RAYOVAC CORP
Form 10-Q
May 12, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 28, 2004

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 001-13615

Rayovac Corporation

(Exact name of registrant as specified in its charter)

Wisconsin (State or other jurisdiction of incorporation or organization)	**22-2423556** (I.R.S. Employer Identification Number)
Six Concourse Parkway, Suite 3300, Atlanta, Georgia (Address of principal executive offices)	**30328** (Zip Code)

(770) 829-6200
(Registrant's telephone number, including area code)

601 Rayovac Drive, Madison, Wisconsin 53711
(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 ý No o

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

The number of shares outstanding of the Registrant's common stock, $.01 par value, as of May 5, 2004, was 34,443,818.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

RAYOVAC CORPORATION
Condensed Consolidated Balance Sheets
March 28, 2004 and September 30, 2003
(Unaudited)
(In thousands)

	March 28, 2004	September 30, 2003
-ASSETS-		
Current assets:		
Cash and cash equivalents, including cash in escrow of $17,133 and $0, respectively	$ 34,334	$ 107,774
Receivables, less allowances of $25,349 and $22,911, respectively	259,753	270,581
Inventories	196,126	219,254
Prepaid expenses and other	87,530	77,717
Total current assets	577,743	675,326
Property, plant and equipment, net	143,960	150,609
Goodwill	246,685	398,380
Intangible assets, net	418,969	252,870
Deferred charges and other	69,099	71,196
Debt issuance costs	27,380	28,111
Total assets	$ 1,483,836	$ 1,576,492
-LIABILITIES AND SHAREHOLDERS' EQUITY-		
Current liabilities:		
Current maturities of long-term debt	$ 11,725	$ 72,852
Accounts payable	134,446	172,632
Accrued liabilities	191,743	160,041
Total current liabilities	337,914	405,525
Long-term debt, net of current maturities	779,887	870,540
Employee benefit obligations, net of current portion	64,423	63,044
Other	40,569	35,381
Total liabilities	1,222,793	1,374,490
Shareholders' equity:		
Common stock, $.01 par value, authorized 150,000 shares; issued 63,819 and 61,999 shares, respectively; outstanding 34,283 and 32,463 shares, respectively	638	620
Additional paid-in capital	216,956	185,561
Retained earnings	189,504	164,703

	March 28, 2004	September 30, 2003
Accumulated other comprehensive loss	(3,420)	(12,457)
Notes receivable from officers/shareholders	(3,605)	(3,605)
	400,073	334,822
Less treasury stock, at cost, 29,536 shares	(130,070)	(130,070)
Less unearned restricted stock compensation	(8,960)	(2,750)
Total shareholders' equity	261,043	202,002
Total liabilities and shareholders' equity	$ 1,483,836	$ 1,576,492

See accompanying notes which are an integral part of these statements.

RAYOVAC CORPORATION
Condensed Consolidated Statements of Operations

For the three and six month periods ended March 28, 2004 and March 30, 2003
(Unaudited)
(In thousands, except per share amounts)

	THREE MONTHS		SIX MONTHS	
	2004	2003	2004	2003
Net sales	$ 278,023	$ 202,267	$ 732,033	$ 462,489
Cost of goods sold	156,320	121,053	417,300	278,016
Restructuring and related charges	(1,137)	1,585	(1,137)	11,290
Gross profit	122,840	79,629	315,870	173,183
Selling	57,397	43,940	158,840	95,549
General and administrative	33,130	19,299	69,643	41,114
Research and development	4,838	4,044	9,140	7,946
Restructuring and related charges	4,932	3,561	6,032	9,246
Total operating expenses	100,297	70,844	243,655	153,855
Operating income	22,543	8,785	72,215	19,328
Interest expense	16,073	9,500	33,424	19,602
Non-operating expense				3,072
Other income, net	(471)	(1,170)	(1,733)	(2,857)
Income (loss) from continuing operations before income taxes	6,941	455	40,524	(489)
Income tax expense (benefit)	2,638	173	15,399	(186)
Income (loss) from continuing operations	4,303	282	25,125	(303)
Loss from discontinued operations, net of tax benefits of $1,055 and $525, respectively	(1,701)		(324)	
Net income (loss)	$ 2,602	282	$ 24,801	$ (303)
Basic earnings per share:				
Weighted average shares of common stock outstanding	33,096	31,797	32,637	31,799
Income (loss) from continuing operations	$ 0.13	$ 0.01	$ 0.77	$ (0.01)
Loss from discontinued operations	(0.05)		(0.01)	
Net income (loss)	$ 0.08	$ 0.01	$ 0.76	$ (0.01)
Diluted earnings per share:				
Weighted average shares and equivalents outstanding	34,469	32,474	33,703	31,799
Income (loss) from continuing operations	$ 0.12	$ 0.01	$ 0.75	$ (0.01)
Loss from discontinued operations	(0.04)		(0.01)	

	THREE MONTHS		SIX MONTHS	
Net income (loss)	$ 0.08	$ 0.01	$ 0.74	$ (0.01)

See accompanying notes which are an integral part of these statements.

RAYOVAC CORPORATION
Condensed Consolidated Statements of Cash Flows
For the six month periods ended March 28, 2004 and March 30, 2003
(Unaudited)
(In thousands)

	SIX MONTHS	
	2004	**2003**
Cash flows from operating activities:		
Net income (loss)	$ 24,801	$ (303)
Non-cash adjustments to net income:		
Discontinued operations	324	
Non-cash restructuring charges	(1,137)	8,472
Depreciation	16,473	16,394
Amortization of intangible assets	474	86
Amortization of debt issuance costs	1,951	935
Amortization of unearned restricted stock compensation	2,799	1,713
Stock option income tax benefit	6,998	124
Deferred income taxes	(4,536)	(8,729)
Other non-cash adjustments	1,709	2,372
Net changes in assets and liabilities, net of acquisitions and discontinued operations	32,646	18,214
Net cash provided by continuing operating activities	82,502	39,278
Cash flows from investing activities:		
Purchases of property, plant and equipment, net	(9,605)	(10,648)
Payment for acquisitions, net of cash acquired	(981)	(245,130)
Net cash used by investing activities	(10,586)	(255,778)
Cash flows from financing activities:		
Reduction of debt	(266,668)	(323,719)
Proceeds from debt financing	106,850	561,521
Extinguishment of debt	(1,002)	
Debt issuance costs	(1,220)	(12,793)
Exercise of stock options	15,405	176
Other	(112)	(713)
Net cash (used) provided by financing activities	(146,747)	224,472
Net cash used by discontinued operations	(315)	
Effect of exchange rate changes on cash and cash equivalents	1,706	(3,201)
Net (decrease) increase in cash and cash equivalents	(73,440)	4,771
Cash and cash equivalents, beginning of period	107,774	9,881

	SIX MONTHS	
Cash and cash equivalents, end of period including cash in escrow	$ 34,334	$ 14,652

See accompanying notes which are an integral part of these statements.

RAYOVAC CORPORATION

Notes to Condensed Consolidated Financial Statements (Unaudited)

(In thousands, except per share amounts)

1 SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation: These financial statements have been prepared by Rayovac Corporation (the "Company"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") and, in the opinion of the Company, include all adjustments (which are normal and recurring in nature) necessary to present fairly the financial position of the Company at March 28, 2004, and the results of operations for the three and six month periods ended March 28, 2004 and March 30, 2003, and cash flows for the six month periods ended March 28, 2004 and March 30, 2003. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such SEC rules and regulations. These condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto as of September 30, 2003. Certain prior amounts have been reclassified to conform with the current presentation.

Significant Accounting Policies and Practices: The consolidated financial statements include the financial statements of Rayovac Corporation and its subsidiaries and are prepared in accordance with accounting principles generally accepted in the United States of America. All intercompany transactions have been eliminated. The Company's fiscal year ends September 30. References herein to 2003 and 2004 refer to the fiscal years ended September 30, 2003 and 2004, respectively.

The Company's Condensed Consolidated Balance Sheets as of March 28, 2004 and September 30, 2003 give effect to the acquisition of Remington Products Company, L.L.C., ("Remington"), which occurred on September 30, 2003. The Company's Condensed Consolidated Statements of Operations for the three and six months ended March 30, 2003, include only the results attributable to Rayovac and its subsidiaries prior to the Remington acquisition. Consequently, all Condensed Consolidated Statements of Operations footnote disclosures exclude the results of Remington for the three and six months ended March 30, 2003. See footnote 10, Acquisitions, for additional information on the Remington acquisition.

Change in Accounting Policy: In previous years, the Company deferred certain advertising costs incurred on an interim basis in accordance with APB 28. The Company chose the deferral method to match advertising expenses to the level of sales on an interim basis (i.e., more advertising expenses were recognized in quarters in which the level of sales was higher) as management believed that the benefits of the advertising expenditures extended beyond the interim period in which the expenditures were made. However, in the Company's annual financial statements, there was no deferral of advertising costs incurred and the Company recognized advertising costs in accordance with the American Institute of Certified Public Accountants' Statement of Position No. 93-7, *Reporting on Advertising Costs*. The acquisition of Remington on September 30, 2003, resulted in an increased level of advertising expenditures required for Remington's electric personal care products, as well as expenses that are more seasonal in nature, as compared to the Company's legacy battery products. Therefore, during 2004, the Company began expensing all advertising costs in the period in which they are incurred for interim reporting purposes. This change has no impact on the reported results for prior fiscal years. Management believes the new policy of expensing all advertising expenses as incurred is preferable as it eliminates the uncertainty in estimating overall expected net sales and the benefit period of the advertising on an interim basis. In addition, the new accounting policy results in the recognition of advertising costs in the interim period in which they are actually incurred, and conforms the Company's interim accounting policy with that used to prepare the annual financial statements. The impacts on net income (loss) and earnings per share related to the change in accounting policy is as follows:

	Three Months		Six Months	
	2004	2003	2004	2003
Income (loss) before change in accounting policy	$ 1,416	$ 282	$ 26,839	$ (303)
Impact due to change in accounting policy, net of tax	1,186		(2,038)	
Net income (loss), as reported	$ 2,602	$ 282	$ 24,801	$ (303)
Basic earnings per share:				
Income (loss) before change in accounting policy	$ 0.04	$ 0.01	$ 0.82	$ (0.01)
Impact due to change in accounting policy, net of tax	0.04		(0.06)	
Net income (loss), as reported	$ 0.08	$ 0.01	$ 0.76	$ (0.01)
Diluted earnings per share:				
Income (loss) before change in accounting policy	$ 0.05	$ 0.01	$ 0.80	$ (0.01)
Impact due to change in accounting policy, net of tax	0.03		(0.06)	
Net income (loss), as reported	$ 0.08	$ 0.01	$ 0.74	$ (0.01)

Had the prior year's advertising expense been recognized consistent with the policy used in the current fiscal year, the Company's pro forma net income (loss) and earnings per share would have been as follows:

	Three Months		Six Months	
	2004	2003	2004	2003
Pro forma amounts assuming new accounting policy is applied retroactively:				
Net income (loss)	$ 2,602	$ 716	$ 24,801	$ (2,535)
Basic earnings (loss) per share	$ 0.08	$ 0.02	$ 0.76	$ (0.08)
Diluted earnings (loss) per share	$ 0.08	$ 0.02	$ 0.74	$ (0.08)

The effect of restricted stock and unexercised stock options of approximately 695 thousand shares outstanding for the six months ended March 30, 2003 were excluded from the diluted EPS calculation, as their effect was anti-dilutive.

Discontinued Operations: The Company has reflected Remington's United States and United Kingdom Service Centers as discontinued operations. The Company will discontinue operations at these Service Centers during 2004 as part of our Remington integration initiatives. See footnote 8, Restructuring and Related Charges, for additional discussion of Remington integration initiatives. The following amounts have been segregated from continuing operations and are reflected as discontinued operations for the three and six months ended March 28, 2004:

	Three Months	Six Months
Net sales	$ 6,917	$ 20,564
Loss from discontinued operations before income taxes	(2,756)	(849)
Provision for income tax benefits	1,055	525
Loss from discontinued operations, net of tax	$ (1,701)	$ (324)
Depreciation expense associated with discontinued operations	$ 121	$ 254

Revenue Recognition: The Company recognizes revenue from product sales upon shipment to the customer which is the point at which all risks and rewards of ownership of the product are passed, provided that: there are no uncertainties regarding customer acceptance; persuasive evidence of an arrangement exists; the price to the buyer is fixed or determinable; and collectibility is deemed reasonably assured. The Company is generally not obligated to allow for, and the Company's general policy is not to accept, product returns. The Company does recognize a reserve for potential returns, when appropriate, based on past experience and our latest contractual arrangements with certain customers.

The Company enters into various promotional arrangements, primarily with retail customers, including arrangements entitling such retailers to cash rebates from the Company based on the level of their purchases, which require the Company to estimate and accrue the estimated costs of the promotional programs. These costs are generally treated as a reduction of net sales.

The Company also enters into promotional arrangements targeted to the ultimate consumer. Such arrangements are treated as either a reduction of net sales or an increase of cost of sales, based on the type of promotional program. The income statement characterization of the Company's promotional arrangements complies with EITF 01-09, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products).*

For all types of promotional arrangements and programs, the Company monitors its commitments and uses statistical measures and past experience to determine amounts to be recorded for the estimate of the earned, but unpaid, promotional costs. The terms of the Company's customer-related promotional arrangements and programs are individualized to each customer and are generally documented through written contracts, correspondence or other communications with the individual customers.

The Company also enters into various contractual arrangements, primarily with retail customers, which require the Company to make upfront cash, or "slotting" payments, to secure the right to distribute through such customer. The Company capitalizes slotting payments, provided the payments are supported by a time or volume based contractual arrangement with the retailer, and amortizes the associated payment over the appropriate time or volume based term of the contractual arrangement. The amortization of the slotting payment is treated as a reduction in net sales and the corresponding asset is included in Deferred charges and other in the Condensed Consolidated Balance Sheets.

Shipping and Handling Costs: The Company incurred shipping and handling costs of $15,062 and $33,291 for the three and six months ended March 28, 2004, and $11,229 and $24,249 for the three and six months ended March 30, 2003, respectively. These costs are included in selling expense. Shipping and handling costs include costs incurred with third-party carriers to transport products to customers and salaries and overhead costs related to activities to prepare the Company's products for shipment at the Company's distribution facilities.

Concentrations of Credit Risk: Trade receivables subject the Company to credit risk. The Company extends credit to its customers based upon an evaluation of the customer's financial condition and credit history and generally does not require collateral. The Company monitors its customers' credit and financial condition based on changing economic conditions and will make adjustments to credit policies as required. The Company has historically incurred minimal credit losses, but in 2002 experienced a significant loss resulting from the bankruptcy filing of a large retailer in the United States.

The Company has a broad range of customers including many large retail outlet chains, one of which accounts for a significant percentage of our sales volume. This major customer also represented approximately 12% and 13%, respectively, of our receivables as of March 28, 2004 and September 30, 2003.

Following the acquisition of Remington, approximately 52% of the Company's sales occur outside of North America. These sales and related receivables are subject to varying degrees of credit, currency, and political and economic risk. The Company monitors these risks and makes appropriate provisions for collectibility based on an assessment of the risks present.

Stock Based Compensation: The Company has stock option and other stock-based compensation plans, which are fully described in the Company's financial statements and notes thereto as of September 30, 2003. The Company accounts for its stock-based compensation plans using the intrinsic value method, under the principles prescribed by the Accounting Principles Board's ("APB"), Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. For stock options granted, no employee compensation cost is reflected in the Company's results of operations, as all options granted under the plans have an exercise price equal to the market value of the underlying common stock at the grant date.

The Company's stock option awards that vest based on the passage of time qualify for fixed accounting under the provisions of APB No. 25. Certain awards issued during the current fiscal year vest based on the Company's attainment of certain performance measures and have, to date, been accounted for as variable awards under the provisions of APB No. 25, with appropriate charges to compensation expense each period. After the end of the second quarter ended March 28, 2004, the Company amended the vesting provisions of the performance based awards to provide for ultimate vesting of the shares generally at the end of two years. Due to this amendment, the performance based awards will be accounted for as fixed awards in future periods.

Results of operations include compensation cost related to grants of restricted stock of $1,887 and $880 and $2,799 and $1,713 for the three and six months ended March 28, 2004 and March 30, 2003, respectively.

The Company has adopted the disclosure-only provisions of FASB Statement No. 123, ("Statement No. 123") *Accounting for Stock Based Compensation*, as amended by FASB Statement No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure.* Accordingly, no compensation cost has been recognized in the results of operations for the stock option plans. Had compensation cost for stock options granted been determined based on the fair value at the grant date for awards consistent with an alternative method prescribed by Statement No. 123, the Company's net income (loss) and earnings per share would have reflected the pro forma amounts indicated below:

	Three Months		Six Months	
	2004	**2003**	**2004**	**2003**
Net income (loss), as reported	$ 2,602	$ 282	$ 24,801	$ (303)
Add: Stock-based compensation expense included in reported net income, net of tax	1,152	537	1,708	1,045
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of tax	(2,291)	(1,680)	(3,806)	(3,535)
Pro forma net income (loss)	$ 1,463	$ (861)	$ 22,703	$ (2,793)
Basic earnings per share:				
Net income (loss), as reported	$ 0.08	$ 0.01	$ 0.76	$ (0.01)
Net income (loss), Pro forma	$ 0.04	$ (0.03)	$ 0.70	$ (0.09)
Diluted earnings per share:				
Net income (loss), as reported	$ 0.08	$ 0.01	$ 0.74	$ (0.01)
Net income (loss), Pro forma	$ 0.04	$ (0.03)	$ 0.67	$ (0.09)

The effect of restricted stock and unexercised stock options of approximately 677 thousand and 695 thousand shares outstanding for the three and six months ended March 30, 2003 were excluded from the diluted EPS calculation, as their effect was anti-dilutive.

Derivative Financial Instruments: The Company uses interest rate swaps to manage its interest rate risk. The swaps are designated as cash flow hedges with the fair value recorded in Other Comprehensive Income ("OCI") and as a hedge asset or liability, as applicable. The swaps settle periodically in arrears with the related amounts for the current settlement period payable to, or receivable from, the counter-parties included in accrued liabilities or accounts receivable and recognized in earnings as an adjustment to interest expense from the underlying debt to which the swap is designated. During the three and six months ended March 28, 2004 and March 30, 2003, respectively, $1,247 and $1,200 and $2,467 and $2,284, respectively, of pretax derivative losses from such hedges were recorded as an adjustment to interest expense. At March 28, 2004, the Company had a portfolio of interest rate swaps outstanding which effectively fixes the interest rates on floating rate debt at rates as follows: 4.458% for a notional principal amount of $70,000 through July 2004, 3.974% for a notional principal amount of $70,000 from July 2004 through October 2005, 3.769% for a notional principal amount of $100,000 through August 2004 and 3.799% for a notional principal amount of $100,000 from August 2004 through November 2005. The derivative net loss on these contracts recorded in OCI at March 28, 2004 was an after-tax loss of $3,622.

The Company periodically enters into forward and swap foreign exch