POWER ONE INC
Form 10-Q
August 15, 2001

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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 July 1, 2001

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 No. O-29454

POWER-ONE, INC.

(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	**77-0420182** (I.R.S. Employer Identification No.)
740 CALLE PLANO, CAMARILLO, CA (Address of principal executive offices)	**93012** (Zip code)

Registrant's telephone number, including area code **(805) 987-8741**

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 a 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 /x/ No / /

As of August 13, 2001 there were outstanding 78,821,669 shares of common stock, $.001 par value.

POWER-ONE, INC.

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PART I FINANCIAL INFORMATION

ITEM 1 CONSOLIDATED FINANCIAL STATEMENTS

POWER-ONE, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	June 30, 2001	December 31, 2000
	(Unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 84,230	$ 137,113
Accounts receivable:		
Trade, less allowance for doubtful accounts: $3,170 at June 30, 2001; $2,573 at December 31, 2000	110,636	124,306

	June 30, 2001		December 31, 2000	
Other		7,207		7,736
Inventories		149,283		225,121
Refundable income taxes		11,088		
Deferred income taxes		30,950		4,527
Prepaid expenses and other current assets		6,415		4,300
Total current assets		399,809		503,103
PROPERTY & EQUIPMENT, net of accumulated depreciation and amortization: $41,475 at June 30, 2001; $33,144 at December 31, 2000		109,174		104,020
INTANGIBLE ASSETS, net		155,894		162,799
OTHER ASSETS		11,167		12,395
TOTAL ASSETS	$	676,044	$	782,317
LIABILITIES & STOCKHOLDERS' EQUITY				
CURRENT LIABILITIES:				
Bank credit facilities	$	14,846	$	9,279
Current portion of long-term debt		1,540		2,630
Current portion of long-term capital leases		414		558
Bank overdraft		4,226		12,879
Accounts payable		30,638		71,721
Accrued payroll and related expenses		5,228		5,642
Restructuring reserve		7,551		
Other accrued expenses		21,680		23,570
Total current liabilities		86,123		126,279
LONG-TERM DEBT, less current portion		8,324		9,131
LONG-TERM CAPITAL LEASES, less current portion		104		281
DEFERRED INCOME TAXES		10,624		12,319
OTHER LIABILITIES		548		579
STOCKHOLDERS' EQUITY				
Common stock, par value $0.001; 300,000 shares authorized; 78,744 and 78,498 shares issued and outstanding at June 30, 2001 and December 31, 2000, respectively		78		78
Additional paid-in-capital		574,208		564,325
Accumulated other comprehensive loss		(11,505)		(2,188)
Retained earnings		7,540		71,513
Total stockholders' equity		570,321		633,728
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$	676,044	$	782,317

See notes to consolidated financial statements.

POWER-ONE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2001	**June 30, 2000**	**June 30, 2001**	**June 30, 2000**
NET SALES	$ 92,904	$ 113,839	$ 262,756	$ 190,851
COST OF GOODS SOLD	151,816	69,030	259,045	113,986
GROSS PROFIT (LOSS)	(58,912)	44,809	3,711	76,865
EXPENSES:				
Selling, general and administrative	20,663	16,175	41,716	40,079
Engineering and quality assurance	10,589	7,012	21,015	17,622
Amortization of intangible assets	3,654	2,750	7,392	4,072
Restructuring costs	14,091		14,091	
Impairment of fixed assets	11,073		11,073	
Total expenses	60,070	25,937	95,287	61,773
INCOME (LOSS) FROM OPERATIONS	(118,982)	18,872	(91,576)	15,092
OTHER INCOME (EXPENSE)				
Interest income	1,030	432	2,736	1,180
Interest expense	(646)	(1,308)	(1,355)	(1,620)
Other income (expense), net	412	(1,196)	(76)	(1,061)
Total other income (expense)	796	(2,072)	1,305	(1,501)
INCOME (LOSS) BEFORE INCOME TAXES	(118,186)	16,800	(90,271)	13,591
PROVISION (BENEFIT) FOR INCOME TAXES	(37,824)	6,204	(26,298)	4,484
NET INCOME (LOSS)	$ (80,362)	$ 10,596	$ (63,973)	$ 9,107
BASIC EARNINGS (LOSS) PER COMMON SHARE	$ (1.02)	$ 0.14	$ (0.81)	$ 0.13
DILUTED EARNINGS (LOSS) PER COMMON SHARE	$ (1.02)	$ 0.14	$ (0.81)	$ 0.12
BASIC WEIGHTED AVERAGE SHARES OUTSTANDING	78,702	73,258	78,626	72,789
DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	78,702	77,054	78,626	76,105

See notes to consolidated financial statements.

POWER-ONE, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2001	June 30, 2000	June 30, 2001	June 30, 2000
NET INCOME (LOSS)	$ (80,362)	$ 10,596	$ (63,973)	$ 9,107
OTHER COMPREHENSIVE INCOME (LOSS)				
Foreign currency translation adjustment	(2,669)	3,939	(9,317)	2,462
COMPREHENSIVE INCOME (LOSS)	$ (83,031)	$ 14,535	$ (73,290)	$ 11,569

See notes to consolidated financial statements.

POWER-ONE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended	
	June 30, 2001	June 30, 2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (63,973)	$ 9,107
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	16,164	9,428
Asset impairment	14,404	
Tax benefit on exercise of stock options	7,569	
Stock compensation	13	13,312
Loss on disposal of property and equipment	95	7
Deferred income taxes	(27,507)	(893)
Changes in operating assets and liabilities:		
Accounts receivable, net	10,683	(24,498)
Inventories	73,500	(37,610)
Refundable income tax	(11,088)	72
Prepaid expenses and other current assets	(2,230)	(101)
Accounts payable	(41,261)	15,713
Accrued expenses	(1,577)	9,246
Restructuring reserve	5,390	
Income taxes payable	2,890	
Other liabilities	13	(9)

	Six Months Ended	
Net cash used in operating activities	(16,915)	(6,226)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in Powec, net of cash acquired (Note 4)	(6,335)	(72,545)
Telecommunications product line acquired from Eldec (Note 4)		(14,000)
Investment in IPD (Note 5)		(13,000)
Acquisition of property and equipment	(28,396)	(15,740)
Proceeds from sale of property and equipment	29	2
Other assets	865	(2,294)
Net cash used in investing activities	(33,837)	(117,577)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings on bank credit facilities	11,733	87,340
Repayments of borrowings on bank credit facilities	(5,042)	(12,761)
Bank overdraft	(8,377)	454
Proceeds from borrowings on long-term debt	879	54
Repayments of long-term debt	(1,984)	(1,966)
Principal payments under capital lease obligations	(308)	(538)
Issuance of common stock-net	1,643	1,037
Proceeds from notes receivable from stockholders		109
Distributions to stockholders		(865)
Net cash provided by (used in) financing activities	(1,456)	72,864
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(675)	4
DECREASE IN CASH AND CASH EQUIVALENTS	(52,883)	(50,935)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	137,113	63,769
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 84,230	$ 12,834
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid for		
Interest	$ 1,187	$ 1,066
Income taxes	$ 7,723	$ 2,882

SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING ACTIVITIES:

During the three-months ended June 30, 2001, the Company issued 28,154 shares of Company stock valued at $657,000 to the sellers of Powec as additional consideration pursuant to the terms of the acquisition agreement for 2000 operational performance. See Note 4.

See notes to consolidated financial statements.

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POWER-ONE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 BASIS OF PRESENTATION

The accompanying Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. In the opinion of management, adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the period ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. For further information, refer to the consolidated financial statements and notes thereto for the year ended December 31, 2000, included in the Company's 2000 Annual Report on Form 10-K.

The Company's reporting period coincides with the 52- to 53-week period ending on the Sunday closest to December 31 and its fiscal quarters are the 13- to 14-week periods ending on the Sunday nearest to March 31, June 30, September 30 and December 31. For simplicity of presentation, the Company has described the three-month periods ended July 1, 2001 and July 2, 2000 as June 30, 2001 and June 30, 2000, respectively.

All share and per share amounts have been retroactively restated to give effect to the Company's three-for-two stock split that occurred on June 2, 2000 and the Company's two-for-one stock split that occurred on September 11, 2000.

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. In addition, this statement requires hedge accounting when certain conditions are met. This statement is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. We did not hold any derivative financial instruments during 2001 or 2000. As a result, the adoption of SFAS No. 133 did not have a significant effect on the Company's financial position, operations or cash flows.

Recent Pronouncements:

In June 2001, the Financial Accounting Standards Board issued two new pronouncements: Statement of Financial Accounting Standard ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets."

SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Goodwill and certain intangible assets will remain on the balance sheet and not be amortized.

SFAS No. 142 changes accounting for goodwill from an amortization method to an impairment-only approach. Amortization of goodwill, including goodwill recorded from past business combination, will cease on December 31, 2001 upon adoption of this statement. On an annual basis, and when there is reason to believe that their values may have been diminished or impaired, these assets must be tested for impairment, and write-downs may be necessary.

The Company is required to adopt these standards effective January 2002. The Company is currently assessing, but has not yet determined the impact that these statements will have on its financial statements.

NOTE 2 INVENTORIES

Inventories consist of the following (in thousands):

	June 30, 2001	December 31, 2000
Raw materials	$ 112,936	$ 189,131
Subassemblies-in-process	13,296	19,845
Finished goods	23,051	16,145
	$ 149,283	$ 225,121

During the second quarter of 2001, the Company analyzed its inventory position and recorded a charge of $85,148,000 to value its inventory at the lower of cost or market and to write off excess and obsolete inventory. This charge is reflected in cost of goods sold for the three- and six-months ended June 30, 2001.

NOTE 3 EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted average common shares outstanding for the period while diluted earnings per share also includes the dilutive impact of stock options. Basic and diluted earnings (loss) per share for the three-month period ended June 30 are calculated as follows (in thousands, except per share data):

	Three Months Ended June 30, 2001			Three Months Ended June 30, 2000		
	Net (Loss)	Average Shares	Per Share	Net Income	Average Shares	Per Share
Net income (loss)	$ (80,362)			$ 10,596		
Basic EPS Share outstanding		78,702			73,258	
Basic EPS	(80,362)	78,702	$ (1.02)	10,596	73,258	$ .14
Dilutive securities Stock options					3,796	
Diluted EPS	$ (80,362)	78,702	$ (1.02)	$ 10,596	77,054	$ .14

	Six Months Ended June 30, 2001			Six Months Ended June 30, 2000		
	Net (Loss)	Average Shares	Per Share	Net Income	Average Shares	Per Share
Net income (loss)	$ (63,973)			$ 9,107		
Basic EPS Share outstanding		78,626			72,789	
Basic EPS	(63,973)	78,626	$ (.81)	9,107	72,789	$ .13
Dilutive securities Stock options					3,316	
Diluted EPS	$ (63,973)	78,626	$ (.81)	$ 9,107	76,105	$ .12

The dilutive effect of options outstanding at June 30, 2001 was not included in the calculation of diluted loss per share for the three- and six-month periods ended June 30, 2001 because to do so would have had an anti-dilutive effect as the Company had a net loss for both periods. The weighted average number of such options excluded from the diluted loss per share computation was approximately 2,437,000 and 2,846,000 for the three- and six-month periods ended June 30, 2001, respectively.

The Company had approximately 2,548,000 and 26,000 of potential anti-dilutive shares for the three-month periods ended June 30, 2001 and 2000, respectively, and 1,559,000 and 144,000 of potential anti-dilutive shares for the six-month periods ended June 30, 2001 and 2000, respectively.

NOTE 4 ACQUISITIONS

On February 29, 2000, the Company acquired HC Power, Inc. ("HCP"); the former shareholders of HCP received a total of 6,363,621 shares of the Company's common stock for all shares of common stock of HCP outstanding on the effective date of the merger. Of the total shares issued, 636,351 shares were placed in an escrow to fund possible indemnification claims under the merger agreement. The Company authorized distribution of 436,349 shares from the escrow fund on March 30, 2001, reserving 200,002 shares in escrow for potential compensation of a pending claim for indemnification made by the Company on March 21, 2001. The merger has been accounted for as a pooling of interests.

HCP provided for stock bonus incentives to certain key employees. The stock bonus agreements provided for the granting of HCP common stock to the employees over specified vesting periods, ranging from three to 12 years. All stock bonus agreements contained accelerated vesting provisions upon a change in control of HCP. The unvested shares were granted and became vested at the time of the merger with the Company. 812,928 shares of the Company's common stock were issued to the employees of HCP in exchange for the accelerated shares. The Company recorded compensation expense of $13.3 million in the first quarter of 2000 which was based on $16.38 per share, the fair value of the Company's common stock on February 29, 2000.

On May 16, 2000, the Company acquired Norwegian-based Powec AS and the minority interests of certain Powec subsidiaries (collectively referred to as "Powec") for approximately $74.5 million in cash including $2.5 million in acquisition costs, 428,070 shares of the Company's common stock, and assumption of $12.0 million of Powec's debt. The market value of the Company's common stock on the date of acquisition was $29.75 per share. Certain additional payments may be made to former Powec

stockholders based on the attainment of defined operational performance through 2003. During the second quarter of 2001, $6.3 million in cash and 28,154 shares of Company stock valued at $657,000 were paid to the sellers of Powec as additional consideration pursuant to the terms of the acquisition agreement for 2000 operational performance.

On May 16, 2000, the Company also acquired a telecommunications product line from Eldec Corporation, a subsidiary of Crane Co. ("Eldec"), for $14.0 million in cash.

In addition to the shares issued, the purchase of Powec and the telecommunications product line were financed with $20.0 million of the Company's cash and approximately $68.5 million of advances under the Company's credit facility.

The acquisitions of Powec and the telecommunications product line were accounted for using the purchase method of accounting. The net purchase price, plus transaction costs, was allocated to tangible assets and intangible assets. The excess of the aggregate purchase price over the estimated fair values of the net tangible assets acquired was recognized as goodwill and other identifiable intangible assets, and is being amortized over periods ranging from three to 15 years. The fair value of Powec's assets and liabilities, as well as the fair value of the assets and liabilities acquired from Eldec, have been included in the Company's balance sheet as of December 31, 2000. The consolidated statements of operations and comprehensive income (loss) for the three- and six-months ended June 30, 2000, and of cash flows for the six-months ended June 30, 2000 include two months of Powec's operations.

The following unaudited pro forma financial information combines the consolidated results of operations as if the acquisitions of Powec and the telecommunications product line had occurred as of the beginning of the six-month period presented. Pro forma adjustments include only the effects of events directly attributable to the transaction that are expected to have a continuing impact and that are factually supportable. The pro forma amounts contained in the table below include adjustments for amortization or intangibles, assumed interest expense, assumed decrease in interest earned and the related income tax effect of such adjustments. The pro forma amounts for the six-month period ended June 30, 2000 exclude non-recurring items totaling $1.5 million, which consist of an inventory fair market value write-up of $2.0 million, net of related income tax benefit.

Pro forma:	**Six months ended June 30, 2000**	
	(In thousands, except per share amounts)	
Net sales	$	216,521
Net income	$	9,852
Basic earnings per common share	$	0.14
Diluted earnings per common share	$	0.13

NOTE 5 INTANGIBLE ASSETS

Intangible assets include cost in excess of net assets acquired in connection with management's acquisition of the Company in 1995, and the acquisitions of Melcher Holding AG ("Melcher") in 1998, of International Power Devices, Inc. ("IPD") in 1999 and of Powec in 2000, which have been allocated among certain intangible items determined by management to have value, such as the company name, distribution network and product lines. Provision for amortization has been made based upon the

estimated useful lives of the intangible asset categories, which range from three to 20 years, using the straight-line method.

During the second quarter of 2001, the Company paid $7.0 million in cash and stock to the sellers of Powec as earnout consideration pursuant to the terms of the acquisition agreement for 2000 operational performance. This additional consideration has been recorded as an addition to goodwill related to the Powec acquisition.

Intangible assets consist of the following (in thousands):

	June 30, 2001	December 31, 2000
Goodwill and trade name	$ 123,682	$ 122,291
Distribution network	5,207	5,207
Sales force	604	675
Product technology	26,755	27,516
Assembled workforce	1,566	