

FRANKLIN ELECTRIC CO INC
Form 10-Q
November 08, 2010

UNITED STATES
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 October 2, 2010

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 0-362

FRANKLIN ELECTRIC CO., INC.
(Exact name of registrant as specified in its charter)

Indiana
(State or other jurisdiction of incorporation or
organization)

35-0827455
(I.R.S. Employer Identification No.)

400 East Spring Street
Bluffton, Indiana
(Address of principal executive offices)

46714
(Zip Code)

(260) 824-2900
(Registrant's telephone number, including area code)

Not Applicable
(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

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 (Section 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, a non-accelerated filer, or a smaller reporting company. See definition 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class of Common Stock	Outstanding at November 3, 2010
\$.10 par value	23,209,516 shares

FRANKLIN ELECTRIC CO., INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FRANKLIN ELECTRIC CO., INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Third Quarter Ended		Nine Months Ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
(In thousands, except per share amounts)				
Net sales	\$188,409	\$166,007	\$538,820	\$481,082
Cost of sales	129,138	115,764	364,643	338,479
Gross profit	59,271	50,243	174,177	142,603
Selling, general and administrative expenses	39,596	33,817	118,599	102,898
Restructuring expenses	242	964	5,343	5,610
Operating income	19,433	15,462	50,235	34,095
Interest expense	(2,254)	(2,471)	(6,745)	(7,245)
Other income/(expense)	763	445	(1,066)	978
Foreign exchange gain/(loss)	(510)	(520)	(200)	(143)
Income before income taxes	17,432	12,916	42,224	27,685
Income taxes	4,960	4,094	10,973	8,801
Net income	12,472	8,822	31,251	18,884
Less: Net income attributable to noncontrolling interests	(253)	(190)	(793)	(579)
Net income attributable to Franklin Electric Co., Inc.	\$12,219	\$8,632	\$30,458	\$18,305
Per share data:				
Basic earnings	\$0.53	\$0.37	\$1.32	\$0.79
Diluted earnings	\$0.52	\$0.37	\$1.30	\$0.79
Dividends per common share	\$0.13	\$0.13	\$0.39	\$0.38

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN ELECTRIC CO., INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands, except share amounts)	October 2, 2010	January 2, 2010
ASSETS		
Current assets:		
Cash and equivalents	\$ 122,149	\$ 86,875
Receivables, less allowances of \$2,826 and \$2,464, respectively	78,807	62,847
Inventories:		
Raw materials	57,932	53,889
Work-in-process	13,231	12,555
Finished goods	83,640	82,288
LIFO reserve	(14,832)	(14,328)
	139,971	134,404
Deferred income taxes	16,123	15,577
Other current assets	14,744	11,890
Total current assets	371,794	311,593
Property, plant and equipment, at cost:		
Land and buildings	83,802	83,917
Machinery and equipment	180,562	188,543
Furniture and fixtures	20,557	18,772
Other	6,846	3,533
Total property, plant and equipment	291,767	294,765
Allowance for depreciation	(148,153)	(147,594)
Total property, plant and equipment, net	143,614	147,171
Assets held for sale	2,325	-
Intangible assets	90,300	88,912
Goodwill	165,162	161,761
Other assets	9,376	8,861
Total assets	\$ 782,571	\$ 718,298

See Notes to Condensed Consolidated Financial Statements.

(In thousands, except share amounts)	October 2, 2010	January 2, 2010
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	\$49,761	\$31,699
Accrued liabilities	64,578	44,261
Income taxes, net	7,990	6,448
Current maturities of long-term debt and short-term borrowings	2,112	735
Total current liabilities	124,441	83,143
Long-term debt	151,820	151,242
Deferred income taxes	12,014	3,266
Employee benefit plan obligations	63,008	74,179
Other long-term liabilities	8,195	8,865
Commitments and contingencies	-	-
Redeemable noncontrolling interest	7,414	7,393
Shareowners' equity:		
Common shares (65,000 shares authorized, \$.10 par value) outstanding (23,206 and 23,128, respectively)	2,321	2,313
Additional capital	125,768	119,133
Retained earnings	302,268	285,467
Accumulated other comprehensive loss	(16,629)	(18,740)
Total shareowners' equity	413,728	388,173
Noncontrolling interest	1,951	2,037
Total equity	415,679	390,210
Total liabilities and equity	\$782,571	\$718,298

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN ELECTRIC CO., INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	Nine Months Ended	
	October 2, 2010	October 3, 2009
Cash flows from operating activities:		
Net income	\$31,251	\$18,884
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	18,638	18,778
Share-based compensation	3,434	4,189
Deferred income taxes	9,047	1,493
(Gain)/loss on disposals of plant and equipment	(1,096)	2,940
Restructuring and asset impairment	2,459	-
Excess tax from share-based compensation arrangements	(667)	(61)
Changes in assets and liabilities:		
Receivables	(10,769)	3,196
Inventories	(2,449)	39,988
Accounts payable and other accrued liabilities	31,507	(1,706)
Income taxes, net	1,374	6,904
Employee benefit plan obligations	(8,956)	(1,755)
Other, net	(4,553)	(4,561)
Net cash flows from operating activities	69,220	88,289
Cash flows from investing activities:		
Additions to property, plant and equipment	(11,326)	(8,215)
Proceeds from sale of property, plant and equipment	1,591	64
Additions to other assets	(333)	-
Cash paid for acquisitions, net of debt and cash acquired	(11,771)	(16,767)
Net cash flows from investing activities	(21,839)	(24,918)
Cash flows from financing activities:		
Proceeds from short-term debt	-	28,000
Repayment of short-term debt	-	(63,000)
Repayment of long-term debt	(712)	(734)
Proceeds from issuance of common stock	1,913	282
Excess tax from share-based compensation arrangements	667	61
Purchases of common stock	(4,390)	-
Dividends paid	(9,311)	(9,002)
Net cash flows from financing activities	(11,833)	(44,393)
Effect of exchange rate changes on cash	(274)	5,317
Net change in cash and equivalents	35,274	24,295
Cash and equivalents at beginning of period	86,875	46,934
Cash and equivalents at end of period	\$122,149	\$71,229
Cash paid for income taxes, net	\$(373)	\$6,242
Cash paid for interest	\$6,754	\$7,254

Non-cash items:

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Additions to property, plant, and equipment, not yet paid	\$1,800	\$25
Payable to seller of Healy Systems, Inc.	\$599	\$1,439
Payable to seller of Western Pumps, LLC	\$-	\$77
Stock in connection with stock option exercises, forfeitures, or stock retirements	\$599	\$-

See Notes to Condensed Consolidated Financial Statements.

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FRANKLIN ELECTRIC CO., INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The accompanying condensed consolidated balance sheet as of January 2, 2010, which has been derived from audited financial statements, and the unaudited interim condensed consolidated financial statements as of October 2, 2010 and for the third quarter and nine months ended October 2, 2010 and October 3, 2009, have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, all accounting entries and adjustments (including normal, recurring accruals) considered necessary for a fair presentation of the financial position and the results of operation for the interim period have been made. Operating results for the third quarter and nine months ended October 2, 2010 are not necessarily indicative of the results that may be expected for the fiscal year ending January 1, 2011. For further information, including a description of Franklin Electric's critical accounting policies, refer to the consolidated financial statements and notes thereto included in Franklin Electric Co., Inc.'s Annual Report on Form 10-K for the year ended January 2, 2010.

2. ACQUISITIONS

In an agreement dated September 3, 2010, between Coverco S.r.l (a wholly owned subsidiary of the Company) and PetroTechnik Limited and its subsidiaries ("Petrotechnik"), the Company acquired all of the outstanding shares of Petrotechnik, net of debt acquired, for approximately £8.4 million, \$12.9 million at the then current exchange rate, subject to certain terms and conditions. The consideration transferred to the sellers consisted of cash.

Petrotechnik, located in Suffolk, United Kingdom, is a leader in the lightweight and flexible underground pipe work systems which are used in a variety of fuel transfer applications and is also the United Kingdom's leading designer and manufacturer of above and below ground fuel storage systems and pressure vessels. Petrotechnik's systems are internationally recognized as being the industry standard and provide the Company access to a worldwide customer base and access to growth territories.

The preliminary intangible assets of \$8.5 million consist primarily of trade names, customer relationships, and goodwill. All of the goodwill was recorded as part of the Fueling Systems segment and is not expected to be deductible for tax purposes.

The purchase price assigned to each major identifiable asset and liability was as follows:

(In millions)

Assets:

Current assets	\$ 12.0
Property, plant and equipment	4.6
Intangible assets	5.1
Goodwill	3.4
Other assets	\$0.1 25.2

Total assets	
Liabilities	(12.3)
Total purchase price	\$12.9

The fair value of the identifiable intangible assets and property, plant and equipment are provisional amounts pending final valuations. The Company utilized management estimates and consultation with an independent third-party valuation firm to assist in the valuation. Acquisition-related costs, included in selling, general and administrative expenses in the Company's statement of income, were \$0.5 million for the nine months ended October 2, 2010.

The results of operations of Petrotechnik were included in the Company's consolidated statement of income, from its acquisition date through the third quarter ended October 2, 2010. The difference between actual sales for the Company and proforma annual sales including Petrotechnik as if it were acquired at the beginning of the year was not material as a component of the Company's consolidated sales for the nine months ending October 2, 2010.

3. FAIR VALUE MEASUREMENTS

Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 825, Financial Instruments, provides a framework for measuring fair value under generally accepted accounting principles. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Disclosures about instruments measured at fair value were expanded and a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value was established. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 – Quoted prices for identical assets and liabilities in active markets;

Level 2 – Quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3 – Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The Company designates the cash equivalents as Level 1, as they are Money Market accounts backed by Treasury Bills. As of October 2, 2010, and January 2, 2010, our assets measured at fair value on a recurring basis were as follows:

		Quoted prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	October 2, (in millions) 2010			
Cash Equivalents	\$ 11.1	\$ 11.1	\$-	\$ -

		Quoted prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	January 2, 2010			
Cash Equivalents	\$ 11.1	\$ 11.1	\$-	\$ -

The following table summarizes information regarding the Company’s non-financial assets measured at fair value on a non-recurring basis:

	Quoted prices in Active Markets for	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Recognized Loss
October 2, 2010				

Identical
Assets
(Level 1)

Assets held for sale	\$2.3	\$-	\$-	\$ 2.3	\$2.4
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During the second quarter of 2010, the Company recorded the impairment as a restructuring expense on property, plant, and equipment relating to the Siloam Springs facility which is classified as held for sale. The fair value was based on appraised values and management estimates less costs to sell. See Note 16 (Restructuring) for discussion of the restructuring plans.

4. EQUITY INVESTMENTS

The Company holds a 35 percent equity interest in Pioneer Pump, Inc., which is accounted for using the equity method and included in "Other assets" on the face of the balance sheet. The carrying amount of the investment is adjusted for the Company's proportionate share of earnings, losses and dividends. The carrying value of the investment was \$8.5 million and \$7.7 million as of October 2, 2010, and January 2, 2010, respectively. The Company's proportionate share of Pioneer Pump, Inc. earnings, included in "Other income/(expense)" in the Company's statements of income was \$0.3 million and zero for the third quarter ended October 2, 2010 and October 3, 2009, respectively, and \$0.7 million and \$0.1 million for the nine months ended October 2, 2010 and October 3, 2009, respectively.

5. INTANGIBLE ASSETS AND GOODWILL

The carrying amounts of the Company's intangible assets are as follows:

(In millions)	October 2, 2010		January 2, 2010	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangibles:				
Patents	\$7.9	\$ (4.7)	\$8.0	\$ (4.3)
Supply agreements	4.4	(3.8)	7.2	(6.2)
Technology	7.3	(2.1)	7.2	(1.7)
Customer relationships	71.0	(12.1)	68.2	(9.5)
Other	1.2	(1.1)	2.1	(2.0)
Total	\$91.8	\$ (23.8)	\$92.7	\$ (23.7)
Unamortized intangibles:				
Trade names	22.3	-	19.9	-
Total intangibles	\$114.1	\$ (23.8)	\$112.6	\$ (23.7)

Amortization expense related to intangible assets for the third quarter ended October 2, 2010 and October 3, 2009 was \$1.3 million and \$1.2 million, respectively, and for the nine months ended October 2, 2010 and October 3, 2009, \$3.8 million and \$3.7 million, respectively.

Amortization expense is projected as follows:

(In millions)	2010	2011	2012	2013	2014
	\$5.3	\$5.9	\$5.5	\$5.3	\$5.1

The changes in the carrying amount of goodwill for the nine months ended October 2, 2010, are as follows:

(In millions)	Water Systems	Fueling Systems	Consolidated
Balance as of January 2, 2010	\$108.4	\$53.4	\$ 161.8
Acquisition	-	3.4	3.4
Adjustments to prior year acquisitions	-	0.9	0.9
Foreign currency translation	(1.0)	-	(1.0)
Balance as of October 2, 2010	\$107.4	\$57.7	\$ 165.1

The 2006 purchase agreement for Healy Systems, Inc. provided for additional payments of 5 percent of certain Healy Systems product sales through August 31, 2011. Adjustments to prior year acquisitions primarily include those contingency commitments to the principal seller of Healy Systems, Inc.

6. EMPLOYEE BENEFIT PLANS

Defined Benefit Plans – As of October 2, 2010, the Company maintained three domestic pension plans and one German pension plan, (the “Pension Plans”). The Company uses a December 31 measurement date for the Pension Plans.

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The following table sets forth aggregated net periodic benefit cost for the third quarter and nine months ended October 2, 2010 and October 3, 2009:

(In millions)	Pension Benefits Third Quarter Ended		Pension Benefits Nine Months Ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
Service cost	\$0.8	\$1.1	\$2.3	\$2.5
Interest cost	2.1	2.7	6.5	7.4
Expected return on assets	(2.2)	(3.0)	(7.4)	(8.1)
Loss	0.4	0.1	1.4	0.2
Prior service cost	0.1	0.1	0.2	0.3
Curtailment cost	-	-	0.9	-
Settlement cost	-	-	0.4	-
Total net periodic benefit cost	\$1.2	\$1.0	\$4.3	\$2.3

The following table sets forth other benefit cost for the third quarter and nine months ended October 2, 2010 and October 3, 2009:

(In millions)	Other Benefits Third Quarter Ended		Other Benefits Nine Months Ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
Service cost	\$-	\$-	\$-	\$-
Interest cost	0.2	0.1	0.6	0.2
Curtailment cost	-	-	0.2	-
Total net periodic benefit cost	\$0.2	\$0.1	\$0.8	\$0.2

Through October 2, 2010, the Company made contributions to the Pension Plans of \$14.3 million. The amount of contributions to be made during plan year 2009 was finalized September 15, 2010 based upon the Pension Plans' year-end valuation at December 31, 2009 and the desired funding level to be achieved as of December 31, 2009.

7. INCOME TAXES

The effective tax rate on income before income taxes in 2010 and 2009 varies from the United States statutory rate of 35 percent primarily due to the effects of state and foreign income taxes net of federal tax benefits, as well as, changes to the reserve for uncertain tax positions, which relate mainly to the reduction in unrecognized tax benefits that were subject to indemnification in acquisition purchase agreements.

8. ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES

As of the beginning of fiscal year 2010, the Company had gross unrecognized tax benefits of \$6.8 million, excluding accrued interest and penalties. The unrecognized tax benefits were reduced by \$0.2 million for state income tax liabilities and \$3.3 million for federal tax liabilities based on evaluations during the first three quarters of 2010. The Company had gross unrecognized tax benefits, excluding accrued interest and penalties, of \$3.3 million as of October 2, 2010. Of the unrecognized tax benefits, \$1.0 million are related to acquisitions occurring prior to 2010 for which indemnification was provided for in the respective purchase agreements. The impact of all unrecognized benefits on the effective tax rate, if recognized, would be the net unrecognized tax benefit of \$2.9 million, which is net of the federal benefit for state tax of \$0.4 million.

The Company recognizes interest and penalties related to unrecognized tax benefits as income tax expense. The Company's reserve for interest and penalties as of October 2, 2010 and as of January 2, 2010 was approximately \$0.4 million and \$0.7 million, respectively. Interest and penalties recorded through the third quarter of 2010 were not considered significant.

The Company is subject to periodic audits by domestic and foreign tax authorities. Currently, the Company is undergoing routine periodic audits in both domestic and foreign tax jurisdictions. It is reasonably possible that the amounts of unrecognized tax benefits could change in the next 12 months as a result of the audits.

For the majority of tax jurisdictions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2007.

9. DEBT

Debt consisted of the following:

(In millions)	October 2, 2010	January 2, 2010
Prudential Agreement - 5.79 percent	\$ 150.0	\$ 150.0
Capital leases	1.0	1.2
Other Debt	2.9	0.7
	153.9	151.9
Less current maturities	(2.1)	(0.7)
Long-term debt:	\$ 151.8	\$ 151.2

The estimated fair value of long term debt was \$158.8 million and \$153.4 million at October 2, 2010 and January 2, 2010 respectively. In the absence of quoted prices in active markets considerable judgment is required in developing estimates of fair value. Estimates are not necessarily indicative of the amounts the Company could realize in a current market transaction. In determining the fair value of its long term debt the Company uses estimates based on rates currently available to the Company for debt with similar terms and remaining maturities.

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The following debt payments are expected to be paid in accordance with the following schedule:

(In millions)

	Total	Year 1	Year 2	Year 3	Year 4	Year 5	More than 5 years
Debt	\$152.9	\$1.6	\$0.7	\$0.6	\$-	\$-	\$150.0
Capital leases	1.0	0.5	0.4	0.1	-	-	-
	\$153.9	\$2.1	\$1.1	\$0.7	\$-	\$-	\$150.0

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10. EARNINGS PER SHARE

Following is the computation of basic and diluted earnings per share:

(In millions, except per share amounts)	Third Quarter Ended		Nine Months Ended	
	October	October	October	October
	2,	3,	2,	3,
Numerator:	2010	2009	2010	2009