

SYSTEMAX INC
Form 10-Q
August 12, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 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 1-13792

Systemax Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

11-3262067
(I.R.S. Employer
Identification No.)

11 Harbor Park Drive

Port Washington, New York 11050

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: **(516) 608-7000**

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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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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.

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes ☐ No ☒

The number of shares outstanding of the registrant's Common Stock as of August 3, 2009 was 36,841,878

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Available Information

We maintain an internet web site at www.systemax.com. We file reports with the Securities and Exchange Commission (SEC) and make available free of charge on or through this web site our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, including all amendments to those reports. These are available as soon as is reasonably practicable after they are filed with the SEC. All reports mentioned above are also available from the SEC's web site (www.sec.gov). The information on our web site is not part of this or any other report we file with, or furnish to, the SEC.

Our Board of Directors has adopted the following corporate governance documents with respect to the Company (the Corporate Governance Documents):

- Corporate Ethics Policy for officers, directors and employees
- Charter for the Audit Committee of the Board of Directors
- Charter for the Compensation Committee of the Board of Directors
- Charter for the Nominating/Corporate Governance Committee of the Board of Directors
- Corporate Governance Guidelines and Principles

In accordance with the corporate governance rules of the New York Stock Exchange, each of the Corporate Governance Documents is available on our Company web site (www.systemax.com) or can be obtained by writing to Systemax Inc., Attention: Board of Directors (Corporate Governance), 11 Harbor Park Drive, Port Washington, NY 11050.

Table of Contents**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****Systemax Inc.**

Condensed Consolidated Balance Sheets

(In thousands)

| | June 30, 2009 (Unaudited) | December 31, 2008 |
|---|---------------------------------|----------------------|
| ASSETS: | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 87,923 | \$ 115,967 |
| Accounts receivable, net | 173,629 | 182,532 |
| Inventories | 310,014 | 290,594 |
| Prepaid expenses and other current assets | 12,891 | 12,667 |
| Deferred income taxes | 11,588 | 10,423 |
| Total current assets | 596,045 | 612,183 |
| Property, plant and equipment, net | 51,493 | 48,465 |
| Deferred income taxes | 10,245 | 11,452 |
| Goodwill and intangibles | 44,505 | 30,326 |
| Other assets | 714 | 837 |
| Total assets | \$ 703,002 | \$ 703,263 |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | |
| Current liabilities: | | |
| Current portion of capitalized lease obligations | \$ 832 | \$ 773 |
| Accounts payable | 269,714 | 284,378 |
| Accrued expenses and other current liabilities | 65,746 | 73,075 |
| Deferred income taxes | 865 | 865 |
| Total current liabilities | 337,157 | 359,091 |
| Capitalized lease obligations, net of current portion | 1,061 | 1,411 |
| Deferred income taxes | 253 | 254 |
| Other liabilities | 8,243 | 8,552 |
| Total liabilities | 346,714 | 369,308 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Preferred stock | | |
| Common stock | 389 | 389 |
| Additional paid-in capital | 179,931 | 179,241 |
| Treasury stock | (30,719) | (31,158) |
| Retained earnings | 207,590 | 192,401 |
| Accumulated other comprehensive loss, net of tax | (903) | (6,918) |
| Total shareholders' equity | 356,288 | 333,955 |

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| | | | | |
|--|----|---------|----|---------|
| Total liabilities and shareholders' equity | \$ | 703,002 | \$ | 703,263 |
|--|----|---------|----|---------|

See notes to condensed consolidated financial statements.

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Condensed Consolidated Statements of Operations (Unaudited)

(In thousands, except per share amounts)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|------------|------------------------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| Net sales | \$ 721,599 | \$ 756,035 | \$ 1,473,867 | \$ 1,480,772 |
| Cost of sales | 614,545 | 641,281 | 1,259,263 | 1,252,269 |
| Gross profit | 107,054 | 114,754 | 214,604 | 228,503 |
| Selling, general & administrative expenses | 98,385 | 93,639 | 190,915 | 181,352 |
| Operating income | 8,669 | 21,115 | 23,689 | 47,151 |
| Foreign currency exchange (gain) loss | (181) | 59 | 600 | (1,438) |
| Interest and other income, net | (259) | (545) | (544) | (1,323) |
| Interest expense | 149 | 86 | 307 | 136 |
| Income before income taxes | 8,960 | 21,515 | 23,326 | 49,776 |
| Provision for income taxes | 2,469 | 7,974 | 8,137 | 18,174 |
| Net income | \$ 6,491 | \$ 13,541 | \$ 15,189 | \$ 31,602 |
| Net income per common share: | | | | |
| Basic | \$.18 | \$.36 | \$.41 | \$.86 |
| Diluted | \$.17 | \$.36 | \$.41 | \$.84 |
| Weighted average shares outstanding: | | | | |
| Basic | 36,683 | 37,130 | 36,652 | 36,918 |
| Diluted | 36,940 | 37,372 | 36,908 | 37,251 |
| Dividends declared | | | \$ | 1.00 |

See notes to condensed consolidated financial statements.

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Systemax Inc.

Condensed Consolidated Statements of Cash Flows (Unaudited)

(In Thousands)

| | Six Months Ended June 30, | |
|---|------------------------------|-----------|
| | 2009 | 2008 |
| Cash flows from operating activities: | | |
| Net income | \$ 15,189 | \$ 31,602 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 5,407 | 4,846 |
| Provision for deferred income taxes | 185 | 2,183 |
| Provision for returns and doubtful accounts | 1,551 | 891 |
| Compensation expense related to equity compensation plans | 1,629 | 1,785 |
| Excess tax benefit from exercises of stock options | (28) | (1,204) |
| Loss on dispositions and abandonment | 86 | 13 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 11,828 | (8,385) |
| Inventories | (17,325) | (45,295) |
| Prepaid expenses and other current assets | 179 | 5,929 |
| Accounts payable, accrued expenses and other current liabilities | (26,404) | 26,170 |
| Net cash (used in) provided by operating activities | (7,703) | 18,535 |
| Cash flows from investing activities: | | |
| Purchase of Circuit City assets | (14,494) | |
| Purchase of CompUSA | | (30,649) |
| Purchases of property, plant and equipment | (6,207) | (10,729) |
| Proceeds from disposals of property, plant and equipment | 84 | 58 |
| Net cash used in investing activities | (20,617) | (41,320) |
| Cash flows from financing activities: | | |
| Repayments of borrowings from banks | | (2,969) |
| Proceeds from (repayments of) capital lease obligations, net | (291) | 329 |
| Dividends paid | | (37,126) |
| Proceeds from issuance of common stock, net of repurchases | 181 | 908 |
| Repurchase of common stock | (1,174) | |
| Excess tax benefit from exercises of stock options | 28 | 1,204 |
| Net cash used in financing activities | (1,256) | (37,654) |
| Effects of exchange rates on cash | 1,532 | (807) |
| Net decrease in cash and cash equivalents | (28,044) | (61,246) |
| Cash and cash equivalents beginning of period | 115,967 | 128,021 |
| Cash and cash equivalents end of period | \$ 87,923 | \$ 66,775 |
| Supplemental disclosures of non-cash investing and financing activities: | | |
| Acquisitions of equipment through capital leases | \$ 152 | \$ 653 |

See notes to condensed consolidated financial statements.

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Systemax Inc.

Condensed Consolidated Statement of Shareholders' Equity (Unaudited)

(In thousands)

| | Common Stock | | Additional | | Treasury | Retained | Accumulated | Comprehensive |
|--|--------------|--------|------------|-------------|------------|------------|---------------|---------------|
| | Number of | Amount | Paid-in | | Stock, | Earnings | Other | |
| | Shares | | Capital | | At Cost | | Comprehensive | Income |
| | Outstanding | | | | | | Income, | |
| | | | | | | | Net of Tax | |
| Balances, January 1, 2009 | 36,224 | \$ 389 | \$ 179,241 | \$ (31,158) | \$ 192,401 | \$ (6,918) | | |
| Stock-based compensation expense | | | 1,554 | | | | | |
| Issuance of restricted stock | 106 | | (754) | 1,183 | | | | |
| Exercise of stock options | 36 | | (249) | 430 | | | | |
| Repurchase of common stock | (99) | | | (1,174) | | | | |
| Income tax benefit on stock-based compensation | | | 139 | | | | | |
| Change in cumulative translation adjustment | | | | | | | 6,015 | \$ 6,015 |
| Net income | | | | | | 15,189 | | 15,189 |
| Total comprehensive income | | | | | | | | \$ 21,204 |
| Balances, June 30, 2009 | 36,267 | \$ 389 | \$ 179,931 | \$ (30,719) | \$ 207,590 | \$ (903) | | |

See notes to condensed consolidated financial statements.

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Systemax Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The accompanying condensed consolidated financial statements of the Company and its wholly-owned subsidiaries are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America are not required in these interim financial statements and have been condensed or omitted. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to current year presentation.

In the opinion of management, the accompanying condensed consolidated financial statements contain all normal and recurring adjustments necessary to present fairly the financial position of the Company as of June 30, 2009 and the results of operations for the three and six month periods ended June 30, 2009 and 2008, cash flows for the six month periods ended June 30, 2009 and 2008 and changes in shareholders' equity for the six month period ended June 30, 2009. The December 31, 2008 condensed consolidated balance sheet has been derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements as of December 31, 2008 and for the year then ended included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008. The results for the three and six months ended June 30, 2009 are not necessarily indicative of the results for an entire year.

Systemax manages its business and reports using a 52-53 week fiscal year that ends at midnight on the Saturday closest to December 31. For clarity of presentation herein, fiscal years and quarters are referred to as if they ended on the traditional calendar month. The actual fiscal second quarter ended on July 4, 2009. The second quarters of both 2009 and 2008 included 13 weeks, and the six month periods of both 2009 and 2008 included 26 weeks.

2. Acquisitions

On April 5, 2009, the Company entered into an Asset Purchase Agreement with Circuit City Stores, Inc. and Circuit City Stores West Coast, Inc. (the "Sellers"). Pursuant to the Asset Purchase Agreement, on May 19, 2009 the Company acquired certain intellectual property and ecommerce assets owned by the Sellers for \$14.0 million in cash. In addition, the Company will pay the Sellers a royalty based on a percentage of sales over a thirty month period dependent upon levels of sales achieved from the acquired assets, with a minimum payment of \$3.0 million. The Company capitalized legal and other fees incurred of approximately \$0.5 million. The acquisition has been accounted for as an asset purchase rather than a business combination as the acquisition does not meet the definition of a business as defined in Financial Accounting Standards Board Statement No. 141R, "Business Combinations".

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The Company has done a preliminary purchase price allocation and recorded assets of approximately \$4.8 million for Trademarks and Trade Names, \$6.8 million for Domain Names and \$2.9 million for Client Lists. These assets were recorded in the Company's Technology Products business segment. The Company expects to amortize its Client Lists over a 5 year period. All other assets have indefinite lives. The gross carrying amount and accumulated amortization for amortizable intangible assets related to this acquisition at June 30, 2009 was as follows (in thousands):

| | Gross Carrying Amount | | Accumulated Amortization |
|--------------|----------------------------------|----|-------------------------------------|
| Client Lists | \$ 2,928 | \$ | 73 |

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The aggregate amortization expense was approximately \$73,000 for second quarter of 2009. The estimated amortization for future years ending December 31 is as follows (in thousands):

| | | |
|-------|----|-------|
| 2009 | \$ | 368 |
| 2010 | | 591 |
| 2011 | | 591 |
| 2012 | | 591 |
| 2013 | | 591 |
| 2014 | | 196 |
| Total | \$ | 2,928 |

3. Stock-based Compensation Plans

Pre-tax stock-based compensation expense for the six months ended June 30, 2009 and 2008 was \$1,629,000 and \$1,785,000 respectively.

4. Net Income per Common Share

In June 2008, the FASB issued FASB Staff Position No. EITF 03-6-1 Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (EITF 03-6-1). This FSP was issued to clarify that instruments granted in share-based payment transactions can be participating securities prior to the requisite service having been rendered. The guidance in this FSP applies to the calculation of Earnings Per Share (EPS) under Statement 128 for share-based payment awards with rights to dividends or dividend equivalents. Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of EPS pursuant to the two-class method. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period EPS data presented shall be adjusted retrospectively (including interim financial statements, summaries of earnings, and selected financial data) to conform with the provisions of this FSP. The Company adopted EITF 03-6-1 in January 2009. The Company's adoption of EITF 03-6-1 did not have a material impact on its consolidated financial statements.

Net income per common share - basic was calculated based upon the weighted average number of common shares outstanding during the respective periods presented using the two class method of computing earnings per share in accordance with EITF 03-6-1. Net income per common share - diluted was calculated based upon the weighted average number of common shares outstanding and included the equivalent shares for dilutive options outstanding during the respective periods, including unvested options. The dilutive effect of outstanding options issued by the Company is reflected in net income per share - diluted using the treasury stock method. Under the treasury stock method, options will only have a dilutive effect when the average market price of common stock during the period exceeds the exercise price of the options. The weighted average number of stock options outstanding excluded from the computation of diluted earnings per share was 632,000 and 597,000 shares for the three months ended June 30, 2009 and 2008, and 661,000 and 603,000 for the six months ended June 30, 2009 and 2008, respectively, due to their antidilutive effect.

5. Comprehensive Income

Comprehensive income consists of net income and foreign currency translation adjustments, net of tax, and is included in the condensed consolidated statement of shareholders' equity. For the three month periods ended June 30, 2009 and 2008, comprehensive income was \$13,149,000 and \$13,598,000, respectively. For the six month periods ended June 30, 2009 and 2008, comprehensive income was \$21,204,000 and \$33,417,000, respectively.

6. Credit Facilities

The Company maintains a \$120.0 million (which may be increased by up to \$30.0 million, subject to certain conditions) secured revolving credit agreement with a group of financial institutions which provides for borrowings in the United States and United Kingdom. The borrowings are secured by all of the Company's domestic and United Kingdom accounts receivable, the domestic inventories of the Company, general intangibles and the Company's shares of stock in its domestic subsidiaries and the Company's United Kingdom headquarters building. The credit facility expires and the outstanding

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borrowings thereunder are due on October 26, 2010. The revolving credit agreement contains certain financial and other covenants, including maintaining a minimum level of availability and restrictions on capital expenditures, acquisitions and payments of dividends. The Company was in compliance with all of the covenants as of June 30, 2009. As of June 30, 2009, eligible collateral under the agreement was \$114.0 million, total availability was \$101.9 million and there were outstanding letters of credit of \$12.1 million and there were no outstanding advances.

7. Business Exit Costs

During the second quarter of 2009 the Company announced plans to exit its Software Solutions segment as the result of economic conditions and difficulties in marketing the segment's products successfully. The Company expects to incur charges related to this exit activity of approximately \$4.0 to \$5.0 million during 2009. In the second quarter of 2009 the Company incurred approximately \$2.4 million of these charges including \$1.1 million in severances, \$1.2 million in estimated contractual termination costs and \$0.1 million in other costs. These costs were recorded in selling, general & administrative expenses and interest and other income, net in the accompanying condensed consolidated statement of operations.

The following table reconciles the associated liabilities incurred (in thousands):

| | Severance and Personnel Costs | Contract Termination Costs | Other Exit Costs | Total |
|------------------------------|--|----------------------------------|------------------|----------|
| Balance, beginning of period | \$ | \$ | \$ | \$ |
| Charged to expense | 1,064 | 1,262 | 80 | 2,406 |
| Paid or otherwise settled | (372) | (567) | (80) | (1,019) |
| Balance, end of period | \$ 692 | \$ 695 | \$ | \$ 1,387 |

8. Segment Information

Systemax is primarily a direct marketer of brand name and private label products. Our operations are organized in three reportable business segments—Technology Products, Industrial Products and Software Solutions. Our Technology Products segment sells computers, computer supplies and consumer electronics which are marketed in North America and Europe. Except for certain personal computer (PC) products that we assemble ourselves and sell under the trademarks *Systemax* and *Ultra*, substantially all of our products are manufactured by other companies. We also sell certain computer-related products manufactured for us to our own design under the trademark *Systemax* and *Ultra*.

Our Industrial Products segment sells a wide array of material handling equipment, storage equipment and consumable industrial items which are marketed in North America. Substantially all of these products are manufactured by other companies. Some products are manufactured for us to our own design and marketed under the trademarks *Global*, *GlobalIndustrial.com* and *Nexel*.

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The Company announced plans to exit the Software Solutions segment during the second quarter ended June 30, 2009. The Company is in the process of winding down operations and anticipates completing this process by the end of 2009 (See Note 7).

The Company's chief operating decision-maker is the Company's Chief Executive Officer. The Company evaluates segment performance based on operating income, before net interest, foreign exchange gains and losses, internal management fees and income taxes. Corporate costs not identified with the disclosed segments are grouped as Corporate and other expenses. The chief operating decision-maker reviews assets and makes capital expenditure decisions for the Company on a consolidated basis only. The accounting policies of the segments are the same as those of the Company.

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Financial information relating to the Company's operations by reportable segment was as follows (in thousands):

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|--------------------------|---------------------------------------|-------------|-------------------------------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| Net sales: | | | | |
| Technology Products | \$ 672,004 | \$ 694,350 | \$ 1,378,276 | \$ 1,361,647 |
| Industrial Products | 48,848 | 61,617 | 94,504 | 118,979 |
| Software Solutions | 747 | 68 | 1,087 | 146 |
| Consolidated | \$ 721,599 | \$ 756,035 | \$ 1,473,867 | \$ 1,480,772 |
| Operating income (loss): | | | | |