FRANKLIN ELECTRIC CO INC
Form 10-Q
May 09, 2013
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 30, 2013

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 0-362

FRANKLIN ELECTRIC CO., INC.
(Exact name of registrant as specified in its charter)

Indiana	35-0827455
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

400 East Spring Street Bluffton, Indiana	46714
(Address of principal executive offices)	(Zip Code)

(260) 824-2900
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES x	NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES x NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

YES o NO x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class of Common Stock	Outstanding at April 30, 2013
$.10 par value	47,416,920 shares

FRANKLIN ELECTRIC CO., INC.
TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(In thousands, except per share amounts)	First Quarter Ended	
	March 30, 2013	March 31, 2012
Net sales	$222,524	$201,924
Cost of sales	148,583	135,652
Gross profit	73,941	66,272
Selling, general, and administrative expenses	50,065	45,347
Restructuring (income)/expense	710	(73)
Operating income	23,166	20,998
Interest expense	(2,590)	(2,588)
Other income	447	13,534
Foreign exchange income/(expense)	(171)	(298)
Income before income taxes	20,852	31,646
Income taxes	5,237	8,485
Net income	$15,615	$23,161
Less: Net income attributable to noncontrolling interests	(159)	(115)
Net income attributable to Franklin Electric Co., Inc.	$15,456	$23,046
Income per share:		
Basic	$0.32	$0.49
Diluted	$0.32	$0.48
Dividends per common share	$0.07	$0.07

Shares and per share data have been adjusted for all periods presented to reflect a two-for-one stock split effective March 18, 2013.

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

(In thousands)	First Quarter Ended March 30, 2013	March 31, 2012
Net income	$15,615	$23,161
Other comprehensive income/(loss), before tax:		
Foreign currency translation adjustments	(5,789)	11,214
Employee benefit plan activity	970	587
Other comprehensive income/(loss)	$(4,819)	$11,801
Income tax related to items of other comprehensive income	(380)	(230)
Other comprehensive income/(loss), net of tax	$(5,199)	$11,571
Comprehensive income	$10,416	$34,732
Comprehensive loss attributable to noncontrolling interest	279	163
Comprehensive income attributable to Franklin Electric Co., Inc	$10,695	$34,895

Shares and per share data have been adjusted for all periods presented to reflect a two-for-one stock split effective March 18, 2013.

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands)	March 30, 2013	December 29, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$74,666	$103,338
Receivables, less allowances of $3,269 and $3,148, respectively	130,884	102,918
Inventories:		
Raw material	77,695	72,536
Work-in-process	18,223	18,295
Finished goods	109,440	101,017
	205,358	191,848
Deferred income taxes	11,386	7,912
Other current assets	21,886	22,901
Total current assets	444,180	428,917
Property, plant and equipment, at cost:		
Land and buildings	90,276	90,616
Machinery and equipment	206,176	204,408
Furniture and fixtures	26,740	26,887
Other	43,699	33,500
	366,891	355,411
Less: Allowance for depreciation	(185,898)	(183,436)
	180,993	171,975
Deferred income tax	2,658	2,540
Intangible assets, net	155,393	158,117
Goodwill	206,861	208,141
Other assets	6,372	6,689
Total assets	$996,457	$976,379

	March 30, 2013	December 29, 2012
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$63,978	$68,660
Deferred tax liability	1,173	1,173
Accrued expenses	47,987	60,415
Income taxes	713	215
Current maturities of long-term debt and short-term borrowings	15,945	15,176
Total current liabilities	129,796	145,639
Long-term debt	174,854	150,729
Deferred income taxes	41,329	40,136
Employee benefit plans	76,144	78,967
Other long-term liabilities	39,331	38,659
Commitments and contingencies (see Note 16)	—	—
Redeemable noncontrolling interest	4,578	5,263
Shareowners' equity:		
Common stock (65,000 shares authorized, $.10 par value) outstanding (47,412 and 47,132, respectively)	4,741	4,712
Additional capital	179,124	170,890
Retained earnings	405,481	395,950
Accumulated other comprehensive loss	(61,907)	(57,146)
Total shareowners' equity	527,439	514,406
Noncontrolling interest	2,986	2,580
Total equity	530,425	516,986
Total liabilities and equity	$996,457	$976,379

Shares and per share data have been adjusted for all periods presented to reflect a two-for-one stock split effective March 18, 2013.

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	First Quarter Ended	
	March 30, 2013	March 31, 2012
Cash flows from operating activities:		
Net income	$15,615	$23,161
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	7,367	6,158
Share-based compensation	2,158	982
Deferred income taxes	(2,623)	5,592
(Gain)/loss on disposals of plant and equipment	(1)	(322)
Gain on equity investment	—	(12,212)
Asset impairment	—	200
Foreign exchange expense	171	298
Excess tax from share-based payment arrangements	(2,063)	(731)
Changes in assets and liabilities, net of acquisitions:		
Receivables	(28,686)	(25,395)
Inventory	(17,038)	(18,199)
Accounts payable and accrued expenses	(8,441)	(1,637)
Income taxes	2,459	(3,344)
Employee benefit plans	(1,485)	(693)
Other	1,788	(2,841)
Net cash flows from operating activities	(30,779)	(28,983)
Cash flows from investing activities:		
Additions to property, plant, and equipment	(16,515)	(4,170)
Proceeds from sale of property, plant, and equipment	55	1,204
Additions to intangibles	48	—
Cash paid for acquisitions, net of cash acquired	—	(27,862)
Net cash flows from investing activities	(16,412)	(30,828)
Cash flows from financing activities:		
Proceeds from issuance of debt	25,101	3,759
Repayment of debt	(85)	(1,739)
Proceeds from issuance of common stock	4,128	2,613
Excess tax from share-based payment arrangements	2,063	731
Purchases of common stock	(2,504)	(30)
Dividends paid	(3,417)	(3,152)
Payment of contingent consideration liability	(5,555)	—
Net cash flows from financing activities	19,731	2,182
Effect of exchange rate changes on cash	(1,212)	3,228
Net change in cash and equivalents	(28,672)	(54,401)
Cash and equivalents at beginning of period	103,338	153,337
Cash and equivalents at end of period	$74,666	$98,936

Cash paid for income taxes	$4,430	$6,245
Cash paid for interest, net of capitalized interest of $235 and $20, respectively	$2,379	$2,330
Non-cash items:		
Payable to seller of Pioneer Pump Holdings Inc.	$—	$1,698
Pioneer Pump Holdings, Inc. liability for mandatory share purchase	$—	$22,924
Payable to seller of Impo Motor Pompa Sanayi ve Ticaret A.S.	$—	$420
Additions to property, plant, and equipment, not yet paid	$1,297	$4

Shares and per share data have been adjusted for all periods presented to reflect a two-for-one stock split effective March 18, 2013.

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN ELECTRIC CO., INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
The accompanying condensed consolidated balance sheet as of December 29, 2012, which has been derived from audited financial statements, and the unaudited interim condensed consolidated financial statements as of March 30, 2013, and for the first quarters ended March 30, 2013 and March 31, 2012, have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, all accounting entries and adjustments (including normal, recurring adjustments) considered necessary for a fair presentation of the financial position and the results of operations for the interim period have been made. Operating results for the first quarter ended March 30, 2013, are not necessarily indicative of the results that may be expected for the fiscal year ending December 28, 2013. For further information, including a description of the Company’s critical accounting policies, refer to the consolidated financial statements and notes thereto included in Franklin Electric Co., Inc.'s Annual Report on Form 10-K for the year ended December 29, 2012.

2. ACCOUNTING PRONOUNCEMENTS
In March 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-02 Comprehensive Income. This guidance requires companies to disclose additional information about items reclassified out of accumulated other comprehensive income ("AOCI") either on the face of the income statement or as a separate footnote to the financial statements. In addition, changes in AOCI balance by component are to be presented. ASU 2013-02 is effective for both annual and interim periods for fiscal years beginning after December 15, 2012. The Company adopted ASU 2013-02 on a prospective basis, effective December 30, 2012. Refer to Note 14 for disclosures made. As the ASU addressed only disclosure requirements, adoption of ASU 2013-02 did not have a material impact on the Company's financial position, results of operations, or cash flows.

3. STOCK SPLIT
On February 22, 2013, the Company announced that its Board of Directors declared a two-for-one stock split of the Company's common stock in the form of a 100 percent stock distribution. The stock distribution was distributed or paid on March 18, 2013, to stockholders of record as of March 4, 2013. As a result of this action, approximately 23.7 million shares were issued to stockholders of record as of March 4, 2013. The par value of the common stock remains at $0.10 per share and, accordingly, approximately $2.37 million was transferred from retained earnings to common stock. Earnings and dividends declared per share and weighted average shares outstanding are presented in this Form 10-Q after the effect of the 100 percent stock distribution. The two-for-one stock split is reflected in the share and per share amounts in all periods presented in this Form 10-Q.

4. ACQUISITIONS
The fair values of the identifiable intangible assets and property, plant, and equipment for the 2012 Pioneer Pump Holdings, Inc. ("PPH") acquisition were final as of the first quarter ended March 30, 2013. The Company utilized management estimates and consultation with an independent third-party valuation firm to assist in the valuation. No adjustments were required as a result of the final valuation to the preliminary amounts previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2012.

Transaction costs were expensed as incurred under the guidance of FASB ASC Topic 805, Business Combinations. There were no transaction costs included in selling, general, and administrative expense in the Company’s condensed consolidated statement of income for the first quarter ended March 30, 2013.

5. REDEEMABLE NONCONTROLLING INTERESTS

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

The noncontrolling interest in Impo is redeemable at other than fair value as the redemption value is determined based on a specified formula. The noncontrolling interest becomes redeemable after the passage of time and, therefore, the Company records the carrying amount of the noncontrolling interest at the greater of (1) the initial carrying amount, increased or decreased for each noncontrolling interest's share of net income or loss and its share of other comprehensive income or loss and dividends (“carrying amount”) or (2) the redemption value which is determined based on the greater of the redemption floor value or the then-current specified earnings multiple. As of March 30, 2013, the Impo redeemable noncontrolling interest was recorded at the carrying amount.

According to FASB ASC Topic 810, Consolidation and Emerging Issues Task Force ("EITF") Topic No. D-98, Classification and Measurement of Redeemable Securities, for redeemable noncontrolling interests issued in the form of common securities, to the extent that the noncontrolling interest holder has a contractual right to receive an amount upon share redemption that is other than the fair value of such shares, the noncontrolling interest holder has, in substance, received a dividend distribution that is different from other common shareholders. Therefore, adjustments to the noncontrolling interest to reflect the redemption amount should be reflected in the computation of earnings per share using the two-class method. Under the two-class method, the Company has elected to treat as a dividend only the portion of the periodic redemption value adjustment (if any) that reflects a redemption value in excess of fair value. No adjustments were necessary for the first quarters ended March 30, 2013 or March 31, 2012.

6. FAIR VALUE MEASUREMENTS
FASB ASC Topic 820, Fair Value Measurements and Disclosures, provides guidance for defining, measuring, and disclosing fair value within an established framework and hierarchy. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The standard established a fair value hierarchy which requires an entity to maximize the use of observable inputs and to minimize the use of unobservable inputs when measuring fair value. The three levels of inputs that may be used to measure fair value within the hierarchy are as follows:

Level 1 – Quoted prices for identical assets and liabilities in active markets;

Level 2 – Quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3 – Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

As of March 30, 2013, and December 29, 2012, the assets and liabilities measured at fair value on a recurring basis were as set forth in the table below. The "Recognized Loss" amounts in the table are accumulated totals since inception.

(In millions)	March 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Recognized Loss
Cash equivalents	$12.8	$12.8	$—	$—	$—
Impo contingent consideration	—	—	—	—	—

	December 29, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Recognized Loss
Cash equivalents	$13.8	$13.8	$—	$—	$—

Impo contingent consideration	5.6	—	—	5.6	0.8

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

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

During the second quarter of 2011, the Company recorded $5.5 million (TL 8.5 million) of contingent consideration related to the second quarter 2011 acquisition of Impo. The fair value of this Level 3 liability was $5.6 million (TL 10.0 million) as of December 29, 2012, based on Impo achieving specified financial targets. The contingent consideration of $5.6 million (TL 10.0 million) was paid out during the first quarter of 2013.

7. OTHER ASSETS

In 2005, the Company acquired a 35.0 percent equity interest in Pioneer Pump, Inc. ("PPI"), which was accounted for using the equity method. During the first quarter of 2012, the shareholders of PPI and Pioneer Pump, Ltd. ("PPL") contributed shares to form a new holding company, PPH, in exchange for equivalent value and control in PPH. As a result of this contribution, the Company's equity interest decreased to 31.0 percent of PPH. On March 7, 2012, the Company acquired a controlling interest in PPH, resulting in the consolidation of PPH in the Company's financial statements. Accordingly, the original equity interest in PPH was remeasured to its fair value of $23.9 million as of March 7, 2012. The carrying amount of the equity investment prior to the acquisition of the controlling interest was $11.7 million as of March 6, 2012. As a result, the Company recognized a one-time gain of $12.2 million in the "Other income" line of the Company's condensed consolidated statement of income for the first quarter ended March 31, 2012. Prior to the acquisition, the Company’s proportionate share of Pioneer Pump, Inc. earnings, included in the “Other income” line of the Company’s condensed consolidated statements of income, was $0.4 million for the first quarter ended March 31, 2012. The additional purchase was made in 2012, bringing total ownership to 70.5 percent.

During the second quarter of 2011, the Company entered into a loan agreement with the parent of a customer. The current maturity is included in "Receivables" and the long-term portion is included in "Other assets" on the Company's consolidated balance sheet. The agreement provides for interest on the loan at a variable market interest rate with the customer to repay the loan plus interest in semi-annual installments throughout the 7-year term. The Company has a long-term relationship with the customer and considers the loan fully collectible.

8. INTANGIBLE ASSETS AND GOODWILL

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

(In millions)	March 30, 2013		December 29, 2012	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangibles:				
Patents	$7.8	$(5.7)	$7.8	$(5.7)
Supply agreements	4.4	(4.4)	4.4	(4.4)
Technology	7.5	(3.4)	7.5	(3.2)
Customer relationships	125.3	(24.8)	125.9	(23.1)
Software	1.7	(0.1)	1.7	(0.1)
Other	1.2	(1.2)	1.2	(1.2)
Total	$147.9	$(39.6)	$148.5	$(37.7)
Unamortized intangibles:				
Trade names	47.1	—	47.3	—
Total intangibles	$195.0	$(39.6)	$195.8	$(37.7)

Amortization expense related to intangible assets for the first quarters ended March 30, 2013 and March 31, 2012, was $2.0 million and $1.5 million, respectively.

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

(In millions)	2013	2014	2015	2016	2017
	$8.4	$8.4	$8.4	$8.3	$8.0

The change in the carrying amount of goodwill by reporting segment for the first quarter ended March 30, 2013, is as follows:

(In millions)	Water Systems	Fueling Systems	Consolidated
Balance as of December 29, 2012	$144.9	$63.2	$208.1
Acquisitions	—	—	—
Adjustments to prior year acquisitions	—	—	—
Foreign currency translation	(0.9)	(0.3)	(1.2)
Balance as of March 30, 2013	$144.0	$62.9	$206.9

9. EMPLOYEE BENEFIT PLANS

Defined Benefit Plans - As of March 30, 2013, the Company maintained two domestic pension plans and three German pension plans. The Company used a December 29 measurement date for these plans.

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

The following table sets forth the aggregated net periodic benefit cost for all pension plans for the first quarters ended March 30, 2013 and March 31, 2012, respectively:

(In millions)	Pension Benefits		Other Benefits	
	First Quarter Ended		First Quarter Ended	
	March 30, 2013	March 31, 2012	March 30, 2013	March 31, 2012
Service cost	$0.4	$0.4	$—	$—
Interest cost	1.9	2.1	0.1	0.1
Expected return on assets	(2.5)	(2.6)	—	—
Prior service cost	—	—	0.1	0.1
Loss	0.9	0.5	0.1	—
Total net periodic benefit cost	$0.7	$0.4		