MAGNETEK INC
Form 10-Q
November 09, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 30, 2004

OR

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

For the transition period from ___________________

Commission file number 1-10233

MAGNETEK, INC.

(Exact name of registrant as specified in its charter)

Delaware	**95-3917584**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

10900 Wilshire Blvd., Suite 850

Los Angeles, California 90024

(Address of principal executive offices)

(Zip Code)

(310) 208-1980

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year,

if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ý No o

Indicate by check mark whether the registrant is an accelerated filer as defined in Rule 12b-2 of the Exchange Act. Yes ý No o

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares outstanding of Registrant s Common Stock, as of October 29, 2004, was 28,528,239 shares.

2005 MAGNETEK FORM 10-Q

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PART I FINANCIAL INFORMATION

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MAGNETEK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED

September 30, 2004 and 2003

(amounts in thousands, except per share data)

(unaudited)

	2004	2003
Net sales	$ 69,178	$ 50,435
Cost of sales	52,240	40,089
Gross profit	16,938	10,346
Research and development	3,694	2,843
Selling, general and administrative	11,705	10,470
Income (loss) from operations	1,539	(2,967)
Interest and other expense, net	364	672
Income (loss) before provision for income taxes	1,175	(3,639)
Provision for income taxes	235	
Net income (loss)	$ 940	$ (3,639)
Earnings (loss) per common share		
Basic and diluted:		
Net income (loss)	$ 0.03	$ (0.15)

See accompanying notes

MAGNETEK, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

September 30, 2004 and JUNE 30, 2004

(amounts in thousands)

	September 30 (unaudited)	June 30
ASSETS		
Current assets:		
Cash	$ 3,481	$ 2,318
Accounts receivable, net	59,371	55,822
Inventories	51,242	51,432
Prepaid expenses and other	4,761	9,027
Total current assets	118,855	118,599
Property, plant and equipment	127,006	123,036
Less-accumulated depreciation and amortization	95,093	90,918
Property, plant and equipment, net	31,913	32,118
Goodwill	64,141	63,828
Prepaid pension	57,202	57,523
Other assets	13,322	14,293
Total Assets	$ 285,433	$ 286,361
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 39,017	$ 41,181
Accrued liabilities	9,404	11,551
Current portion of long-term debt	703	211
Total current liabilities	49,124	52,943
Long-term debt, net of current portion	15,732	16,129
Other long-term obligations	96,739	96,441
Deferred income taxes	8,403	8,326
Stockholders equity		
Common stock	285	285
Paid in capital in excess of par value	127,790	127,692
Retained earnings	70,428	69,488
Accumulated other comprehensive loss	(83,068)	(84,943)
Total stockholders equity	115,435	112,522
Total Liabilities and Stockholders Equity	$ 285,433	$ 286,361

See accompanying notes

MAGNETEK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW

FOR THE THREE MONTHS ENDED

September 30, 2004 and 2003

(amounts in thousands)

(unaudited)

	2004	2003
Cash flows from operating activities:		
Net income (loss)	$ 940	$ (3,639)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,490	2,481
Tax refund proceeds, net	3,332	
Changes in operating assets and liabilities	(4,123)	1,539
Total adjustments	1,699	4,020
Net cash provided by operating activities	2,639	381
Cash flows from investing activities:		
Proceeds from sale of businesses		1,250
Capital expenditures	(1,649)	(775)
Net cash provided by (used in) investing activities	(1,649)	475
Cash flow from financing activities:		
Proceeds from issuance of common stock	98	62
Borrowings under (repayment of) bank and other long term obligations	95	(825)
Increase in deferred financing costs	(20)	(377)
Net cash provided by (used in) financing activities	173	(1,140)
Net increase (decrease) in cash	$ 1,163	$ (284)
Cash at the beginning of the period	2,318	1,680
Cash at the end of the period	$ 3,481	$ 1,396

See accompanying notes

MAGNETEK, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2004

(Amounts in thousands, except per share data)

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles for complete financial statements. For further information, refer to the financial statements and footnotes thereto included in the Company s Form 10-K for the year ended June 30, 2004 filed with the Securities and Exchange Commission. In the Company s opinion, these unaudited statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial position of the Company as of September 30, 2004, and the results of its operations and its cash flows for the three-month periods ended September 30, 2004 and 2003. Results for the three-months ended September 30, 2004 are not necessarily indicative of results that may be experienced for the full fiscal year.

The Company uses a fifty-two, fifty-three week fiscal year ending on the Sunday nearest to June 30. Fiscal quarters are the thirteen or fourteen week periods ending on the Sunday nearest September 30, December 31, March 31 and June 30. For clarity of presentation, all periods are presented as if they ended on the last day of the calendar period. The three-month periods ended September 30, 2004 and 2003 contained fourteen and thirteen weeks, respectively.

2. Summary of Significant Accounting Policies

Principles of Consolidation The condensed consolidated financial statements include the accounts of Magnetek, Inc. and its subsidiaries (the Company). All significant inter-company accounts and transactions have been eliminated.

Use of Estimates - The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant areas requiring management estimates include the following key financial areas:

Accounts Receivable

Accounts receivable represent amounts due from customers in the ordinary course of business. The Company is subject to losses from uncollectible receivables in excess of its allowances. The Company maintains allowances for doubtful accounts for estimated losses from customers inability to make required payments. In order to estimate the appropriate level of this allowance, the Company analyzes historical bad debts, customer concentrations, current customer creditworthiness, current economic trends and changes in customer payment patterns. If the financial conditions of the Company s customers were to deteriorate and impair their ability to make payments, additional allowances may be required in future periods. The Company s management believes that all appropriate allowances have been provided.

Inventories

The Company s inventories are stated at the lower of cost or market. Cost is determined by the first-in, first-out (FIFO) method, including material, labor and factory overhead. Inventory on hand may exceed future demand either because the product is obsolete, or the amount on hand is more than can be used to meet future needs. The Company identifies potentially obsolete and excess inventory by evaluating overall inventory levels. In assessing the ultimate realization of inventories, the Company is required to make judgments as to future demand requirements and compare those with the current or committed inventory levels. If future demand requirements are less favorable than those projected by management, additional inventory write-downs may be required.

Reserves for Contingencies

The Company periodically records the estimated impacts of various conditions, situations or circumstances involving uncertain outcomes. The accounting for such events is prescribed under Statement of Financial Accounting Standard (SFAS) No. 5, Accounting for Contingencies. SFAS No. 5 defines a contingency as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur.

SFAS No. 5 does not permit the accrual of gain contingencies under any circumstances. For loss contingencies, the loss must be accrued if (1) information is available that indicates it is probable that the loss has been incurred, given the likelihood of uncertain events; and (2) that the amount of the loss can be reasonably estimated.

The accrual of a contingency involves considerable judgment on the part of management. The Company uses its internal expertise, and outside experts, as necessary, to help estimate the probability that a loss has been incurred and the amount (or range) of the loss.

Income Taxes

The Company uses the liability method to account for income taxes. The preparation of consolidated financial statements involves estimating the Company s current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the consolidated balance sheets. An assessment of the recoverability of the deferred tax assets is made, and a valuation allowance is established based upon this assessment.

The Company does not record deferred taxes on domestic pretax income or losses, due to (1) the availability of net operating loss (NOL) carryforwards that have been fully reserved through valuation allowances for pretax income, and (2) uncertainty surrounding the timing of realizing NOL carryforwards generated in the current period in future periods.

Federal income taxes are not provided currently on undistributed earnings of foreign subsidiaries since the Company presently intends to reinvest any earnings overseas indefinitely.

Pension Benefits

The valuation of the Company s pension plan requires the use of assumptions and estimates to develop actuarial valuations of expenses and assets/liabilities. These assumptions include discount rates, investment returns and mortality rates. Changes in assumptions and future investments returns could potentially have a material impact on the Company s expenses and related funding requirements.

<u>Revenue Recognition</u> The Company s policy is to record and recognize sales only upon shipment. Amounts billed to customers for shipping costs are reflected in net sales; shipping costs are reflected in cost of sales.

Property, Plant and Equipment   Additions and improvement are capitalized at cost, whereas expenditures for maintenance and repair are charged to expense as incurred. Depreciation is provided over the estimated useful lives of the respective assets (ranging from three to forty years) principally using the straight-line method.

Goodwill   In accordance with SFAS No. 142,   Goodwill and Other Intangible Assets,   the Company reviews the carrying value of goodwill at least annually, and more frequently if indicators of potential impairment arise, using discounted future cash flow analyses as prescribed in SFAS No. 142.

Deferred Financing Costs   Costs incurred to obtain financing are deferred and included in other assets in the condensed consolidated balance sheets. Deferred financing costs are amortized over the term of the financing facility, and related amortization expenses are included in interest and other expense in the condensed consolidated statements of operations.

Earnings per Share   In accordance with SFAS No. 128,   Earnings per Share   , basic earnings per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share incorporate the incremental shares issuable upon the assumed exercise of stock options as if all exercises had occurred at the beginning of the fiscal period.

Stock-Based Compensation   The Company has elected to continue to use the intrinsic-value method of accounting as prescribed by Accounting Principles Board (APB) No. 25   Accounting for Stock Issued to Employees   in accounting for stock based awards to employees. Under APB 25, the Company recognizes no compensation expense with respect to such awards when the exercise price is equal to or greater than the market price at the date of grant. Accordingly, no stock-based employee compensation cost is reflected in reported results of operations for all periods presented. The Company adopted the interim disclosure provisions of SFAS No. 148,   Accounting for Stock-Based Compensation   Transition and Disclosure   an Amendment of FASB Statement no. 123   .

The following table illustrates the effect on net income (loss) and earnings (loss) per share for the three months ended September 30, 2004 and 2003, if the Company had applied the fair value recognition provisions of SFAS No. 123,   Accounting for Stock-Based Compensation   , to stock-based employee compensation:

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003
Net income (loss)	$ 940	$ (3,639)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(1,224)	(1,141)
Pro forma net loss	$ (284)	$ (4,780)
Earnings (loss) per share as reported:		
Basic and diluted	$ 0.03	$ (0.15)
Pro forma loss per share:		
Basic and diluted	$ (0.01)	$ (0.20)

Recent Accounting Pronouncement - In October 2004, the Financial Accounting Standards Board (FASB) concluded that SFAS No. 123R, Share-Based Payment, which would require all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, would be effective for interim or annual periods beginning after June 15, 2005. The Company could adopt the new standard in one of two ways the modified prospective transition method or the modified retrospective transition method. Assuming the new standard is implemented as scheduled, the Company will adopt this new standard at the beginning of fiscal year 2006 and is currently evaluating the effect that the adoption of this standard will have on its financial position and results of operations.

Derivative Financial Instruments The Company periodically uses derivative financial instruments to reduce financial market risks. These instruments are used to hedge foreign currency and interest rate market exposures. The Company does not use derivative financial instruments for speculative or trading purposes. The Company accounts for derivative instruments in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , and SFAS No. 149, Amendment of Statement 133 on Derivatives and Hedging . These statements require that an entity recognize all derivatives as either assets or liabilities in the statement of financial position, measured at fair value, and that hedge accounting be applied when certain conditions are met. The Company had no derivative financial instruments at September 30, 2004.

Foreign Currency Translation - The Company s foreign entities accounts are measured using local currency as the functional currency. Assets and liabilities are translated at the exchange rate in effect at year-end. Revenues and expenses are translated at the rates of exchange prevailing during the year. Unrealized translation gains and losses arising from differences in exchange rates from period to period are included as a component of accumulated other comprehensive loss in stockholders equity.

Reclassifications Certain prior year balances were reclassified to conform to the current year presentation.

3. Inventories

Inventories at September 30, 2004 and June 30, 2004 consist of the following:

	September 30	June 30
Raw materials and stock parts	$ 33,122	$ 29,237

Work-in-process		10,264		13,498
Finished goods		7,856		8,697
	$	51,242	$	51,432

4. Commitments and Contingencies

The Company is a party to a number of product liability lawsuits associated with discontinued business operations that have been sold. As part of the sales transactions, the Company agreed for a limited time to defend and indemnify the purchasers of the discontinued business operations against certain product liability claims. The last remaining contractual indemnification obligation of that type terminated on December 14, 2003; however, the Company remains obligated to continue defending and indemnifying valid claims made prior to the applicable termination date for each such obligation. The Company is also a named party in two product liability lawsuits related to the Telemotive Industrial Controls business that was acquired in December 2002. The Company believes that liability for those lawsuits will be covered by insurance policies in effect for the Telemotive Industrial Controls business prior to the sale or will be indemnified by the selling shareholders. All of the pending product liability cases are being aggressively defended by the Company, and management believes that its insurers will bear all liability, if any, that exceeds applicable deductibles, and that none of these proceedings individually or in the aggregate will have a material adverse effect on the Company s results of operations or financial position.

The Company has been named, along with numerous other defendants, in asbestos-related lawsuits associated with business operations previously acquired by the Company, but which are no longer owned. During the Company s ownership, none of the businesses produced or sold asbestos-containing products. With respect to these claims, the Company is either contractually indemnified against liability for asbestos-related claims or believes that it has no liability for such claims. While the outcome of these cases cannot be predicted with certainty, the Company is aggressively seeking dismissal from the proceedings and does not believe the proceedings, individually or in the aggregate, will have a material adverse effect on its financial position or results of operations.

In April 1998, Ole K. Nilssen filed a lawsuit in the U.S. District Court for the Northern District of Illinois alleging infringement by the Company of seven of his patents pertaining to electronic ballast technology, and seeking unspecified damages and injunctive relief to preclude the Company from making, using or selling products allegedly infringing his patents. The Company denied that its products infringed any valid patent and filed a response asserting affirmative defenses, as well as a counterclaim for a judicial declaration that its products do not infringe the patents asserted by Mr. Nilssen and also that the asserted patents are invalid. In June 2001, the Company sold its lighting business to Universal Lighting Technologies, Inc. (ULT), and agreed to provide a limited indemnification against certain claims of infringement that Mr. Nilssen might allege against ULT. In April 2003, Mr. Nilssen s lawsuit and the counterclaims were dismissed with prejudice and both parties agreed to submit limited issues in dispute to binding arbitration before an arbitrator with a relevant technical background. Arbitration commenced on November 8, 2004, and proceedings are ongoing. The Company will assert what it believes are strong defenses at arbitration; however, an unfavorable decision could have a material adverse effect on the Company s financial position and results of operations

In February 2003, Mr. Nilssen filed a lawsuit in the U.S. District Court for the Northern District of Illinois alleging infringement by ULT of twenty-nine of his patents pertaining to electronic ballast technology, and seeking unspecified damages and injunctive relief to preclude ULT from making, using or selling products allegedly infringing his patents. ULT made a claim for indemnification, which the Company accepted, subject to the limitations set forth in the purchase and sale agreement. The Company denies that the products for which it has an indemnification obligation to ULT infringe any valid patent and has filed a response on behalf of ULT asserting affirmative defenses, as well as a counterclaim for a judicial declaration that the products do not infringe Mr. Nilssen s patents and that the patents are invalid. The Company will aggressively defend the claims against ULT that are subject to defense and indemnification; however, an unfavorable decision could have a material adverse effect on the Company s financial position and results of operations.

From time to time, the Company discovered the existence of hazardous substances at certain facilities associated with previously owned businesses and responded as necessary to bring the facilities into compliance with applicable laws and regulations. Upon sale of the businesses, the Company agreed, in some cases, to indemnify the buyers against environmental claims associated with the divested operations, subject to various conditions and limitations. Remediation activities, including those related to the Company s indemnification obligations, did not involve material expenditures during the first quarter of fiscal 2005, or during fiscal years 2004, 2003 and 2002.

The Company has also been identified by the United States Environmental Protection Agency and certain state agencies as a potentially responsible party for cleanup costs associated with alleged past waste disposal practices at several previously owned facilities and offsite locations. Its remediation activities as a potentially responsible party were not material in the first quarter of fiscal 2005, or in fiscal years 2004, 2003 and 2002. Although the materiality of future expenditures for environmental activities may be affected by the level and type of contamination, the extent and nature of cleanup activities required by governmental authorities, the nature of the Company s alleged connection to the contaminated sites, the number and financial resources of other potentially responsible parties, the availability of indemnification rights against third parties and the identification of additional contaminated sites, the Company s estimated share of liability, if any, for environmental remediation, including its indemnification obligations, is not expected to be material.

Prior to the Company s purchase of Century Electric, Inc. (Century Electric) in 1986, Century Electric acquired a business from Gould Inc. (Gould) in May 1983 that included a leasehold interest in a fractional horsepower electric motor manufacturing facility located in McMinnville, Tennessee. Gould agreed to indemnify Century Electric from and against liabilities and expenses arising out of the handling and cleanup of certain waste materials, including but not limited to cleaning up any polychlorinated biphenyls (PCBs) at the McMinnville facility (the 1983 Indemnity). The presence of PCBs and other substances, including solvents, in the soil and in the groundwater underlying the facility and in certain offsite soil, sediment and biota samples has been identified. The McMinnville plant is listed as a Tennessee Inactive Hazardous Waste Substance Site and plant employees were notified of the presence of contaminants at the facility. Gould has completed an interim remedial excavation and disposal of onsite soil containing PCBs and a preliminary investigation and cleanup of certain onsite and offsite contamination. The Company believes the cost of further investigation and remediation (including ancillary costs) are covered by the 1983 Indemnity. The Company sold its leasehold interest in the McMinnville plant in August 1999 and while the Company believes that Gould will continue to perform substantially under its indemnity obligations, Gould s substantial failure to perform such obligations could have a material adverse effect on the Company s financial position, cash flows or results of operations.

In 1986, the Company acquired the stock of Universal Manufacturing Company (Universal) from a predecessor of Fruit of the Loom (FOL), and the predecessor agreed to indemnify the Company against certain environmental liabilities arising from pre-acquisition activities at a facility in Bridgeport, Connecticut. Environmental liabilities covered by the indemnification agreement include completion of additional cleanup activities, if any, at the Bridgeport facility (sold in connection with the sale of the transformer business in June 2001) and defense and indemnification against liability for potential response costs related to offsite disposal locations. FOL, the successor to Universal, filed a petition for Reorganization under Chapter 11 of the Bankruptcy Code in 1999 and the Company filed a proof of claim in the proceeding for obligations related to the environmental indemnification agreement. The Company believes that FOL had substantially completed the clean-up obligations required by the indemnification agreement prior to the bankruptcy filing. In November 2001, the Company and FOL entered into an agreement involving the allocation of certain potential tax credits and Magnetek withdrew its claims in the bankruptcy proceeding. FOL s obligation to the state of Connecticut was not discharged in the reorganization proceeding. FOL s inability to satisfy its remaining obligations related to the Bridgeport facility and any offsite disposal locations, or the discovery of additional environmental contamination at the Bridgeport facility could have a material adverse effect on the Company s financial position or results of operations.

5. Comprehensive Income (Loss)

For the fiscal quarters ended September 30, 2004 and 2003, comprehensive income (loss) consisted of the following:

	Three Months Ended September 30, 2004		Three Months Ended September 30, 2003	
Net income (loss)	$	940	$	(3,639)
Currency translation adjustment		1,875		1,092
Comprehensive income (loss)	$			