PENN ENGINEERING & MANUFACTURING CORP
Form 10-Q
November 13, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2001

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 number 1-5356

PENN ENGINEERING & MANUFACTURING CORP.
(Exact name of registrant as specified in its charter)

Delaware	23-0951065
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5190 Old Easton Highway, P.O. Box 1000, Danboro, Pennsylvania	18916
(Address of principal executive offices)	(Zip Code)

(215)-766-8853
(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 documents and 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 ___

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date: 3,350,164 shares of Class A common stock, $.01 par value, and 13,964,795 shares of common stock, $.01 par value, outstanding on November 8, 2001.

1

PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PENN ENGINEERING & MANUFACTURING CORP.
CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

ASSETS

	(UNAUDITED) SEPTEMBER 30, 2001	DECEMBER 31, 2000
CURRENT ASSETS		
Cash and cash equivalents	$ 9,120	$ 3,550
Short-term investments	777	3,064
Accounts receivable-net	31,839	43,039
Inventories	59,992	46,847
Other current assets	2,728	5,139
Total current assets	104,456	101,639
PROPERTY		
Property, plant & equipment	170,793	153,811
Less accumulated depreciation	75,389	69,524
Property - net	95,404	84,287
GOODWILL, NET	26,505	20,570
OTHER ASSETS	3,000	3,500
TOTAL	$229,365	$209,996

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES		
Accounts payable-trade	$ 4,884	$ 10,612
Bank debt	18,159	2,783
Dividends payable	1,383	0
Accrued expenses:		
Pension & profit sharing	5,668	3,106
Payroll & commissions	2,415	4,712
Other	1,277	1,890
Total current liabilities	33,786	23,103
ACCRUED PENSION COST	5,965	5,965
DEFERRED INCOME TAXES	4,644	4,640
STOCKHOLDERS' EQUITY		
Common stock	147	146

Class A common stock	35	35
Additional paid-in capital	38,852	37,646
Retained earnings	153,247	145,339
Accumulated other comprehensive income	(1,875)	(1,442)
Treasury stock	(5,436)	(5,436)
Total stockholders' equity	184,970	176,288
TOTAL	$229,365	$209,996

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

PENN ENGINEERING & MANUFACTURING CORP.
STATEMENTS OF CONDENSED CONSOLIDATED INCOME
(Unaudited)

(Dollars in thousands except per share amounts)

	THREE MONTHS ENDED		NINE MONT
	SEPTEMBER 30, 2001	SEPTEMBER 30, 2000	SEPTEMBER 30, 2001
NET SALES	$36,616	$66,551	$156,822
COST OF PRODUCTS SOLD	25,511	42,432	105,303
GROSS PROFIT	11,105	24,119	51,519
SELLING EXPENSES	4,967	7,460	16,321
GENERAL AND ADMINISTRATIVE EXPENSES	5,000	5,929	17,737
OPERATING INCOME	1,138	10,730	17,461
OTHER INCOME (EXPENSE):			
Interest income	46	100	245
Interest expense	(269)	(56)	(790)
Other, net	(296)	(292)	344
TOTAL OTHER INCOME (EXPENSE)	(519)	(248)	(201)
INCOME BEFORE INCOME TAXES	619	10,482	17,260
PROVISION FOR INCOME TAXES	(200)	3,004	5,208
NET INCOME	$ 819	$ 7,478	$ 12,052
PER SHARE DATA:			
Basic earnings	$ 0.05	$ 0.44	$ 0.70
Diluted earnings	$ 0.05	$ 0.43	$ 0.68

	=======	=======	========
Cash dividends declared	$ 0.08	$ 0.07	$ 0.24
	=======	=======	========

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

PENN ENGINEERING & MANUFACTURING CORP.
STATEMENTS OF CONDENSED CONSOLIDATED CASH FLOWS
(Unaudited)

(Dollars in thousands)

	NINE MONTHS ENDED	
	SEPTEMBER 30, 2001	SEPTEMBER 30,
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 12,052	$ 19,354
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	7,567	7,004
Amortization	1,001	795
Deferred income taxes	4	192
Foreign currency transaction losses	679	
Loss on disposal of property	155	34
Changes in assets and liabilities:		
Decrease (increase) in receivables	11,230	(7,946)
(Increase) decrease in inventories	(12,896)	2,958
Decrease (increase) in prepaid expenses	2,578	(4,446)
Decrease in other assets	500	150
(Decrease) increase in accounts payable	(6,195)	2,061
(Decrease) increase in accrued expenses	(585)	9,172
Decrease in accrued pension cost	0	(992)
Net cash provided by operating activities	16,090	28,336
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property additions	(10,179)	(10,167)
Acquisitions of businesses (net of cash)	(16,707)	(1,791)
Proceeds from disposal of held-to-maturity investments	2,296	6,118
Proceeds from disposal of property	242	144
Net cash used in investing activities	(24,348)	(5,696)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net short-term borrowings (repayments)	15,377	(4,083)
Net long-term repayments	0	(15,653)
Dividends paid	(2,760)	(2,056)

Issuance of common stock	1,206	400
Net cash provided by (used in) financing activities	13,823	(21,392)
Effect of exchange rate changes on cash	5	(207)
Net increase in cash and cash equivalents	5,570	1,041
Cash and cash equivalents at beginning of year	3,550	4,231
Cash and cash equivalents at end of period	$ 9,120	$ 5,272

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

PENN ENGINEERING & MANUFACTURING CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2001

NOTE 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The accompanying interim financial statements should be read in conjunction with the annual financial statements and notes thereto included in the Company's Annual Report for the year ended December 31, 2000. The information contained in this report is unaudited and subject to year-end audit and adjustment. In the opinion of management, all adjustments (which include only normal recurring adjustments) have been made which are necessary for a fair presentation of the Company's consolidated financial position at September 30, 2001 and 2000 and the consolidated statements of income and cash flows for the nine-month periods then ended. The results of operations for the three and nine months ended September 30, 2001 are not necessarily indicative of the results of operations to be expected for the year ending December 31, 2001.

NOTE 2. INVENTORIES

Substantially all of the Company's domestic fastener inventories are priced on the lower of last-in, first-out (LIFO) cost or market method. The remainder of the inventories are priced on the first-in, first-out (FIFO) method, at the lower of cost or market.

Inventories are as follows: (dollars in thousands)

	(UNAUDITED) SEPTEMBER 30, 2001	DECEMBER 31, 2000
Raw material	$ 6,241	$ 6,157
Tooling	4,250	4,145
Work-in-process	10,921	12,828
Finished goods	38,580	23,717
TOTAL	$59,992	$46,847

If the FIFO method of inventory valuation had been used by the Company for all inventories, inventories would have been $11,147,000 and $10,322,000 higher than reported at September 30, 2001 and December 31, 2000, respectively, and net income would have been $576,000 and $635,000 higher than reported for the nine months ended September 30, 2001 and 2000, respectively. Other assets consist of long-term tooling inventory totaling $3,000,000 and $3,500,000 at September 30, 2001 and December 31, 2000, respectively.

NOTE 3. BANK DEBT

As of September 30, 2001, the Company has three unsecured line-of-credit facilities available. All lines-of-credit bear interest at interest rate options provided in the facilities. The first line-of-credit facility permits maximum borrowings of $15,000,000, due on demand. At September 30, 2001, $8,580,000, bearing interest at 3.13%, was outstanding on this facility. The availability of funds under this facility is periodically reviewed by the bank. The second line-of-credit facility permits borrowings of up to $10,000,000 and expires on November 30, 2001 unless extended by the bank. At September 30, 2001, $1,508,000, bearing interest at 3.13%, was outstanding on this facility. In addition to the above short-term lines of credit, the Company has an unsecured line of credit with a bank that permits borrowings of up to $30,000,000 to finance acquisitions. At September 30, 2001, $721,000, bearing interest at 5.3295%, was outstanding on this facility and has been classified as short-term debt. The acquisition line of credit requires the Company to comply with certain financial covenants. At September 30, 2001 the Company was in compliance with all financial covenants. The Company also has two commercial loans outstanding as of September 30, 2001 for a total amount of $7,350,000. As of September 30, 2001, the loans are classified as short-term debt since it is the Company's intention to liquidate this debt within one year. The interest rate on both loans is 5.45%.

5

PENN ENGINEERING & MANUFACTURING CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2001

NOTE 4. COMPREHENSIVE INCOME

Total comprehensive income amounted to $2,623,000 and $7,429,000 for the three months ended September 30, 2001 and 2000, respectively and $11,619,000 and $19,049,000 for the nine months ended September 30, 2001 and 2000, respectively.

NOTE 5. USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 6. SEGMENT INFORMATION

Effective January 1, 2001, the Company reorganized its operations and implemented a new internal reporting system. As a result of this reorganization, the Company has subdivided what was previously called the fasteners segment into two reportable segments - fasteners (which includes the results of PEM Fastening Systems and Atlas Engineering) and distribution (which includes the results of the Arconix Group). There is no change in the motor segment (which includes the results of Pittman). Due to the nature of this change, it is impracticable to restate prior years segment data in a manner consistent with current year data. Segment data reported in a manner consistent with prior years is as follows:

(Dollars in Thousands)

	THREE MONTHS ENDED SEPTEMBER 30, 2001		THREE MONTHS ENDED SEPTEMBER 30, 2000	
	FASTENERS	MOTORS	FASTENERS	MOTORS
Revenues from external customers	$28,586	$8,030	$55,782	$10,769
Operating profit	775	363	9,231	1,499

	NINE MONTHS ENDED SEPTEMBER 30, 2001		NINE MONTHS ENDED SEPTEMBER 30, 2000	
	FASTENERS	MOTORS	FASTENERS	MOTORS
Revenues from external customers	$129,820	$27,002	$164,539	$31,800
Operating profit	16,489	972	25,110	3,802

Segment data reported under the new method of internal reporting is as follows:

(Dollars in Thousands)

	THREE MONTHS ENDED SEPTEMBER 30, 2001			NIN SEP
	FASTENERS	DISTRIBUTION	MOTORS	FASTENERS
Revenues from external customers	$20,999	$7,587	$8,030	$101,354
Intersegment revenues	4,192			21,113
Operating profit (loss)	(1,068)	1,470	363	17,060

PENN ENGINEERING & MANUFACTURING CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2001

A reconciliation of combined operating profit for the reportable segments to consolidated income before income taxes is as follows:

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2001	2000	2001	2000
Total profit for reportable segments	$ 765	$10,730	$20,148	$28,912
Unallocated corporate income (expense)	373		(2,687)	
Other income (expense)	(519)	(248)	(201)	(226)
Income before income taxes	$ 619	$10,482	$17,260	$28,686

NOTE 7. EARNINGS PER SHARE DATA

The following table sets forth the computation of basic and diluted earnings per share for the periods indicated. All share and per share amounts have been adjusted to account for the two-for-one stock split in the form of a 100% stock dividend that was issued on May 1, 2001.

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2001	2000	2001	2000
(In Thousands, except per share data)				
Basic:				
Net income	$ 819	$ 7,478	$12,052	$19,354
Average shares outstanding	17,286	17,156	17,253	17,142
Basic EPS	$ 0.05	$ 0.44	$ 0.70	$ 1.13
Diluted:				
Net income	$ 819	$ 7,478	$12,052	$19,354
Average shares outstanding	17,286	17,156	17,253	17,142
Net effect of dilutive stock options- based on treasury stock method	329	352	418	223
Totals	17,615	17,508	17,671	17,365
Diluted EPS	$ 0.05	$ 0.43	$ 0.68	$ 1.11

NOTE 8. RECLASSIFICATIONS

Certain reclassifications have been made to prior year amounts and balances to conform with the 2001 presentation.

7

PENN ENGINEERING & MANUFACTURING CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2001

NOTE 9. RECENT ACCOUNTING DEVELOPMENTS

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No, 141, "Business Combinations", and No. 142, "Goodwill and other Intangible Assets", effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of 2002. Application of the nonamortization provisions of the Statement is expected to result in an increase in net income of $960,000 ($0.05 per share) per year. The Company will perform the first of the required impairment tests of goodwill as of January 1, 2002 and has not yet determined what the effect of these tests will be on the earnings and financial position of the Company.

8

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

PENN ENGINEERING & MANUFACTURING CORP.
SEPTEMBER 30, 2001

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

QUARTER ENDED SEPTEMBER 30, 2001 VS. QUARTER ENDED SEPTEMBER 30, 2000

Consolidated net sales for the quarter ended September 30, 2001 were $36.6 million, versus $66.6 million for the quarter ended September 30, 2000, a 45.0% decrease. Net sales to customers outside the United States for the quarter ended September 30, 2001 were $11.1 million, versus $16.5 million for the quarter ended September 30, 2000, a 32.7% decrease. Net sales for the fastener and distribution operations for the quarter ended September 30, 2001 were $28.6 million, versus $55.8 million for the quarter ended September 30, 2000, a 48.7%

decrease. Motor net sales were $8.0 million for the quarter ended September 30, 2001, versus $10.8 million recorded for the quarter ended September 30, 2000, a 25.9% decrease.

Within the fastener and distribution operations, sales volume decreased approximately 50.0% in the third quarter of 2001 compared to the third quarter of 2000. The number of fastener units sold within North America decreased approximately 58.5% in the third quarter of 2001 compared to the third quarter of 2000. The number of fastener units sold into Europe decreased approximately 26.0% in the third quarter of 2001 compared to the third quarter of 2000, while the number of fastener units sold into the Asia-Pacific region decreased approximately 33.1% during the same period. The Company continues to be impacted by the effect of the economic downturn that began early in the year in the PC, telecommunications, server, and electronics markets, which together constitute approximately 77% of the Company's sales volume. The downturn appears to be spreading to our foreign markets as well as our domestic markets. Within the motor division the number of motors sold decreased 17.4% in the third quarter of 2001 compared to the third quarter of 2000 while the average selling price also decreased 9.7%. Downturns in the semiconductor and the data storage industries accounted for a majority of this decrease.

Consolidated gross profit for the third quarter of 2001 was $11.1 million, versus $24.1 million for the third quarter of 2000, a decrease of 53.9%. Fastener and distribution gross profit decreased 56.8% in the third quarter of 2001 compared to the third quarter of 2000 while motor gross profit decreased 37.5%. Both segments were affected by lower sales volume and decreased capacity utilization. The Company has begun to implement cost saving measures - the Fastening division will close its Suffolk, Virginia manufacturing facility effective December 9, 2001 while its Willimantic, Connecticut facility was closed and disposed of in July 2001. Employee reductions in both the fastener and motor divisions have also been made to balance Company resources with current economic conditions and future business requirements. These actions are expected to result in one-time costs of approximately $1.0 million in the fourth quarter of 2001.

Consolidated selling, general, and administrative expenses ("SG&A") for the third quarter of 2001 were $10.0 million, versus $13.4 million for the third quarter of 2000. Commission expense decreased 48.7% from the third quarter of 2000 to the third quarter of 2001 due to the reduced sales volume.

Consolidated net income for the third quarter of 2001 was $0.8 million, versus $7.5 million for the third quarter of 2000. The Company benefited from tax refunds due to foreign tax credits from prior years as well as a reduced effective tax rate from foreign sales tax planning.

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

NINE MONTHS ENDED SEPTEMBER 30, 2001 VS. NINE MONTHS ENDED SEPTEMBER 30, 2000

Consolidated net sales for the nine months ended September 30, 2001 were $156.8 million, versus $196.3 million for the nine months ended September 30, 2000, a 20.1% decrease. Net sales to customers outside the United States for the nine months ended September 30, 2001 were $44.1 million, versus $49.4 million for the nine months ended September 30, 2000, a 10.7% decrease. Net sales for the fastener and distribution operations for the nine months ended September 30, 2001 were $129.8 million, versus $164.5 million for the nine months ended September 30, 2000, a 21.1% decrease. Motor sales were $27.0 million for the nine months ended September 30, 2001, versus $31.8 million for the nine months ended September 30, 2000, a 15.1% decrease.

Within the fastener and distribution operations, sales volume decreased 21.8% from the first nine months of 2000 to the first nine months of 2001. Price increases averaging 3.2% were put into effect in the fourth quarter of 2000; however, the full effect of these increases was mitigated by currency fluctuations in Europe. The number of fastener units sold within North America decreased approximately 28.0% in the first nine months of 2001 compared to the first nine months of 2000 due to the economic slowdown in the PC, telecommunications, server, and electronics markets which began early in the year. The number of fastener units sold into Europe increased less than 1% in the first nine months of 2001 compared to the first nine months of 2000 as the European economy remained steady through the first half of 2001. The number of fastener units sold into the Asia-Pacific region decreased approximately 26.3% in the first nine months of 2001 compared to the first nine months of 2000 as electronics production has fallen off sharply in that region as a result of the slowdown in the computer market. The number of motors sold decreased 12.0% in the first nine months of 2001 compared to the first nine months of 2000 and the average selling price decreased 3.5% during the same period.

Consolidated gross profit for the first nine months of 2001 was $51.5 million, versus $67.7 million for the first nine months of 2000, a 23.9% decrease. Fastener and distribution gross profit decreased 23.3% in the first nine months of 2001 compared to the first nine months of 2000 while motor gross profit decreased 27.3% during the same period. Both segments continue to be affected by decreasing volume requirements while much of the Company's cost savings measures will not be fully realized until the first quarter of 2002.

Consolidated SG&A expenses for the first nine months of 2001 were $34.1 million (21.7% of net sales), versus $38.8 million (19.8% of net sales) for the first nine months of 2000. The Company is attempting to adjust its SG&A spending level to the reduced sales demands through staff reductions and tighter control over spending.

Consolidated net income for the first nine months of 2001 was $12.1 million, versus $19.4 million for the first nine months of 2000. The Company incurred $790,000 of interest expense in the first nine months of 2001 related to loans outstanding to finance acquisitions and benefited from a lower effective tax rate in 2001 due to foreign tax credits from prior years.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operations totaled $16.1 million for the nine months ended September 30, 2001 as compared to $28.3 million in the comparable period of 2000. The Company's accounts receivable balance decreased $11.2 million from December 31, 2000 to September 30, 2001 as a result of increased collection efforts and reduced sales volume. Funds from operations were sufficient to pay normal dividends and capital expenditures. The Company anticipates that its existing capital resources and cash flow generated from future operations as well as existing short-term lines of credit will enable it to maintain its current level of operations and its planned growth for the foreseeable future.

FORWARD-LOOKING STATEMENTS

Forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 under the Private Securities Litigation Reform Act of 1995, are made throughout this Management's Discussion and Analysis. The Company's results may differ materially from those in the forward-looking statements. Forward-looking statements are based on management's current views and assumptions, and involve risks and uncertainties that significantly affect expected results. For example, operating results may be affected by external factors such as: changes in laws and regulations, changes in accounting standards, fluctuations in demand in markets served by the Company, particularly the computer and telecommunications markets, fluctuations in the cost and availability of the supply chain resources, and foreign economic conditions, including currency rate fluctuations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.

There have been no material changes to Part 2, Item 7A of the Company's Form 10-K Annual Report for the year ended December 31, 2000.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Reference is made to Part 1, Item 3 of the Company's Form 10-K Annual Report for the year ended December 31, 2000.

ITEM 2. CHANGES IN SECURITIES

Not Applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not Applicable

ITEM 5. OTHER INFORMATION

Not Applicable

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a) Exhibits

Exhibit No.	Description
3.1	Restated Certificate of Incorporation (Incorporated by reference to Exhibit 3.1 of the Company's Form 10-Q Quarterly Report for the period ended March 31, 2001.)
3.2	By-laws, as amended (Incorporated by reference to Exhibit 3.2 of the Company's Form 10-Q Quarterly Report for the period ended June 30, 2000.)

b) Reports on Form 8-K

None.

SIGNATURE

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

PENN ENGINEERING & MANUFACTURING CORP.

Dated: November 13, 2001

By: --------------------------
Kenneth A. Swanstrom
Chairman/CEO

Dated: November 13, 2001

By: --------------------------
Mark W. Simon
Vice President - Finance