

FLOW INTERNATIONAL CORP

Form 10-Q

March 16, 2004

Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended January 31, 2004

OR

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

For the transition period from _____ to _____

Commission file number 0-12448

FLOW INTERNATIONAL CORPORATION

WASHINGTON
(State or other jurisdiction)

91-1104842
(I.R.S. Employer)

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of incorporation or organization)

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 No .

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

The number of shares outstanding of common stock, as of March 8, 2004 is 15,358,759 shares.

Table of Contents

FLOW INTERNATIONAL CORPORATION

INDEX

	<u>Page</u>
Part I - <u>FINANCIAL INFORMATION</u>	
Item 1. <u>Condensed Consolidated Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets - January 31, 2004 and April 30, 2003.</u>	3
<u>Condensed Consolidated Statements of Operations - Three and Nine Months Ended January 31, 2004 and 2003</u>	4
<u>Condensed Consolidated Statements of Cash Flows - Nine Months Ended January 31, 2004 and 2003</u>	5
<u>Condensed Consolidated Statements of Comprehensive Operations - Three and Nine Months Ended January 31, 2004 and 2003</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	14
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	23
Item 4. <u>Controls and Procedures</u>	23
Part II - <u>OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	25
Item 2. <u>Changes in Securities and Use of Proceeds</u>	25
Item 3. <u>Defaults Upon Senior Securities</u>	25
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	25
Item 5. <u>Other Information</u>	25
Item 6. <u>Exhibits and Reports on Form 8-K</u>	25
<u>Signatures</u>	26

Table of Contents**FLOW INTERNATIONAL CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS**

(unaudited; in thousands, except share amounts)

	January 31, 2004	April 30, 2003
	<u> </u>	<u> </u>
<u>ASSETS</u>		
Current Assets:		
Cash and Cash Equivalents	\$ 16,369	\$ 15,045
Receivables, Net	32,143	34,600
Inventories, Net	29,297	40,883
Deferred Income Taxes	1,130	957
Assets of Discontinued Operations		1,191
Other Current Assets	7,550	7,464
	<u> </u>	<u> </u>
Total Current Assets	86,489	100,140
Property and Equipment, Net	14,484	12,987
Patents and Other Intangible Assets, Net	11,916	11,866
Goodwill	10,891	10,141
Other Assets	8,087	11,130
	<u> </u>	<u> </u>
	<u>\$ 131,867</u>	<u>\$ 146,264</u>
<u>LIABILITIES, MINORITY INTEREST AND SHAREHOLDERS (DEFICIT) EQUITY</u>		
Current Liabilities:		
Notes Payable	\$ 4,417	\$ 4,610
Current Portion of Long-Term Obligations	45,037	23
Accounts Payable	12,301	12,250
Accrued Payroll and Related Liabilities	6,368	4,512
Other Accrued Taxes	1,748	58
Deferred Revenue	1,884	4,803
Customer Advances	12,370	5,159
Other Accrued Liabilities	13,933	19,499
	<u> </u>	<u> </u>
Total Current Liabilities	98,058	50,914
Long-Term Obligations	32,416	83,775
Other Long-Term Liabilities	4,187	3,791
	<u> </u>	<u> </u>
Total Liabilities	134,661	138,480
	<u> </u>	<u> </u>
Commitments and Contingencies		
Minority Interest	2,315	2,325
	<u> </u>	<u> </u>
Shareholders (Deficit) Equity		
Series A 8% Convertible Preferred Stock \$.01 par value, 1,000,000 shares authorized, none issued		
Common Stock - \$.01 par value, 29,000,000 shares authorized, 15,358,759 shares outstanding at January 31, 2004 and at April 30, 2003	154	154
Capital in Excess of Par	56,234	55,869
Accumulated Deficit	(52,386)	(40,806)

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Accumulated Other Comprehensive Loss	(9,111)	(9,758)
Total Shareholders' (Deficit) Equity	(5,109)	5,459
	\$ 131,867	\$ 146,264

See Accompanying Notes to
Condensed Consolidated Financial Statements

- 3 -

Table of Contents**FLOW INTERNATIONAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(unaudited; in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	January 31,		January 31,	
	2004	2003	2004	2003
Revenues	\$ 42,382	\$ 30,546	\$ 123,253	\$ 112,381
Cost of Sales	25,813	31,013	77,681	85,371
Gross Margin	16,569	(467)	45,572	27,010
Expenses:				
Sales and Marketing	6,531	10,827	19,766	27,047
Research and Engineering	2,974	3,696	8,863	10,324
General and Administrative	5,697	7,357	16,650	16,626
Restructuring	1,312		3,614	
Goodwill Impairment		7,145		7,145
	16,514	29,025	48,893	61,142
Operating Income (Loss)	55	(29,492)	(3,321)	(34,132)
Interest Expense, Net	3,009	3,198	9,776	8,201
Other (Income) Expense, Net	(2,590)	3,233	(2,771)	4,052
Loss Before Provision for Income Taxes	(364)	(35,923)	(10,326)	(46,385)
Provision for Income Taxes	(775)	(5,312)	(1,780)	(7,831)
Loss Before Discontinued Operations	(1,139)	(41,235)	(12,106)	(54,216)
Discontinued Operations, Net of Tax		(384)	526	(241)
Net Loss	\$ (1,139)	\$ (41,619)	\$ (11,580)	\$ (54,457)
Basic and Diluted Loss Per Share:				
Loss Before Discontinued Operations	\$ (.07)	\$ (2.68)	\$ (.78)	\$ (3.53)
Effect of Discontinued Operations, Net of Tax		(.03)	.03	(.02)
Net Loss	\$ (.07)	\$ (2.71)	\$ (.75)	\$ (3.55)
Weighted Average Shares Used in Computing Basic and Diluted Loss Per Share				
Basic	15,359	15,359	15,359	15,345
Diluted	15,359	15,359	15,359	15,345

See Accompanying Notes to

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Condensed Consolidated Financial Statements

- 4 -

Table of Contents**FLOW INTERNATIONAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(unaudited; in thousands)

	Nine Months Ended January 31,	
	2004	2003
Cash Flows from Operating Activities:		
Net Loss	\$ (11,580)	\$ (54,457)
Adjustments to Reconcile Net Loss to Cash Provided by (Used In) Operating Activities:		
Depreciation and Amortization	4,817	7,638
Gain on Sale of Discontinued Operations	(650)	
Gain on Sale of Equity Securities	(2,618)	
Deferred Taxes	310	7,095
Goodwill Impairment		7,145
Loss on Valuation of Operating Assets		8,052
Provision for Losses on Trade Accounts Receivable	187	3,269
Provision for Losses on Inventory		3,272
Other Non-Cash Items	1,169	884
	<u>(8,365)</u>	<u>(17,102)</u>
Decrease in Receivables	3,045	18,966
Decrease (Increase) in Inventory	12,625	(6,085)
Decrease (Increase) in Other Operating Assets	389	(1,257)
Increase (Decrease) in Customer Advances	6,539	(6,542)
(Decrease) Increase in Other Operating Liabilities	(1,037)	2,522
	<u>13,196</u>	<u>(9,498)</u>
Cash Provided by (Used in) Operating Activities		
Cash Flows from Investing Activities:		
Expenditures for Property and Equipment	(5,009)	(3,635)
Proceeds from Sale of Property and Equipment		2,769
Proceeds from Sale of Discontinued Operations	1,837	
Proceeds from Sale of Equity Securities	3,275	
Other	354	
	<u>457</u>	<u>(866)</u>
Cash Provided by (Used in) Investing Activities		
Cash Flows from Financing Activities:		
(Repayments) Borrowings under Line of Credit Agreements, Net	(12,389)	11,421
Payments of Long-Term Obligations, Net	(880)	(4,856)
Proceeds from Issuance of Common Stock		428
	<u>(13,269)</u>	<u>6,993</u>
Cash (Used In) Provided by Financing Activities		
Effect of Changes in Exchange Rates	940	2,850
	<u>1,324</u>	<u>(521)</u>
Increase (Decrease) in Cash and Cash Equivalents		

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Cash and Cash Equivalents at Beginning of Period	15,045	7,120
Cash and Cash Equivalents at End of Period	\$ 16,369	\$ 6,599
<u>Supplemental Disclosure of Noncash Financing Activity</u>		
Conversion of Interest Payable to Long-Term Obligations	\$ 5,250	\$

See Accompanying Notes to
Condensed Consolidated Financial Statements

- 5 -

Table of Contents**FLOW INTERNATIONAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE OPERATIONS**

(unaudited, in thousands)

	Three Months Ended January 31,	
	2004	2003
Net Loss	\$ (1,139)	\$ (41,619)
Other Comprehensive Income (Loss):		
Reclassification Adjustment, Net of Tax	(1,589)	
Unrealized Gain on Equity Securities Available for Sale, Net of Tax		469
Unrealized Gain (Loss) on Cash Flow Hedges, Net of Tax	493	(32)
Cumulative Translation Adjustment	(141)	3,851
Comprehensive Loss	<u>\$ (2,376)</u>	<u>\$ (37,331)</u>
	Nine Months Ended January 31,	
	2004	2003
Net Loss	\$ (11,580)	\$ (54,457)
Other Comprehensive Income:		
Reclassification Adjustment, Net of Tax	(809)	
Unrealized Gain on Equity Securities Available for Sale, Net of Tax		663
Unrealized Gain on Cash Flow Hedges, Net of Tax	516	62
Cumulative Translation Adjustment	940	5,081
Comprehensive Loss	<u>\$ (10,933)</u>	<u>\$ (48,651)</u>

See Accompanying Notes to

Condensed Consolidated Financial Statements

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Nine Months Ended January 31, 2004

(unaudited)

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. These interim financial statements do not include all information and footnote 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 April 30, 2003 consolidated financial statements included in the Company's Annual Report filed with the Securities and Exchange Commission on Form 10-K. The preparation of these 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. Actual results may differ from these estimates under different assumptions or conditions. Operating results for the three and nine months ended January 31, 2004 may not be indicative of future results.

2. **Liquidity**

The Company has incurred losses during fiscal 2002, 2003 and year-to-date 2004. In February 2003, the Company announced a comprehensive two-year restructuring plan intended to return the Company to profitability through reductions in headcount, consolidation of facilities and operations, and closure or divestiture of selected operations. The Company has been able to satisfy its needs for working capital and capital expenditures, due in part to its ability to access adequate financing arrangements. The Company expects that operations will continue, with the realization of assets and discharge of liabilities in the ordinary course of business. Compliance with future debt covenants requires the Company to meet its operating projections, which include achieving certain revenues, costs, consistent operating margins, and working capital targets.

The Company believes that its existing cash and credit facilities at January 31, 2004 are adequate to fund its operations through July 31, 2004, the expiration of the Company's credit facility. However, demand for the Company's products and timing of cost reductions are difficult to project. The Company's restructuring initiatives may have unanticipated effects on its business. If the Company fails to achieve its planned revenues, costs and working capital objectives, management believes it has the ability to use its existing cash to meet its current requirements and debt covenants through July 31, 2004.

If the Company is unable to comply with the amended debt covenants, and the lenders are unwilling to waive or amend the debt covenants, certain components of the long-term obligations and notes payable would become callable, and the Company would be required to seek alternative financing. There can be no assurance that alternative sources of financing will be available if required or, if available, may not be on satisfactory terms. If the Company is unable to obtain alternative financing on satisfactory terms, it could have a material adverse effect on the Company's business, and the Company may be required to further curtail capital spending, further reduce expenses, and otherwise modify its planned operations including potentially discontinuing operations. See Note 11 for more information on Notes Payable and Long-Term Obligations.

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

For the Nine Months Ended January 31, 2004

(unaudited)

3. Restructuring

The following table summarizes accrued restructuring activity (in thousands):

	Severance Benefits	Facility Exit Costs	Professional Fees	Other	Total
Q1 restructuring charge	\$ 248	\$	\$ 1,100	\$	\$ 1,348
Q1 cash payments	(248)		(1,100)		(1,348)
<hr/>					
Balance, July 31, 2003					
Q2 restructuring charge	201	296	97	360	954
Q2 cash payments	(201)		(97)	(133)	(431)
Q2 charge-offs				(227)	(227)
<hr/>					
Balance, October 31, 2003		296			296
Q3 restructuring charge	99	492	77	644	1,312
Q3 cash payments		(284)	(77)	(160)	(521)
Q3 charge-offs		(85)		(484)	(569)
<hr/>					
Balance, January 31, 2004	\$ 99	\$ 419	\$	\$	\$ 518

Since May 2003, the Company has been executing on a plan intended to return it profitability through reductions in headcount, consolidation of facilities and operations, and closure or divestiture of selected operations. The Company incurred over \$1.0 million in professional fees associated with the restructuring of its debt on July 29, 2003. The Company further evaluated the workforce and skill levels necessary to satisfy the expected future requirements of the business. As a result, the Company has implemented plans to eliminate redundant positions and realign and modify certain roles based on skill assessments. The Company has recorded restructuring charges of \$3.6 million through January 31, 2004, which included \$548,000 in employee severance related costs for approximately 48 individuals. The Company has provided notification to an additional 20 associates. However, as these associates are required to perform their job duties through their termination date, the Company has continued to reflect this cost in operating expenses. The fiscal 2004 reductions to-date in the global workforce were made across manufacturing, engineering as well as general and administrative functions within the Company. The Company has also recorded \$788,000 of facility exit costs through the nine months ended January 31, 2004 primarily as a result of consolidation of its two Kent facilities into one facility with excess space. Of the total \$3.6 million of restructuring charges recorded through January 31, 2004, \$3.1 million related to Waterjet Systems and \$0.5 million related to Avure Technologies.

The remaining accrued severance costs of \$99,000 as of January 31, 2004 will be paid over the next quarter; and the remaining accrued facility exit costs of \$419,000, which consist of long-term lease commitments, will be paid primarily over the next several years.

During the quarter the Company terminated its relationship with the Food Partners, LLC, an investment banking firm specializing in the food industry, to develop and implement value-maximizing strategic alternatives for Avure Technologies. Those alternatives included the continuation of operations in the present form, operations on a diminished scale, suspension of operations, shutdown, or a complete or partial divestiture. To date, the Company has not received an acceptable offer for the business. In response, the Company has downsized the business and is continuing the operation of Avure Technologies. Recent contract awards of food and General Press orders will consume available capacity at current manufacturing levels through December 2004. The Company continues to review the best options for this segment.

- 8 -

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

For the Nine Months Ended January 31, 2004

(unaudited)

4. Discontinued Operations

At April 30, 2003, the Company reported one of its subsidiaries as a discontinued operation. This wholly owned subsidiary of the Company was involved in the decommissioning of oil wells. On May 16, 2003, the Company consummated the sale of the subsidiary's assets, recording proceeds of \$1.8 million and a gain on the sale of \$650,000, and retains no future interest in the subsidiary. The Company segregated this subsidiary's assets as assets of discontinued operations on the April 30, 2003 Consolidated Balance Sheet and presented the subsidiary's results of operations as discontinued operations, net of applicable taxes, on the Condensed Consolidated Statement of Operations for the three and nine months ended January 31, 2004 and 2003. The subsidiary had no significant liabilities. The results of discontinued operations, for the three and nine months ended January 31, 2004 and 2003, are summarized below:

(in thousands)	Three Months Ended January 31,	
	2004	2003
Net Sales	\$	\$ 319
Loss Before Tax		(384)
Net Loss		(384)

(in thousands)	Nine Months Ended January 31,	
	2004	2003
Net Sales	\$	\$ 1,171
Loss Before Tax	(124)	(241)
Net Loss	(124)	(241)

5. Sale of Long-Term Assets

In January 2004, the Company sold its investment in marketable securities of WGI Heavy Minerals for \$3.3 million and realized a gain of \$2.6 million on the transaction which is reflected in Other Income, net on the Consolidated Statement of Operations for the three and nine months ended January 31, 2004. All proceeds were used to pay down outstanding borrowings and permanently reduce the available borrowing capacity of the senior credit facility. In addition, the Company relinquished its seat on the Board of Directors of WGI Heavy Minerals.

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In December 2003, the Company received \$1.0 million from a customer to prepay a \$1.1 million long-term note receivable which the Company had previously discounted to \$921,000. The difference of \$79,000 was recorded as Other Income, Net.

6. Loss Per Share and Stock-Based Compensation

Basic earnings (loss) per share represents net income (loss) available to common shareholders divided by the weighted average number of shares outstanding during the period. Diluted earnings (loss) per share represents net income (loss) available to common shareholders divided by the weighted average number of shares outstanding including the potentially dilutive impact of stock options and warrants, except when the effect of their inclusion would be anti-dilutive.

- 9 -

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

For the Nine Months Ended January 31, 2004

(unaudited)

The effect of all stock options and a total of 860,000 potentially dilutive shares from warrants have been excluded from the diluted weighted average share denominator for both the three and nine months ended January 31, 2004 and 2003, as their effect would be anti-dilutive.

The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards No. 123 (FAS 123), Accounting for Stock Based Compensation to stock-based employee compensation:

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2004	2003	2004	2003
(in thousands, except per share data)				
Net loss, as reported	\$ (1,139)	\$ (41,619)	\$ (11,580)	\$ (54,457)
Add: Stock compensation under APB 25 included in net loss, net of related tax effects	135	75	241	101
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax related effects	(216)	(75)	(621)	(248)
Pro forma net loss	\$ (1,220)	\$ (41,619)	\$ (11,960)	\$ (54,604)
Loss per share basic and diluted:				
As reported	\$ (.07)	\$ (2.71)	\$ (.75)	\$ (3.55)
Pro forma	\$ (.08)	\$ (2.71)	\$ (.78)	\$ (3.56)

To determine compensation expense under FAS 123, the Company used the following assumptions:

	Fiscal 2004	Fiscal 2003
Risk-free interest rates	3.62% to 3.7%	3.7%
Expected lives	Six years	Six years
Expected dividend yields	0%	0%
Expected volatility	61.1% to 61.6%	55.4% to 58.9%

7. Segment Information

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The Company analyzes its operations based on two reportable segments, Flow Waterjet Systems and Avure Technologies. The Flow Waterjet Systems segment includes cutting and cleaning operations, which are focused on providing total solutions for the aerospace, automotive, job shop, surface preparation and paper industries. The Avure Technologies segment includes the Fresher Under Pressure® food processing technology, as well as the isostatic and flexform press (General Press) operations. The Fresher Under Pressure technology provides food safety and quality enhancement solutions for food producers, while the General Press business manufactures systems which shape and strengthen advanced materials for the aerospace, automotive and medical industries. The accounting policies of the segments are the same as those described in the Summary of Significant Accounting Policies included in the Company's April 30, 2003 Annual Report filed with the Securities and Exchange Commission on Form 10-K. Segment operating results are measured on income (loss) from operations.

- 10 -

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

For the Nine Months Ended January 31, 2004

(unaudited)

A summary of operations by reportable segment is as follows:

(in thousands)	Three Months Ended January 31,		Nine Months Ended January 31,	
	2004	2003	2004	2003
Revenues				
Flow Waterjet Systems	\$ 31,329	\$ 30,213	\$ 97,859	\$ 95,373
Avure Technologies	11,053	333	25,394	17,008
	<u>\$ 42,382</u>	<u>\$ 30,546</u>	<u>\$ 123,253</u>	<u>\$ 112,381</u>
Operating Income (Loss)				
Flow Waterjet Systems	\$ (1,731)	\$ (20,597)	\$ (1,399)	\$ (21,714)
Avure Technologies	1,786	(8,895)	(1,922)	(12,418)
	<u>\$ 55</u>	<u>\$ (29,492)</u>	<u>\$ (3,321)</u>	<u>\$ (34,132)</u>

Inter-segment sales from Flow Waterjet Systems to Avure Technologies amounted to \$315,000 and \$151,000 for the three months ended January 31, 2004 and 2003, respectively, and \$722,000 and \$2.9 million for the nine months ended January 31, 2004 and 2003, respectively.

8. Receivables

Receivables consist of the following:

(in thousands)	January 31, 2004	April 30, 2003
Trade Accounts Receivable	\$ 26,003	\$ 31,107
Unbilled Revenues	11,346	8,512
	<u>37,349</u>	<u>39,619</u>
Less Allowance for Doubtful Accounts	5,206	5,019

	\$ 32,143	\$ 34,600
	<u> </u>	<u> </u>

9. Inventories

Inventories consist of the following:

(in thousands)	January 31, 2004	April 30, 2003
	<u> </u>	<u> </u>
Raw Materials and Parts	\$ 14,809	\$ 22,658
Work in Process	9,263	10,859
Finished Goods	8,266	11,702
	<u> </u>	<u> </u>
	32,338	45,219
Less Provision for Slow-Moving and Obsolete Inventories	3,041	4,336
	<u> </u>	<u> </u>
	\$ 29,297	\$ 40,883
	<u> </u>	