EnerSys
Form 10-Q
February 05, 2014

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 December 29, 2013

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 001-32253

EnerSys
(Exact name of registrant as specified in its charter)

Delaware	23-3058564
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2366 Bernville Road
Reading, Pennsylvania 19605
(Address of principal executive offices) (Zip Code)

Registrant’s telephone number, including area code: 610-208-1991

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. ý YES ¨ NO.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Securities Exchange Act of 1934.

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). ¨ YES ý NO.

Common Stock outstanding at January 31, 2014: 47,161,914 shares

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PART I –FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

ENERSYS
Consolidated Condensed Balance Sheets (Unaudited)
(In Thousands, Except Share and Per Share Data)

	December 29, 2013	March 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$211,641	$249,348
Accounts receivable, net of allowance for doubtful accounts: December 29, 2013 - $9,368; March 31, 2013 - $9,292	535,024	448,068
Inventories, net	360,839	353,941
Deferred taxes	41,502	37,786
Prepaid and other current assets	86,619	63,819
Total current assets	1,235,625	1,152,962
Property, plant, and equipment, net	368,356	350,126
Goodwill	429,484	345,499
Other intangible assets, net	156,087	103,701
Other assets	52,790	35,579
Total assets	$2,242,342	$1,987,867
Liabilities and Equity		
Current liabilities:		
Short-term debt	$32,607	$22,702
Current portion of long-term debt and capital lease obligations	365	311
Accounts payable	242,261	249,359
Accrued expenses	212,818	195,187
Total current liabilities	488,051	467,559
Long-term debt and capital lease obligations	281,033	155,476
Deferred taxes	99,925	88,036
Other liabilities	83,572	90,418
Total liabilities	952,581	801,489
Commitments and contingencies	—	—
Redeemable noncontrolling interests	7,279	11,095
Redeemable equity component of Convertible Notes	11,577	—
Equity:		
Common Stock, $0.01 par value per share, 135,000,000 shares authorized; 53,257,394 shares issued and 47,227,415 shares outstanding at December 29, 2013; 52,970,281 shares issued and 47,840,204 shares outstanding at March 31, 2013	532	529
Additional paid-in capital	496,055	501,646
Treasury stock, at cost, 6,029,979 shares held as of December 29, 2013; 5,130,077 shares held as of March 31, 2013	(150,344)	(100,776)
Retained earnings	842,342	727,347
Accumulated other comprehensive income	76,326	40,655
Total EnerSys stockholders’ equity	1,264,911	1,169,401
Nonredeemable noncontrolling interests	5,994	5,882
Total equity	1,270,905	1,175,283

Total liabilities and equity	$2,242,342	$1,987,867

See accompanying notes.

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ENERSYS
Consolidated Condensed Statements of Income (Unaudited)
(In Thousands, Except Share and Per Share Data)

	Quarter ended December 29, 2013	December 30, 2012
Net sales	$643,031	$557,320
Cost of goods sold	475,909	413,622
Gross profit	167,122	143,698
Operating expenses	90,083	80,185
Restructuring charges	12,920	3,776
Goodwill impairment charge	5,179	—
Operating earnings	58,940	59,737
Interest expense	4,597	4,612
Other (income) expense, net	8,193	1,271
Earnings before income taxes	46,150	53,854
Income tax (benefit) expense	(6,240)	15,177
Net earnings	52,390	38,677
Net losses attributable to noncontrolling interests	(2,910)	(507)
Net earnings attributable to EnerSys stockholders	$55,300	$39,184
Net earnings per common share attributable to EnerSys stockholders:		
Basic	$1.17	$0.81
Diluted	$1.10	$0.80
Dividends per common share	$0.125	$—
Weighted-average number of common shares outstanding:		
Basic	47,351,750	48,176,206
Diluted	50,214,782	48,682,346

See accompanying notes.

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Consolidated Condensed Statements of Income (Unaudited)
(In Thousands, Except Share and Per Share Data)

	Nine months ended	
	December 29, 2013	December 30, 2012
Net sales	$1,809,175	$1,705,442
Cost of goods sold	1,357,564	1,275,099
Gross profit	451,611	430,343
Operating expenses	249,419	232,025
Restructuring charges	14,460	5,441
Goodwill impairment charge	5,179	—
Operating earnings	182,553	192,877
Interest expense	12,987	14,286
Other (income) expense, net	11,066	727
Earnings before income taxes	158,500	177,864
Income tax expense	24,542	50,612
Net earnings	133,958	127,252
Net losses attributable to noncontrolling interests	(3,528)	(1,526)
Net earnings attributable to EnerSys stockholders	$137,486	$128,778
Net earnings per common share attributable to EnerSys stockholders:		
Basic	$2.89	$2.68
Diluted	$2.77	$2.65
Dividends per common share	$0.375	$—
Weighted-average number of common shares outstanding:		
Basic	47,598,076	48,088,580
Diluted	49,641,848	48,609,751

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ENERSYS

Consolidated Condensed Statements of Comprehensive Income (Unaudited)

(In Thousands)

	Quarter ended		Nine months ended	
	December 29, 2013	December 30, 2012	December 29, 2013	December 30, 2012
Net earnings	$52,390	$38,677	$133,958	$127,252
Other comprehensive income (loss):				
Net unrealized gain on derivative instruments, net of tax	1,322	997	3,612	3,588
Pension funded status adjustment, net of tax	152	(90)	468	(6)
Foreign currency translation adjustment	7,665	12,705	30,332	(3,476)
Total other comprehensive income (loss), net of tax	9,139	13,612	34,412	106
Total comprehensive income	61,529	52,289	168,370	127,358
Comprehensive loss attributable to noncontrolling interests	(3,157)	(679)	(4,787)	(2,119)
Comprehensive income attributable to EnerSys stockholders	$64,686	$52,968	$173,157	$129,477

See accompanying notes.

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Consolidated Condensed Statements of Cash Flows (Unaudited)

(In Thousands)

	Nine months ended December 29, 2013	December 30, 2012
Cash flows from operating activities		
Net earnings	$133,958	$127,252
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	38,903	37,779
Non-cash write-off of assets relating to restructuring	5,298	3,636
Non-cash write-off of other assets	5,000	—
Goodwill impairment charge	5,179	—
Derivatives not designated in hedging relationships:		
Net losses (gains)	56	(1,541)
Cash settlements	(420)	(1,965)
Provision for doubtful accounts	278	1,132
Deferred income taxes	(24,942)	(1,135)
Non-cash interest expense	6,594	6,512
Stock-based compensation	12,186	10,960
(Gain) loss on disposal of property, plant, and equipment	(301)	128
Changes in assets and liabilities:		
Accounts receivable	(46,548)	848
Inventories	5,774	(18,022)
Prepaid and other current assets	(15,720)	(5,747)
Other assets	95	1,030
Accounts payable	(26,348)	(18,441)
Accrued expenses	11,218	(7,373)
Other liabilities	(11,210)	444
Net cash provided by operating activities	99,050	135,497
Cash flows from investing activities		
Capital expenditures	(48,856)	(37,624)
Purchases of businesses	(146,196)	—
Proceeds from disposal of property, plant, and equipment	1,373	113
Net cash used in investing activities	(193,679)	(37,511)
Cash flows from financing activities		
Net increase in short-term debt	12,264	13,181
Proceeds from revolving credit borrowings	213,100	230,450
Repayments of revolving credit borrowings	(93,300)	(258,150)
Proceeds from long-term debt - other	—	5,556
Payments of long-term debt - other	—	(11,800)
Deferred financing costs	(823)	—
Capital lease obligations	(277)	(253)
Option proceeds (taxes paid related to net share settlement of equity awards), net	(7,945)	8,864
Excess tax benefits from exercise of stock options and vesting of equity awards	4,614	4,965
Purchase of treasury stock	(49,568)	(22,593)

Dividends paid to stockholders	(17,809)	—
Payment of deferred consideration	(4,820)	—
Purchase of noncontrolling interests	(6,012)	(2,131)
Proceeds from noncontrolling interests	—	613
Net cash provided by (used in) financing activities	49,424	(31,298)
Effect of exchange rate changes on cash and cash equivalents	7,498	1,468
Net (decrease) increase in cash and cash equivalents	(37,707)	68,156
Cash and cash equivalents at beginning of period	249,348	160,490
Cash and cash equivalents at end of period	$211,641	$228,646

See accompanying notes.

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ENERSYS
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Unaudited)
(In Thousands, Except Share and Per Share Data)

1. Basis of Presentation

The accompanying interim unaudited consolidated condensed financial statements of EnerSys (the “Company”) 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 the information and notes required for complete financial statements. In the opinion of management, the unaudited consolidated condensed financial statements include all normal recurring adjustments considered necessary for the fair presentation of the financial position, results of operations, and cash flows for the interim periods presented. The financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company’s 2013 Annual Report on Form 10-K (SEC File No. 001-32253), which was filed on May 28, 2013.

The Company reports interim financial information for 13-week periods, except for the first quarter, which always begins on April 1, and the fourth quarter, which always ends on March 31. The four quarters in fiscal 2014 end on June 30, 2013, September 29, 2013, December 29, 2013, and March 31, 2014, respectively. The four quarters in fiscal 2013 ended on July 1, 2012, September 30, 2012, December 30, 2012, and March 31, 2013, respectively.

The consolidated condensed financial statements include the accounts of the Company and its wholly-owned subsidiaries and any partially owned subsidiaries that the Company has the ability to control. All intercompany transactions and balances have been eliminated in consolidation.

The Company also consolidates certain subsidiaries in which the noncontrolling interest party has within its control the right to require the Company to redeem all or a portion of its interest in the subsidiary. The redeemable noncontrolling interests are reported at their estimated redemption value, and the amount presented in temporary equity is not less than the initial amount reported in temporary equity. Any adjustment to the redemption value impacts retained earnings but does not impact net income or comprehensive income. Noncontrolling interests which are redeemable only upon future events, the occurrence of which is not currently probable, are recorded at carrying value.

Certain amounts in the prior year's financial statements have been reclassified to conform to the current-year presentation for non-cash write-off of assets relating to restructuring.

Recently Adopted Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (“FASB”) finalized the disclosure requirements on how entities should present financial information about reclassification adjustments from accumulated other comprehensive income in ASU No. 2013-02, “Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." The standard requires that companies present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. If a component is not required to be reclassified to net income in its entirety, companies would instead cross-reference to the related footnote for additional information. The Company adopted ASU No. 2013-02 as of April 1, 2013, and the adoption did not have a material impact on the Company's consolidated condensed financial statements.

2. Acquisitions

During the third quarter of fiscal 2014, the Company completed the following acquisitions in the Americas, using both cash on hand and borrowings under the 2011 Credit Facility.

On October 8, 2013, the Company completed the acquisition of Purcell Systems Inc., a designer, manufacturer and marketer of thermally managed electronic equipment and battery cabinet enclosures, headquartered in Spokane, Washington, for $119,540, net of cash acquired. The Company acquired tangible and intangible assets, including trademarks, technology, customer relationships and goodwill. Based on preliminary valuations performed, trademarks were valued at $15,000, technology at $5,000, customer relationships at $25,000, and goodwill was recorded at $68,818.

On November 1, 2013, the Company completed the acquisition of Quallion, LLC, a manufacturer of lithium ion cells and batteries for medical devices, defense, aviation and space, headquartered in Sylmer, California, for $25,800, net of cash acquired. The Company acquired tangible and intangible assets, in connection with the acquisition, including trademarks, technology, customer relationships and goodwill. Based on preliminary valuations performed, trademarks were valued at $2,000, technology at $3,000, customer relationships at $4,000, and goodwill was recorded at $11,367.

The Company made an initial allocation of the purchase price to tangible and intangible assets acquired and liabilities assumed based on their estimated respective fair values as of the date of acquisition. The valuation of these tangible and identifiable intangible assets and liabilities is preliminary, subject to completion of a formal valuation process and further management review, and may be retrospectively adjusted, if necessary, as additional information becomes available. The fair valuation estimates particularly subject to change are those relating to accounts receivable and identifiable intangible assets subject to amortization. The excess of the purchase price over the tangible and identifiable intangible assets acquired and liabilities assumed has been allocated to goodwill. The Company expects to finalize the valuations and complete the purchase price allocations by 2014 fiscal year-end.

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3. Inventories

Inventories, net consist of:

	December 29, 2013	March 31, 2013
Raw materials	$90,386	$88,787
Work-in-process	124,174	113,119
Finished goods	146,279	152,035
Total	$360,839	$353,941

4. Goodwill Impairment Charge

Goodwill is tested annually for impairment during the fourth quarter or earlier upon the occurrence of certain events or substantive changes in circumstances that indicate goodwill is more likely than not impaired. During the third quarter of fiscal 2014, the Company determined that the fair value of its subsidiary in India, which was acquired in fiscal 2012, was less than its carrying amount based on the Company's analysis of the estimated future expected cash flows the Company anticipates from the operations of this subsidiary. Accordingly, the Company recorded a non-cash charge of $5,179 for goodwill impairment relating to this subsidiary.

The changes in the carrying amount of goodwill by reportable segment are as follows:

	Nine months ended December 29, 2013			
	EMEA	Americas	Asia	Total
Balance at March 31, 2013	$166,708	$150,031	$28,760	$345,499
Goodwill acquired during the period	—	80,415	—	80,415
Goodwill impairment charge	—	—	(5,179)	(5,179)
Foreign currency translation adjustment	10,148	(1,756)	357	8,749
Balance at December 29, 2013	$176,856	$228,690	$23,938	$429,484

5. Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company uses the following valuation techniques to measure fair value for its financial assets and financial liabilities:

Level 1	Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.
Level 2	Inputs are quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable and market-corroborated inputs which are derived principally from or corroborated by observable market data.
Level 3	Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable.

The following tables represent the financial assets and (liabilities), measured at fair value on a recurring basis as of December 29, 2013 and March 31, 2013 and the basis for that measurement:

	Total Fair Value Measurement December 29,	Quoted Price in Active Markets for Identical	Significant Other Observable	Significant Unobservable Inputs

	2013	Assets (Level 1)	Inputs (Level 2)	(Level 3)
Lead forward contracts	$3,151	$—	$3,151	$—
Foreign currency forward contracts	320	—	320	—
Total derivatives	$3,471	$—	$3,471	$—

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	Total Fair Value Measurement March 31, 2013	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest rate swap agreements	$(654)	$—	$(654)	$—
Lead forward contracts	(2,832)	—	(2,832)	—
Foreign currency forward contracts	(11)	—	(11)	—
Total derivatives	$(3,497)	$—	$(3,497)	$—

The fair values of interest rate swap agreements are based on observable prices as quoted for receiving the variable three month LIBOR and paying fixed interest rates and, therefore, were classified as Level 2. At December 29, 2013, the Company had no interest rate swap agreements.

The fair values of lead forward contracts are calculated using observable prices for lead as quoted on the London Metal Exchange ("LME") and, therefore, were classified as Level 2.

The fair values for foreign currency forward contracts are based upon current quoted market prices and are classified as Level 2 based on the nature of the underlying market in which these derivatives are traded.

Financial Instruments

The fair values of the Company's cash and cash equivalents, accounts receivable and accounts payable approximate carrying value due to their short maturities.

The fair value of the Company's short-term debt approximates its carrying value, as it is variable rate debt and the terms are comparable to market terms as of the balance sheet dates and is classified as Level 2.

The Company's senior 3.375% convertible notes ("Convertible Notes"), with a face value of $172,500, were issued when the Company's stock price was trading at $30.19 per share. On December 29, 2013, the Company's stock price closed at $70.09 per share. The Convertible Notes have a conversion option of $40.33 per share which equates to 24.7953 shares of the Company's common stock per one thousand dollars in principal amount of the Convertible Notes as of January 2, 2014, the date when the the holders were notified that they can submit the Convertible Notes for conversion. The conversion rate may be adjusted in accordance with the terms of the Convertible Notes and the indenture under which the Convertible Notes were issued. The fair value of these notes represent the trading values based upon quoted market prices and are classified as Level 2. The Convertible Notes were trading at 177% of face value on December 29, 2013, and 126% of face value on March 31, 2013. See Note 11 for further details.

The carrying amounts and estimated fair values of the Company's derivatives and Convertible Notes at December 29, 2013 and March 31, 2013 were as follows:

	December 29, 2013		March 31, 2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Derivatives (1)	$3,521	$3,521	$241	$241
Financial liabilities:				
Convertible Notes	$160,923 (2)	$305,325 (3)	$155,273 (2)	$217,350 (3)
Derivatives (1)	50	50	3,738	3,738

(1) Represents interest rate swap agreements, lead and foreign currency hedges.

(2) The carrying amounts of the Convertible Notes at December 29, 2013 and March 31, 2013 represent the $172,500 principal value, less the unamortized debt discount (see Note 11 for further details).

(3) The fair value amounts of the Convertible Notes at December 29, 2013 and March 31, 2013 represent the trading values of the Convertible Notes with a principal value of $172,500.

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6. Derivative Financial Instruments

The Company utilizes derivative instruments to reduce its exposure to fluctuations in commodity prices, foreign exchange rates and interest rates, under established procedures and controls. The Company does not enter into derivative contracts for speculative purposes. The Company’s agreements are with creditworthy financial institutions and the Company anticipates performance by counterparties to these contracts and therefore no material loss is expected.

Derivatives in Cash Flow Hedging Relationships

Lead Hedge Forward Contracts

The Company enters into lead hedge forward contracts to fix the price for a portion of its lead purchases. Management considers the lead hedge forward contracts to be effective against changes in the cash flows of the underlying lead purchases. The vast majority of such contracts are for a period not extending beyond one year and the notional amounts at December 29, 2013 and March 31, 2013 were 64.2 million pounds and 56.3 million pounds, respectively.

Foreign Currency Forward Contracts

The Company uses foreign currency forward contracts to hedge a portion of the Company’s foreign currency exposures for lead as well as other foreign currency exposures so that gains and losses on these contracts offset changes in the underlying foreign currency denominated exposures. The vast majority of such contracts are for a period not extending beyond one year. As of December 29, 2013 and March 31, 2013, the Company had entered into a total of $79,803 and $51,366, respectively, of such contracts.

In the coming twelve months, the Company anticipates that $4,017 of pretax gain relating to lead and foreign currency forward contracts will be reclassified from accumulated other comprehensive income (“AOCI”) as part of cost of goods sold. This amount represents the current unrealized impact of hedging lead and foreign exchange rates, which will change as market rates change in the future, and will ultimately be realized in the income statement as an offset to the corresponding actual changes in lead costs to be realized in connection with the variable lead cost and foreign exchange rates being hedged.

Derivatives not Designated in Hedging Relationships

Interest Rate Swap Agreements

As of March 31, 2013, the Company maintained interest rate swap agreements that converted $65,000 of variable-rate debt to a fixed-rate basis, utilizing the three-month LIBOR, as a floating rate reference. These agreements expired during the first quarter ended June 30, 2013, and the Company had no interest rate swap agreements as of December 29, 2013. The Company recorded expense relating to changes in the fair value of these agreements in the consolidated condensed statements of income, within other (income) expense, net of $7 and $99 during the third quarter and nine months ended December 30, 2012, respectively.

Foreign Currency Forward Contracts

The Company also enters into foreign currency forward contracts to economically hedge foreign currency fluctuations on intercompany loans and foreign currency denominated receivables and payables. These are not designated as hedging instruments and changes in fair value of these instruments are recorded directly in the consolidated condensed statements of income. As of December 29, 2013 and March 31, 2013, the notional amount of these contracts was $23,205 and $21,749, respectively. The Company recorded income in the consolidated condensed statements of income within other (income) expense, net of $124 and $2,058 during the third quarter of fiscal 2014 and fiscal 2013, respectively, and expense of $56 and income of $1,640 for the nine months ended December 29, 2013 and December 30, 2012, respectively.

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Presented below in tabular form is information on the location and amounts of derivative fair values in the consolidated condensed balance sheets and derivative gains and losses in the consolidated condensed statements of income:

Fair Value of Derivative Instruments
December 29, 2013 and March 31, 2013

	Derivatives and Hedging Activities Designated as Cash Flow Hedges		Derivatives and Hedging Activities Not Designated as Hedging Instruments	
	December 29, 2013	March 31, 2013	December 29, 2013	March 31, 2013
Prepaid and other current assets				
Foreign currency forward contracts	$370	$—	$—	$ 241
Lead hedge forward contracts	3,070	—	—	—
Other assets				
Lead hedge forward contracts	81	—	—	—
Total assets	$3,521	$—	$—	$ 241
Accrued expenses				
Interest rate swap agreements	$—	$—	$—	$ 654
Lead hedge forward contracts	—	2,832	—	—
Foreign currency forward contracts	—	252	50	—
Total liabilities	$—	$3,084	$ 50	$ 654

The Effect of Derivative Instruments on the Consolidated Condensed Statements of Income
For the quarter ended December 29, 2013

Derivatives Designated as Cash Flow Hedges	Pretax Gain (Loss) Recognized in AOCI on Derivative (Effective Portion)	Location of Gain (Loss) Reclassified from AOCI into Income (Effective Portion)	Pretax Gain (Loss) Reclassified from AOCI into Income (Effective Portion)
Lead hedge contracts	$2,657	Cost of goods sold	$1,293
Foreign currency forward contracts	644	Cost of goods sold	225
Total	$3,301		$1,518

Derivatives Not Designated as Hedging Instruments