CIRCOR INTERNATIONAL INC
Form 10-Q
October 31, 2013

UNITED STATES
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 29, 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 001-14962

CIRCOR INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	04-3477276 (I.R.S. Employer Identification No.)
c/o CIRCOR, Inc. 30 Corporate Drive, Suite 200, Burlington, MA (Address of principal executive offices)	01803-4238 (Zip Code)

(781) 270-1200
(Registrant's telephone number, including area code)

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 (§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 (Do not check if a smaller reporting company)	Smaller reporting company	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 x

As of October 22, 2013, there were 17,590,812 shares of the registrant's Common Stock, par value $0.01 per share, outstanding.

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PART I FINANCIAL INFORMATION.
ITEM 1. FINANCIAL STATEMENTS
CIRCOR INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	September 29, 2013 (Unaudited)	December 31, 2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$86,285	$61,738
Short-term investments	98	101
Trade accounts receivable, less allowance for doubtful accounts of $2,334 and $1,706, respectively	151,528	150,825
Inventories	198,454	198,005
Prepaid expenses and other current assets	18,185	16,510
Deferred income tax asset	15,601	15,505
Assets held for sale	480	542
Total Current Assets	470,631	443,226
PROPERTY, PLANT AND EQUIPMENT, NET	107,415	105,903
OTHER ASSETS:		
Goodwill	76,066	77,428
Intangibles, net	42,728	45,157
Deferred income tax asset	22,600	30,064
Other assets	5,923	8,203
TOTAL ASSETS	$725,363	$709,981
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$78,112	$80,361
Accrued expenses and other current liabilities	59,674	67,235
Accrued compensation and benefits	30,575	26,540
Income taxes payable	2,610	393
Notes payable and current portion of long-term debt	6,667	7,755
Total Current Liabilities	177,638	182,284
LONG-TERM DEBT, NET OF CURRENT PORTION	43,250	62,729
DEFERRED INCOME TAXES	10,037	10,744
OTHER NON-CURRENT LIABILITIES	35,380	35,977
CONTINGENCIES AND COMMITMENTS (See Note 10)		
SHAREHOLDERS' EQUITY:		
Preferred stock, $0.01 par value; 1,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $0.01 par value; 29,000,000 shares authorized; 17,590,312 and 17,445,687 shares issued and outstanding at September 29, 2013 and December 31, 2012, respectively	176	174
Additional paid-in capital	267,562	262,744
Retained earnings	194,797	158,509
Accumulated other comprehensive loss, net of taxes	(3,477)	(3,180)
Total Shareholders' Equity	459,058	418,247
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$725,363	$709,981

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CIRCOR INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Net revenues	$214,731	$209,804	$643,773	$643,946
Cost of revenues	144,593	151,109	443,679	462,823
GROSS PROFIT	70,138	58,695	200,094	181,123
Selling, general and administrative expenses	46,392	44,314	139,561	134,562
Impairment charges	—	10,348	—	10,348
Special charges / (recoveries)	(190)	1,377	3,441	1,377
OPERATING INCOME	23,936	2,656	57,092	34,836
Other (income) expense:				
Interest income	(67)	(101)	(189)	(262)
Interest expense	812	1,223	2,559	3,482
Other expense (income), net	568	564	1,807	887
TOTAL OTHER EXPENSE	1,313	1,686	4,177	4,107
INCOME BEFORE INCOME TAXES	22,623	970	52,915	30,729
Provision (benefit) for income taxes	4,903	(899)	14,619	9,138
NET INCOME	$17,720	$1,869	$38,296	$21,591
Earnings per common share:				
Basic	$1.01	$0.11	$2.18	$1.24
Diluted	$1.00	$0.11	$2.18	$1.24
Weighted average number of common shares outstanding:				
Basic	17,582	17,433	17,553	17,391
Diluted	17,667	17,467	17,602	17,436
Dividends paid per common share	$0.0375	$0.0375	$0.1125	$0.1125

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CIRCOR INTERNATIONAL, INC.
STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME (LOSS)
(In thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Net income	$ 17,720	$ 1,869	$ 38,296	$ 21,591
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	8,236	7,670	(295)	802
Other comprehensive income (loss)	8,236	7,670	(295)	802
COMPREHENSIVE INCOME (LOSS)	$ 25,956	$ 9,539	$ 38,001	$ 22,393

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CIRCOR INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended	
	September 29, 2013	September 30, 2012
OPERATING ACTIVITIES		
Net income	$38,296	$21,591
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	11,943	11,765
Amortization	2,273	2,823
Payment for Leslie bankruptcy settlement	—	(1,000)
Impairment charges	—	10,348
Compensation expense of share-based plans	3,343	3,409
Tax effect of share-based compensation	(536)	573
(Gain) loss on property, plant and equipment	(70)	1,148
Gain on return of acquisition purchase price	(3,400)	—
Change in operating assets and liabilities, net of effects from business acquisitions:		
Trade accounts receivable	493	(123)
Inventories	(33)	8,586
Prepaid expenses and other assets	193	(2,110)
Accounts payable, accrued expenses and other liabilities	1,259	(26,178)
Net cash provided by operating activities	53,761	30,832
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(13,579)	(14,097)
Proceeds from the sale of property, plant and equipment	348	200
Business acquisitions, return of purchase price	3,400	—
Net cash used in investing activities	(9,831)	(13,897)
FINANCING ACTIVITIES		
Proceeds from long-term debt	104,626	170,795
Payments of long-term debt	(124,351)	(192,040)
Dividends paid	(2,011)	(1,997)
Proceeds from the exercise of stock options	1,843	348
Tax effect of share-based compensation	536	(573)
Net cash used in financing activities	(19,357)	(23,467)
Effect of exchange rate changes on cash and cash equivalents	(27)	653
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	24,547	(5,879)
Cash and cash equivalents at beginning of period	61,738	54,855
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$86,285	$48,976
Supplemental Cash Flow Information:		
Cash paid during the period presented for:		
Income taxes	$5,463	$12,959
Interest	$3,132	$2,333

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CIRCOR INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Basis of Presentation

The accompanying unaudited, consolidated financial statements have been prepared according to the rules and regulations of the United States Securities and Exchange Commission ("SEC") and, in the opinion of management, reflect all adjustments, which include normal recurring adjustments, necessary for a fair presentation of the consolidated balance sheets, consolidated statements of income and consolidated statements of cash flows of CIRCOR International, Inc. ("CIRCOR", the "Company", "us", "we" or "our") for the periods presented. We prepare our interim financi information using the same accounting principles as we use for our annual audited financial statements. Certain information and note disclosures normally included in the annual audited financial statements have been condensed or omitted in accordance with prescribed SEC rules. We believe that the disclosures made in our consolidated financial statements and the accompanying notes are adequate to make the information presented not misleading.

The consolidated balance sheet at December 31, 2012 is as reported in our audited financial statements as of that date. Our accounting policies are described in the notes to our December 31, 2012 financial statements, which were included in our Annual Report filed on Form 10-K. We recommend that the financial statements included in our Quarterly Report on Form 10-Q be read in conjunction with the financial statements and notes included in our Annual Report filed on Form 10-K for the year ended December 31, 2012.

We operate and report financial information using a 52-week fiscal year ending December 31. The data periods contained within our Quarterly Reports on Form 10-Q reflect the results of operations for the 13-week, 26-week and 39-week periods which generally end on the Sunday nearest the calendar quarter-end date. Operating results for the three and nine months ended September 29, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013.

(2) Summary of Significant Accounting Policies

The significant accounting policies used in preparation of these condensed consolidated financial statements for the three and nine months ended September 29, 2013 are consistent with those discussed in Note 2 to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2012.

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income ("AOCI"). The new ASU requires entities to disclose in a single location (either on the face of the financial statement that reports net income or in the notes) the effects of reclassifications out of accumulated other comprehensive income. For items reclassified out of AOCI in their entirety into net income, entities must disclose the effect of the reclassification on each affected net income item. For AOCI reclassification items that are not reclassified in their entirety into net income, entities must provide a cross reference to other required U.S. GAAP disclosures. The new disclosure requirements are effective for annual reporting after December 15, 2012, and interim periods within those years. No reclassifications out of AOCI were made by the Company for the three and nine months ended September 29, 2013 or the three and nine months ended September 30, 2012 and therefore no additional AOCI disclosure is presented in our Quarterly Report on Form 10-Q.

In July 2013, FASB issued ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The new ASU requires companies to present an unrecognized tax benefit as a reduction of a deferred tax asset for a tax loss or credit carryforward on the balance sheet when either: (A) the tax law requires the company to use the tax loss or credit carryforward to satsify amounts payable upon disallowance of the tax position, or (B) the tax loss or credit carryforward is available to satisfy amounts payable upon disallowance of the tax position, and the company intends to use the deferred tax asset for that purpose. The new disclosure requirements are effective for annual reporting after December 15, 2013 and interim periods within those years. We do not believe the adoption of this update will have a material impact on our financial statements.

There were no additional new accounting pronouncements adopted during the nine months ended September 29, 2013 that had a material impact on our financial statements.

Subsequent events - On October 31, 2013, we announced an organizational restructuring under which we will simplify the manner in which we manage our businesses. Under this restructuring we will consolidate our group structure from three groups to two, reducing management layers and administrative expenses. Consistent with our new management structure we intend to begin reporting in two segments during the fourth quarter of 2013. The first segment will be ‘Energy,’ which will include all of the businesses from the existing Energy segment and the majority of the current ‘Flow Technologies’ businesses. The second segment will be ‘Aerospace and Defense,’ which will include all of the current Aerospace segment businesses plus a few primarily defense-oriented businesses currently in the Flow Technologies segment.

We expect to complete this reorganization in the fourth quarter of 2013 and expect to incur special charges of between $2.6 million to $3.0 million associated with this reorganization during the fourth quarter of 2013.

(3) Share-Based Compensation

As of September 29, 2013, we have one share-based compensation plan. The Amended and Restated 1999 Stock Option and Incentive Plan (the “1999 Stock Plan”), which was adopted by our Board of Directors and approved by our shareholders, permits the granting of the following types of awards to our officers, other employees and non-employee directors: incentive stock options; non-qualified stock options; deferred stock awards; restricted stock awards; unrestricted stock awards; performance share awards; cash-based awards; stock appreciation rights and dividend equivalent rights. The 1999 Stock Plan provides for the issuance of up to 3,000,000 shares of common stock (subject to adjustment for stock splits and similar events). New options granted under the 1999 Stock Plan could have varying vesting provisions and exercise periods. Options granted vest in periods ranging from one year to five years and expire ten years after the grant date. Restricted stock units granted generally vest from three years to six years. Vested restricted stock units will be settled in shares of our common stock. As of September 29, 2013, there were 279,819 stock options (including the April 9, 2013 CEO stock option award noted below) and 274,675 restricted stock units outstanding. In addition, there were 397,730 shares available for grant under the 1999 Stock Plan as of September 29, 2013. As of September 29, 2013, there were no outstanding restricted stock units that contain rights to nonforfeitable dividend equivalents and are considered participating securities that are included in our computation of basic and fully diluted earnings per share. There is no difference in the earnings per share amounts between the two class method and the treasury stock method, which is why we continue to use the treasury stock method.

For all stock options granted under the 1999 Stock Plan, the fair value of each grant was estimated at the date of grant using the Black-Scholes option pricing model. Black-Scholes utilizes assumptions related to volatility, the risk-free interest rate, the dividend yield and employee exercise behavior. Expected volatilities utilized in the model are based on the historic volatility of the Company’s stock price. The risk free interest rate is derived from the U.S. Treasury Yield curve in effect at the time of the grant.

On April 9, 2013, the Company granted stock options to purchase 200,000 shares of common stock to its newly appointed President and Chief Executive Officer, Scott A. Buckhout, at an exercise price of $41.17 per share. This option award was not granted under the Company's 1999 Stock Plan and includes both a service period and a market vesting condition. The stock options will vest if the following stock price targets are met based on the stock price closing at or above these targets for 60 consecutive trading days:

Stock Price Target	Cumulative Vested Portion of Stock Options (in Shares)
$50.00	50,000
$60.00	100,000
$70.00	150,000
$80.00	200,000

Vested options may be exercised 25% at the time of vesting, 50% one year from the date of vesting and 100% two years from the date of vesting. On August 8, 2013, the $50.00 Price Target was met, therefore, 50,000 options have vested and 12,500 are currently exercisable. This stock option award is being expensed utilizing a graded method and is subject to forfeiture in the event of employment termination (whether voluntary or involuntary) prior to vesting. To the extent that the market conditions above (stock price targets) are not met, those options will not vest and will forfeit 5 years from grant date. The Company used a Monte Carlo simulation option pricing model to value this option award with the following assumptions: 10 year term, expected life of 5.5 years, risk-free rate of 1.2%, expected volatility of 41.2%, and fair value of $14.46 per share at grant date. No other options were granted during the first nine months of 2013.

We account for Restricted Stock Unit ("RSU Awards") by expensing the weighted average fair value to selling, general and administrative expenses ratably over vesting periods generally ranging from three years to six years. During the nine months ended September 29, 2013 and September 30, 2012, we granted 130,845 and 132,471 RSU Awards with approximate fair values of $41.96 and $33.54 per RSU Award, respectively.

The CIRCOR Management Stock Purchase Plan, which is a component of the 1999 Stock Plan, provides that eligible employees may elect to receive restricted stock units in lieu of all or a portion of their pre-tax annual incentive bonus and, in some cases, make after-tax contributions in exchange for restricted stock units ("RSU MSPs"). In addition, non-employee directors may elect to receive restricted stock units in lieu of all or a portion of their annual directors' fees. Each RSU MSP represents a right to receive one share of our common stock after a three year vesting period. RSU MSPs are granted at a discount of 33% from the fair market value of the shares of our common stock on the date of grant. This discount is amortized as compensation expense, to selling, general and administrative expenses, over a four year period. A total of 28,463 and 34,534 RSU MSPs with per unit discount amounts representing fair values of $13.90 and $10.81 were granted under the CIRCOR Management Stock Purchase Plan during the nine months ended September 29, 2013 and September 30, 2012, respectively.

Compensation expense related to our share-based plans for the nine month periods ended September 29, 2013, and September 30, 2012 was $3.5 million and $3.3 million, respectively, and was recorded as selling, general and administrative expense. As of September 29, 2013, there was $9.0 million of total unrecognized compensation costs related to our outstanding share-based compensation arrangements (inclusive of the April 9, 2013 CEO option award). That cost is expected to be recognized over a weighted average period of 2.2 years.

The weighted average contractual term for stock options outstanding and options exercisable as of September 29, 2013 was 8.9 years and 7.4 years, respectively. The aggregate intrinsic value of stock options exercised during the nine months ended September 29, 2013 was $1.1 million and the aggregate intrinsic value of stock options outstanding and options exercisable as of September 29, 2013 was $6.5 million and $1.0 million, respectively.

The aggregate intrinsic value of RSU Awards settled during the nine months ended September 29, 2013 was $3.6 million and the aggregate intrinsic value of RSU Awards outstanding and RSU Awards vested and deferred as of September 29, 2013 was $12.7 million and $0.0 million, respectively.

The aggregate intrinsic value of RSU MSPs settled during the nine months ended September 29, 2013 was $0.7 million and the aggregate intrinsic value of RSU MSPs outstanding and RSU MSPs vested and deferred as of September 29, 2013 was $2.6 million and $0.0 million, respectively.

(4) Inventories
Inventories consist of the following (in thousands):

	September 29, 2013	December 31, 2012
Raw materials	$53,429	$63,104
Work in process	99,153	86,564
Finished goods	45,872	48,337
	$198,454	$198,005

(5) Goodwill and Intangible Assets
The following table shows goodwill, by segment, as of September 29, 2013 (in thousands):

	Energy	Aerospace	Flow Technologies	Consolidated Total
Goodwill as of December 31, 2012	$51,526	$22,121	$ 3,781	$ 77,428
Currency translation adjustments	(1,169)	42	(235)	(1,362)
Goodwill as of September 29, 2013	$50,357	$22,163	$ 3,546	$ 76,066

The table below presents gross intangible assets and the related accumulated amortization as of September 29, 2013 (in thousands):

	Gross Carrying Amount	Accumulated Amortization
Patents	$6,078	$(5,671)
Non-amortized intangibles (primarily trademarks and trade names)	23,601	—
Customer relationships	34,032	(18,088)
Backlog	1,114	(1,114)
Other	7,479	(4,703)
Total	$72,304	$(29,576)
Net carrying value of intangible assets	42,728	

The table below presents estimated remaining amortization expense for intangible assets recorded as of September 29, 2013 (in thousands):

	2013	2014	2015	2016	2017	After 2017
Estimated amortization expense	$774	$3,066	$3,045	$2,760	$2,626	$6,856

(6) Segment Information

The following table presents certain reportable segment information (in thousands):

	Energy	Aerospace	Flow Technologies	Corporate / Eliminations	Consolidated Total
Three Months Ended September 29, 2013					
Net revenues	$108,474	$36,483	$69,775	$—	$214,731
Inter-segment revenues	410	32	126	(568)	—
Operating income (loss)	21,620	3,002	8,334	(9,020)	23,936
Interest income					(67)
Interest expense					812
Other expense, net					568
Income before income taxes					$22,623
Identifiable assets	410,975	180,025	223,737	(89,374)	725,363
Capital expenditures	1,381	2,071	906	489	4,847
Depreciation and amortization	1,651	1,167	1,508	346	4,672
Three Months Ended September 30, 2012					
Net revenues	$109,968	$31,795	$68,041	$—	$209,804
Inter-segment revenues	577	10	194	(781)	—
Operating income (loss)	11,236	(10,284)	8,873	(7,169)	2,656
Interest income					(101)
Interest expense					1,223
Other expense, net					564
Income before income taxes					$970
Identifiable assets	366,730	180,547	204,107	(53,748)	