FLOW INTERNATIONAL CORP
Form 10-Q
March 12, 2009

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

FORM 10-Q

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

For the quarterly period ended January 31, 2009

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 number 0-12448

FLOW INTERNATIONAL CORPORATION

WASHINGTON	**91-1104842**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

23500 64th Avenue South
Kent, Washington 98032
(253) 850-3500

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 þ No o.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company) o	Smaller reporting company 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 þ.

The registrant had 37,652,696 shares of Common Stock, $0.01 par value per share, outstanding as of February 27, 2009.

Explanatory Note:

This Form 10-Q reflects the restatement of the Company s unaudited Condensed Consolidated Financial Statements for the three and nine months ended January *31, 2008 and related Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 2 herein. The restatement is more fully described in Note 17 to the unaudited Condensed Consolidated Financial Statements under Item 1, Financial Information herein.*

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FLOW INTERNATIONAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited; in thousands, except share amounts)

	January 31, 2009	April 30, 2008
ASSETS:		
Current Assets:		
Cash and Cash Equivalents	$ 13,107	$ 29,099
Restricted Cash	403	142
Receivables, net	33,202	33,632
Inventories	25,037	29,339
Deferred Income Taxes	10,630	2,889
Deferred Acquisition Costs	12,411	7,953
Other Current Assets	8,243	6,456
Total Current Assets	103,033	109,510
Property and Equipment, net	21,286	18,790
Intangible Assets, net	4,377	4,062
Goodwill (Note 16)		2,764
Deferred Income Taxes	15,461	15,535
Other Assets	5,382	494
	$ 149,539	$ 151,155
LIABILITIES AND SHAREHOLDERS EQUITY:		
Current Liabilities:		
Notes Payable	$ 2,221	$ 1,118
Current Portion of Long-Term Obligations	1,283	977
Accounts Payable	14,184	19,516
Accrued Payroll and Related Liabilities	5,464	8,189
Taxes Payable and Other Accrued Taxes	2,352	3,617
Deferred Income Taxes	564	686
Deferred Revenue	3,936	4,980
Customer Deposits	3,379	4,549
Reserve for Patent Litigation (Note 5)	23,000	
Other Accrued Liabilities	9,742	9,753
Total Current Liabilities	66,125	53,385
Long-Term Obligations, net	1,940	2,333
Deferred Income Taxes	7,298	7,787
Reserve for Patent Litigation (Note 5)	6,000	
Other Long-Term Liabilities	1,410	1,586
	82,773	65,091
Commitments and Contingencies (Note 7)		
Shareholders Equity:		

Series A 8% Convertible Preferred Stock $.01 par value, 1,000,000 shares authorized, none issued		
Common Stock $.01 par value, 49,000,000 shares authorized, 37,652,696 and 37,589,787 shares issued and outstanding at January 31, 2009 and April 30, 2008, respectively	371	371
Capital in Excess of Par	140,470	139,007
Accumulated Deficit	(66,929)	(47,584)
Accumulated Other Comprehensive Loss:		
Defined Benefit Plan Obligation, net of income tax of $93 and $93	(280)	(280)
Cumulative Translation Adjustment, net of income tax of $1,159 and $764	(6,866)	(5,450)
Total Shareholders Equity	66,766	86,064
	$ 149,539	$ 151,155

See Accompanying Notes to
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FLOW INTERNATIONAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited; in thousands, except per share amounts)

	Three Months Ended January 31, 2009	Three Months Ended January 31, 2008 (Restated, see Note 17)	Nine Months Ended January 31, 2009	Nine Months Ended January 31, 2008 (Restated, see Note 17)
Sales	$ 48,711	$ 65,369	$ 166,353	$ 180,986
Cost of Sales	29,565	37,487	95,436	105,758
Gross Margin	19,146	27,882	70,917	75,228
Operating Expenses:				
Sales and Marketing	9,996	10,520	31,996	31,818
Research and Engineering	2,281	2,163	6,809	6,589
General and Administrative	6,418	6,346	22,586	25,991
Provision for Patent Litigation (Note 5)	29,000		29,000	
Goodwill Impairment	2,764		2,764	
Restructuring and Other Operating Charges	514		2,394	
Total Operating Expenses	50,973	19,029	95,549	64,398
Operating Income (Loss)	(31,827)	8,853	(24,632)	10,830
Interest Income (Expense), net	(348)	37	(337)	301
Other Income (Expense), net	392	(422)	(56)	(756)
Income (Loss) Before Provision for Income Taxes	(31,783)	8,468	(25,025)	10,375
(Provision) Benefit for Income Taxes	11,106	(2,234)	6,277	(1,774)
Income (Loss) From Continuing Operations	(20,677)	6,234	(18,748)	8,601
Income (Loss) from Operations of Discontinued Operations, net of Income Tax of $(46), $28, $0 and $210	(686)	55	(597)	418
Net Income (Loss)	$ (21,363)	$ 6,289	$ (19,345)	$ 9,019
Basic Income (Loss) Per Share:				
Income (Loss) From Continuing Operations	$ (0.55)	$ 0.17	$ (0.50)	$ 0.23
Income (Loss) from Operations of Discontinued Operations	(0.02)	.00	(0.01)	.01
Net Income (Loss)	$ (0.57)	$ 0.17	$ (0.51)	$ 0.24
Diluted Income (Loss) Per Share:				
Income (Loss) From Continuing Operations	$ (0.55)	$ 0.17	$ (0.50)	$ 0.23
	(0.02)	.00	(0.01)	.01

Income (Loss) from Operations of Discontinued Operations				
Net Income (Loss)	$ (0.57)	$ 0.17	$ (0.51)	$ 0.24
Weighted Average Shares Used in Computing Basic and Diluted Income (Loss) Per Share:				
Basic	37,639	37,471	37,609	37,366
Diluted	37,639	37,652	37,609	37,572

See Accompanying Notes to
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FLOW INTERNATIONAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited; in thousands)

	Nine Months Ended January 31, 2009	Nine Months Ended January 31, 2008 (Restated, see Note 17)
Cash Flows from Operating Activities:		
Net Income (Loss)	$ (19,345)	$ 9,019
Adjustments to Reconcile Net Income (Loss) to Cash (Used in) Operating Activities:		
Depreciation and Amortization	3,210	2,636
Deferred Income Taxes	(7,375)	(673)
Provision for Slow Moving and Obsolete Inventory	199	1,151
Bad Debt Expense	1,048	1,652
Warranty Expense	2,423	2,566
Incentive Stock Compensation Expense	1,473	675
Repurchase of Warrants		629
Unrealized Foreign Exchange Currency Losses (Gains)	1,524	(85)
Provision for Patent Litigation	29,000	
Goodwill Impairment	2,764	
Other	419	345
Changes in Operating Assets and Liabilities:		
Receivables	(2,287)	(8,976)
Inventories	1,849	(3,499)
Other Operating Assets	(4,798)	682
Accounts Payable	(5,854)	(4,117)
Accrued Payroll and Payroll Related Liabilities	(2,319)	816
Deferred Revenue	(760)	2,342
Customer Deposits	(678)	(581)
Other Operating Liabilities	(3,454)	(4,786)
Cash (Used in) Operating Activities	(2,961)	(204)
Cash Flows From Investing Activities:		
Expenditures for Property and Equipment	(6,251)	(4,345)
Expenditures for Intangible Assets	(611)	(388)
Proceeds from Sale of Short-term Investments		639
Proceeds from Sale of Property and Equipment	118	247
Payments for Pending OMAX Acquisition	(4,182)	(6,430)
Payments for Dardi Investment	(3,282)	
Restricted Cash	(304)	
Cash (Used in) Investing Activities	(14,512)	(10,277)
Cash Flows from Financing Activities:		

Repayments Under Notes Payable		(5,892)
Borrowings Under Notes Payable	1,285	460
Borrowings Under Other Financing Arrangements	1,269	
Repayments Under Other Financing Arrangements	(232)	
Payments of Capital Lease Obligations	(85)	
Payments of Long-Term Obligations	(795)	(625)
Proceeds from Exercise of Stock Options		1,198
Payment for Warrant Repurchase		(3,010)
Cash Provided by (Used in) Financing Activities	1,442	(7,869)
Effect of Changes in Exchange Rates	39	459
Decrease in Cash And Cash Equivalents	(15,992)	(17,891)
Cash and Cash Equivalents at Beginning of Period	29,099	38,288
Cash and Cash Equivalents at End of Period	$ 13,107	$ 20,397
Supplemental Disclosures of Noncash Investing and Financing Activities:		
Accounts Payable incurred to acquire Property and Equipment, and Intangible Assets	787	357
Accrued Liabilities Incurred for Dardi Investment and Pending Acquisition	551	789

See Accompanying Notes to Condensed Consolidated Financial Statements

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FLOW INTERNATIONAL CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY
AND COMPREHENSIVE INCOME (LOSS)
(unaudited, in thousands)

	Common Stock Shares	Common Stock Par Value	Capital In Excess of Par	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balances, May 1, 2007	37,268	$ 367	$ 139,207	$ (69,395)	$ (8,955)	$ 61,224
Components of Comprehensive Income:						
Net Income (restated, see Note 17)				9,019		9,019
Cumulative Translation Adjustment, Net of Income Tax of $288					2,382	2,382
Total Comprehensive Income (restated, see Note 17)						11,401
Cumulative effect upon adoption of FIN 48				(543)		(543)
Exercise of Options	252	3	1,195			1,198
Repurchase of Warrants			(2,380)			(2,380)
Stock Compensation	66	1	675			676
Balances, January 31, 2008 (restated, see Note 17)	37,586	$ 371	$ 138,697	$ (60,919)	$ (6,573)	$ 71,576
Balances, May 1, 2008	37,590	$ 371	$ 139,007	$ (47,584)	$ (5,730)	$ 86,064
Components of Comprehensive Income (Loss):						
Net Loss				(19,345)		(19,345)
Cumulative Translation Adjustment, Net of Income Tax of $395					(1,416)	(1,416)
Total Comprehensive Income (Loss)						(20,761)
Stock Compensation	63	0	1,463			1,463
Balances, January 31, 2009	37,653	$ 371	$ 140,470	$ (66,929)	$ (7,146)	$ 66,766

See Accompanying Notes to
Condensed Consolidated Financial Statements

FLOW INTERNATIONAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(All tabular dollar amounts in thousands, except per share amounts)
(Unaudited)

Note 1 Basis of Presentation

In the opinion of the management of Flow International Corporation (the Company), the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring items and accruals necessary to fairly present the financial position, results of operations and cash flows of the Company. The financial information as of April 30, 2008 is derived from the Company s audited consolidated financial statements and notes thereto for the fiscal year ended April 30, 2008 included in Item 8 in the fiscal year 2008 Annual Report on Form 10-K (10-K). These interim condensed consolidated financial statements do not include all information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, and should be read in conjunction with the Company s fiscal year 2008 Form 10-K. The preparation of these interim condensed consolidated financial statements requires management to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the Company s financial statements. The results of operation for the three months ended January 31, 2009, includes amounts related to vacation accrual and certain other items which were not recorded in the Company s results of operation for the three months ended July 31, 2008, and the three and six months ended October 31, 2008. The effect of the correction of these errors resulted in an aggregate increase of $888,000 to pretax loss and $491,000 to net loss for the three and nine months ended January 31, 2009, respectively, which the Company deemed to be immaterial when considered in relation to the estimated full fiscal year results of operation and the trend of operating results. Operating results for the three and nine months ended January 31, 2009 may not be indicative of future results, and actual results may differ from these estimates.

Historically, the most significant sources of financing for the Company have been funds generated by operating activities, available cash and cash equivalents and available lines of credit. From time to time, the Company has borrowed funds from its available revolving credit facility. On March 10, 2009, the Company amended certain terms under its Credit Facility Agreement, as discussed in Note 6 *Long-term Obligations and Notes Payable* to the Condensed Consolidated Financial Statements, reducing the amount available under the Line of Credit from $65 million to $40 million and, for the three months ended January 31, 2009, amending certain definitions of the financial covenants to exclude the $29 million provision for patent litigation with OMAX from the calculation of Consolidated Adjusted Earnings before Interest Taxes Depreciation and Amortization (EBITDA). In connection with the amendment, on March 11, 2009, the Company borrowed $15 million under such Line of Credit. The Company has the ability to draw funds from its Line of Credit as needed, subject to the financial covenants. The Company is currently in negotiations with its lenders to further amend the terms of its Line of Credit on a longer-term basis, including amending certain financial covenants to allow for, among other items, the exclusion of the $29 million provision for patent litigation with OMAX from Consolidated Adjusted EBITDA in periods subsequent to January 31, 2009. In the event the exclusion of the $29 million from Consolidated Adjusted EBITDA is not amended for subsequent periods, it is probable the Company would be in violation of certain financial covenants under the credit facility, as early as the fourth quarter in fiscal year 2009. In this event, the $15 million borrowed under the Line of Credit would become due and payable immediately unless the Company obtained a waiver. The Company believes that it is likely that it will be able to amend the terms of the Line of Credit so that it will not be in violation of its financial covenants in future periods, however, there can be no assurance that it will obtain the amendment or, if it does, on reasonable terms. Additionally, in the event that the Company is unable to obtain an amendment it would be unable to repay the amount due and would need to seek replacement financing. The Company s ability to obtain replacement financing could be constrained by current economic conditions affecting the credit and equity markets, which have significantly deteriorated over the last several months, and may further decline, resulting in significantly higher interest rates and related charges, may impose significant restrictions on the use of borrowed funds or may be on terms that are not acceptable to the Company, which raises substantial doubt about the Company s going concern assumption. The financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company s ability to continue as a going concern is dependent on amending the financial covenants of its credit facility on a long-term basis or obtaining replacement financing.

Note 2 Recently Issued Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Defining Fair Value Measurement (SFAS 157), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 became effective for the Company as of May 1, 2008. In February 2008, the FASB issued FSP 157-2, Partial Deferral of the Effective Date of Statement 157 (FSP No. 157-2). FSP 157-2 delays the effective date of SFAS 157, for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. The Company therefore adopted SFAS 157 solely as it applies to its financial assets and liabilities. This adoption at May 1, 2008 did not have a material impact on the financial statements of the Company. See *Note 15 Fair Value of Financial Instruments* for additional disclosure on the adoption of SFAS 157. Nonfinancial assets and nonfinancial liabilities for which we have not applied the provisions of FAS 157 include those measured at fair value like goodwill and indefinite lived intangible asset impairment testing, and asset retirement obligations initially measured at fair value. The Company is currently evaluating the impact of adopting SFAS 157 for its nonfinancial assets and nonfinancial liabilities on its Consolidated Financial Statements at the beginning of its fiscal year 2010. On October 10, 2008, the FASB issued FSP No. 157-3, (FSP No. 157-3), Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active. FSP No. 157-3 clarifies the application of SFAS 157 in a market that is not active and provides factors to take into consideration when determining the fair value of an asset in an inactive market. FSP No. 157-3 was effective upon issuance, including prior periods for which financial statements have not been issued. This FSP did not have a material impact on our condensed consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 was effective for the Company in the first quarter of its fiscal year 2009. SFAS 159 provides entities the option to choose to measure eligible items at fair value at specified election dates. If elected, an entity must report unrealized gains and losses on the item in earnings at each subsequent reporting date. The fair value option may be applied instrument by instrument, and with a few exceptions, such as investments otherwise accounted for by the equity method, is irrevocable (unless a new election date occurs); and is applied only to entire instruments and not to portions of instruments. The Company did not elect to apply the fair value option to any of its financial instruments.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations (SFAS 141R) and Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51 (SFAS 160). These new standards are the U.S. GAAP outcome of a joint project with the International Accounting Standards Board. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141R requires that the fair value of the purchase price of an acquisition including the issuance of equity securities be determined on the acquisition date; requires that all assets, liabilities, contingent consideration, contingencies, and in-process research and development costs of an acquired business be recorded at fair value at the acquisition date; requires that acquisition costs generally be expensed as incurred; requires that restructuring costs generally be expensed in periods subsequent to the acquisition date; and requires that changes in deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period impact income tax expense. SFAS 160 establishes reporting requirements that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. As of January 31, 2009, the Company had $12.4 million of deferred acquisition costs related to the pending merger with OMAX, which included $3.4 million of direct transaction costs that had been capitalized as part of the cost of the acquisition under SFAS 141R. Under SFAS 141R, the Company has the option to expense these costs in the fourth quarter of its fiscal year 2009 should it be deemed probable that the transaction with OMAX will not close prior to the adoption of SFAS 141R on May 1, 2009. The Company continues to evaluate the impact of adopting SFAS 141R and SFAS 160 on its Consolidated Financial Statements at the beginning of its fiscal year 2010.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (SFAS 161), which requires enhanced disclosures about a company s derivative and hedging activities. The Company adopted SFAS 161 at the beginning of its interim period ended January 31, 2009, which did not have a material impact on the Consolidated Financial Statements.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS 162). The new standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with generally accepted accounting principles (GAAP) for nongovernmental entities in the United States. SFAS 162 is effective 60 days following SEC approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company does not anticipate that the adoption of this standard will have a material impact on the Consolidated Financial Statements.

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Note 3 Receivables, Net

Receivables, net as of January 31, 2009 and April 30, 2008 consisted of the following:

	January 31, 2009	April 30, 2008
Trade Accounts Receivable	$ 30,014	$ 32,410
Unbilled Revenues	6,098	4,589
	36,112	36,999
Less: Allowance for Doubtful Accounts	(2,910)	(3,367)
	$ 33,202	$ 33,632

Note 4 Inventories

Inventories are stated at the lower of cost (determined by using the first-in first-out or average cost method) or market. Costs included in inventories consist of materials, labor, and manufacturing overhead, which are related to the purchase or production of inventories. Write-downs, when required, are made to reduce excess inventories to their estimated net realizable values. Such estimates are based on assumptions regarding future demand and market conditions. If actual conditions become less favorable than the assumptions used, an additional inventory write-down may be required. Inventories as of January 31, 2009 and April 30, 2008 consisted of the following:

	January 31, 2009	April 30, 2008
Raw Materials and Parts	$ 14,417	$ 19,671
Work in Process	2,035	3,215
Finished Goods	8,585	6,453
	$ 25,037	$ 29,339

Note 5 Other Accrued Liabilities

The Company s other accrued liabilities consist of warranty obligations, restructuring liabilities, professional fee accruals, provisions for litigation, and other items.

Warranty Obligations

The Company s estimated obligations for warranty are accrued concurrently with the revenue recognized. The Company makes provisions for its warranty obligations based upon historical costs incurred for such obligations adjusted, as necessary, for current conditions and factors. Due to the significant uncertainties and judgments involved in estimating the Company s warranty obligations, including changing product designs and specifications, the ultimate amount incurred for warranty costs could change in the near term from the current estimate.