

Edgar Filing: TECHNITROL INC - Form 10-Q

TECHNITROL INC  
Form 10-Q  
November 09, 2005

UNITED STATES  
SECURITIES & EXCHANGE COMMISSION

Washington, D.C. 20549

-----  
FORM 10-Q

The Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the three months ended September 30, 2005, 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. 1-5375

TECHNITROL [GRAPHIC]  
TECHNITROL, INC.

(Exact name of registrant as specified in its Charter)

PENNSYLVANIA  
(State or other jurisdiction of  
incorporation or organization)

23-1292472  
(IRS Employer  
Identification Number)

1210 Northbrook Drive, Suite 470  
Trevose, Pennsylvania  
(Address of principal executive offices)

19053  
(Zip Code)

Registrant's telephone number, including area code: 215-355-2900

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 the filing requirements for at least the past 90 days. YES  NO

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES  NO

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of the latest practicable date: 40,529,151

1

TABLE OF CONTENTS

PART I	FINANCIAL INFORMATION	PAGE
Item 1.	Financial Statements	3

## Edgar Filing: TECHNITROL INC - Form 10-Q

	Consolidated Balance Sheets (Unaudited)	3
	Consolidated Statements of Operations (Unaudited)	4
	Consolidated Statements of Cash Flows (Unaudited)	5
	Consolidated Statements of Changes in Shareholders' Equity (Unaudited)	6
	Notes to Unaudited Consolidated Financial Statements	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	31
Item 4.	Controls and Procedures	31
PART II	OTHER INFORMATION	
Item 1.	Legal Proceedings	33
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	33
Item 3.	Defaults Upon Senior Securities	33
Item 4.	Submission of Matters to a Vote of Security Holders	33
Item 5.	Other Information	33
Item 6.	Exhibits	33
	Exhibit Index	34

2

### PART I. FINANCIAL INFORMATION

#### Item 1: Financial Statements

##### Technitrol, Inc. and Subsidiaries

##### Consolidated Balance Sheets

In thousands

	September 30, 2005 ----	December 31, 2004 ----
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 98,975	\$155,952
Trade receivables, net	126,335	109,652
Inventories	75,061	77,481
Prepaid expenses and other current assets	14,885	20,917
	-----	-----
Total current assets	315,256	364,002
Property, plant and equipment	241,227	233,563
Less accumulated depreciation	144,431	131,387
	-----	-----

Edgar Filing: TECHNITROL INC - Form 10-Q

Net property, plant and equipment	96,796	102,176
Deferred income taxes	10,012	8,898
Goodwill	155,592	126,178
Other intangibles, net	9,098	22,685
Other assets	2,554	2,648
	-----	-----
	\$589,308	\$626,587
	=====	=====
Liabilities and Shareholders' Equity		
Current liabilities:		
Current installments of long-term debt	\$ 124	\$ 130
Short-term debt	6,084	6,717
Accounts payable	64,353	48,655
Accrued expenses	72,053	69,602
	-----	-----
Total current liabilities	142,614	125,104
Long-term liabilities:		
Long-term debt, excluding current installments	6,220	7,125
Other long-term liabilities	14,634	14,766
Minority interest	12,732	14,730
Shareholders' equity:		
Common stock and additional paid-in capital	215,359	213,694
Retained earnings	195,902	239,752
Deferred compensation	(1,612)	(1,968)
Other comprehensive income	3,459	13,384
	-----	-----
Total shareholders' equity	413,108	464,862
	-----	-----
	\$589,308	\$626,587
	=====	=====

See accompanying Notes to Unaudited Consolidated Financial Statements.

3

Technitrol, Inc. and Subsidiaries  
Consolidated Statements of Operations  
(Unaudited)  
In thousands, except per share data

	Three Months Ended		Septe
	September 30, 2005 ----	October 1, 2004 ----	
Net sales	\$147,217	\$140,606	
Costs and expenses:			
Cost of sales	113,211	105,949	
Selling, general and administrative expenses	25,574	26,825	
Severance and asset impairment expense	1,438	2,399	
	-----	-----	

Edgar Filing: TECHNITROL INC - Form 10-Q

Total costs and expenses applicable to sales	140,223	135,173
Operating profit (loss)	6,994	5,433
Other income (expense):		
Interest income (expense), net	377	(100)
Equity method investment earnings	--	395
Other	(203)	170
	-----	-----
Total other income	174	465
	-----	-----
Earnings (loss) from continuing operations before taxes and minority interest	7,168	5,898
Income taxes	1,551	1,304
Minority interest	327	141
	-----	-----
Net earnings (loss) from continuing operations	\$ 5,290	\$ 4,453
Net (loss) earnings from discontinued operations, net of taxes	(701)	(15)
	-----	-----
Net earnings (loss)	\$ 4,589	\$ 4,438
	=====	=====
Basic and diluted earnings (loss) per share from continuing operations	\$ 0.13	\$ 0.11
	=====	=====
Basic and diluted (loss) per share from discontinued operations	\$ (0.02)	\$ --
	=====	=====
Basic and diluted earnings (loss) per share	\$ 0.11	\$ 0.11
	=====	=====

See accompanying Notes to Unaudited Consolidated Financial Statements.

4

Technitrol, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows  
(Unaudited)  
In thousands

	Nine Months Ended September 30, ----- 2005 -----	October -----
Cash flows from operating activities:		
Net (loss) earnings	\$ (32,821)	\$

## Edgar Filing: TECHNITROL INC - Form 10-Q

Adjustments to reconcile net (loss) earnings to net cash provided by operating activities:		
Depreciation and amortization	15,808	
Tax effect of employee stock compensation	(151)	
Amortization of stock incentive plan expense	2,828	
Minority interest in net earnings of consolidated subsidiary	1,045	
Severance and asset impairment expense, net of cash payments	46,065	
Changes in assets and liabilities, net of effect of acquisitions:		
Trade receivables	(8,696)	
Inventories	(191)	
Prepaid expenses and other current assets	1,224	
Accounts payable and accrued expenses	2,527	
Other, net	5,499	
Net cash provided by operating activities	33,137	
Cash flows from investing activities:		
Acquisitions, net of cash acquired	(84,599)	
Proceeds from sale of business	6,724	
Capital expenditures	(12,167)	
Proceeds from sale of property, plant and equipment	2,006	
Foreign currency impact on intercompany lending	8,032	
Net cash (used in) investing activities	(80,004)	
Cash flows from financing activities:		
Principal payments of long-term debt, net	(754)	
Dividends paid	(7,088)	
Sale of stock through employee stock purchase plan	--	
Net cash (used in) provided by financing activities	(7,842)	
Net effect of exchange rate changes on cash		
	(2,646)	
Net (decrease) increase in cash and cash equivalents from continuing operations		
	(57,355)	
Net increase (decrease) in cash and cash equivalents from discontinued operations		
	378	
Cash and cash equivalents at beginning of period		
	155,952	1
Cash and cash equivalents at end of period		
	\$ 98,975	\$1

See accompanying Notes to Unaudited Consolidated Financial Statements.

Technitrol, Inc. and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity

Nine Months Ended September 30, 2005

(Unaudited)  
In thousands

Edgar Filing: TECHNITROL INC - Form 10-Q

	Common stock and paid-in capital		Retained earnings	Deferre compen sation
	Shares	Amount		
Balance at December 31, 2004	40,448	\$213,694	\$239,752	\$ (1,96
Stock options, awards and related compensation	21	594	--	2
Tax effect of stock compensation	--	(54)	--	--
Currency translation adjustments	--	--	--	--
Net earnings	--	--	5,109	--
Comprehensive income				
Dividends declared (\$0.0875 per share)	--	--	(3,541)	--
Balance at April 1, 2005	40,469	214,234	241,320	(1,94
Stock options, awards and related compensation	61	990	--	(7
Tax effect of stock compensation	--	152	--	--
Currency translation adjustments	--	--	--	--
Net (loss)	--	--	(42,914)	--
Comprehensive (loss)				
Dividends declared (\$0.0875 per share)	--	--	(3,547)	--
Balance at July 1, 2005	40,530	215,376	194,859	(2,01
Stock options, awards and related compensation	(1)	232	--	40
Tax effect of stock compensation	--	(249)	--	--
Currency translation adjustments	--	--	--	--
Net earnings	--	--	4,589	--
Comprehensive income				
Dividends declared (\$0.0875 per share)	--	--	(3,546)	--
Balance at September 30, 2005	40,529	\$215,359	\$195,902	\$ (1,61

See accompanying Notes to Unaudited Consolidated Financial Statements.

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(1) Accounting policies

For a complete description of the accounting policies of Technitrol, Inc. and its consolidated subsidiaries, refer to Note 1 of Notes to Consolidated

## Edgar Filing: TECHNITROL INC - Form 10-Q

Financial Statements included in Technitrol's Form 10-K filed for the year ended December 31, 2004. We sometimes refer to Technitrol as "we" or "our".

The results for the nine months ended September 30, 2005 and October 1, 2004 have been prepared by our management without audit by our independent auditors. In the opinion of management, the financial statements fairly present in all material respects, the financial position and results of operations for the periods presented. To the best of our knowledge and belief, all adjustments have been made to properly reflect income and expenses attributable to the periods presented. Except for severance and asset impairment expenses, all such adjustments are of a normal recurring nature. Operating results for the nine months ended September 30, 2005 are not necessarily indicative of annual results.

### New Accounting Pronouncements

In March 2005, the FASB issued Financial Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations ("FIN 47"). FIN 47 clarifies the term, "conditional asset retirement obligation", as used in SFAS No. 143 Accounting for Asset Retirement Obligations, which refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event. Uncertainty about the timing and/or method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. FIN 47 becomes effective no later than the end of fiscal years ending after December 15, 2005. We are evaluating the effect FIN 47 will have on our consolidated financial statements.

In December 2004, the FASB issued Statement No. 123(R), Share-Based Payment, ("SFAS 123(R)"), which amends SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123(R) requires compensation expense to be recognized for all share-based payments made to employees based on the fair value of the award at the date of grant, eliminating the intrinsic value alternative allowed by SFAS 123. Generally, the approach to determining fair value under the original pronouncement has not changed, however, there are revisions to the accounting guidelines established, such as accounting for forfeitures. SFAS 123(R) becomes effective at the beginning of our fiscal 2006. Adoption of this standard is not expected to have a material impact on our revenue, operating results, financial position or liquidity.

In December 2004, the FASB issued Staff Position No. FAS 109-2 ("FAS 109-2"), Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creations Act of 2004. The American Jobs Creation Act ("AJCA") introduces a limited time 85% dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. FAS 109-2 provides accounting and disclosure guidance for the repatriation provision. Based on the AJCA legislation and 2005 guidance by the Department of Treasury, we decided in the third quarter of 2005 to repatriate \$53.0 million of foreign earnings before the end of 2005. A charge of \$5.6 million related to the planned repatriation was accrued in the third quarter of 2005 and is included in income taxes (from continuing operations) in the accompanying consolidated statements of operations.

## Edgar Filing: TECHNITROL INC - Form 10-Q

### (1) Accounting policies, continued

In November 2004, the FASB issued Statement No. 151, Inventory Costs or Amendment of ARB No.43, Chapter 4 ("SFAS 151"). SFAS 151 provides for certain fixed production overhead cost to be reflected as a period cost and not capitalized as inventory. SFAS 151 becomes effective at the beginning of our fiscal 2006. Adoption of this standard is not expected to have a material impact on our revenue, operating results, financial position or liquidity.

#### Reclassifications

Certain amounts in the prior year financial statements have been reclassified to conform with the current year presentation.

### (2) Acquisitions

LK Products Oy: On September 8, 2005, we acquired all of the capital stock of LK Products Oy ("LK"), headquartered in Kempele, Finland with production operations in Finland, China and Hungary as well as offices in South Korea and San Diego. The results of LK's operations have been included in the consolidated financial statements since that date. LK produces antennas and integrated modules for mobile communications and information devices and will be the cornerstone of Pulse's antenna products division. The purchase price was approximately \$82.6 million, net of cash acquired of \$0.4 million. The purchase price was funded with cash on hand. The purchase agreement also includes a revenue-based earnout provision whereby we will pay the seller one euro for each euro of revenue in excess of (euro)85.0 million achieved by LK during the 12 months ended May 31, 2006. We will record this contingent consideration as additional goodwill, when and if paid. The preliminary fair value of the net tangible assets acquired approximated \$24.7 million. We are in the process of obtaining third-party valuations of the property, plant and equipment and intangible assets. Therefore, the allocation of the purchase price is subject to adjustment. The full excess purchase price has been recorded as goodwill on the consolidated balance sheet until the valuation is completed. We will record cumulative amortization in the fourth quarter of 2005. The following table summarizes the preliminary fair values of the assets acquired and liabilities assumed at the date of acquisition (in millions):

Current assets	\$ 26.6
Property, plant & equipment	15.8
Goodwill	58.4
	-----
Total assets acquired	100.8
Current liabilities	17.4
Long-term liabilities	0.3
	-----
Total liabilities assumed	17.7
Net assets acquired	\$ 83.1
	=====

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

### (2) Acquisitions, continued



## Edgar Filing: TECHNITROL INC - Form 10-Q

Had the acquisition of LK occurred on January 1, 2004, unaudited pro forma results would have been as follows (in millions, except per share amounts):

	Nine Months Ended 9/30/2005 -----	Nine Months Ended 10/1/2004 -----
Net sales	\$495.0	\$486.7
Net earnings (loss) from continuing operations	(30.9)	27.5
Net earnings (loss) from continuing operations per common share:		
Basic	(0.77)	0.68
Diluted	(0.77)	0.68

The pro forma results reflect adjustments for the increased amortization and the reduction in interest income attributable to the acquisition. Potential cost savings, however, from combining LK with our operations are not reflected. For this and other reasons, the pro forma results are not indicative of the results that would have occurred had the acquisition actually been consummated on January 1, 2004, and are not intended to be a projection of future results or trends.

Full Rise Electronic Co., Ltd. (FRE): FRE is based in the Republic of China (Taiwan) and manufactures connector products, including single and multiple-port jacks, and supplies products to us under a cooperation agreement. In April 2001, we made a minority investment in the common stock of FRE, which was accounted for by the cost-basis method of accounting. On July 27, 2002, we made an additional investment in FRE of \$6.7 million which increased the total investment to \$20.9 million. As a result of the increased ownership percentage to approximately 29%, we began to account for the investment under the equity method of accounting beginning in the three months ended September 27, 2002. Shares of FRE began trading on the Taiwan Stock Exchange in January 2003, and they experienced considerable price volatility. In the three months ended December 26, 2003, we recorded an \$8.7 million net loss to adjust our original cost basis of the investment to market value. In July 2004, we purchased an additional 9.0 million shares of common stock in FRE for \$10.5 million. On September 13, 2004, we acquired an additional 2.4 million shares of common stock in FRE for \$2.5 million, bringing our ownership percentage up to 51%. Accordingly, FRE's operating results were consolidated with our own beginning September 13, 2004. Our net earnings therefore reflect FRE's net earnings, after deducting the minority interest due to the minority shareholders. During the nine months ended September 30, 2005, we acquired an additional 2.8 million shares of common stock in FRE for \$2.2 million, bringing our ownership percentage up to 57%. Additional purchases of common stock in FRE are allocated, on a pro rata basis, to goodwill, identifiable intangible assets, and property, plant, and equipment according to amounts recorded as of September 13, 2004. The fair value of the net tangible assets acquired through September 13, 2004 approximated \$28.8 million, less a minority interest of \$14.0 million. Based on the fair value of net tangible assets acquired and our current ownership percentage, the allocation of the investment to intangibles includes \$0.5 million for technology, \$0.6 million for trademarks, \$2.1 million for customer relationships and \$10.7 million of goodwill. All of the separately identifiable intangibles are being amortized, with useful lives of 4 years for technology and customer relationships.

# Edgar Filing: TECHNITROL INC - Form 10-Q

## Technitrol, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements, continued

(3) Severance and asset impairment expense

In the nine months ended September 30, 2005, we accrued \$4.6 million for a number of actions to streamline operations at Pulse and AMI Doduco. These include severance and related payments comprised of \$0.8 million related to Pulse's termination of manufacturing and support personnel at facilities in Italy and Turkey, \$1.6 million related to AMI Doduco's termination of manufacturing and support personnel at a facility in Italy, \$0.3 million related to Pulse's termination of a lease in China, \$0.2 million related to AMI Doduco's shutdown of a facility in the United Kingdom, \$0.4 million related to the transfer of Pulse consumer division assets from Pulse's facility in Turkey to China, and \$1.3 million for severance and facility closure costs at other locations. The majority of these accruals will be paid by December 31, 2005, except for remaining lease or severance payments to be made over a specified term. Additionally, in the three months ended July 1, 2005, we recorded a \$46.0 million impairment charge of Pulse consumer division assets consisting of \$25.6 million of goodwill, \$11.5 million of identifiable intangibles, and \$8.9 million of property, plant, and equipment. These impairments resulted from updated cash flow projections which reflect the shift of production by Pulse to China-based locations, decreasing average selling prices for television transformers resulting from competition with Asian companies selling in U.S. dollars, and the recent weakness in the European television market. We expect to accrue an additional \$0.3 million of severance in the fourth quarter of 2005 in connection with the termination of manufacturing and support personnel in the consumer division and \$0.2 million for severances at other locations. Additionally, we expect to accrue an additional \$0.6 million in contract termination costs and asset impairments at AMI Doduco's facility in Italy in the fourth quarter of 2005.

In the nine months ended October 1, 2004 we accrued \$6.7 million for severance and related payments comprised of \$3.0 million related to AMI Doduco's termination of manufacturing and support personnel at a facility in Germany, \$2.5 million related to the termination of manufacturing and support personnel at a facility in France, \$0.8 million related to Pulse's shutdown of a facility in Carlsbad, California and \$0.4 million for other severances in various locations. The vast majority of these accruals were utilized by December 31, 2004.

Our severance and asset impairment charges are summarized on a year-to-date basis for 2005 as follows (in millions):

	AMI Doduco -----	Pulse -----	Total -----
Balance accrued at December 31, 2004	\$ 1.8	\$ 1.2	\$ 3.0
Accrued during the nine months ended September 30, 2005	2.2	48.4	50.6
Severance and other cash payments	(1.9)	(2.6)	(4.5)
Non-cash asset disposals	(0.2)	(46.1)	(46.3)
	-----	-----	-----
Balance accrued at September 30, 2005	\$ 1.9	\$ 0.9	\$ 2.8
	=====	=====	=====

(4) Inventories

Inventories consisted of the following (in thousands):

Edgar Filing: TECHNITROL INC - Form 10-Q

	September 30, 2005 ----	December 31, 2004 ----
Finished goods	\$30,632	\$27,394
Work in process	20,247	20,312
Raw materials and supplies	24,182	29,775
	-----	-----
	\$75,061	\$77,481
	=====	=====

10

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(5) Derivatives and other financial instruments

We utilize derivative financial instruments, primarily forward exchange contracts, to manage foreign currency risks. While these hedging instruments are subject to fluctuations in value, such fluctuations are generally offset by the value of the underlying exposures being hedged.

At September 30, 2005, we had one foreign exchange forward contract outstanding to sell forward approximately 49.1 million euros in the aggregate, in order to hedge intercompany loans. The term of this contract was approximately 30 days although we routinely settle such obligations and enter into new 30-day contracts each month. We had no other derivative instruments at September 30, 2005. In addition, management believes that there is no material risk of loss from changes in inherent market rates or prices in our other financial instruments.

(6) Earnings per share

Basic earnings per share are calculated by dividing net earnings by the weighted average number of common shares outstanding (excluding restricted shares) during the period. We had unvested restricted shares outstanding of approximately 197,000 and 211,000 as of September 30, 2005 and October 1, 2004, respectively. For calculating diluted earnings per share, common share equivalents and unvested restricted stock outstanding are added to the weighted average number of common shares outstanding. Common share equivalents are comprised of outstanding options to purchase common stock and the amount of compensation cost attributed to future services not yet recognized as calculated using the treasury stock method. There were no common share equivalents for the three and nine months ended September 30, 2005, as the exercise prices of outstanding share options were greater than the average stock price for the period. There were approximately 475,000 stock options outstanding as of September 30, 2005 and approximately 435,000 as of October 1, 2004.

Earnings (loss) per share calculations are as follows (in thousands, except per share amounts):

Three Months Ended		Nine Months Ended	
September 30, 2005 ----	October 1, 2004 ----	September 30, 2005 ----	October 1, 2004 ----

Edgar Filing: TECHNITROL INC - Form 10-Q

Net earnings (loss) from continuing operations	\$ 5,290	\$ 4,453	\$ (32,821)	\$ 19,36
Net (loss) earnings from discontinued operations	(701)	(15)	(395)	11
Net earnings (loss)	\$ 4,589	\$ 4,438	\$ (33,216)	19,47
Basic earnings (loss) per share:				
Shares	40,318	40,204	40,286	40,16
Continuing operations	\$ 0.13	\$ 0.11	\$ (0.81)	\$ 0.4
Discontinued operations	(0.02)	--	(0.01)	--
Per share amount	\$ 0.11	\$ 0.11	\$ (0.82)	\$ 0.4
Diluted earnings (loss) per share:				
Shares	40,445	40,439	40,286	40,38
Continuing operations	\$ 0.13	\$ 0.11	\$ (0.81)	\$ 0.4
Discontinued operations	(0.02)	--	(0.01)	--
Per share amount	\$ 0.11	\$ 0.11	\$ (0.82)	\$ 0.4

11

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(7) Business segment information

For the three and nine months ended September 30, 2005 and October 1, 2004 there were immaterial amounts of intersegment revenues eliminated in consolidation. There has been no material change in segment assets from December 31, 2004 to September 30, 2005, except for the acquisition of LK of \$83.1 million (Note 2) and the impairment writedown in the Pulse consumer division of \$46.0 million (Note 3). In addition, the basis for determining segment financial information has not changed from 2004. Specific segment data are as follows (in thousands):

	Three Months Ended		Nine Months
	September 30,	October 1,	September 30,
	2005	2004	2005
	----	----	----
Net sales:			
Pulse	\$ 86,626	\$ 77,373	\$240,554
AMI Doduco	60,591	63,233	191,359
Total	\$147,217	\$140,606	\$431,913
Earnings (loss) from continuing operations before income taxes and minority interest:			
Pulse	\$ 6,196	\$ 5,934	\$ (29,864)
AMI Doduco	798	(501)	2,049
Operating profit (loss)	\$ 6,994	\$ 5,433	\$ (27,815)

Edgar Filing: TECHNITROL INC - Form 10-Q

Other income, net	174	465	64
	-----	-----	-----
Earnings (loss) from continuing operations before income taxes and minority interest	\$ 7,168	\$ 5,898	\$(27,751)
	=====	=====	=====

(8) Accounting for stock based compensation

We adopted SFAS 123, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123 ("SFAS 148"), at the beginning of the 2003 fiscal year. We implemented SFAS 123 under the prospective method approach per SFAS 148, whereby compensation expense is recorded for all awards granted subsequent to adoption.

If compensation cost for our stock option plan and stock purchase plan had been determined based on the fair value as required by SFAS 123 for all awards (including those made prior to 2003), our pro forma net earnings and earnings per basic and diluted share would have been as follows, (in thousands, except per share amounts):

	Three Months Ended		Ni
	September 30,	October 1,	September
	2005	2004	
	----	----	
Net earnings (loss), as reported	\$ 4,589	\$ 4,438	\$(33
Add: Stock-based compensation expense included in reported net earnings (loss), net of taxes	448	548	1
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of taxes	(495)	(664)	(1
Net earnings (loss) adjusted	\$ 4,542	\$ 4,322	\$(33
Basic net earnings (loss) per share - as reported	\$ 0.11	\$ 0.11	\$ (
Basic net earnings (loss) per share - adjusted	\$ 0.11	\$ 0.11	\$ (
Diluted net earnings (loss) per share - as reported	\$ 0.11	\$ 0.11	\$ (
Diluted net earnings (loss) per share - adjusted	\$ 0.11	\$ 0.11	\$ (

12

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(8) Accounting for stock based compensation, continued

At September 30, 2005, we had approximately 475,000 options outstanding, representing approximately 1% of our outstanding shares of common stock. The value of restricted stock has always been and continues to be recorded as compensation expense over the restriction period, and such expense is included in the results of operations for the periods ended September 30, 2005 and October 1, 2004, respectively.

(9) Pension

In the nine months ended September 30, 2005 we were not required to, nor

## Edgar Filing: TECHNITROL INC - Form 10-Q

did we, make any contributions to our qualified pension plan. Our net periodic expense was approximately \$1.1 million in the nine months ended September 30, 2005 and October 1, 2004, and is expected to be approximately \$1.4 million for the full fiscal year in 2005.

### (10) Discontinued operations

In the second quarter of 2005, we received approximately \$6.7 million for the sale of AMI Doduco's bimetal and metal cladding operations. We realized a gain of approximately \$1.4 million from the sale of approximately \$5.1 million of inventory and \$0.2 million of machinery and equipment. During the nine months ended September 30, 2005, we accrued \$1.3 million for severance and related payments resulting from the announcement to terminate manufacturing and support personnel and incurred other expenses related to the shutdown of operations. Additionally, we realized a \$1.0 million pension curtailment gain as a result of the reduced estimated future service period of the severed personnel. We have reflected the results of the bimetal and metal cladding operations as discontinued operations on the consolidated statements of operations for all periods presented. Summary results of operations for the bimetal and metal cladding operations were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2005 ----	October 1, 2004 ----	September 30, 2005 ----	October 1, 2004 ----
Net sales	\$ --	\$ 5,845	\$ 9,020	\$15,832
(Loss) earnings before income taxes	(1,078)	(23)	(607)	172

The net book value of the land and building was approximately \$1.3 million at September 30, 2005. These assets are included in other current assets on the consolidated balance sheets as the assets are held for sale.

13

### Technitrol, Inc. and Subsidiaries

#### Notes to Unaudited Consolidated Financial Statements, continued

### (11) Goodwill and other intangibles, net

The changes in the carrying amounts of goodwill for the nine months ended September 30, 2005 are as follows (in thousands):

Balance at December 31, 2004	\$126,178
Goodwill acquired during the year (Note 2)	58,474
Purchase price allocation and other adjustments	1,245
Impairment adjustment	(25,614)
Currency translation adjustment	(4,691)
	-----
Balance at September 30, 2005	\$155,592
	=====

The majority of our goodwill and other intangibles relate to our Pulse segment.

Other intangible assets were as follows (in thousands):

## Edgar Filing: TECHNITROL INC - Form 10-Q

	September 30, 2005 ----
Intangible assets subject to amortization (definite lived)	\$10,682
Accumulated amortization	(6,242) -----
Net intangible assets subject to amortization	4,440
Intangibles assets not subject to amortization (indefinite lived)	4,658 -----
	\$ 9,098 =====

Amortization expense was \$1.2 million and \$3.3 million for the nine months ended September 30, 2005 and October 1, 2004, respectively. Exclusive of LK, estimated annual amortization expense for each of the next five years is as follows (in thousands):

Year Ending	
2006	\$999
2007	999
2008	928
2009	350
2010	90

In the three months ended July 1, 2005, we recorded a \$46.0 million impairment charge of Pulse consumer division assets including \$25.6 million of goodwill and \$11.5 million of identifiable intangibles. These impairments resulted from updated cash flow projections which reflect the shift of production by Pulse to China-based locations, decreasing average selling prices for television transformers, and the overall decline in the European television market.

14

### Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

#### Introduction

This discussion and analysis of our financial condition and results of operations as well as other sections of this report contain certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and involve a number of risks and uncertainties. Actual results may differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us described in "Risk Factors" section of this report on page 25 through 31.

#### Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles requires us to make judgments, assumptions and estimates that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Note 1 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the period ended December 31, 2004 describes the significant accounting policies and methods used in the preparation of the Consolidated Financial Statements.

## Edgar Filing: TECHNITROL INC - Form 10-Q

Estimates are used for, but not limited to, the accounting for inventory valuation, impairment of goodwill and other intangibles, severance and asset impairment expense, income taxes, and contingency accruals. Actual results could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of the Consolidated Financial Statements.

**Inventory Valuation.** We carry our inventories at lower of cost or market. We establish inventory provisions to write down excess and obsolete inventory to market value. We utilize historical trends and customer forecasts to estimate expected usage of on-hand inventory. In addition, inventory purchases are based upon future demand forecasts estimated by taking into account actual sales of our products over recent historical periods and customer forecasts. If there is a sudden and significant decrease in demand for our products or there is a higher risk of inventory obsolescence because of rapidly changing technology or customer requirements, we may be required to write down our inventory and our gross margin could be negatively affected. Conversely, if we were to sell or use a significant portion of inventory already written down, our gross margin could be positively affected.

**Impairment of Goodwill and Other Intangibles.** We assess the carrying cost of goodwill and intangible assets with indefinite lives on an annual basis and on an interim basis in certain circumstances. This assessment is based on comparing fair value to carrying cost. Fair value is based on estimating future cash flows using various growth assumptions and discounting based on a present value factor. Assigning a useful life and periodically reassessing a remaining useful life (for purposes of systematic amortization) is also predicated on various economic assumptions. Our intangible assets are also subject to impairment as a result of other factors such as changing technology, declines in demand that lead to excess capacity and other factors. In addition to the various assumptions, judgments and estimates mentioned above, we may strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses in response to changes in industry or market conditions, which could result in an impairment of goodwill or other intangibles.

**Severance and Asset Impairment Expense.** We record severance, tangible asset and other restructuring charges such as lease terminations, in response to declines in demand that lead to excess capacity, changing technology and other factors. These costs are expensed during the period in which we determine that we will incur those costs, and all of the requirements for accrual are met in accordance with the applicable accounting guidance. Restructuring costs are recorded based upon our best estimates at the time, such as estimated residual values. Our actual expenditures for the restructuring activities may differ from the initially recorded costs. If this occurs, we could be required either to record additional expenses in future periods if our initial estimates were too low, or reverse part of the charges that we recorded initially if our initial estimates were too high. In the case of acquisition-related restructuring costs,

15

depending on whether the assets impacted came from the acquired entity and the timing of the restructuring charge, such adjustment would generally require a change in value of the goodwill appearing on our balance sheet, which may not affect our earnings.

**Income Taxes.** We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year and for deferred tax liabilities and assets for the future tax consequences of events that have been



## Edgar Filing: TECHNITROL INC - Form 10-Q

recognized in an entity's financial statements or tax returns. We must make assumptions, judgments and estimates to determine our current provision for income taxes and also our deferred tax assets and liabilities and any valuation allowance to be recorded against a deferred tax asset. Our judgments, assumptions and estimates relative to the current provision for income tax take into account current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. Changes in tax law or our interpretation of tax laws and the resolution of current and future tax audits could significantly impact the amounts provided for income taxes in our consolidated financial statements. Our assumptions, judgments and estimates relative to the value of a deferred tax asset take in to account predictions of the amount and category of future taxable income. Actual operating results and the underlying amount and category of income in future years could render our current assumptions, judgments and estimates of recoverable net deferred taxes inaccurate. Any of the assumptions, judgments and estimates mentioned above could cause our actual income tax obligations to differ from our estimates.

Contingency Accruals. During the normal course of business, a variety of issues may arise, which may result in litigation, environmental compliance and other contingent obligations. In developing our contingency accruals we consider both the likelihood of a loss or incurrence of a liability as well as our ability to reasonably estimate the amount of exposure. We record contingency accruals when a liability is probable and the amount can be reasonably estimated. We periodically evaluate available information to assess whether contingency accruals should be adjusted. Our evaluation includes an assessment of legal interpretations, judicial proceedings, recent case law and specific changes or developments regarding known claims. We could be required to record additional expenses in future periods if our initial estimates were too low, or reverse part of the charges that we recorded initially if our estimates were too high.

### Overview

We are a global producer of precision-engineered passive electronic components and electrical contact products and materials. We believe we are a leading global producer of these products and materials in the primary markets we serve based on our estimates of the size of our primary markets in annual revenues and our share of those markets relative to our competitors.

We operate our business in two distinct segments:

- o the electronic components segment, which operates under the name Pulse, and
- o the electrical contact products segment, which operates under the name AMI Doduco.

General. We define net sales as gross sales less returns and allowances. We sometimes refer to net sales as revenue.

Prior to 2001, the growth in our consolidated net sales was due in large part to the growth of electronic component markets served by Pulse. However, beginning in late 2000, the electronics markets served by Pulse experienced a severe global contraction. In late 2002, many of these markets began to stabilize or increase in terms of unit sales. However, because of excess capacity, relocation by customers from North America and Europe to Asia, and emergence of strong competitors in Asia, the pricing environment for Pulse's products has been and remains challenging, preventing total revenue from growing proportionately with unit sales growth. Pulse has undertaken a series of cost-reduction actions to optimize its capacity with market conditions.

Since late 2000 and continuing through late 2003, the markets in both North America and Europe for AMI Doduco's products were weak. The markets in both North America and Europe strengthened significantly during 2004. Demand at AMI Doduco typically mirrors the prevailing economic conditions in North America and Europe. This is true for electrical contacts, and for component subassemblies for automotive applications such as multi-function switches, motor control sensors and ignition security systems, and for non-automotive uses such as appliance and industrial controls. AMI Doduco continues its cost reduction actions including work force adjustments and plant consolidations in line with demand around the world in order to optimize efficiency.

Historically, the gross margin at Pulse has been significantly higher than at AMI Doduco. As a result, the mix of net sales generated by Pulse and AMI Doduco during a period affects our consolidated gross margin. Our gross margin is also significantly affected by capacity utilization, particularly at AMI Doduco and the Pulse consumer division. Pulse's markets are characterized by relatively short product life cycles compared to AMI Doduco. As a result, significant product turnover occurs each year. Therefore, Pulse's changes in average selling prices do not necessarily provide a meaningful and quantifiable measure of Pulse's operations. AMI Doduco has relatively long-term and mature product lines, with less turnover, and with less frequent variation in the prices of product sold, relative to Pulse. Many of AMI Doduco's products are sold under annual (or longer) purchase contracts. Therefore, AMI Doduco's revenues historically have not been subject to significant price fluctuations. In addition, sales growth and contraction at AMI Doduco and Pulse's consumer division are generally attributable to changes in unit volume and changes in unit pricing, as well as foreign exchange rates, especially the U.S. dollar to the euro.

Acquisitions. Historically, acquisitions have been an important part of our growth strategy. In many cases, our move into new product lines and extensions of our existing product lines or markets has been facilitated by acquisition. Our acquisitions continually change the mix of our net sales. Pulse made numerous acquisitions in recent years which have increased our penetration into our primary markets and expanded our presence in new markets. Excelsus was acquired in August 2001 and was a leading producer of customer-premises digital subscriber line filters and other broadband accessories, and it is now a core part of Pulse's telecommunications product division. Pulse acquired Eldor's consumer electronics business in January 2003 and this became the Pulse consumer division headquartered in Italy with production operations in Turkey and in the Peoples Republic of China ("PRC"). The consumer division is a leading supplier of flyback transformers to the European television industry. We acquired a controlling interest in Full Rise Electronic Co., Ltd. ("FRE") in 2004. FRE is based in the Republic of China (Taiwan) and manufactures connector products, including single and multiple-port jacks, and supplies such products to Pulse under a cooperation agreement. LK Products Oy ("LK") was acquired in September 2005. Headquartered in Kempele, Finland, LK produces antennas and integrated modules for mobile communications and information devices. AMI Doduco has also made acquisitions over the years. Generally, AMI Doduco's acquisitions have been driven by our strategy of expanding our product and geographical market presence for electrical contact products. Due to our integration of acquisitions and the interchangeable sources of net sales between existing and acquired operations, we have not separately tracked the net sales of an acquisition after the date of the transaction.

Technology. Our business is continually affected by changes in technology, design, and preferences of consumers and other end users of our products, as well as changes in regulatory requirements. We address these changes by

## Edgar Filing: TECHNITROL INC - Form 10-Q

continuing to invest in new product development and by maintaining a diverse product portfolio which contains both mature and emerging technologies in order to meet customer demands.

Management Focus. Our executives focus on a number of important factors in evaluating our financial condition and operational performance. One of these factors is economic profit, which we define as operating profit after tax, less our cost of capital. Revenue growth, gross profit as a percentage of revenue, and operating profit as a percent of revenue are also among these factors. Operating leverage or

17

incremental operating profit as a percentage of incremental sales is a factor that is discussed frequently with analysts and investors, as this is believed to reflect the benefit of absorbing fixed overhead and operating expenses. In evaluating working capital management, liquidity and cash flow, our executives also use performance measures such as days sales outstanding, days payable outstanding and inventory turnover. The continued success of our business is largely dependent on meeting and exceeding our customers' expectations. Therefore, non-financial performance measures relating to on-time delivery and quality assist our management in monitoring customer satisfaction on an on-going basis.

Cost Reduction Programs. Our manufacturing business model for Pulse's non-consumer markets has a very high variable cost component due to the labor-intensity of many processes, which allows us to quickly change our capacity based on market demand. The Pulse consumer division, however, is capital intensive and therefore more sensitive to volume changes. AMI Doduco has a higher fixed cost component of manufacturing activity than Pulse, as it is more capital intensive. Therefore, AMI Doduco is unable to expand or contract its capacity as quickly as Pulse in response to market demand, although significant actions have been taken to align AMI Doduco's capacity with current market demand.

As a result of our continuing focus on both economic and operating profit, we will continue to aggressively size both Pulse and AMI Doduco so that costs are optimally matched to current and anticipated future revenue and unit demand. Therefore, we may restructure our business in the future and the amounts of additional charges will depend on specific actions taken. The actions taken over the past several years such as plant closures, plant relocations, asset impairments and reduction in personnel worldwide have resulted in the elimination of a variety of costs. The majority of these costs represent the annual salaries and benefits of terminated employees, both those directly related to manufacturing and those providing selling, general and administrative services, as well as lower overhead costs resulting from factory relocations to lower-cost locations. The eliminated costs also include depreciation savings from disposed equipment. We have implemented a succession of cost reduction initiatives and programs, summarized as follows:

During 2004, we accrued for the termination of personnel at AMI Doduco's facility in Germany; for Pulse's shutdown of a facility in Carlsbad, California; to reduce capacity at a Pulse facility in the PRC; to shutdown AMI Doduco's facility in France; and for other severance in various locations.

During 2005, we accrued for the termination of personnel at Pulse's facilities in Italy and Turkey (coincident with moving these operations to China) and AMI Doduco's facility in Italy (coincident with moving these operations to Spain); the termination of a lease in the PRC; and for other severance in various locations. An additional provision was recorded related to

## Edgar Filing: TECHNITROL INC - Form 10-Q

asset write-downs of Pulse's consumer business in Italy and Turkey.

International Operations. As of September 30, 2005, we had manufacturing operations in 9 countries and had no significant net sales in currencies other than the U.S. dollar and the euro. A large percentage of our sales in recent years has been outside of the United States. Fluctuating exchange rates often impact our financial results and our period-over-period comparisons. This is particularly true of movements in the exchange rate between the U.S. dollar and the euro. AMI Doduco's European and Pulse's consumer division sales are denominated primarily in euros, and euro-denominated sales and earnings may result in higher or lower dollar sales and net earnings upon translation for our U.S. consolidated financial statements. We may also experience a positive or negative translation adjustment to equity because our investment in Pulse's consumer division and AMI Doduco's European operations may be worth more or less in U.S. dollars after translation for our U.S. consolidated financial statements. The Pulse non-consumer operations may incur foreign currency gains or losses as euro-denominated transactions are remeasured to U.S. dollars for financial reporting purposes. If a higher percentage of our sales is denominated in non-U.S. currencies, increased exposure to currency fluctuations may result. In order to reduce our exposure resulting from currency fluctuations, we may purchase currency exchange forward contracts and/or currency options. These contracts guarantee a predetermined range of exchange rates at the time the contract is purchased. This allows us to shift the majority of the risk of currency

18

fluctuations from the date of the contract to a third party for a fee. In determining the use of forward exchange contracts and currency options, we consider the amount of sales, purchases and net assets or liabilities denominated in local currencies, the type of currency, and the costs associated with the contracts.

Income Taxes. Our effective income tax rate is affected by the proportion of our income earned in high-tax jurisdictions such as those in Europe and the income earned in low-tax jurisdictions, particularly Izmir, Turkey and the PRC. This mix of income can vary significantly from one period to another. We have benefited in recent years from favorable tax incentives, inside and outside of the U.S. However, there is no guarantee as to how long these benefits will continue to exist. In October 2004, the American Jobs Creation Act of 2004 ("AJCA") was signed into law. The AJCA creates a temporary incentive for U.S. multi-national corporations to repatriate accumulated income abroad by providing an 85% dividends received deduction for certain dividends from controlled foreign corporations. Based on this legislation and 2005 guidance by the Department of Treasury, we decided in the third quarter of 2005 to repatriate \$53.0 million of foreign earnings before the end of 2005. A charge of \$5.6 million related to the planned repatriation was accrued in the third quarter of 2005 and is included in income taxes (from continuing operations) in the accompanying consolidated statements of operations.

### Results of Operations

Three months ended September 30, 2005 compared to the three months ended October 1, 2004

Net Sales. Net sales for the three months ended September 30, 2005 increased \$6.6 million, or 4.7%, to \$147.2 million from \$140.6 million in the three months ended October 1, 2004. Our sales increase from the comparable period in prior year was primarily attributable to the consolidation of LK's net sales with Pulse's net sales beginning on September 9, 2005, partially offset by

## Edgar Filing: TECHNITROL INC - Form 10-Q

weakness in Pulse's consumer division and lower demand for AMI Doduco's products in Southern Europe. Net sales in the third fiscal quarter of 2005 included only thirteen weeks versus fourteen weeks in 2004.

Pulse's net sales increased \$9.3 million, or 12.0 %, to \$86.6 million for the three months ended September 30, 2005 from \$77.4 million in the three months ended October 1, 2004. This increase was primarily attributable to the consolidation of LK's net sales with Pulse's net sales beginning on September 9, 2005. Additionally, FRE's net sales were consolidated with Pulse's net sales for the full quarter of 2005, as compared with two weeks in the comparable period of 2004. Net sales in Pulse's legacy business (networking, telecommunications, military/aerospace, and power conversion) were up modestly in the current period with the prior year period, offset by continued weakness in Pulse's consumer division.

AMI Doduco's net sales decreased \$2.6 million, or 4.2 %, to \$60.6 million for the three months ended September 30, 2005 from \$63.2 million in the three months ended October 1, 2004. Sales in the 2005 period compared to 2004 period reflect lower demand in Southern Europe, and flat demand in North America and China. Partially offsetting this decrease was the positive impact of an increase in the average selling prices of precious metals compared to 2004.

Cost of Sales. As a result of higher sales, our cost of sales increased \$7.3 million, or 6.9%, to \$113.2 million for the three months ended September 30, 2005 from \$105.9 million for the three months ended October 1, 2004. Our consolidated gross margin for the three months ended September 30, 2005 was 23.1% compared to 24.7% for the three months ended October 1, 2004. Our consolidated gross margin in 2005 was negatively affected by unabsorbed capacity in the Pulse consumer division, statutory minimum wage and social cost increases in China in 2005 compared to 2004, and higher material costs at FRE in 2005.

19

Selling, General and Administrative Expenses. Total selling, general and administrative expenses for the three months ended September 30, 2005 decreased \$1.3 million, or 4.7%, to \$25.6 million, or 17.4 % of net sales, from \$26.8 million, or 19.1% of net sales for the three months ended October 1, 2004. Decreased spending was a result of lower variable costs such as incentive compensation and selling expense, and the favorable impact of restructuring actions that we took over the last year to reduce costs, including intangible asset writedowns which resulted in intangible amortization expense being \$1.0 million lower in 2005 versus the comparable period in 2004. These decreases were partially offset by the inclusion of LK's expenses in the 2005 period, since the time of the acquisition on September 8, 2005.

Research, development and engineering expenses are included in selling, general and administrative expenses. We refer to research, development and engineering expenses as RD&E. For the three months ended September 30, 2005 and October 1, 2004 respectively, RD&E by segment was as follows (in thousands):

	2005	2004
	----	----
Pulse	\$5,475	\$4,846
Percentage of segment sales	6.3%	6.2%
 AMI Doduco	 \$ 988	 \$1,043
Percentage of segment sales	1.6%	1.6%

We believe that future sales in the electronic components markets will be driven by next-generation products. Design and development activities with our

## Edgar Filing: TECHNITROL INC - Form 10-Q

OEM customers continue at an aggressive pace.

**Severance and Asset Impairment Expense.** Severance and asset impairment expense for the three months ended September 30, 2005 was \$1.4 million compared to \$2.4 million in the three months ended October 1, 2004.

**Interest.** Net interest income was \$0.4 million for the three months ended September 30, 2005 compared to net interest expense of \$ 0.1 million for the three months ended October 1, 2004. The higher average balance of invested cash in 2005 over the comparable period in 2004, combined with a higher interest income yield, resulted in higher net interest income. Recurring components of interest expense (silver leasing fees, interest on bank debt and bank commitment fees) approximated those of 2004.

**Other.** Other income (expense) was \$0.2 million of expense for the three months ended September 30, 2005 versus \$0.2 million of income for the three months ended October 1, 2004.

**Income Taxes.** The effective income tax rate for the three months ended September 30, 2005 was 21.6 % compared to 22.1% for the three months ended October 1, 2004. The \$5.6 million tax expense on the repatriation was substantially offset by the tax benefit related to the expiration of the statute of limitations for tax reserve items.

Nine months ended September 30, 2005 compared to the nine months ended October 1, 2004

**Net Sales.** Net sales for the nine months ended September 30, 2005 increased \$14.7 million, or 3.5%, to \$431.9 million from \$417.2 million in the nine months ended October 1, 2004. Our sales increase was attributable to improvement in the markets for AMI Doduco and the inclusion of LK Product's net sales in our consolidated financial statements beginning September 9, 2005. AMI Doduco's increase in net sales was due to strengthening markets, higher prices for precious metals and favorable translation effect of a stronger euro.

Pulse's net sales increased \$4.2 million, or 1.8 %, to \$240.6 million for the nine months ended September 30, 2005 from \$236.4 million in the nine months ended October 1, 2004. This increase was attributable to the inclusion of LK's net sales in our consolidation beginning September 9, 2005, and the inclusion of FRE's net sales in our consolidation for the full year of 2005, as compared with two weeks in the comparable period of 2004, partially offset by weakness in Pulse's consumer division.

20

AMI Doduco's net sales increased \$10.5 million, or 5.8 %, to \$191.4 million for the nine months ended September 30, 2005 from \$180.8 million in the nine months ended October 1, 2004. Sales in the 2005 period reflect improving demand in North America, particularly in the commercial and industrial markets, whereas Southern European markets were flat to down, particularly in the automotive sector. The sales benefited from an increase in the average U.S. dollar-to-euro exchange rate and higher prices for precious metals which were passed on to customers. The higher average U.S. dollar-to-euro exchange rate during 2005 versus the comparable 2004 nine months increased sales by approximately \$4.0 million in the nine months ended September 30, 2005, relative to the comparable period of 2004.

**Cost of Sales.** As a result of higher net sales, our cost of sales increased \$25.8 million, or 8.4%, to \$331.4 million for the nine months ended September 30, 2005 from \$305.6 million for the nine months ended October 1,

## Edgar Filing: TECHNITROL INC - Form 10-Q

2004. Our consolidated gross margin for the nine months ended September 30, 2005 was 23.3% compared to 26.8% for the nine months ended October 1, 2004. Our consolidated gross margin was negatively affected by:

- o decreased gross margin on Pulse consumer division sales, which was negatively impacted by the continuing weak U.S. dollar relative to the euro and lower demand for television sets in Europe;
- o increases in statutory minimum wages and social costs in China. The local government in the PRC increased wages in Southern coastal provinces of the PRC by 17% in May 2005; and
- o higher material costs at FRE.

Selling, General and Administrative Expenses. Total selling, general and administrative expenses for the nine months ended September 30, 2005 decreased \$4.7 million, or 5.7%, to \$77.7 million, or 18.0% of net sales, from \$82.4 million, or 19.7% net of sales for the nine months ended October 1, 2004. Decreased spending was primarily a result of lower variable cost, such as decreased incentive expense, which was \$2.7 million lower in 2005 versus the comparable period in 2004. We also benefited from the favorable impact of restructuring actions and expense reduction measures that we took over the last year. Intangible amortization expense was also \$2.1 million lower in 2005 versus the comparable period in 2004.

Research, development and engineering expenses are included in selling, general and administrative expenses. We refer to research, development and engineering expenses as RD&E. For the nine months ended September 30, 2005 and October 1, 2004 respectively, RD&E by segment was as follows (in thousands):

	2005	2004
	----	----
Pulse	\$14,983	\$14,135
Percentage of segment sales	6.2%	6.0%
AMI Doduco	\$ 3,165	\$ 3,037
Percentage of segment sales	1.7%	1.7%

We believe that future sales in the electronic components markets will be driven by next-generation products. Design and development activities with our OEM customers continue at an aggressive pace.

Severance and Asset Impairment Expense. Severance and asset impairment expense for the nine months ended September 30, 2005 was \$50.6 million compared to \$6.7 million in the nine months ended October 1, 2004. The increase in the 2005 period was primarily due to the \$46.0 million asset impairment in Pulse's consumer division, consisting of \$25.6 million of goodwill, \$11.5 of identified intangibles and \$8.9 million of property, plant and equipment. These impairments resulted from updated cash flow

projections which reflect the shift of production by Pulse to China-based locations, decreasing average selling prices for television transformers, and recent weakness in the European television market.

Interest. Net interest income was \$1.2 million for the nine months ended September 30, 2005 compared to net interest expense of \$0.4 million for the nine months ended October 1, 2004. The higher average balance of invested cash in 2005 over the comparable period in 2004, combined with a higher interest income

## Edgar Filing: TECHNITROL INC - Form 10-Q

yield, resulting in higher net interest income. Recurring components of interest expense (silver leasing fees, interest on bank debt and bank commitment fees) approximated those of 2004, except for the inclusion of interest expense on FRE debt which began on September 13, 2004 upon our acquisition of a controlling interest in FRE.

Other. Other income (expense) was \$1.1 million of expense for the nine months ended September 30, 2005 versus \$0.7 million of income for the nine months ended October 1, 2004. The decrease from 2004 is primarily attributable to \$1.1 million gain in 2004 related to the sale of equity rights arising from the acquisition of the Engelhard-CLAL electrical contacts business in 2001 and \$1.1 million higher foreign currency exchange losses in the 2005 period compared to 2004.

Income Taxes. The effective income tax rate for the nine months ended September 30, 2005 was 14.5% compared to 17.4% for the nine months ended October 1, 2004. The lower tax rate in 2005 was primarily a result of the non-deductibility of the consumer division impairment charge of approximately \$46.0 million. The effective rate without the impairment charge was 23.2%. The \$5.6 million tax expense on the repatriation was substantially offset by the tax benefit related to the expiration of the statute of limitations for tax reserve items.

### Liquidity and Capital Resources

Working capital as of September 30, 2005 was \$172.6 million compared to \$238.9 million as of December 31, 2004, a decrease of \$66.3 million. Cash and cash equivalents, which is included in working capital, decreased from \$156.0 million as of December 31, 2004 to \$99.0 million as of September 30, 2005, a decrease of \$57.0 million. This decrease in cash related primarily to cash used in the acquisition of LK on September 8, 2005, which was only partially offset by increases in working capital of LK subsequent to the acquisition date. At each balance sheet date, components of working capital will be affected by various items such as operating activities, foreign exchange rate changes, and acquisitions.

Net cash provided by operating activities was \$33.1 million for the nine months ended September 30, 2005 and \$21.5 million in the comparable period of 2004, an increase of \$11.7 million. This increase is primarily attributable to positive working capital changes of \$15.8 million during the nine months ended September 30, 2005, as compared to the nine months ended October 1, 2004.

We present our statement of cash flows using the indirect method as permitted under Financial Accounting Standards Board Statement No. 95, Statement of Cash Flows. Our management has found that investors and analysts typically refer to changes in accounts receivable, inventory, and other components of working capital when analyzing operating cash flows. Also, changes in working capital are more directly related to the way we manage our business for cash flow than are items such as cash receipts from the sale of goods, as would appear using the direct method.

Capital expenditures were \$12.2 million during the nine months ended September 30, 2005 and \$5.4 million in the comparable period of 2004. During the nine months ended September 30, 2005, we included \$6.8 million of capital spending of FRE in conjunction with our consolidation of FRE's financial statements. We make capital expenditures to expand production capacity, improve our operating efficiency, and enhance workplace safety. We plan to continue making such expenditures in the future as and when necessary.



## Edgar Filing: TECHNITROL INC - Form 10-Q

We used \$7.1 million for dividend payments during the nine months ended September 30, 2005. On July 27, 2005, we announced a quarterly dividend of \$0.0875 per common share, payable on October 21, 2005 to shareholders of record on October 7, 2005. This quarterly dividend will result in a cash payment to shareholders of approximately \$3.5 million in the fourth quarter of 2005. On October 27, 2005 we announced a quarterly cash dividend of \$0.0875 per common share, payable on January 20, 2006 to shareholders of record on January 2, 2006. This quarterly dividend will result in a cash payment to shareholders of approximately \$3.5 million in the first quarter of 2006.

We used \$84.6 million for acquisitions during the nine months ended September 30, 2005 and \$4.8 million for acquisitions during the nine months ended October 1, 2004, net of cash acquired in both years. The 2005 expenditures relate primarily to our acquisition of LK on September 8, 2005. The 2004 expenditures related to the acquisition by Pulse of a plastics fabrication operation in the PRC for \$3.6 million and an investment in FRE of \$13.0 million, net of cash acquired of \$11.7 million. We may acquire other businesses or product lines to expand our breadth and scope of operations.

We entered into a credit agreement on October 14, 2005 providing for \$200.0 million of credit capacity. The facility consists of an aggregate U.S. dollar-equivalent revolving line of credit in the principal amount of up to \$200.0 million, and provides for borrowings in multiple currencies including but not limited to, U.S. dollars, euros, and Japanese yen, including individual sub-limits of:

- a U.S. dollar-based swing-line loan not to exceed \$20.0 million;
- a multicurrency facility providing for the issuance of letters of credit in an aggregate amount not to exceed the U.S. dollar equivalent of \$25.0 million; and
- a Singapore sub-facility not to exceed the U.S. dollar equivalent of \$50.0 million.

The credit agreement permits us to request one or more increases in the total commitment not to exceed \$100.0 million, provided the minimum increase is \$25.0 million, subject to bank approval.

The total amount outstanding under the credit facility may not exceed \$200.0 million, provided we do not request an increase in total commitment as noted above.

Outstanding borrowings are subject to two financial covenants, which are both computed on a rolling twelve-month basis as of the most recent quarter-end. The first is maximum debt outstanding amounting to three and one-half times our earnings before interest, taxes, depreciation and amortization (EBITDA), as defined by the credit agreement. The second is maximum debt service expenses amounting to two and one-half times our cash interest expense, as defined by the credit agreement.

The credit agreement also contains covenants specifying capital expenditure limitations and other customary and normal provisions. We have no outstanding borrowings under this five-year revolving credit agreement.

We pay a commitment fee on the unborrowed portion of the commitment, which ranges from 0.15% to 0.25% of the total commitment, depending on our debt-to-EBITDA ratio, as defined above. The interest rate for each currency's borrowing will be a combination of the base rate for that currency plus a credit margin spread. The base rate is different for each currency. The credit margin spread is the same for each currency and is 0.60% to 1.25%, depending on our

## Edgar Filing: TECHNITROL INC - Form 10-Q

debt-to-EBITDA ratio, as defined in the credit agreement. Each of our domestic subsidiaries with net worth equal to or greater than \$10 million has guaranteed all obligations incurred under the credit facility.

Simultaneously with the execution of our current credit agreement, we terminated our previous \$125.0 million credit agreement, dated June 17, 2004.

We also have an obligation outstanding due in August 2009 under an unsecured term loan agreement with Sparkasse Pforzheim, for the borrowing of approximately 5.1 million euros.

23

At September 30, 2005, our balance sheet includes \$6.1 million of outstanding debt of Full Rise Electronic Co., Ltd. in connection with our consolidation of FRE's financial statements. FRE has a total credit limit of approximately \$6.9 million in U.S. dollar equivalents as of September 30, 2005. Neither Technitrol, nor any of its subsidiaries, has guaranteed or otherwise participated in the credit facilities of FRE or assumed any responsibility for the current or future indebtedness of FRE.

We had three standby letters of credit outstanding at September 30, 2005 in the aggregate amount of \$1.1 million securing transactions entered into in the ordinary course of business.

We had commercial commitments outstanding at September 30, 2005 of approximately \$77.4 million due under precious metal consignment-type leases. This represents a decrease of \$6.0 million from the \$83.4 million outstanding as of December 31, 2004 and is primarily attributable to lower average silver prices at September 30, 2005.

We believe that the combination of cash on hand, cash generated by operations and, if necessary, borrowings under our credit agreement will be sufficient to satisfy our operating cash requirements in the foreseeable future. In addition, we may use internally generated funds or obtain borrowings or equity offerings for acquisitions of suitable businesses or assets.

All retained earnings are free from legal or contractual restrictions as of September 30, 2005, with the exception of approximately \$14.0 million of retained earnings primarily in the PRC, that are restricted in accordance with Section 58 of the PRC Foreign Investment Enterprises Law. Included in the \$14.0 million are \$1.8 million of retained earnings of FRE of which we own 57%. The amount restricted in accordance with the PRC Foreign Investment Enterprise Law is applicable to all foreign investment enterprises doing business in the PRC. The restriction applies to 10% of our net earnings in the PRC, limited to 50% of the total capital invested in the PRC. We have not experienced any significant liquidity restrictions in any country in which we operate and none are foreseen. However, foreign exchange ceilings imposed by local governments and the sometimes-lengthy approval processes which foreign governments require for international cash transfers may delay our internal cash movements from time to time. The retained earnings in other countries represent a material portion of our assets. Except where it is advantageous for tax purposes, we expect to reinvest these earnings outside of the United States because we anticipate that a significant portion of our opportunities for growth in the coming years will be abroad. If these earnings were brought back to the United States, significant tax liabilities could be incurred in the United States as several countries in which we operate have tax rates significantly lower than the U.S. statutory rate. Additionally, we have not accrued U.S. income and foreign withholding taxes on foreign earnings that have been indefinitely invested abroad.

## Edgar Filing: TECHNITROL INC - Form 10-Q

In October 2004, the American Jobs Creation Act of 2004 ("AJCA") was signed into law. The AJCA creates a temporary incentive for U.S. multi-national corporations to repatriate accumulated income abroad by providing an 85% dividends received deduction for certain dividends from controlled foreign corporations. Based on this legislation and 2005 guidance by the Department of Treasury, we decided in the third quarter of 2005 to repatriate \$53.0 million of foreign earnings before the end of 2005. A charge of \$5.6 million related to the planned repatriation was accrued in the third quarter of 2005 and is included in income taxes (from continuing operations) in the accompanying consolidated statement of operations. Prior to the passage of the AJCA, a majority of the undistributed earnings of foreign subsidiaries were considered to be indefinitely reinvested, and in accordance with APB Opinion No. 23 ("APB 23"), Accounting for Income Taxes - Special Areas, no provision for U.S. federal or state income taxes had been provided on these undistributed earnings. The tax expense related to dividend repatriation may be reduced or increased in future periods due to changes in key assumptions such as applicable law or business conditions

24

### Risk Factors

Cyclical changes in the markets we serve could result in a significant decrease in demand for our products and reduce our profitability.

Our components are used in various products for the electronic and electrical equipment markets. These markets are highly cyclical. The demand for our components reflects the demand for products in the electronic and electrical equipment markets generally. A contraction in demand would result in a decrease in sales of our products, as our customers:

- o may cancel many existing orders;
- o may introduce fewer new products; and
- o may decrease their inventory levels.

A decrease in demand for our products would have a significant adverse effect on our operating results and profitability. Accordingly, we may experience volatility in both our revenues and profits.

Reduced prices for our products may adversely affect our profit margins if we are unable to reduce our costs of production.

The average selling prices for our products tend to decrease over their life cycle. In addition, foreign currency movements and the need to retain market share increase the pressure on our customers to seek lower prices from their suppliers. As a result, our customers are likely to continue to demand lower prices from us. To maintain our margins and remain profitable, we must continue to meet our customers' design needs while reducing costs through efficient raw material procurement and process and product improvements. Our profit margins will suffer if we are unable to reduce our costs of production as sales prices decline.

An inability to adequately respond to changes in technology or customer needs may decrease our sales.

Pulse operates in an industry characterized by rapid change caused by the frequent emergence of new technologies. Generally, we expect life cycles for our products in the electronic components industry to be relatively short. This

## Edgar Filing: TECHNITROL INC - Form 10-Q

requires us to anticipate and respond rapidly to changes in industry standards and customer needs and to develop and introduce new and enhanced products on a timely and cost effective basis. Our engineering and development teams place a priority on working closely with our customers to design innovative products and improve our manufacturing processes. Our inability to react to changes in technology or customer needs quickly and efficiently may decrease our sales, thus reducing profitability.

If our inventories become obsolete, our future performance and operating results will be adversely affected.

The life cycles of our products depend heavily upon the life cycles of the end products into which our products are designed. Many of Pulse's products have very short life cycles which are measured in quarters. Products with short life cycles require us to closely manage our production and inventory levels. Inventory may become obsolete because of adverse changes in end market demand. During market slowdowns, this may result in significant charges for inventory write-offs. Our future operating results may be adversely affected by material levels of obsolete or excess inventories.

An inability to capitalize on our recent or future acquisitions may adversely affect our business.

We have completed several acquisitions in recent years. We continually seek acquisitions to grow our business. We may fail to derive significant benefits from our acquisitions. In addition, if we fail to

25

achieve sufficient financial performance from an acquisition, goodwill and other intangibles could become impaired, resulting in our recognition of a loss. In 2004, we recorded an aggregate intangible impairment charge of \$18.5 million related to Pulse. In 2005 we recorded a \$46.0 million impairment charge related to Pulse's consumer division. The success of any of our acquisitions depends on our ability to:

- o successfully integrate or consolidate acquired operations into our existing businesses;
- o develop or modify the financial reporting and information systems of the acquired entity to ensure overall financial integrity and adequacy of control procedures;
- o identify and take advantage of cost reduction opportunities; and
- o further penetrate the markets for the product capabilities acquired.

Integration of acquisitions may take longer than we expect and may never be achieved to the extent originally anticipated. This could result in slower than anticipated business growth or higher than anticipated costs. In addition, acquisitions may:

- o cause a disruption in our ongoing business;
- o distract our managers;
- o unduly burden our other resources; and
- o result in an inability to maintain our historical standards, procedures and controls, which may result in non-compliance with

## Edgar Filing: TECHNITROL INC - Form 10-Q

external laws and regulations.

Integration of acquisitions into the acquiring segment may limit the ability of investors to track the performance of individual acquisitions and to analyze trends in our operating results.

Our historical practice has been to quickly integrate acquisitions into the existing business of the acquiring segment and to report financial performance on the segment level. As a result of this practice, we do not separately track the stand-alone performance of acquisitions after the date of the transaction. Consequently, investors cannot quantify the financial performance and success of any individual acquisition or the financial performance and success of a particular segment excluding the impact of acquisitions. In addition, our practice of quickly integrating acquisitions into the financial performance of each segment may limit the ability of investors to analyze any trends in our operating results over time.

An inability to identify additional acquisition opportunities may slow our future growth.

We intend to continue to identify and consummate additional acquisitions to further diversify our business and to penetrate important markets. We may not be able to identify suitable acquisition candidates at reasonable prices. Even if we identify promising acquisition candidates, the timing, price, structure and success of future acquisitions are uncertain. An inability to consummate attractive acquisitions may reduce our growth rate and our ability to penetrate new markets.

If our customers terminate their existing agreements, or do not enter into new agreements or submit additional purchase orders for our products, our business will suffer.

Most of our sales are made on a purchase order basis as needed by our customers. In addition, to the extent we have agreements in place with our customers, most of these agreements are either short term in nature or provide our customers with the ability to terminate the arrangement with little or no prior notice. Our contracts typically do not provide us with any material recourse in the event of non-renewal or early termination. We will lose business and our revenues will decrease if a significant number of customers:

- o do not submit additional purchase orders;
- o do not enter into new agreements with us; or
- o elect to terminate their relationship with us.

26

If we do not effectively manage our business in the face of fluctuations in the size of our organization, our business may be disrupted.

We have grown rapidly over the last ten years, both organically and as a result of acquisitions. However, we significantly reduce or expand our workforce and facilities in response to changes in demand for our products due to prevailing global market conditions. These rapid fluctuations place strains on our resources and systems. If we do not effectively manage our resources and systems, our businesses may be adversely affected.

Uncertainty in demand for our products may result in increased costs of production, an inability to service our customers, or higher inventory levels

## Edgar Filing: TECHNITROL INC - Form 10-Q

which may adversely affect our results of operations and financial condition.

We have very little visibility into our customers' purchasing patterns and are highly dependent on our customers' forecasts. These forecasts are non-binding and often highly unreliable. Given the fluctuation in growth rates and cyclical demand for our products, as well as our reliance on often-imprecise customer forecasts, it is difficult to accurately manage our production schedule, equipment and personnel needs and our raw material and working capital requirements. Our failure to effectively manage these issues may result in:

- o production delays;
- o increased costs of production;
- o excessive inventory levels and reduced financial liquidity;
- o an inability to make timely deliveries; and
- o a decrease in profits.

A decrease in availability or increase in cost of our key raw materials could adversely affect our profit margins.

We use several types of raw materials in the manufacturing of our products, including:

- o precious metals such as silver;
- o other base metals such as copper and brass; and
- o ferrite cores.

Some of these materials are produced by a limited number of suppliers. From time to time, we may be unable to obtain these raw materials in sufficient quantities or in a timely manner to meet the demand for our products. The lack of availability or a delay in obtaining any of the raw materials used in our products could adversely affect our manufacturing costs and profit margins. In addition, if the price of our raw materials increases significantly over a short period of time, customers may be unwilling to bear the increased price for our products and we may be forced to sell our products containing these materials at prices that reduce our profit margins.

Some of our raw materials, such as precious metals, are considered commodities and are subject to price volatility. We attempt to limit our exposure to fluctuations in the cost of precious materials, including silver, by holding the majority of our precious metal inventory through leasing or consignment arrangements with our suppliers. We then typically purchase the precious metal from our supplier at the current market price on the day after delivery to our customer and pass this cost on to our customer. In addition, leasing and consignment costs have historically been substantially below the costs to borrow funds to purchase the precious metals. We currently have four consignment or leasing agreements related to precious metals, all of which generally have one year terms with varying maturity dates, but can be terminated by either party with 30 days' prior notice. Our results of operations and liquidity will be negatively impacted if:

27

- o we are unable to enter into new leasing or consignment arrangements with similarly favorable terms after our existing agreements

## Edgar Filing: TECHNITROL INC - Form 10-Q

terminate, or

- o our leasing or consignment fees increase significantly in a short period of time and we are unable to recover these increased costs through higher sale prices.

Fees charged by the consignor are driven by interest rates and the market price of the consigned material. The market price of the consigned material is determined by the supply of and the demand for the material. Consignment fees may increase if interest rates or the price of the consigned material increase.

Competition may result in lower prices for our products and reduced sales.

Both Pulse and AMI Doduco frequently encounter strong competition within individual product lines from various competitors throughout the world. We compete principally on the basis of:

- o product quality and reliability;
- o global design and manufacturing capabilities;
- o breadth of product line;
- o customer service;
- o price; and
- o on-time delivery.

Our inability to successfully compete on any or all of the above factors may result in reduced sales.

Our backlog is not an accurate measure of future revenues and is subject to customer cancellation.

While our backlog consists of firm accepted orders with an express release date generally scheduled within nine months of the order, many of the orders that comprise our backlog may be canceled by customers without penalty. It is widely known that customers in the electronics industry have on occasion double and triple-ordered components from multiple sources to ensure timely delivery when quoted lead time is particularly long. In addition, customers often cancel orders when business is weak and inventories are excessive. Although backlog should not be relied on as an indicator of our future revenues, our results of operations could be adversely impacted if customers cancel a material portion of orders in our backlog.

Fluctuations in foreign currency exchange rates may adversely affect our operating results.

We manufacture and sell our products in various regions of the world and export and import these products to and from a large number of countries. Fluctuations in exchange rates could negatively impact our cost of production and sales that, in turn, could decrease our operating results and cash flow. In addition, if the functional currency of our manufacturing costs strengthened compared to the functional currency of our competitors manufacturing costs, our products may get more costly than our competitors. Although we engage in limited hedging transactions, including foreign currency contracts, to reduce our transaction and economic exposure to foreign currency fluctuations, these measures may not eliminate or substantially reduce our risk in the future.

Our international operations subject us to the risks of unfavorable political, regulatory, labor and tax conditions in other countries.

## Edgar Filing: TECHNITROL INC - Form 10-Q

We manufacture and assemble most of our products in locations outside the United States, including the Peoples' Republic of China, or PRC, Hungary, and Turkey and a majority of our revenues are derived from sales to customers outside the United States. Our future operations and earnings may be

28

adversely affected by the risks related to, or any other problems arising from, operating in international markets.

Risks inherent in doing business internationally may include:

- o economic and political instability;
- o expropriation and nationalization;
- o trade restrictions;
- o capital and exchange control programs;
- o transportation delays;
- o foreign currency fluctuations; and
- o unexpected changes in the laws and policies of the United States or of the countries in which we manufacture and sell our products.

Pulse has substantially all of its non-consumer manufacturing operations in the PRC. Our presence in the PRC has enabled Pulse to maintain lower manufacturing costs and to adjust our work force to demand levels for our products. Although the PRC has a large and growing economy, the potential economic, political, legal and labor developments entail uncertainties and risks. For example, in May 2005 the local government in the PRC increased wages in the southern coastal provinces of the PRC by 17%. While the PRC has been receptive to foreign investment, we cannot be certain that its current policies will continue indefinitely into the future. In the event of any changes that adversely affect our ability to conduct our operations within the PRC, our businesses may suffer. We also have manufacturing operations in Turkey subject to unique risks, including earthquakes and those associated with Middle East geo-political events.

We have benefited over recent years from favorable tax treatment as a result of our international operations. We operate in countries where we realize favorable income tax treatment relative to the U.S. statutory rate. We have also been granted special tax incentives commonly known as tax holidays in countries such as the PRC, Hungary, and Turkey. This favorable situation could change if these countries were to increase rates or revoke the special tax incentives, or if we discontinue our manufacturing operations in any of these countries and do not replace the operations with operations in other locations with favorable tax incentives. Accordingly, in the event of changes in laws and regulations affecting our international operations, we may not be able to continue to take advantage of similar benefits in the future.

Shifting our operations between regions may entail considerable expense.

In the past we have shifted our operations from one region to another in order to maximize manufacturing and operational efficiency. We may close one or more additional factories in the future. This could entail significant one-time earnings charges to account for severance, equipment write-offs or write-downs



## Edgar Filing: TECHNITROL INC - Form 10-Q

and moving expenses as well as certain adverse tax consequences including the loss of specialized tax incentives. In addition, as we implement transfers of our operations we may experience disruptions, including strikes or other types of labor unrest resulting from layoffs or termination of employees.

Liquidity requirements could necessitate movements of existing cash balances which may be subject to restrictions or cause unfavorable tax and earnings consequences.

A significant portion of our cash is held offshore by our international subsidiaries and is predominantly denominated in U.S. dollars. While we intend to use a significant amount of the cash held overseas to fund our international operations and growth, if we encounter a significant domestic need for liquidity, such as paying dividends, that we cannot fulfill through borrowings, equity offerings, or other internal or external sources, we may experience unfavorable tax and earnings consequences if this cash is transferred to the United States. These adverse consequences would occur if the transfer of cash into the United States is taxed and no offsetting foreign tax credit is available to offset the U.S. tax liability,

29

resulting in lower earnings. In addition, we may be prohibited from transferring cash from the PRC. With the exception of approximately \$14.0 million of non-cash retained earnings as of December 31, 2004 in primarily the PRC that are restricted in accordance with the PRC Foreign Investment Enterprises Law, substantially all retained earnings are free from legal or contractual restrictions. The PRC Foreign Investment Enterprise Law restricts 10% of our net earnings in the PRC, up to a maximum amount equal to 50% of the total capital we have invested in the PRC. We have not experienced any significant liquidity restrictions in any country in which we operate and none are presently foreseen. However, foreign exchange ceilings imposed by local governments and the sometimes-lengthy approval processes which some foreign governments require for international cash transfers may delay our internal cash movements from time to time.

Losing the services of our executive officers or our other highly qualified and experienced employees could adversely affect our business.

Our success depends upon the continued contributions of our executive officers and management, many of whom have many years of experience and would be extremely difficult to replace. We must also attract and maintain experienced and highly skilled engineering, sales and marketing and managerial personnel. Competition for qualified personnel is intense in our industries, and we may not be successful in hiring and retaining these people. If we lose the services of our executive officers or cannot attract and retain other qualified personnel, our businesses could be adversely affected.

Public health epidemics (such as flu strains, severe acute respiratory syndrome) or other natural disasters (such as earthquakes or fires) may disrupt operations in affected regions and affect operating results.

Pulse maintains extensive manufacturing operations in the PRC and Turkey, as do many of our customers and suppliers. A sustained interruption of our manufacturing operations, or those of our customers or suppliers, as a result of complications from severe acute respiratory syndrome or another public health epidemic or other natural disasters, could have a material adverse effect on our business and results of operations.

Costs associated with precious metals may not be recoverable.

## Edgar Filing: TECHNITROL INC - Form 10-Q

AMI Doduco uses silver, as well as other precious metals, in manufacturing some of its electrical contacts, contact materials and contact subassemblies. Historically, we have leased or held these materials through consignment arrangements with our suppliers. Leasing and consignment costs have typically been below the costs to borrow funds to purchase the metals, and more importantly, these arrangements eliminate the effects of fluctuations in the market price of owned precious metal and enable us to minimize our inventories. AMI Doduco's terms of sale generally allow us to charge customers for precious metal content based on market value of precious metal on the day after shipment to the customer. Thus far we have been successful in managing the costs associated with our precious metals. While limited amounts are purchased for use in production, the majority of our precious metal inventory continues to be leased or held on consignment. If our leasing/consignment fees increase significantly in a short period of time, and we are unable to recover these increased costs through higher sale prices, a negative impact on our results of operations and liquidity may result. Leasing/consignment fee increases are caused by increases in interest rates or volatility in the price of the consigned material.

The unavailability of insurance against certain business risks may adversely affect our future operating results.

As part of our comprehensive risk management program, we purchase insurance coverage against certain business risks. If any of our insurance carriers discontinues an insurance policy or significantly reduces available coverage or increases in the deductibles and we cannot find another insurance carrier to

30

write comparable coverage, we may be subject to uninsured losses which may adversely affect our operating results.

Environmental liability and compliance obligations may affect our operations and results.

Our manufacturing operations are subject to a variety of environmental laws and regulations as well as internal programs and policies governing:

- o air emissions;
- o wastewater discharges;
- o the storage, use, handling, disposal and remediation of hazardous substances, wastes and chemicals; and
- o employee health and safety.

If violations of environmental laws should occur, we could be held liable for damages, penalties, fines and remedial actions. Our operations and results could be adversely affected by any material obligations arising from existing laws, as well as any required material modifications arising from new regulations that may be enacted in the future. We may also be held liable for past disposal of hazardous substances generated by our business or businesses we acquire. In addition, it is possible that we may be held liable for contamination discovered at our present or former facilities.

We are aware of contamination at two locations. In Sinsheim, Germany, there is a shallow groundwater and soil contamination that is naturally

## Edgar Filing: TECHNITROL INC - Form 10-Q

decreasing over time. The German environmental authorities have not required corrective action to date. In addition, property in Leesburg, Indiana, which was acquired with our acquisition of GTI in 1998, is the subject of a 1994 Corrective Action Order to GTI by the Indiana Department of Environmental Management (IDEM). Although we sold the property in early 2005, we retained the responsibility for existing environmental issues at the site. The order requires us to investigate and take corrective actions. Substantially all of the corrective actions relating to impacted soil have been taken and IDEM has issued us no further action letters for the remediated areas. Studies and analysis are ongoing with respect to a ground water issue. We anticipate making additional environmental expenditures in the future to continue our environmental studies, analysis and remediation activities with respect to the ground water. Based on current knowledge, we do not believe that any future expenses or liabilities associated with environmental remediation will have a material impact on our operations or our consolidated financial position, liquidity or operating results; however, we may be subject to additional costs and liabilities if the scope of the contamination or the cost of remediation exceeds our current expectations.

### Item 3: Quantitative and Qualitative Disclosures about Market Risk

There were no material changes in market risk exposures that affect the quantitative and qualitative disclosures presented in our Form 10-K for the year ended December 31, 2004.

### Item 4: Controls and Procedures

An evaluation was performed under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act of 1934 as of September 30, 2005. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit is recorded, processed, summarized and reported, as specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial

31

officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in these controls or procedures that occurred during the three months ended September 30, 2005 that have materially affected, or are reasonably likely to materially affect, these controls or procedures. We completed the acquisition of LK Products Oy on September 8, 2005 and we are still in the process of evaluating internal control over financial reporting at LK Products Oy.

On September 13, 2004, we acquired additional shares of common stock in Full Rise Electronic Co., Ltd. (FRE) bringing our cumulative ownership to 51%. Management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, FRE's internal control over financial reporting. As of September 30, 2005 it is management's assessment that FRE has a significant deficiency over its internal control over financial reporting. We have identified action plans to mitigate

## Edgar Filing: TECHNITROL INC - Form 10-Q

such significant deficiency as of September 30, 2005, and we expect to have this issue fully remediated before the end of our fiscal 2005.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

32

### PART II. OTHER INFORMATION

Item 1	Legal Proceedings	None
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	None
Item 3	Defaults Upon Senior Securities	None
Item 4	Submission of Matters to a Vote of Security Holders	None
Item 5	Other Information	None
Item 6	Exhibits	

#### (a) Exhibits

The Exhibit Index is on page 34.

33

#### Exhibit Index

- 2.1 Share Purchase Agreement, dated as of January 9, 2003, by Pulse Electronics (Singapore) Pte. Ltd. and Forfin Holdings B.V. that are signatories thereto (incorporated by reference to Exhibit 2 to our Form 8-K dated January 10, 2003).
- 3.1 Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to our Form 10-K for the year ended December 26, 2003)
- 3.3 By-laws (incorporated by reference to Exhibit 3.3 to our Form 10-K for the year ended December 27, 2002).

## Edgar Filing: TECHNITROL INC - Form 10-Q

- 4.1 Rights Agreement, dated as of August 30, 1996, between Technitrol, Inc. and Registrar and Transfer Company, as Rights Agent (incorporated by reference to Exhibit 3 to our Registration Statement on Form 8-A dated October 24, 1996).
- 4.2 Amendment No. 1 to the Rights Agreement, dated March 25, 1998, between Technitrol, Inc. and Registrar and Transfer Company, as Rights Agent (incorporated by reference to Exhibit 4 to our Registration Statement on Form 8-A/A dated April 10, 1998).
- 4.3 Amendment No. 2 to the Rights Agreement, dated June 15, 2000, between Technitrol, Inc. and Registrar and Transfer Company, as Rights Agent (incorporated by reference to Exhibit 5 to our Registration Statement on Form 8-A/A dated July 5, 2000).
- 10.1 Technitrol, Inc. 2001 Employee Stock Purchase Plan (incorporated by reference to Exhibit 4.1 to our Registration Statement on Form S-8 dated June 28, 2001, File Number 333-64060).
- 10.1(1) Form of Stock Option Agreement (incorporated by reference to Exhibit 10.1(1) to our Form 10-Q for the three months ended October 1, 2004).
- 10.2 Technitrol, Inc. Restricted Stock Plan II, as amended and restated as of January 1, 2001 (incorporated by reference to Exhibit C, to our Definitive Proxy on Schedule 14A dated March 28, 2001).
- 10.3 Technitrol, Inc. 2001 Stock Option Plan (incorporated by reference to Exhibit 4.1 to our Registration Statement on Form S-8 dated June 28, 2001, File Number 333-64068).
- 10.4 Technitrol, Inc. Board of Directors Stock Plan, as amended (incorporated by reference to Exhibit 10 to our Form 8-K dated May 18, 2005).
- 10.5 Credit Agreement, by and among Technitrol, Inc. and certain of its subsidiaries, Bank of America N.A. as Administrative Agent and Lender, and certain other Lenders that are signatories thereto, dated as of October 14, 2005. (incorporated by reference to Exhibit 10.1 to our Form 8-K dated October 20, 2005).
- 10.6 Lease Agreement, dated October 15, 1991, between Ridilla-Delmont and AMI Doduco, Inc. (formerly known as Advanced Metallurgy Incorporated), as amended September 21, 2001 (incorporated by reference to Exhibit 10.6 to the Company's Amendment No. 1 to Registration Statement on Form S-3 dated February 28, 2002, File Number 333-81286).
- 10.7 Incentive Compensation Plan of Technitrol, Inc. (incorporated by reference to Exhibit 10.7 to Amendment No. 1 to our Registration Statement on Form S-3 filed on February 28, 2002, File Number 333-81286).

- 10.8 Technitrol, Inc. Supplemental Retirement Plan, amended and restated January 1, 2002 (incorporated by reference to Exhibit 10.8 to

## Edgar Filing: TECHNITROL INC - Form 10-Q

Amendment No. 1 to our Registration Statement on Form S-3 filed on February 28, 2002, File Number 333-81286).

- 10.9 Agreement between Technitrol, Inc. and James M. Papada, III, dated July 1, 1999, as amended April 23, 2001, relating to the Technitrol, Inc. Supplemental Retirement Plan (incorporated by reference to Exhibit 10.9 to Amendment No. 1 to our Registration Statement on Form S-3 filed on February 28, 2002, File Number 333-81286).
- 10.10 Letter Agreement between Technitrol, Inc. and James M. Papada, III, dated April 16, 1999, as amended October 18, 2000 (incorporated by reference to Exhibit 10.10 to Amendment No. 1 to our Registration Statement on Form S-3 filed on February 28, 2002, File Number 333-81286).
- 10.10(1) Letter Agreement between Technitrol, Inc. and James M. Papada, III dated July 1, 2004 (incorporated by reference to Exhibit 10.10(1) to our Form 10-Q for the three months ended October 1, 2004).
- 10.11 Form of Indemnity Agreement (incorporated by reference to Exhibit 10.11 to our Form 10-K for the year ended December 27, 2002).
- 10.12 Technitrol Inc. Supplemental Savings Plan (incorporated by reference to Exhibit 10.15 to our Form 10-Q for the three months ended September 26, 2003)
- 10.13 Technitrol, Inc. 401(K) Retirement Savings Plan, as amended (incorporated by reference to post-effective Amendment No. 1, to our Registration Statement on Form S-8 filed on October 31, 2003, File Number 033-35334) (incorporated by reference to Exhibit 10.16 to our Form 10-Q for the three months ended March 26, 2003).
- 10.14 Pulse Engineering, Inc. 401(K) Plan as amended (incorporated by reference to post-effective Amendment No. 1, to our Registration Statement on Form S-8 filed on October 31, 2003, File Number 033-94073) (incorporated by reference to Exhibit 10.16 to our Form 10-Q for the three months ended March 26, 2003).
- 10.15 Amended and Restated Short-Term Incentive Plan (incorporated by reference to Exhibit 10.15 to our Form 10-K for the year ended December 31, 2004).
- 10.16 Amended and Restated Consignment Agreement, Dated May 27, 1997, by and among Rhode Island Hospital Trust National Bank, Doduco GmbH, Doduco Espana, S.A. and Technitrol, Inc. (incorporated by reference to Exhibit 10.16 to our Form 10-Q for the three months ended October 1, 2004).
- 10.16(1) First Amendment to Amended and Restated Consignment Agreement, Dated May 27, 1997, by and among Rhode Island Hospital Trust National Bank, Doduco GmbH, Doduco Espana, S.A. and Technitrol, Inc. (incorporated by reference to Exhibit 10.16 to our Form 10-Q for the three months ended October 1, 2004).

- 10.16(2) Second Amendment to Amended and Restated Consignment Agreement, Dated May 27, 1997, by and among Rhode Island Hospital Trust

## Edgar Filing: TECHNITROL INC - Form 10-Q

National Bank, Doduco GmbH, Doduco Espana, S.A. and Technitrol, Inc. (incorporated by reference to Exhibit 10.16(2) to our Form 10-Q for the three months ended October 1, 2004).

- 10.16(3) Third Amendment to Amended and Restated Consignment Agreement, Dated May 27, 1997, by and among Rhode Island Hospital Trust National Bank, Doduco GmbH, Doduco Espana, S.A. and Technitrol, Inc. (incorporated by reference to Exhibit 10.16(3) to our Form 10-Q for the three months ended October 1, 2004).
- 10.17 Amended and Restated Consignment Agreement dated July 29, 2005, among Fleet Precious Metals Inc. d/b/a Bank of America Precious Metals, Technitrol, Inc. and AMI Doduco, Inc. (incorporated by reference to Exhibit 10.1 to our Form 8-K dated August 2, 2005).
- 10.18 Silver Lease Agreement dated April 9, 1996 between Standard Chartered Bank Mocatta Bullion - New York and Advanced Metallurgy, Inc. and Guarantee dated April 29, 1996 by Technitrol, Inc. (incorporated by reference to Exhibit 10.18 to our Form 10-Q for the three months ended October 1, 2004).
- 10.18(1) Letter Agreement dated April 9, 1996 between Standard Chartered Bank Mocatta Bullion - New York and Advanced Metallurgy, Inc. (incorporated by reference to Exhibit 10.18(1) to our Form 10-Q for the three months ended October 1, 2004).
- 10.18(2) Amendment to Silver Lease Agreement dated February 14, 1997 between Standard Chartered Bank Mocatta Bullion - New York and Advanced Metallurgy Inc. (incorporated by reference to Exhibit 10.18(2) to our Form 10-Q for the three months ended October 1, 2004).
- 10.18(3) Amendment to Silver Lease Agreement dated November 3, 1997 between Standard Chartered Bank Mocatta Bullion - New York and Advanced Metallurgy Inc. (incorporated by reference to Exhibit 10.18(3) to our Form 10-Q for the three months ended October 1, 2004).
- 10.18(4) Amendment to Silver Lease Agreement dated May 21, 2003 between Standard Chartered Bank Mocatta Bullion - New York and AMI Doduco, Inc. (incorporated by reference to Exhibit 10.18(4) to our Form 10-Q for the three months ended October 1, 2004).
- 10.19 Consignment Agreement dated September 24, 2004 between Mitsui & Co. Precious Metals Inc., and AMI Doduco, Inc. (incorporated by reference to Exhibit 10.19 to our Form 10-Q for the three months ended October 1, 2004).
- 10.20 Unlimited Guaranty dated December 16, 1996 by Technitrol, Inc. in favor of Rhode Island Hospital Trust National Bank (incorporated by reference to Exhibit 10.20 to our Form 10-Q for the three months ended October 1, 2004).

### Exhibit Index, continued

- 10.21 Corporate Guaranty dated November 1, 2004 by Technitrol, Inc. in favor of Mitsui & Co. Precious Metals, Inc. (incorporated by reference to Exhibit 10.21 to our Form 10-Q for the three months ended October 1, 2004).

Edgar Filing: TECHNITROL INC - Form 10-Q

- 10.22 Separation Agreement between Technitrol, Inc. and Albert Thorp, III dated June 29, 2005. (incorporated by reference to Exhibit 10.22 to our Form 10-Q for the three months ended July 1, 2005).
- 10.23 Share Purchase Agreement dated August 8, 2005 among Pulse Electronics (Singapore) Pte. Ltd., as Purchaser, and Filtronic Plc and Filtronic Comtek Oy, as Sellers (incorporated by reference to Exhibit 10.1 to our Form 8-K dated August 11, 2005).
- 10.30 Schedule of Board of Director and Committee Fees (incorporated by reference to Exhibit 10.30 to our Form 10-K for the year ended December 31, 2004).
- 31.1 Certification of Principal Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

37

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Technitrol, Inc.

-----  
(Registrant)

November 9, 2005

-----  
(Date)

/s/ Drew A. Moyer

-----  
Drew A. Moyer  
Senior Vice President and Chief Financial  
Officer  
(duly authorized officer, principal financial  
and accounting officer)

38