MAGNETEK INC
Form 10-Q
February 10, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: January 1, 2006

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from

Commission file number 1-10233

MAGNETEK, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE	**95-3917584**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

8966 Mason Ave.

Chatsworth, California 91311

(Address of principal executive offices)

(818) 727-2216

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year,

if changed since last report)

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

Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer ý Non-accelerated filer o

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

Yes o No ý

The number of shares outstanding of Registrant s Common Stock, as of January 31, 2006, was 29,090,834 shares.

2006 MAGNETEK, INC. FORM 10-Q

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PART I FINANCIAL INFORMATION

Item 1 Financial Statements

MAGNETEK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED

January 1, 2006 and January 2, 2005

(amounts in thousands, except per share data)

(unaudited)

	Three Months Ended	
	(13 weeks) January 1, 2006	(13 weeks) January 2, 2005 (restated)
Net sales	$ 59,333	$ 61,999
Cost of sales	44,026	46,397
Gross profit	15,307	15,602
Research and development	3,947	3,694
Selling, general and administrative	10,281	10,557
Income from operations	1,079	1,351
Interest expense	856	274
Other (income) expense	149	(1,240)
Income from continuing operations before provision for income taxes	74	2,317
Provision for income taxes	750	540
Net income (loss) from continuing operations	(676)	1,777
Loss from discontinued operations	(1,049)	(1,615)
Net income (loss)	$ (1,725)	$ 162
Earnings (loss) per common share		
Basic and diluted:		
Net income (loss) from continuing operations	$ (0.02)	$ 0.06
Loss from discontinued operations	(0.04)	(0.05)
Net income (loss)	$ (0.06)	$ 0.01
Weighted shares outstanding:		
Basic	28,890	28,520
Diluted	28,890	29,278

See accompanying notes

MAGNETEK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE SIX MONTHS ENDED

January 1, 2006 and January 2, 2005

(amounts in thousands, except per share data)

(unaudited)

	Six Months Ended	
	(26 Weeks) January 1, 2006	**(27 Weeks) January 2, 2005 (restated)**
Net sales	$ 115,844	$ 128,207
Cost of sales	86,049	96,484
Gross profit	29,795	31,723
Research and development	7,476	7,189
Selling, general and administrative	20,218	21,083
Income from operations	2,101	3,451
Interest expense	1,202	581
Other (income) expense	525	(1,183)
Income from continuing operations before provision for income taxes	374	4,053
Provision for income taxes	1,700	1,175
Net income (loss) from continuing operations	(1,326)	2,878
Loss from discontinued operations	(1,453)	(2,176)
Net income (loss)	$ (2,779)	$ 702
Earnings (loss) per common share		
Basic and diluted:		
Net income (loss) from continuing operations	$ (0.05)	$ 0.10
Loss from discontinued operations	(0.05)	(0.08)
Net income (loss)	$ (0.10)	$ 0.02
Weighted shares outstanding:		
Basic	28,888	28,511
Diluted	28,888	29,272

See accompanying notes

MAGNETEK, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

January 1, 2006 and July 3, 2005

(amounts in thousands)

	January 1, 2006 (unaudited)	July 3, 2005
ASSETS		
Current assets:		
Cash	$ 3,607	$ 6,854
Restricted cash escrow account	22,602	
Accounts receivable, net	53,474	54,022
Inventories, net	51,523	49,950
Prepaid expenses and other	5,194	5,713
Assets held for sale	6,265	4,727
Total current assets	142,665	121,266
Property, plant and equipment	131,715	129,473
Less accumulated depreciation	100,690	97,534
Net property, plant and equipment	31,025	31,939
Goodwill	63,592	63,656
Other assets	11,229	12,319
Total assets	$ 248,511	$ 229,180
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 34,697	$ 36,974
Accrued liabilities	7,657	8,523
Accrued arbitration award	22,602	22,602
Liabilities held for sale	1,963	1,220
Current portion of long-term debt	28,198	5,702
Total current liabilities	95,117	75,021
Long-term debt, net of current portion	18,024	19,528
Pension benefit obligations, net	72,468	70,568
Other long-term obligations	7,959	7,627
Deferred income taxes	11,134	10,376
Commitments and contingencies		
Stockholders equity:		
Common stock	287	286
Additional paid in capital	129,034	128,664
Retained earnings	37,239	40,018
Accumulated other comprehensive loss	(122,751)	(122,908)
Total stockholders equity	43,809	46,060

Total liabilities and stockholders equity	$	248,511	$	229,180

See accompanying notes

MAGNETEK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW

FOR THE SIX MONTHS ENDED

January 1, 2006 and January 2, 2005

(amounts in thousands)

(unaudited)

	Six Months Ended	
	(26 Weeks) January 1, 2006	**(27 Weeks) January 2, 2005 (restated)**
Cash flows from continuing operating activities:		
Net income (loss) from continuing operations	$ (1,326)	$ 2,878
Adjustments to reconcile net income (loss) from continuing operations to net cash provided by continuing operating activities:		
Depreciation and amortization	4,445	4,834
Tax refund proceeds, net		3,332
Stock based compensation expense	222	
Changes in operating assets and liabilities	1,771	(8,133)
Total adjustments	6,438	33
Net cash provided by continuing operating activities	5,112	2,911
Cash flows from discontinued operations:		
Loss from discontinued operations	(1,453)	(2,176)
Adjustments to reconcile loss from discontinued operations to net cash used in discontinued operations:		
Depreciation and amortization		63
Changes in operating assets and liabilities	(795)	(398)
Capital expenditures		(16)
Net cash used in discontinued operations	(2,248)	(2,527)
Net cash provided by operating activities	2,864	384
Cash flows from investing activities:		
Deposit into escrow account	(22,602)	
Capital expenditures	(3,182)	(3,922)
Net cash used in investing activities	(25,784)	(3,922)
Cash flows from financing activities:		
Proceeds from issuance of common stock	149	236
Borrowings under line-of-credit agreements	687	6,391
Principal repayments under capital lease obligations	(148)	(40)
Borrowings under long term notes	20,819	
Repayments of long term notes	(366)	(1,272)
Increase in deferred financing costs	(1,468)	(41)
Net cash provided by financing activities	19,673	5,274
Net increase (decrease) in cash	(3,247)	1,736
Cash at the beginning of the period	6,854	2,318

Cash at the end of the period	$	3,607	$	4,054

See accompanying notes

MAGNETEK, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JANUARY 1, 2006

(Amounts in thousands unless otherwise noted, except per share data)

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Magnetek, Inc. and its subsidiaries (the Company). All significant intercompany accounts and transactions have been eliminated.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the financial statements and footnotes thereto included in the Company s Form 10-K for the year ended July 3, 2005 filed with the Securities and Exchange Commission. In the Company s opinion, these unaudited statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial position of the Company as of January 1, 2006, and the results of its operations and its cash flows for the three-month and six-month periods ended January 1, 2006 and January 2, 2005. Results for the six-months ended January 1, 2006 are not necessarily indicative of results that may be experienced for the full fiscal year.

The Company uses a fifty-two, fifty-three week fiscal year ending on the Sunday nearest to June 30. Fiscal quarters are the thirteen or fourteen week periods ending on the Sunday nearest September 30, December 31, March 31 and June 30. The three-month periods ended January 1, 2006 and January 2, 2005 each contained 13 weeks; the six-month periods ended January 1, 2006 and January 2, 2005 contained 26 and 27 weeks, respectively.

2. Summary of Significant Accounting Policies

Restatement - The accompanying condensed consolidated financial statements have been restated for the three- and six-month periods ended January 2, 2005.

Since fiscal 2002 the Company has provided valuation reserves against its U.S. deferred tax assets that result in a zero net deferred tax position (net deferred assets equal to deferred tax liabilities). In its 2005 fiscal year-end review of its tax accounts, the Company determined that a portion of its deferred tax liability related to tax-deductible amortization of goodwill that is no longer amortized for financial reporting purposes. Under applicable accounting rules, such deferred tax liabilities are considered to have an indefinite life and are therefore ineligible to be considered as a source of future taxable income in assessing the realization of deferred tax assets.

The Company has determined that such deferred tax liabilities existed at July 3, 2005, and therefore increased its valuation allowance for deferred tax assets and the related provision for income taxes for fiscal year 2005 by $1.6 million. The Company further determined that the increased provision for income taxes should have been recorded on a pro-rata basis throughout fiscal year 2005, and as a result, the Company has restated its quarterly results for fiscal 2005. The impact of this restatement on the three- and six-month periods ended January 2, 2005 was an increase in the Company s valuation allowance for deferred tax assets and related provision for income taxes of $0.4 million and $0.8 million, respectively.

The restatement did not have a material impact on the Company s financial position at the end of the reported period and had no impact on the Company s cash flows for the restated periods.

The table below reflects the impact of the restatement on the Company s results of operations for the three- and six- month periods ended January 2, 2005:

Condensed Consolidated Statements of Operations

For the periods ended January 2, 2005 (Amounts in thousands except per share amounts)	Three Months Ended		Six Months Ended	
	As previously reported	**As restated**	**As previously reported**	**As restated**
Provision for income taxes	$ 140	$ 540	$ 375	$ 1,175
Net income	$ 562	$ 162	$ 1,502	$ 702
Net income per common share, basic and diluted	$ 0.02	$ 0.01	$ 0.05	$ 0.02

Use of Estimates - The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant areas requiring management estimates include the following key financial areas:

Accounts Receivable

Accounts receivable represent receivables from customers in the ordinary course of business. The Company is subject to losses from uncollectible receivables in excess of its allowances. The Company maintains allowances for doubtful accounts for estimated losses from customers inability to make required payments. In order to estimate the appropriate level of this allowance, the Company analyzes historical bad debts, customer concentrations, current customer creditworthiness, current economic trends and changes in customer payment patterns. If the financial conditions of the Company s customers were to deteriorate and to impair their ability to make payments, additional allowances may be required in future periods. The Company s management believes that all appropriate allowances have been provided.

Inventories

The Company s inventories are stated at the lower of cost or market. Cost is determined by the first-in, first-out (FIFO) method, including material, labor and factory overhead. Inventory on hand may exceed future demand either because the product is obsolete, or the amount on hand is more than can be used to meet future needs. The Company identifies potentially obsolete and excess inventory by evaluating overall inventory levels. In assessing the ultimate realization of inventories, the Company is required to make judgments as to future demand requirements and compare those with the current or committed inventory levels. If future demand requirements are less favorable than those projected by management, additional inventory write-downs may be required.

Reserves for Contingencies

The Company periodically records the estimated impacts of various conditions, situations or circumstances involving uncertain outcomes. The accounting for such events is prescribed under Statement of Financial Accounting Standard (SFAS) No. 5, *Accounting for Contingencies*. SFAS No. 5 defines a contingency as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur.

SFAS No. 5 does not permit the accrual of gain contingencies under any circumstances. For loss contingencies, the loss must be accrued if (1) information is available that indicates it is probable that the loss has been incurred, given the likelihood of uncertain events; and (2) that the amount of the loss can be reasonably estimated.

The accrual of a contingency involves considerable judgment on the part of management. The Company uses its internal expertise, and outside experts, as necessary, to help estimate the probability that a loss has been incurred and the amount (or range) of the loss.

Income Taxes

The Company uses the liability method to account for income taxes. The preparation of consolidated financial statements involves estimating the Company s current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the consolidated balance sheets. An assessment of the recoverability of the deferred tax assets is made, and a valuation allowance is established based upon this assessment.

The Company does not record deferred taxes on domestic pre-tax income or losses, due to (1) the availability of net operating loss (NOL) carryforwards that have been fully reserved through valuation allowances for pre-tax income, and (2) uncertainty surrounding the timing of realizing NOL carryforwards generated in the current period in future periods.

With the exception of approximately $3.0 million of foreign earnings that the Company repatriated during the six months ended January 1, 2006 for various financing needs, the Company presently intends to reinvest any earnings overseas indefinitely.

Pension Benefits

The valuation of the Company s pension plan requires the use of assumptions and estimates to develop actuarial valuations of expenses and assets/liabilities. These assumptions include discount rates, investment returns and mortality rates. Changes in assumptions and future investments returns could potentially have a material impact on the Company s expenses and related funding requirements.

Revenue Recognition The Company s policy is to recognize revenue when the earnings process is complete. The criteria used in making this determination are persuasive evidence that an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is reasonably assured. Sales are recorded net of returns and allowances, which are estimated using historical data at the time of sale.

Revenue is recognized upon shipment, except in those few cases where terms of shipment are FOB destination, or where product is shipped to customers with consignment stock agreements, wherein revenue is recognized when the customer receives the product, or removes the product from consignment stock. With the foregoing exceptions, terms of shipment are FOB shipping point, and payment is not contingent upon resale or any other matter other than passage of time. Amounts billed to customers for shipping costs are reflected in net sales; shipping costs are reflected in cost of sales.

Sales to distributors are recorded with appropriate reserves for future returns in accordance with SFAS No. 48, *Revenue Recognition When Right of Return Exists*, and generally do not include future installation obligations or acceptance requirements.

Stock-Based Compensation On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment*, which is a revision of *SFAS No. 123, Accounting for Stock-Based Compensation*. SFAS No. 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees,* and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

Prior to fiscal year 2006, as was permitted under SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company accounted for stock-based awards using the intrinsic-value method under APB No. 25. Under APB No. 25, the Company recognized no compensation expense

with respect to such awards, as the exercise prices of stock option grants were always equal to or greater than the market price of the stock at the grant date. Accordingly, no stock-based employee compensation expense for stock options is reflected in net income in the accompanying condensed consolidated financial statements for the three- and six-month periods ended January 2, 2005.

Effective July 4, 2005, the Company adopted SFAS No. 123 (R), which requires all share-based payments to employees, including grants of employee stock options, to be recognized in the Company s financial statements based upon their fair values. The Company selected the modified prospective method of adoption in which compensation cost is recognized beginning with the effective date. Compensation cost recognized for the three- and six-month periods ended January 1, 2006 is the same as that which would have been recognized had the fair value method of SFAS No. 123 been applied from its original effective date. In accordance with the modified prospective method of adoption, the Company s results of operations for prior periods have not been restated.

In the fourth quarter of fiscal 2005, the Company approved the acceleration of the vesting of all out-of-the-money (underwater) unvested stock options held by the Company s current employees, including executive officers, on June 1, 2005. No stock options held by directors were subject to the acceleration. The decision to accelerate vesting of these underwater options was made primarily to avoid recognizing compensation cost in the consolidated statement of operations upon adoption of SFAS No. 123 (R), as described above. As a result of the acceleration, the Company reduced the stock option compensation expense it otherwise would be required to record by approximately

$1.9 million in fiscal 2006, $1.4 million in fiscal 2007 and less than $0.1 million in fiscal 2008 on a pre-tax basis, resulting in an additional $3.4 million of pro-forma expense in fiscal 2005. The accelerated vesting was a modification of outstanding awards as defined by SFAS No. 123, which resulted in incremental pro-forma compensation expense of $0.3 million in fiscal 2005.

The Company did not issue any stock options during the six-month period ended January 1, 2006. In August 2005, the Company granted 500,000 shares of restricted stock with a fair value of $2.77 per share. The restricted shares fully vest on January 1, 2009. The total estimated compensation expense of $1.4 million related to the grant will be recorded ratably from the grant date through the vesting date. Compensation expense related to the restricted stock grant included in the condensed consolidated statement of operations for the three- and six-month periods ended January 1, 2006 is $103 and $149 respectively. The remaining portion of stock-based compensation expense recorded in the three- and six-month periods ended January 1, 2006, $37 and $73 respectively, relates to non-vested director stock option grants.

The following table illustrates the effect on net income (loss) and earnings (loss) per share as if the fair value method had been applied to all outstanding and unvested awards in each period:

(Amounts in thousands, except per share amounts)	**Three Months Ended**		**Six Months Ended**	
	January 1, 2006	**January 2, 2005 (restated)**	**January 1, 2006**	**January 2, 2005 (restated)**
Net income (loss), as reported	$ (1,725)	$ 162	$ (2,779)	$ 702
Add: Stock-based compensation expense included in reported net income, net of related tax effects	140		222	
Deduct: Total stock-based compensation expense determined under fair value method for all awards, net of related tax effects	(140)	(1,160)	(222)	(2,384)
Pro forma net loss	$ (1,725)	$ (998)	$ (2,779)	$ (1,682)
Earnings (loss) per share as reported:				
Basic and diluted	$ (0.06)	$ 0.01	$ (0.10)	$ 0.02
Pro forma loss per share:				
Basic and diluted	$ (0.06)	$ (0.03)	$ (0.10)	$ (0.06)

The fair value of the Company s stock-based awards to employees was estimated using the Black-Scholes model, assuming no dividends, using the following historical assumptions:

Weighted average assumptions used in recent fiscal years:		**Options**	
	2006	**2005**	**2004**
Expected life (years)	6.1	6.1	6.1
Expected stock price volatility	72.2%	72.2%	65.8%
Risk-free interest rate	4.9%	4.4%	3.5%

As stated above, no options were issued in the first six months of fiscal 2006.

In fiscal year 2005, a total of 750,000 options were granted with exercise prices equal to the market price of the stock on the grant date. The weighted average exercise price was $7.48 and the average fair value of the options was $5.04. In addition, the Company issued 240,000 shares of restricted stock in fiscal 2005.