GARDNER DENVER INC
Form 10-Q
August 07, 2008

Table of Contents

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 June 30, 2008

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 1-13215

GARDNER DENVER, INC.

(Exact name of registrant as specified in its charter)

Delaware	**76-0419383**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1800 Gardner Expressway
Quincy, Illinois 62305
(Address of principal executive offices and Zip Code)
(217) 222-5400
(Registrant s telephone number, including area code)

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 þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a 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 o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 53,222,600 shares of Common Stock, par value $0.01 per share, as of July 27, 2008.

GARDNER DENVER, INC.
Table of Contents

Table of Contents

PART I FINANCIAL INFORMATION
Item 1. Financial Statements

GARDNER DENVER, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Revenues	$ 518,112	$ 459,869	$ 1,013,782	$ 901,287
Cost of sales	350,236	306,037	684,580	598,528
Gross profit	167,876	153,832	329,202	302,759
Selling and administrative expenses	94,281	82,848	179,659	163,870
Operating income	73,595	70,984	149,543	138,889
Interest expense	5,041	6,858	10,641	13,595
Other income, net	(336)	(760)	(577)	(1,506)
Income before income taxes	68,890	64,886	139,479	126,800
Provision for income taxes	19,324	20,115	39,054	39,213
Net income	$ 49,566	$ 44,771	$ 100,425	$ 87,587
Basic earnings per share	$ 0.94	$ 0.84	$ 1.90	$ 1.65
Diluted earnings per share	$ 0.93	$ 0.83	$ 1.87	$ 1.63

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

GARDNER DENVER, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share amounts)

	June 30, 2008 (Unaudited)	December 31, 2007
Assets		
Current assets:		
Cash and equivalents	$ 127,134	$ 92,922
Accounts receivable (net of allowance of $8,130 at June 30, 2008 and $9,737 at December 31, 2007)	329,003	308,748
Inventories, net	262,586	256,446
Deferred income taxes	25,336	21,034
Other current assets	25,870	22,378
Total current assets	769,929	701,528
Property, plant and equipment, net	299,801	293,380
Goodwill	706,137	685,496
Other intangibles, net	210,560	206,314
Other assets	22,672	18,889
Total assets	$ 2,009,099	$ 1,905,607
Liabilities and Stockholders Equity		
Current liabilities:		
Short-term borrowings and current maturities of long-term debt	$ 30,642	$ 25,737
Accounts payable	103,202	101,615
Accrued liabilities	191,868	184,850
Total current liabilities	325,712	312,202
Long-term debt, less current maturities	219,980	263,987
Postretirement benefits other than pensions	16,939	17,354
Deferred income taxes	64,908	64,188
Other liabilities	89,208	88,163
Total liabilities	716,747	745,894
Stockholders equity:		
Common stock, $0.01 par value; 100,000,000 shares authorized; 53,217,157 and 53,546,267 shares issued and outstanding at June 30, 2008 and December 31, 2007, respectively	582	573
Capital in excess of par value	541,706	515,940
Retained earnings	645,509	545,084
Accumulated other comprehensive income	179,102	128,010

Treasury stock at cost; 4,954,080 and 3,758,853 shares at June 30, 2008 and December 31, 2007, respectively	(74,547)	(29,894)
Total stockholders equity	1,292,352	1,159,713
Total liabilities and stockholders equity	$ 2,009,099	$ 1,905,607

The accompanying notes are an integral part of these consolidated financial statements.

4

Table of Contents

GARDNER DENVER, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Cash Flows From Operating Activities		
Net income	$ 100,425	$ 87,587
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	30,281	27,898
Unrealized foreign currency transaction (gain) loss, net	(670)	366
Net loss (gain) on asset dispositions	123	(34)
Stock issued for employee benefit plans	2,557	2,494
Stock-based compensation expense	3,039	3,620
Excess tax benefits from stock-based compensation	(8,479)	(6,170)
Deferred income taxes	(6,922)	(1,474)
Changes in assets and liabilities:		
Receivables	(10,940)	(37,283)
Inventories	5,522	(29,440)
Accounts payable and accrued liabilities	9,252	6,990
Other assets and liabilities, net	(6,789)	(172)
Net cash provided by operating activities	117,399	54,382
Cash Flows From Investing Activities		
Capital expenditures	(20,182)	(17,911)
Net cash paid in business combinations	(217)	(119)
Disposals of property, plant and equipment	1,108	338
Net cash used in investing activities	(19,291)	(17,692)
Cash Flows From Financing Activities		
Principal payments on short-term borrowings	(17,988)	(13,729)
Proceeds from short-term borrowings	17,773	15,973
Principal payments on long-term debt	(110,074)	(93,836)
Proceeds from long-term debt	67,317	49,327
Proceeds from stock option exercises	10,752	8,488
Excess tax benefits from stock-based compensation	8,479	6,170
Purchase of treasury stock	(44,627)	(955)
Other	(1,258)	(958)
Net cash used in financing activities	(69,626)	(29,520)
Effect of exchange rate changes on cash and equivalents	5,730	1,982

Net increase in cash and equivalents	34,212	9,152
Cash and equivalents, beginning of year	92,922	62,331
Cash and equivalents, end of period	$ 127,134	$ 71,483

The accompanying notes are an integral part of these consolidated financial statements.

5

GARDNER DENVER, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except per share amounts and amounts described in millions)
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Gardner Denver, Inc. and its majority-owned subsidiaries (referred to herein as Gardner Denver or the Company). In consolidation, all significant intercompany transactions and accounts have been eliminated.

The financial information presented as of any date other than December 31, 2007 has been prepared from the books and records of the Company without audit. The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation of such financial statements, have been included.

The unaudited interim consolidated financial statements should be read in conjunction with the complete consolidated financial statements and notes thereto included in Gardner Denver s Annual Report on Form 10-K for the year ended December 31, 2007.

The results of operations for the six-month period ended June 30, 2008 are not necessarily indicative of the results to be expected for the full year. The balance sheet at December 31, 2007 has been derived from the audited financial statements as of that date but does not include all of the information and notes required by generally accepted accounting principles for complete financial statements.

Other than as specifically indicated in these Notes to Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, the Company has not materially changed its significant accounting policies from those disclosed in its Form 10-K for the year ended December 31, 2007.

Changes in Accounting Principles and Effects of New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS No. 157), which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. SFAS No. 157 applies whenever other statements require or permit assets or liabilities to be measured at fair value. This statement was effective for the Company on January 1, 2008. In February 2008, the FASB released FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157,* which delayed for one year the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Items in this classification include goodwill, asset retirement obligations, rationalization accruals, intangibles assets with indefinite lives and certain other items. The adoption of the provisions of SFAS No. 157 with respect to the Company s financial assets and liabilities only did not have a significant effect on the Company s consolidated statements of operations, balance sheets and statements of cash flows. The adoption of SFAS No. 157 with respect to the Company s non-financial assets and liabilities, effective January 1, 2009, is not expected to have a significant effect on the Company s consolidated financial statements. See Note 11 Fair Value of Financial Instruments for the disclosures required by SFAS No. 157 regarding the Company s financial instruments measured at fair value.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159), which permits all entities to elect to measure eligible financial instruments and certain other items at fair value. Additionally, this statement establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of financial assets and liabilities. This statement is effective for fiscal years beginning after November 15, 2007 and was adopted by the Company effective January 1, 2008. The Company has currently chosen not to elect the fair value option permitted by SFAS No. 159 for any items that are not already required to be measured at fair value in accordance with

Table of Contents

generally accepted accounting principles. Accordingly, the adoption of this standard had no effect on the Company s consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS No. 141(R)), which establishes principles and requirements for how the acquirer of a business is to (i) recognize and measure in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; (ii) recognize and measure the goodwill acquired in the business combination or a gain from a bargain purchase; and (iii) determine what information to disclose to enable users of its financial statements to evaluate the nature and financial effects of the business combination. This statement requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. This replaces the guidance of SFAS No. 141, *Business Combinations* (SFAS No. 141) which requires the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values. In addition, costs incurred by the acquirer to effect the acquisition and restructuring costs that the acquirer expects to incur, but is not obligated to incur, are to be recognized separately from the acquisition. SFAS No. 141(R) applies to all transactions or other events in which an entity obtains control of one or more businesses. This statement requires an acquirer to recognize assets acquired and liabilities assumed arising from contractual contingencies as of the acquisition date, measured at their acquisition-date fair values. An acquirer is required to recognize assets or liabilities arising from all other contingencies as of the acquisition date, measured at their acquisition-date fair values, only if it is more likely than not that they meet the definition of an asset or a liability in FASB Concepts Statement No. 6, *Elements of Financial Statements.* This Statement requires the acquirer to recognize goodwill as of the acquisition date, measured as a residual, which generally will be the excess of the consideration transferred plus the fair value of any noncontrolling interest in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired. Contingent consideration should be recognized at the acquisition date, measured at its fair value at that date. SFAS No. 141(R) defines a bargain purchase as a business combination in which the total acquisition-date fair value of the identifiable net assets acquired exceeds the fair value of the consideration transferred plus any noncontrolling interest in the acquiree, and requires the acquirer to recognize that excess in earnings as attributable to the acquirer. This statement is effective for 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. Early application is prohibited. The Company is currently evaluating the effect SFAS No. 141(R) will have on its accounting for, and reporting of, business combinations consummated on or after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* (SFAS No. 160). This statement establishes accounting and reporting standards that require (i) ownership interest in subsidiaries held by parties other than the parent be presented and identified in the equity section of the consolidated balance sheet, separate from the parent s equity; (ii) the amount of consolidated net income attributable to the parent and to the noncontrolling interest be identified and presented on the face of the consolidated statement of operations; (iii) changes in a parent s ownership interest while the parent retains its controlling interest be accounted for consistently; (iv) when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value, and the resulting gain or loss be measured using the fair value of any noncontrolling equity investment rather than the carrying amount of that retained investment; and (v) disclosures be provided that clearly identify and distinguish between the interests of the parent and interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, or the Company s 2009 fiscal year. The Company is currently evaluating the effect SFAS No. 160 will have on its financial statements and related disclosure requirements.

In December 2007, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 110, *Certain Assumptions Used in Valuation Methods* (SAB 110). SAB 110 allows public companies which do not have historically sufficient experience to provide a reasonable estimate, to continue use of the simplified method for estimating the expected term of plain vanilla share option grants after December 31, 2007. The Company used the simplified method to determine the expected term for the majority of its 2006 and 2007 option grants. SAB 110 was effective for the Company on January 1, 2008 and, accordingly, the Company will no longer use the simplified method to estimate the expected term of future option grants. The adoption of SAB 110 did not have a material effect on the Company s consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS No. 161). SFAS No. 161 requires enhanced disclosures for derivative instruments and hedging activities, including (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations; and (iii) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. Under SFAS No. 161, entities must disclose the fair value of derivative instruments, their gains or losses and their location in the balance sheet in tabular format, and information about

Table of Contents

credit-risk-related contingent features in derivative agreements, counterparty credit risk, and strategies and objectives for using derivative instruments. The fair value amounts must be disaggregated by asset and liability values, by derivative instruments that are designated and qualify as hedging instruments and those that are not, and by each major type of derivative contract. SFAS No. 161 is effective prospectively for interim periods and fiscal years beginning after November 15, 2008. The Company is currently evaluating the effect SFAS No. 161 will have on its disclosure requirements for derivative instruments and hedging activities.

In April 2008, the FASB issued FASB Staff Position No. 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142), and is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R). FSP FAS 142-3 applies to (i) intangible assets that are acquired individually or with a group of other assets and (ii) intangible assets acquired in both business combinations and asset acquisitions. In developing assumptions about renewal or extension used to determine the useful life of a recognized intangible asset, an entity shall consider its own historical experience in renewing or extending similar arrangements; however, these assumptions should be adjusted for the entity-specific factors described in SFAS No. 142. In the absence of that experience, an entity shall consider the assumptions that market participants would use about renewal or extension, adjusted for the entity-specific factors in SFAS No. 142. FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, or the Company s 2009 fiscal year, and interim periods within those fiscal years. The Company is currently evaluating the effect FSP FAS 142-3 will have on its financial statements and related disclosure requirements.

Note 2. Income Taxes

As of June 30, 2008, the total balance of unrecognized tax benefits was $7.6 million compared with $7.6 million at March 31, 2008 and $7.3 million at December 31, 2007. The increase in the first quarter was primarily a result of changes in foreign currency exchange rates. Included in the unrecognized tax benefits at June 30, 2008 is $1.1 million of uncertain tax positions that would affect the Company s effective tax rate if recognized. The balance of the unrecognized tax benefits, $6.5 million, would be recognized as an adjustment to goodwill if recognized prior to the adoption of SFAS No. 141(R).

The Company expects the following significant changes to its unrecognized tax benefits within the next twelve months: the U.S. federal statutes of limitations with respect to the 2004 tax year will expire on $0.3 million of tax reserves and multiple state statutes of limitations will expire on $2.0 million of tax reserves. The total change in the tax reserves in the next twelve months is expected to be $2.3 million.

The Company s accounting policy with respect to interest expense on underpayments of income tax and related penalties is to recognize such interest expense and penalties as part of the provision for income taxes. The Company s income tax liabilities at June 30, 2008 include approximately $2.3 million of accrued interest, of which approximately $0.8 million relates to goodwill, and no penalties.

The Company s U.S. federal income tax returns for the tax years 2004 and beyond remain subject to examination by the U.S. Internal Revenue Service (the IRS). The IRS, in October 2006, announced an exam of an acquired subsidiary, Thomas Industries Inc. (Thomas), for the year 2004. As of the date of this report, the exam has not commenced. The statutes of limitations for the U.S. state tax returns are open beginning with the 2004 tax year, except for one state for which the statute has been extended beginning with the 2001 tax year.

The Company is subject to income tax in approximately 30 jurisdictions outside the U.S. The statute of limitations varies by jurisdiction with 2001 being the oldest tax year still open, except as noted below. The Company s significant operations outside the U.S. are located in China, the United Kingdom and Germany. In China and the United Kingdom, tax years prior to 2005 are closed. In Germany, generally, the tax years 2003 and beyond remain subject to examination with the statute of limitations for the 2003 tax year expiring during 2008. An acquired subsidiary group is under audit for the tax years 2000 through 2002. In addition, audits are being conducted in various countries for years ranging from 2001 through 2005. To date, no material adjustments have been proposed as a result of these audits.

Table of Contents

Note 3. Inventories

Inventories as of June 30, 2008 and December 31, 2007 consisted of the following:

	June 30, 2008	December 31, 2007
Raw materials, including parts and subassemblies	$ 145,942	$ 142,546
Work-in-process	47,949	47,622
Finished goods	81,940	77,629
	275,831	267,797
Excess of FIFO costs over LIFO costs	(13,245)	(11,351)
Inventories, net	$ 262,586	$ 256,446

Note 4. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill attributable to each business segment for the six-month period ended June 30, 2008, and the year ended December 31, 2007, are presented in the table below. The adjustments to goodwill reflect reallocations of purchase price, primarily related to income tax matters, subsequent to the dates of acquisition for acquisitions completed in prior fiscal years.

	Compressor & Vacuum Products	Fluid Transfer Products	Total
Balance as of December 31, 2006	$ 600,626	$ 76,154	$ 676,780
Adjustments to goodwill	(34,608)	(403)	(35,011)
Foreign currency translation	42,512	1,215	43,727
Balance as of December 31, 2007	608,530	76,966	685,496
Adjustments to goodwill	(1,048)	(64)	(1,112)
Foreign currency translation	20,990	763	21,753
Balance as of June 30, 2008	$ 628,472	$ 77,665	$ 706,137

The following table presents the gross carrying amount and accumulated amortization of identifiable intangible assets, other than goodwill, at the dates presented:

	June 30, 2008		December 31, 2007	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Customer lists and relationships	$ 78,495	$ (18,796)	$ 74,187	$ (16,063)
Acquired technology	46,499	(32,372)	44,658	(28,431)
Other	10,608	(3,515)	9,634	(3,074)
Unamortized intangible assets:				
Trademarks	129,641		125,403	
Total other intangible assets	$ 265,243	$ (54,683)	$ 253,882	$ (47,568)

Amortization of intangible assets for the three and six-month periods ended June 30, 2008 was $3.0 million and $6.0 million, respectively. Amortization of intangible assets for the three and six-month periods ended June 30, 2007 was $3.0 million and $6.3 million, respectively. Amortization of intangible assets is anticipated to be approximately $12.7 million annually in 2008 through 2012, based upon exchange rates as of June 30, 2008 and reflecting intangible assets associated with acquisitions completed through June 30, 2008 (see Note 17 Subsequent Event).

Table of Contents

Note 5. Accrued Product Warranty

A reconciliation of the changes in the accrued product warranty liability for the three and six-month periods ended June 30, 2008 and 2007 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Balance at beginning of period	$ 16,284	$ 15,782	$ 15,087	$ 15,298
Product warranty accruals	3,716	3,626	8,017	7,186
Settlements	(3,157)	(3,409)	(6,710)	(6,564)
Effect of foreign currency translation	15	(538)	464	(459)
Balance at end of period	$ 16,858	$ 15,461	$ 16,858	$ 15,461

Note 6. Pension and Other Postretirement Benefits

The following table summarizes the components of net periodic benefit cost for the Company s defined benefit pension plans and other postretirement benefit plans recognized for the three and six-month periods ended June 30, 2008 and 2007:

	Three Months Ended June 30,					
	Pension Benefits				Other Postretirement Benefits	
	U.S. Plans		Non-U.S. Plans			
	2008	2007	2008	2007	2008	2007
Service cost	$	$	$ 198	$ 1,341	$ 4	$ 4
Interest cost	1,066	1,137	3,161	2,707	282	353
Expected return on plan assets	(1,175)	(1,175)	(3,388)	(2,834)		
Recognition of:						
Unrecognized prior-service cost	4	4			(94)	(111)
Unrecognized net actuarial loss (gain)	55	1	(24)	99	(336)	(207)
Net periodic benefit (income) cost	$ (50)	$ (33)	$ (53)	$ 1,313	$ (144)	$ 39

	Six Months Ended June 30,					
	Pension Benefits				Other Postretirement Benefits	
	U.S. Plans		Non-U.S. Plans			
	2008	2007	2008	2007	2008	2007
Service cost	$	$	$ 386	$ 2,660	$ 8	$ 8
Interest cost	2,132	2,274	6,281	5,369	564	706
Expected return on plan assets	(2,350)	(2,350)	(6,752)	(5,625)		
Recognition of:						
Unrecognized prior-service cost	8	8			(188)	(222)
	110	2	(46)			

Unrecognized net actuarial loss (gain)