

FRANKLIN ELECTRIC CO INC
Form 10-Q
May 08, 2014

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 29, 2014

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 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.)

9255 Coverdale Road
Fort Wayne, Indiana
(Address of principal executive offices)

46809
(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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

1

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the 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
\$.10 par value	April 30, 2014
	47,703,710 shares

FRANKLIN ELECTRIC CO., INC.
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PART I

ITEM 1. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATAFRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIESCONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share amounts)	First Quarter Ended		
	March 29, 2014	March 30, 2013	
Net sales	\$231,421	\$222,524	
Cost of sales	153,310	148,583	
Gross profit	78,111	73,941	
Selling, general, and administrative expenses	52,015	50,065	
Restructuring expense	136	710	
Operating income	25,960	23,166	
Interest expense	(2,784) (2,590)
Other income	325	447	
Foreign exchange expense	(420) (171)
Income before income taxes	23,081	20,852	
Income taxes	5,660	5,237	
Net income	\$17,421	\$15,615	
Less: Net income attributable to noncontrolling interests	(464) (159)
Net income attributable to Franklin Electric Co., Inc.	\$16,957	\$15,456	
Income per share:			
Basic	\$0.35	\$0.32	
Diluted	\$0.35	\$0.32	
Dividends per common share	\$0.0775	\$0.0725	

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)	First Quarter Ended	
	March 29, 2014	March 30, 2013
Net income	\$17,421	\$15,615
Other comprehensive income/(loss), before tax:		
Foreign currency translation adjustments	2,178	(5,789)
Employee benefit plan activity	745	970
Other comprehensive income/(loss)	\$2,923	\$(4,819)
Income tax related to items of other comprehensive income	(257)	(380)
Other comprehensive income/(loss), net of tax	\$2,666	\$(5,199)
Comprehensive income	20,087	10,416
Comprehensive income/(loss) attributable to noncontrolling interest	326	(279)
Comprehensive income attributable to Franklin Electric Co., Inc.	\$19,761	\$10,695

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands)

	March 29, 2014	December 28, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 102,137	\$ 134,553
Receivables, less allowances of \$3,122 and \$3,015, respectively	147,101	115,127
Inventories:		
Raw material	86,501	71,909
Work-in-process	19,552	17,978
Finished goods	117,080	101,674
	223,133	191,561
Deferred income taxes	9,761	10,072
Other current assets	27,172	21,041
Total current assets	509,304	472,354
Property, plant, and equipment, at cost:		
Land and buildings	120,606	121,154
Machinery and equipment	230,974	227,521
Furniture and fixtures	35,198	32,104
Other	27,840	26,844
	414,618	407,623
Less: Allowance for depreciation	(204,288) (199,027
	210,330	208,596
Asset held for sale	—	1,750
Deferred income tax	2,695	2,969
Intangible assets, net	146,973	148,663
Goodwill	207,730	207,220
Other assets	12,708	10,321
Total assets	\$ 1,089,740	\$ 1,051,873

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	March 29, 2014	December 28, 2013
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	\$81,133	\$57,755
Deferred tax liability	1,227	1,227
Accrued expenses	47,376	62,081
Income taxes	1,939	2,048
Current maturities of long-term debt and short-term borrowings	30,607	15,363
Total current liabilities	162,282	138,474
Long-term debt	173,654	174,166
Deferred income taxes	54,347	54,618
Employee benefit plans	38,457	41,685
Other long-term liabilities	39,535	39,543
Commitments and contingencies (see Note 16)	—	—
Redeemable noncontrolling interest	5,288	5,171
Shareowners' equity:		
Common stock (65,000 shares authorized, \$.10 par value) outstanding (47,692 and 47,715, respectively)	4,769	4,771
Additional capital	198,089	194,810
Retained earnings	462,526	450,855
Accumulated other comprehensive loss	(51,925) (54,729
Total shareowners' equity	613,459	595,707
Noncontrolling interest	2,718	2,509
Total equity	616,177	598,216
Total liabilities and equity	\$1,089,740	\$1,051,873

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)	First Quarter Ended	
	March 29, 2014	March 30, 2013
Cash flows from operating activities:		
Net income	\$ 17,421	\$ 15,615
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	8,847	7,367
Share-based compensation	1,392	2,158
Deferred income taxes	(214)	(2,623)
(Gain)/loss on disposals of plant and equipment	5	(1)
Foreign exchange expense	420	171
Excess tax from share-based payment arrangements	(1,448)	(2,063)
Changes in assets and liabilities, net of acquisitions:		
Receivables	(31,451)	(28,686)
Inventory	(31,408)	(17,038)
Accounts payable and accrued expenses	8,408	(8,441)
Income taxes	1,117	2,459
Employee benefit plans	(2,551)	(1,485)
Other	(5,918)	1,788
Net cash flows from operating activities	(35,380)	(30,779)
Cash flows from investing activities:		
Additions to property, plant, and equipment	(8,172)	(16,515)
Proceeds from sale of property, plant, and equipment	1,592	55
Additions to intangibles	—	48
Cash paid for minority equity investment	(2,449)	—
Net cash flows from investing activities	(9,029)	(16,412)
Cash flows from financing activities:		
Proceeds from issuance of debt	21,191	25,101
Repayment of debt	(6,550)	(85)
Proceeds from issuance of common stock	635	4,128
Excess tax from share-based payment arrangements	1,448	2,063
Purchases of common stock	(1,581)	(2,504)
Dividends paid	(3,709)	(3,417)
Payment of contingent consideration liability	—	(5,555)
Net cash flows from financing activities	11,434	19,731
Effect of exchange rate changes on cash	559	(1,212)
Net change in cash and equivalents	(32,416)	(28,672)
Cash and equivalents at beginning of period	134,553	103,338
Cash and equivalents at end of period	\$ 102,137	\$ 74,666

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	First Quarter Ended	
	March 29, 2014	March 30, 2013
Cash paid for income taxes	\$7,905	\$4,430
Cash paid for interest, net of capitalized interest of \$0 and \$235, respectively	\$3,002	\$2,379
Non-cash items:		
Additions to property, plant, and equipment, not yet paid	\$610	\$1,297

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN ELECTRIC CO., INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The accompanying condensed consolidated balance sheet as of December 28, 2013, which has been derived from audited financial statements, and the unaudited interim condensed consolidated financial statements as of March 29, 2014, and for the first quarters ended March 29, 2014 and March 30, 2013, 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 adjustments) considered necessary for a fair presentation of the financial position and the results of operations for the interim period have been made. Operating results for the first quarter ended March 29, 2014, are not necessarily indicative of the results that may be expected for the fiscal year ending January 3, 2015. For further information, including a description of the Company'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/A for the year ended December 28, 2013.

2. ACCOUNTING PRONOUNCEMENTS

In April 2014, FASB issued ASU 2014-08 Presentation of Financial Statements and Property, Plant and Equipment: Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. ASU No. 2014-08 raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. ASU No. 2014-08 is effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning on or after December 15, 2015, with early adoption permitted. The Company has adopted this standard with no impact on the Company's consolidated financial position, results of operations, or cash flows.

3. ACQUISITIONS

Transaction costs were expensed as incurred under the guidance of FASB ASC Topic 805, Business Combinations. Transaction costs included in selling, general, and administrative expenses in the Company's condensed consolidated statement of income for the first quarter ended March 29, 2014, was \$0.1 million. No transaction costs were included in selling, general, and administrative expenses for the first quarter ended March 30, 2013.

4. REDEEMABLE NONCONTROLLING INTERESTS

On May 2, 2011, the Company completed the acquisition of 80 percent of Impo Motor Pompa Sanayi ve Ticaret A.S. ("Impo"). The 20 percent noncontrolling interest was recorded at fair value as of the acquisition date. The noncontrolling interest holders have the option, which is embedded in the noncontrolling interest, to require the Company to redeem their ownership interests after May 2, 2014, three years after the original agreement was signed. The combination of a noncontrolling interest and a redemption feature resulted in a redeemable noncontrolling interest.

The noncontrolling interest in Impo is redeemable at other than fair value as the redemption value is determined based on a specified formula. The noncontrolling interest becomes redeemable after the passage of time, and therefore the Company records the carrying amount of the noncontrolling interest at the greater of (1) the initial carrying amount, increased or decreased for each noncontrolling interest's share of net income or loss and its share of other comprehensive income or loss and dividends ("carrying amount") or (2) the redemption value which is determined based on the greater of the redemption floor value or the then-current specified earnings multiple. As of March 29, 2014, the Impo redeemable noncontrolling interest was recorded at the carrying amount.

According to FASB ASC Topic 810, Consolidation and Emerging Issues Task Force ("EITF") Topic No. D-98, Classification and Measurement of Redeemable Securities, redeemable noncontrolling interests issued in the form of common securities, to the extent that the noncontrolling interest holder has a contractual right to receive an amount upon share redemption that is other than the fair value of such shares, then the noncontrolling interest holder has, in substance, received a dividend distribution that is different from other common shareholders. Therefore, adjustments to the noncontrolling interest to reflect the redemption amount should be reflected in the computation of earnings per share using the two-class method. Under the two-class method, the Company has elected to treat as a dividend only the portion of the periodic redemption value adjustment (if any) that reflects a redemption value in excess of carrying value. No adjustments were necessary for the first quarters ended March 29, 2014 or March 30, 2013.

5. FAIR VALUE MEASUREMENTS

FASB ASC Topic 820, Fair Value Measurements and Disclosures, provides guidance for defining, measuring, and disclosing fair value within an established framework and hierarchy. 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. The standard established a fair value hierarchy which requires an entity to maximize the use of observable inputs and to minimize the use of unobservable inputs when measuring fair value. The three levels of inputs that may be used to measure fair value within the hierarchy are as follows:

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.

As of March 29, 2014 and December 28, 2013, the assets and liabilities measured at fair value on a recurring basis were as set forth in the table below.

	March 29, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Recognized Loss
(In millions)					
Cash equivalents	\$8.2	\$8.2	\$—	\$—	\$—
	December 28, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Recognized Loss
Cash equivalents	\$6.6	\$6.6	\$—	\$—	\$—

The Company's Level 1 assets consist of cash equivalents which are generally comprised of domestic money market funds invested in high quality, short-term liquid assets, and foreign bank guaranteed certificates of deposit.

The Company has no assets or liabilities classified as Level 2 or Level 3.

6. FINANCIAL INSTRUMENTS

The Company's deferred compensation stock program is subject to variable plan accounting and, accordingly, is adjusted for changes in the Company's stock price at the end of each reporting period. During February 2014, the Company entered into a share swap transaction agreement (the "swap") to mitigate the Company's exposure to these fluctuations in the Company's stock price. The swap was not designated as a hedge for accounting purposes and is cancellable with 30 days written notice by either party. The swap has a notional value of 134,000 shares. As of March 29, 2014, the swap transaction resulted in a loss of \$0.2 million. All gains or losses and expenses related to the total return swap are recorded in the Company's consolidated statement of income within the "Selling, general, and administrative expenses" line.

7. OTHER ASSETS

The Company has equity interests in various companies for various strategic purposes. The investments are accounted for under the equity method and are included in "Other assets" on the Company's consolidated balance sheet. The

carrying amount of the investment is adjusted for the Company's proportionate share of earnings, losses, and dividends. The investments are not considered material to the Company's financial position, neither individually nor in aggregate. The Company's proportionate share of earnings from its equity interests, included in the "Other income/(expense)" line of the Company's consolidated statements of income, were immaterial for the quarter ended March 29, 2014.

The Company has a loan agreement with the parent company of a customer. The current maturity is included in "Receivables" and the long-term portion is included in "Other assets" on the Company's consolidated balance sheet. The agreement provides for interest on the loan at a variable market interest rate with the customer to repay the loan plus interest in semi-annual installments. The Company has a long-term relationship with the customer and considers the loan fully collectible. The loan is not considered material to the Company's financial position.

8. GOODWILL AND OTHER INTANGIBLE ASSETS

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

(In millions)	March 29, 2014		December 28, 2013	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangibles:				
Patents	\$7.8	\$(6.0)	\$7.8	\$(5.9)
Supply agreements	4.4	(4.4)	4.4	(4.4)
Technology	7.5	(3.9)	7.5	(3.8)
Customer relationships	125.3	(31.6)	125.1	(29.7)
Software	2.1	(0.4)	2.1	(0.4)
Other	1.3	(1.3)	1.3	(1.2)
Total	\$148.4	\$(47.6)	\$148.2	\$(45.4)
Unamortized intangibles:				
Trade names	46.1	—	45.9	—
Total intangibles	\$194.5	\$(47.6)	\$194.1	\$(45.4)

Amortization expense related to intangible assets for first quarters ended March 29, 2014 and March 30, 2013 was \$2.0 million and \$2.0 million, respectively.

Amortization expense for each of the five succeeding years is projected as follows:

(In millions)	2014	2015	2016	2017	2018
	\$8.1	\$8.1	\$8.1	\$7.8	\$7.7

The change in the carrying amount of goodwill by reporting segment for the first quarter ended March 29, 2014, is as follows:

(In millions)	Water Systems	Fueling Systems	Consolidated
Balance as of December 28, 2013	\$144.1	\$63.1	\$207.2
Foreign currency translation	0.4	0.1	0.5
Balance as of March 29, 2014	\$144.5	\$63.2	\$207.7

9. EMPLOYEE BENEFIT PLANS

Defined Benefit Plans - As of March 29, 2014, the Company maintained two domestic pension plans and three German pension plans. The Company used a December 31 measurement date for these plans.

Other Benefits - The Company's other postretirement benefit plan provides health and life insurance to domestic employees hired prior to 1992.

The following table sets forth the aggregated net periodic benefit cost for all pension plans for the first quarters ended March 29, 2014 and March 30, 2013, respectively:

(In millions)			Pension Benefits		Other
			First Quarter	First	Benefits
			Ended	Quarter	Ended
	March 29, 2014	March 30, 2013	March 29, 2014	March 30, 2013	
Service cost	\$0.3	\$0.4	\$—	\$—	
Interest cost	2.0	1.9	0.1	0.1	
Expected return on assets	(2.6) (2.5) —	—	
Amortization of prior service cost	—	—	0.1	0.1	
Amortization of loss	0.6	0.9	—	0.1	
Net periodic benefit cost	\$0.3	\$0.7	\$0.2	\$0.3	
Settlement cost	0.2	—	—	—	
Total net periodic benefit cost	\$0.5	\$0.7	\$0.2	\$0.3	

In the first quarter ended March 29, 2014, the Company made contributions to the funded plans of \$2.8 million. The amount of contributions to be made to the plans during the calendar year 2014 will be finalized by September 15, 2014, based upon the plan's year-end valuation at December 28, 2013, and the funding level required for the plan year ended December 28, 2013.

10. INCOME TAXES

The effective tax rate continues to be lower than the U.S. statutory rate of 35.0 percent primarily due to the indefinite reinvestment of foreign earnings taxed at rates below the U.S. statutory rate as well as recognition of U.S. tax credits. The Company has the ability to indefinitely reinvest these foreign earnings based on the earnings and cash projections of its other operations as well as cash on hand and available credit.

11. DEBT

Debt consisted of the following:

(In millions)	March 29, 2014	December 28, 2013
Prudential Agreement - 5.79 percent	\$150.0	\$150.0
Tax increment financing debt	24.1	24.6
Revolver	15.0	—
Capital leases	0.7	0.8
Foreign subsidiary debt	14.5	14.2
	204.3	189.6
Less current maturities	(30.6) (15.4
Long-term debt	\$173.7	\$174.2

Foreign subsidiary debt denoted in the table above is predominately comprised of debt at Impto.

The total estimated fair value of debt was \$218.3 million and \$203.7 million at March 29, 2014 and December 28, 2013, respectively. The fair value assumed floating rate debt was valued at par. 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. Accordingly, the fair value of debt is classified as a Level 2 within the valuations hierarchy.

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

