Three Months Ended March 28, 2008 | Three Months Ended March 30, 2007 |
|---|---|---|
| Net sales | $ 274,858 | $ 254,432 |
| Cost of sales | 218,716 | 199,690 |
| Gross profit | 56,142 | 54,742 |
| Selling, general and administrative expenses | 40,812 | 36,736 |
| Severance and asset impairment expense | 1,965 | 9,915 |
| Operating profit | 13,365 | 8,091 |
| Other income (expense): | | |
| Interest expense, net | (2,086) | (1,252) |
| Other income, net | 3,910 | 251 |
| Total other income (expense) | 1,824 | (1,001) |
| Earnings before income taxes and minority interest | 15,189 | 7,090 |
| Income taxes | 371 | 2,189 |
| Minority interest expense | 81 | 190 |
| Net earnings | $ 14,737 | $ 4,711 |
| Earnings per share: | | |
| Basic | $ 0.36 | $ 0.12 |
| Diluted | $ 0.36 | $ 0.12 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

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**Technitrol, Inc. and Subsidiaries**
**Consolidated Statements of Cash Flows**

(Unaudited)
*In thousands*

| | Three Months Ended March 28, 2008 | Three Months Ended March 30, 2007 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net earnings | $ 14,737 | $ 4,711 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 10,200 | 7,990 |
| Forward contract settlements | 6,959 | — |
| Amortization of stock incentive plan expense | 635 | 1,076 |
| Minority interest in net earnings of consolidated subsidiary | 81 | 190 |
| Severance and asset impairment expense, net of cash payments | (1,577) | 8,290 |
| Changes in assets and liabilities, net of effect of acquisitions: | | |
| Trade receivables | 681 | (12,965) |
| Inventories | (5,713) | (1,590) |
| Prepaid expenses and other current assets | (4,713) | (1,907) |
| Accounts payable and accrued expenses | (5,553) | 5,471 |
| Other, net | 34 | 2,050 |
| Net cash provided by operating activities | 15,771 | 13,316 |
| Cash flows from investing activities: | | |
| Acquisitions, net of cash acquired of $6,556 | (421,121) | — |
| Forward contract settlements | (6,959) | — |
| Capital expenditures | (5,251) | (4,512) |
| Purchases of grantor trust investments available for sale | (285) | — |
| Proceeds from sale of property, plant and equipment | 2,450 | 2,159 |
| Foreign currency impact on intercompany lending | (5,666) | 312 |
| Net cash (used in) investing activities | (436,832) | (2,041) |
| Cash flows from financing activities: | | |
| Long-term borrowings | 373,000 | 2,757 |
| Principal payments of long-term debt | (19,943) | (11,614) |
| Dividends paid | (3,579) | (3,567) |
| Exercise of stock options | 17 | 88 |
| Net cash provided by (used in) financing activities | 349,495 | (12,336) |

| | | |
|---|---|---|
| Net effect of exchange rate changes on cash | 9,716 | 1,010 |
| Net (decrease) in cash and cash equivalents | (61,850) | (51) |
| Cash and cash equivalents at beginning of period | 116,289 | 87,195 |
| Cash and cash equivalents at end of period | $ 54,439 | $ 87,144 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

**Technitrol, Inc. and Subsidiaries**
**Consolidated Statements of Changes in Shareholders' Equity**

Three Months Ended March 28, 2008

(Unaudited)
*In thousands, except per share data*

| | Common stock and paid-in capital | | | Accumulated other | |
|---|---|---|---|---|---|
| | Shares | Amount | Retained earnings | comprehensive income | Comprehensive income |
| Balance at December 28, 2007 | 40,901 | $ 222,593 | $ 289,048 | $ 49,438 | |
| Stock options, awards and related compensation | 24 | 548 | — | — | |
| Dividends declared ($0.0875 per share) | — | — | (3,579) | — | |
| Net earnings | — | — | 14,737 | — | $ 14,737 |
| Currency translation adjustments | — | — | — | 37,135 | 37,135 |
| Unrealized holding gains on securities | — | — | — | (657) | (657) |
| Comprehensive income | | | | | $ 51,215 |
| Balance at March 28, 2008 | 40,925 | $ 223,141 | $ 300,206 | $ 85,916 | |

See accompanying Notes to Unaudited Consolidated Financial Statements.

**Technitrol, Inc. and Subsidiaries**
**Notes to Unaudited Consolidated Financial Statements**

(1) Accounting policies

For a complete description of the accounting policies of Technitrol, Inc. and its consolidated subsidiaries, refer to Note 1 of Notes to Consolidated Financial Statements included in Technitrol Inc.'s Form 10-K filed for the year ended December 28, 2007. We sometimes refer to Technitrol, Inc. as "we" or "our". We refer to Pulse as the Electronics Components Group or "Electronics" and AMI Doduco as the Electrical Contact Products Group or "Electrical".

The results for the three months ended March 28, 2008 and March 30, 2007 have been prepared by our management without audit by our independent auditors. In the opinion of management, the consolidated financial statements fairly present in all material respects, the financial position, results of operations and cash flows for the periods presented. To the best of our knowledge and belief, all adjustments have been made to properly reflect income and expenses attributable to the periods presented. Except for severance and asset impairment expenses, all such adjustments are of a normal recurring nature. Operating results for the three months ended March 28, 2008 are not necessarily indicative of annual results.

New Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No.* 51 ("SFAS 160"). This statement will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This statement is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the effect that SFAS 160 will have on our consolidated financial statements.

In December 2007, FASB issued Statement No. 141 (revised 2007), *Business Combinations* ("SFAS 141R"). This statement will change the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, in-process research and development costs and restructuring costs. In addition, SFAS 141R changes the measurement period for deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination. This statement is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the effect that SFAS 141R will have on our consolidated financial statements.

In March 2008, FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ("SFAS 161"). SFAS 161 applies to the disclosure requirements for all derivative instruments and hedged items accounted for under SFAS 133 and its related interpretations. This statement amends and expands the disclosure requirements of Statement 133, requiring qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts and gains and losses on derivative instruments, and disclosures about the credit risk related contingent features in derivative agreements. We are required to adopt this statement starting in 2009. We are currently in the process of evaluating the effect that this Statement will have on the disclosures in our consolidated financial statements.

Recently Adopted Accounting Pronouncements

In February 2007, FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS 159"). This statement provides the option to report certain financial assets and liabilities at fair value, with the intent to mitigate volatility in financial reporting that can occur when related assets and liabilities are recorded on different bases. This statement is effective for us beginning December 29, 2007. Adoption of this statement did not have any impact on our financial statements.

**Technitrol, Inc. and Subsidiaries**

**Notes to Unaudited Consolidated Financial Statements,** continued

(1) Accounting policies, continued

In September 2006, FASB issued Statement No. 157, *Fair Value Measurements* ("SFAS 157"). This statement defines fair value, establishes a framework for measuring fair value in GAAP, and enhances disclosures about fair value measurements. SFAS 157 applies when other accounting pronouncements require fair value measurements; it does not require new fair value measurements. In February 2008, FASB issued FASB Staff Position No. FA5 157-2, Effective Date of FASB Statement No. 157 ("FSP 157-2"), which deferred the effective date of SFAS 157 one year for non-financial assets and liabilities, except on items that are already recognized or disclosed at fair value in the financial statements on a recurring basis. We adopted SFAS 157 for our financial assets and liabilities in the first quarter of 2008. There was no impact to our consolidated financial statements upon adoption of SFAS 157, as our grantor trust investment is classified as available for sale with a fair value based on quoted market prices that meet the specifications of a Level 1 input, as defined in SFAS 157.

(2) Acquisitions

*Sonion A/S*: On February 28, 2008, we acquired all of the capital stock of Sonion A/S ("Sonion"), headquartered in Roskilde, Denmark with manufacturing facilities in Denmark, Poland, China and Vietnam. The results of Sonion's operations have been included in the consolidated financial statements since February 29, 2008. Sonion produces microacoustic transducers and micromechanical components used in hearing instruments, acoustic devices, medical devices and mobile communications devices. Our total investment was $421.1 million, which included $243.3 million, net of cash acquired of $6.6 million, for the outstanding capital stock and $177.8 million of acquired debt which was repaid concurrent with the acquisition. We financed the acquisition with proceeds from our new multi-currency credit facility and with cash on hand. The preliminary fair value of the net tangible assets acquired, excluding the assumed debt, approximated $138.6 million. We are in the process of evaluating the fair value of acquired assets and liabilities of Sonion, which includes obtaining third-party valuations of the property, plant and equipment and intangible assets, therefore, the allocation of the purchase price is preliminary and is subject to adjustment. The excess purchase price has been recorded as goodwill on the consolidated balance sheet until the valuation is completed, however, we recorded an estimate of intangible amortization expense on the unallocated premium in the three months ended March 28, 2008. Also, we have not adjusted our deferred tax asset or liability balances to reflect the allocation of the purchase price as of March 28, 2008. Sonion's mobile communications group will become part of Electronics' wireless communications group, and Sonion's medical and acoustic device groups will form a new medical technology group at Electronics. The following table summarizes the preliminary fair values of the assets acquired and liabilities assumed at the date of acquisition (*in millions*):

| | |
|---|---|
| Current assets | $ 81.2 |
| Property, plant & equipment | 102.3 |
| Goodwill (unallocated premium) | 289.1 |
| Other assets | 4.9 |
| Total assets acquired | 477.5 |
| Current liabilities | 49.8 |
| Debt assumed in acquisition | 177.8 |
| Total liabilities assumed | 227.6 |
| Net assets acquired | $ 249.9 |

**Technitrol, Inc. and Subsidiaries**
**Notes to Unaudited Consolidated Financial Statements,** continued

(2) Acquisitions, continued

Had the acquisition of Sonion occurred on December 30, 2006, unaudited pro forma results would have been as follows (*in millions, except per share amounts*):

| | Three Months Ended | |
|---|---|---|
| | March 28, 2008 | March 30, 2007 |
| Net sales | $ 308.9 | $ 293.0 |
| Net earnings (loss) | $ 6.0 | $ (3.6) |
| Net earnings (loss) per common share: | | |
| Basic | $ 0.15 | $ (0.09) |
| Diluted | $ 0.15 | $ (0.09) |

The pro forma results reflect adjustments for the increased intangible amortization, interest expense and other ongoing charges attributable to the acquisition. However, potential cost savings from combining Sonion with our operations are not reflected. For this and other reasons, the pro forma results are not indicative of the results that would have occurred had the acquisition actually been consummated on December 30, 2006, and are not intended to be a projection of future results or trends.

(3) Inventories

Inventories consisted of the following (*in thousands*):

| | March 28, 2008 | December 28, 2007 |
|---|---|---|
| Finished goods | $ 65,178 | $ 48,940 |
| Work in process | 37,736 | 27,748 |
| Raw materials and supplies | 70,376 | 45,427 |
| | $ 173,290 | $ 122,115 |

(4) Goodwill and other intangibles, net

The changes in the carrying amounts of goodwill for the three months ended March 28, 2008 were as follows (*in thousands*):

| | |
|---|---|
| Balance at December 28, 2007 | $ 224,656 |
| Goodwill and unallocated premium acquired during the period | 289,120 |
| Purchase price allocations and other adjustments | (1,125) |
| Currency translation adjustments | 21,101 |
| Balance at March 28, 2008 | $ 533,752 |

Our goodwill and other intangibles relate to our Electronics segment.

Other intangible assets were as follows (*in thousands*):

| Intangible assets subject to amortization (*definite lives*): | March 28, 2008 | December 28, 2007 |
|---|---|---|
| Technology | $ 11,978 | $ 11,655 |
| Customer relationships | 34,144 | 32,162 |
| Tradename/trademark | 458 | 427 |
| Other | 2,402 | 2,402 |
| Total | $ 48,982 | $ 46,646 |

**Technitrol, Inc. and Subsidiaries**
**Notes to Unaudited Consolidated Financial Statements,** continued

(4) Goodwill and other intangibles, net, continued

| | March 28, 2008 | December 28, 2007 |
|---|---|---|
| Accumulated amortization: | | |
| Technology | $ (8,995) | $ (8,516) |
| Customer relationships | (10,375) | (8,798) |
| Tradename/trademark | (458) | (427) |
| Other | (1,680) | (769) |
| Total | $ (21,508) | $ (18,510) |
| Net tangible assets subject to amortization | $ 27,474 | $ 28,136 |
| Intangible assets not subject to amortization (indefinite lives): | | |
| Tradename | $ 6,658 | $ 6,658 |
| Other intangibles, net | $ 34,132 | $ 34,794 |

Amortization expense was $2.3 million and $1.3 million for the three months ended March 28, 2008 and March 30, 2007, respectively. Excluding amortization of intangible assets acquired in the Sonion acquisition, estimated annual amortization expense for each of the next five years is as follows *(in thousands)*:

| Year Ending | |
|---|---|
| 2009 | $ 5,193 |
| 2010 | $ 4,826 |
| 2011 | $ 3,149 |
| 2012 | $ 3,042 |
| 2013 | $ 3,042 |

(5) Income taxes

At March 28, 2008, we have approximately $21.2 million of unrecognized tax benefits, $20.1 million of which are classified as other long-term liabilities and are not expected to be realized within the next twelve months. All of these tax benefits would affect our effective tax rate, if recognized. During the three months ended March 28, 2008, we recognized approximately $2.6 million of tax benefits due to the expiration of a statute of limitations.

Our continuing practice is to recognize interest and penalties, if any, related to income tax matters as income tax expense. As of March 28, 2008, we have $0.9 million accrued for interest and/or penalties related to uncertain income tax positions.

We are subject to U.S. federal income tax as well as income tax in multiple state and non-U.S. jurisdictions. Federal and state income tax returns for all years after 2003 are subject to future examination by the respective tax authorities. With respect to material non-U.S. jurisdictions where we operate, we have open tax years ranging from 3 to 10 years.

**Technitrol, Inc. and Subsidiaries**
**Notes to Unaudited Consolidated Financial Statements,** continued

(6) Defined benefit plans

In the three months ended March 28, 2008, we contributed less than $0.1 million to our principal defined benefit plans and we expect to contribute approximately $0.3 million for the full fiscal year in 2008. Our net periodic expense was approximately $0.3 million in the three months ended March 28, 2008 and March 30, 2007 and is expected to be approximately $1.0 million for the full fiscal year in 2008.

(7) Accounting for stock-based compensation

The following table presents the amount of stock-based compensation expense included in the Consolidated Statements of Operations during the three months ended March 28, 2008 and March 30, 2007 *(in thousands):*

| | March 28, 2008 | March 30, 2007 |
|---|---|---|
| Restricted stock | $ 585 | $ 933 |
| Stock options | 50 | 143 |
| Total stock-based compensation included in selling, general and administrative expenses | 635 | 1,076 |
| Income tax benefit | (188) | (358) |
| Total after-tax stock-based compensation expense | $ 447 | $ 718 |

*Restricted Stock:* The value of restricted stock issued is based on the market price of the stock at the award date. Shares are held by us until the continued employment requirement has been attained. The market value of the shares at the date of grant is charged to expense on a straight-line basis over the vesting period. Cash awards, which are intended to assist recipients with their resulting personal tax liability, are based on the market value of the shares and are accrued over the vesting period. The expense related to the cash award is fixed and is based on the value of the awarded stock on the grant date if the recipient makes an election under Section 83(b) of the Internal Revenue Code. If the recipient does not make an election under Section 83(b), the cash award will fluctuate based on the current market value of the shares subject to limitation as set forth in our restricted stock plan.

A summary of the restricted stock activity is as follows *(in thousands, except per share data)*:

| | Shares | Weighted Average Stock Grant Price (Per Share) |
|---|---|---|
| Nonvested at December 28, 2007 | 219 | $ 22.85 |
| Granted | 25 | $ 24.68 |
| Vested | (45) | $ 22.78 |
| Forfeited | (4) | $ 24.87 |
| Nonvested at March 28, 2008 | 195 | $ 23.05 |

As of March 28, 2008, there was approximately $2.5 million of total unrecognized compensation cost related to restricted stock grants. This unrecognized compensation is expected to be recognized over a weighted-average period of approximately 1.6 years.

**Technitrol, Inc. and Subsidiaries**
**Notes to Unaudited Consolidated Financial Statements,** continued

(7) Accounting for stock-based compensation, continued

*Stock Options:* Stock options were granted at no cost to the employee and were not granted at a price lower than the fair market value at date of grant. These options expire seven years from the date of grant and vest equally over four years. There were no options issued during the three months ended March 28, 2008 or during the year ended December 28, 2007. We value our stock options according to the fair value method using the Black-Scholes option-pricing model.

A summary of the stock options activity is as follows (*in thousands, except per share data*):

| | Shares | Weighted Average Option Grant Price (Per Share) | Aggregate Intrinsic Value |
|---|---|---|---|
| Outstanding as of December 28, 2007 | 187 | $ 18.96 | |
| Granted | | | |