METHODE ELECTRONICS INC
Form 10-Q
December 10, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q
(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended October 31, 2015

or

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
for the transition period from ______ to ______

Commission file number 0-2816

METHODE ELECTRONICS, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	36-2090085 (I.R.S. Employer Identification No.)
7401 West Wilson Avenue, Harwood Heights, Illinois (Address of principal executive offices)	60706-4548 (Zip Code)

(Registrant’s telephone number, including area code) (708) 867-6777

None
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 smaller reporting company. See definitions of “large accelerated filer” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

At December 8, 2015, registrant had 38,106,823 shares of common stock outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

METHODE ELECTRONICS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
($ in millions)

	As of October 31, 2015 (Unaudited)	As of May 2, 2015
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$186.6	$168.1
Accounts receivable, net	165.2	170.4
Inventories:		
Finished products	13.8	16.0
Work in process	9.7	12.2
Materials	42.7	42.7
	66.2	70.9
Deferred income taxes	13.9	15.0
Prepaid expenses and other current assets	18.5	13.9
TOTAL CURRENT ASSETS	450.4	438.3
PROPERTY, PLANT AND EQUIPMENT	313.5	309.2
Less allowances for depreciation	223.0	215.9
	90.5	93.3
GOODWILL	1.6	1.7
INTANGIBLE ASSETS, net	10.1	11.3
PRE-PRODUCTION COSTS	9.4	10.5
DEFERRED INCOME TAXES	28.9	32.1
OTHER ASSETS	19.0	18.6
	69.0	74.2
TOTAL ASSETS	$609.9	$605.8
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$71.2	$70.1
Other current liabilities	40.3	60.5
TOTAL CURRENT LIABILITIES	111.5	130.6
LONG-TERM DEBT	22.0	5.0
OTHER LIABILITIES	3.9	4.0
DEFERRED COMPENSATION	7.8	7.2
SHAREHOLDERS' EQUITY		
Common stock, $0.50 par value, 100,000,000 shares authorized, 39,453,447 and 39,702,036 shares issued as of October 31, 2015 and May 2, 2015, respectively	19.7	19.9
Additional paid-in capital	108.7	102.2
Accumulated other comprehensive income	(16.4)	(8.3)
Treasury stock, 1,346,624 shares as of October 31, 2015 and May 2, 2015	(11.5)	(11.5)
Retained earnings	364.1	356.5

TOTAL METHODE ELECTRONICS, INC. SHAREHOLDERS' EQUITY	464.6	458.8
Noncontrolling interest	0.1	0.2
TOTAL EQUITY	464.7	459.0
TOTAL LIABILITIES AND EQUITY	$609.9	$605.8

See notes to condensed consolidated financial statements.

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METHODE ELECTRONICS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
($ in millions, except per share data)

	Three Months Ended		Six Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Net sales	$208.4	$ 229.7	$411.7	$ 447.8
Cost of products sold	157.5	169.5	307.2	337.2
Gross profit	50.9	60.2	104.5	110.6
Selling and administrative expenses	24.5	25.4	47.6	47.6
Income from operations	26.4	34.8	56.9	63.0
Interest income, net	(0.3)	(0.1)	(0.5)	(0.2)
Other (income) / expense	(0.2)	0.2	(0.5)	0.1
Income before income taxes	26.9	34.7	57.9	63.1
Income tax expense	5.7	8.7	13.1	15.7
Net income	21.2	26.0	44.8	47.4
Less: Net income attributable to noncontrolling interest	—	—	—	—
NET INCOME ATTRIBUTABLE TO METHODE ELECTRONICS, INC.	$21.2	$ 26.0	$44.8	$ 47.4
Amounts per common share attributable to Methode Electronics, Inc.:				
Basic	$0.55	$ 0.67	$1.15	$ 1.23
Diluted	$0.54	$ 0.66	$1.15	$ 1.21
Cash dividends:				
Common stock	$0.09	$ 0.09	$0.18	$ 0.18
Weighted average number of Common Shares outstanding:				
Basic	38,972,930	38,694,583	38,913,836	38,571,015
Diluted	39,077,839	39,516,436	39,031,424	39,038,647

See notes to condensed consolidated financial statements.

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METHODE ELECTRONICS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
($ in millions)

	Three Months Ended		Six Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Net income	$21.2	$ 26.0	$44.8	$ 47.4
Foreign currency translation adjustment	(2.0)	(10.8)	(8.1)	(16.1)
Comprehensive income	19.2	15.2	36.7	31.3
Less: Comprehensive income attributable to non-controlling interest	—	—	—	—
Comprehensive income attributable to Methode Electronics, Inc.	$19.2	$ 15.2	$36.7	$ 31.3

See notes to consolidated financial statements.

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METHODE ELECTRONICS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
($ in millions)

	Six Months Ended	
	October 31, 2015	November 1, 2014
OPERATING ACTIVITIES		
Net income	$44.8	$47.4
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for depreciation	10.8	11.2
Amortization of intangibles	1.2	0.8
Amortization of stock awards and stock options	2.2	2.2
Changes in operating assets and liabilities	(9.9)	1.6
NET CASH PROVIDED BY OPERATING ACTIVITIES	49.1	63.2
INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(9.5)	(10.8)
NET CASH USED IN INVESTING ACTIVITIES	(9.5)	(10.8)
FINANCING ACTIVITIES		
Taxes paid related to net share settlement of equity awards	(7.6)	—
Purchase of common stock	(22.8)	—
Proceeds from exercise of stock options	0.4	6.3
Excess tax benefit from equity-based compensation	4.0	—
Cash dividends	(6.9)	(6.9)
Proceeds from borrowings	25.0	—
Repayment of borrowings	(8.0)	(18.0)
NET CASH USED IN FINANCING ACTIVITIES	(15.9)	(18.6)
Effect of foreign currency exchange rate changes on cash	(5.2)	(6.0)
INCREASE IN CASH AND CASH EQUIVALENTS	18.5	27.8
Cash and cash equivalents at beginning of period	168.1	116.4
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$186.6	$144.2

See notes to condensed consolidated financial statements.

METHODE ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(Dollar amounts in millions, except per share data)

1. BASIS OF PRESENTATION

Methode Electronics, Inc. was incorporated in 1946 as an Illinois corporation and reincorporated in Delaware in 1966. As used herein, “we,” “us,” “our,” the “Company” or “Methode” means Methode Electronics, Inc. and its subsidiaries. Our business is managed and our financial results are reported on a segment basis, with those segments being Automotive, Interface, Power Products and Other. The condensed consolidated financial statements and related disclosures as of October 31, 2015 and results of operations for the three and six months ended October 31, 2015 and November 1, 2014 are unaudited, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). The May 2, 2015 condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (“U.S. GAAP”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. In our opinion, these financial statements include all adjustments (consisting only of normal recurring adjustments) necessary for the fair statement of the results for the interim periods. These financial statements should be read in conjunction with the financial statements included in our Form 10-K for the year ended May 2, 2015, filed with the SEC on June 25, 2015. Results may vary from quarter to quarter for reasons other than seasonality.

2. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board, ("FASB") issued Accounting Standards Update ("ASU") 2014-09, “Revenue from Contracts with Customers.” The core principle is that a company should recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, “Revenue from Contracts with Customers: Deferral of the Effective Date” which deferred the effective date for all entities by one year so it is now effective for annual periods beginning after December 15, 2017 and interim periods within those annual periods. We are still assessing the impact of adoption on our consolidated financial statements.

In July 2015, FASB issued ASU 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory". This ASU requires an entity to measure inventory at the lower of cost and net realizable value, rather than at the lower of cost or market. The guidance is effective for interim and annual periods beginning after December 15, 2016, and is to be applied prospectively. Early adoption is permitted. We do not believe the adoption of this standard will have a significant effect on our consolidated financial statements.

In May 2015, the FASB issued ASU 2015-7, "Fair Value Measurement: Disclosure for Investments in Certain Entities that calculates Net Asset Value per Share (or its Equivalent)". This amendment removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net value asset per share. This new guidance is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. We do not believe the adoption of this standard will have a significant effect on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs". This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The amendments in this ASU are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The update requires retrospective application and represents a change in accounting principle. We do not believe the adoption of this standard will have a significant effect on our consolidated financial statements.

In January 2015, the FASB issued ASU 2015-01, "Income Statement - Extraordinary and Unusual Items (Subtopic 225-20)", which eliminates the concept of extraordinary items. The standard does not affect disclosure guidance for events or transactions that are unusual in nature or infrequent in their occurrence. The ASU is effective in annual periods, and interim periods within those annual periods, beginning after December 15, 2015. The standard allows prospective or retrospective application. Early adoption is permitted if applied from the beginning of the fiscal year of adoption. We do not believe the adoption of this standard will have any significant effect on our consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16 "Business Combinations Simplifying the Accounting for Measurement-Period Adjustments". The standard requires that an acquirer recognize measurement-period adjustments in the period in which the adjustments are determined. The income effects of such measurement-period adjustments are to be recorded in the same period’s financial statements but calculated as if the accounting had been completed as of the acquisition

METHODE ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(Dollar amounts in millions, except per share data)

date. The impact of measurement-period adjustments to earnings that relate to prior period financial statements are to be presented separately on the income statement or disclosed by line item. This accounting guidance is effective for us on a prospective basis beginning in the first quarter of fiscal 2017.

3. GOODWILL AND INTANGIBLE ASSETS

We review our goodwill and other intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable, and at least annually in accordance with ASC No. 350, "Intangibles — Goodwill and Other". The values assigned to goodwill and intangible assets are normally based on estimates and judgments regarding expectations for the success and life cycle of products and technologies acquired. A severe decline in expectations could result in significant impairment charges, which could have a material adverse effect on our financial condition and results of operations.

The following table shows the roll-forward of goodwill in the financial statements for the six months ended October 31, 2015:

	As of October 31, 2015		
	Interface	Power Products	Total
Balance as of May 2, 2015	$0.7	$1.0	$1.7
Foreign currency translation	(0.1)	—	(0.1)
Balance as of October 31, 2015	$0.6	$1.0	$1.6

The following tables present details of the Company's intangible assets:

	As of October 31, 2015			
	Gross	Accumulated Amortization	Net	Wtd. Avg. Remaining Amortization Periods (Years)
Customer relationships and agreements	$16.3	$15.2	$1.1	8.3
Trade names, patents and technology licenses	25.8	16.8	9.0	2.9
Covenants not to compete	0.1	0.1	—	1.9
Total	$42.2	$32.1	$10.1	

	As of May 2, 2015			
	Gross	Accumulated Amortization	Net	Wtd. Avg. Remaining Amortization Periods (Years)
Customer relationships and agreements	$16.3	$15.0	$1.3	8.8
Trade names, patents and technology licenses	25.8	15.8	10.0	3.3
Covenants not to compete	0.1	0.1	—	2.4
Total	$42.2	$30.9	$11.3	

The estimated aggregate amortization expense for the current fiscal year and each of the four succeeding fiscal years is as follows:

2016	$2.4
2017	$2.3
2018	$2.2
2019	$2.1
2020	$0.2

As of October 31, 2015 and May 2, 2015, the trade names, patents and technology licenses include $1.8 million of trade names that are not subject to amortization.

4. INCOME TAXES

At May 2, 2015, we recorded a deferred tax benefit of $7.2 million related to the release of a foreign valuation allowance and a $1.4 million deferred tax benefit related to the release of our state valuation allowance. The Company evaluated all available positive and negative evidence, including past operating results and projection of future taxable income and determined it is more likely than not that expected future taxable income will be sufficient to utilize substantially all of our foreign, federal and US state net deferred tax assets. The Company maintained a valuation allowance of $1.2 million at October 31, 2015 and May 2, 2015 related to certain state and federal net operating loss carryovers and expects to continue to maintain this allowance until we determine that these deferred tax assets are more likely than not realizable.

At October 31, 2015, we had available $2.1 million of federal and $80.6 million of state net operating loss carry forwards (having a tax benefit of $0.7 million and $3.8 million, respectively) and $3.7 million of foreign tax credit carry forwards. If unused, the U.S. federal net operating loss carry forwards will expire in the fiscal years 2018 through 2031. The state net operating loss carry forwards will expire in the fiscal years 2016 through 2035. The foreign tax credits will expire in the fiscal years 2023 through 2024.

The tax laws of Malta provide for investment tax credits of 30% of certain qualified expenditures. Unused credits of $16.1 million as of October 31, 2015 can be carried forward indefinitely. We record investment tax credits using the "flow through" method.

The Company recognized an income tax provision of $5.7 million and $8.7 million for the three months ended October 31, 2015 and November 1, 2014, respectively. The Company's effective tax rate was 21.2% and 25.1% for the three months ended October 31, 2015 and November 1, 2014, respectively. The Company recognized an income tax provision of $13.1 million and $15.7 million for the six months ended October 31, 2015 and November 1, 2014, respectively. The Company's effective tax rate was 22.7% and 24.9% for the six months ended October 31, 2015 and November 1, 2014, respectively. The income tax provision for both the three and six months ended October 31, 2015 and November 1, 2014 is lower than the U.S. statutory rate primarily due to foreign investment tax credits and foreign operations with lower statutory rates.

We record interest and penalties accrued related to the unrecognized tax benefits in the provision for income taxes. We had approximately $0.1 million accrued at October 31, 2015 for the payment of interest and penalties. The total unrecognized tax benefit as of October 31, 2015 was $0.9 million. We recorded an unrecognized tax benefit of $0.1 million in the first half of fiscal 2016. There have been no material changes to the accrued amounts in the current fiscal year.

The Company and all of its domestic subsidiaries file income tax returns in the U.S. federal jurisdiction and various states. Our foreign subsidiaries file income tax returns in certain foreign jurisdictions since they have operations outside the U.S. The Company and its subsidiaries are generally no longer subject to U.S. federal, state and local examinations by tax authorities for all years except fiscal 2014, 2013, 2012 and 2011.

METHODE ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(Dollar amounts in millions, except per share data)

5. COMMON STOCK AND STOCK-BASED COMPENSATION

During the quarter ended October 31, 2015, the Compensation Committee of the Board of Directors authorized a new long-term incentive program for key employees consisting of performance-based Restricted Stock Awards (“RSAs”) and time-based Restricted Stock Units (“RSUs”).

The number of RSAs earned will vary based on performance relative to established goals for fiscal 2020 adjusted EBITDA, with 50% of the target shares earned for threshold performance (representing 342,000 shares), 100% of the target shares earned for target performance (representing 684,000 shares) and 150% of the target shares earned for maximum performance (representing 1,026,000 shares).

At the target level of performance, the expected expense for the RSAs over the five-year period will be $21.8 million. During the quarter ended October 31, 2015, the Company recorded $0.4 million in compensation expense related to the RSA’s.

As of October 31, 2015, the Company is recording the RSA compensation expense based on target performance. In future periods, if management makes a determination that the target will likely be exceeded for fiscal 2020, a catch-up adjustment to compensation expense will be recorded in that period. This amount could be material to the financial statements.

The Company also granted 516,000 RSU's to key employees. The RSU’s are subject to a five-year vesting period, with 30% vesting on on each April 28, 2018 and 2019 and 40% vesting on May 2, 2020. The total expense for the RSU's is expected to be $16.5 million through 2020. During the quarter ended October 31, 2015, the Company recorded $0.4 million of compensation expense related to the RSU's.

6. NET INCOME PER SHARE

Basic net income per share is calculated by dividing net income attributable to Methode shareholders by the weighted average number of common shares outstanding for the applicable period. Diluted net income per share is calculated after adjusting the denominator of the basic net income per share calculation for the effect of all potentially dilutive stock compensation awards outstanding during the period.

The following table sets forth the computation of basic and diluted net income per share:

	Three Months Ended		Six Months Ended	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014
Numerator - net income attributable to Methode Electronics, Inc.	$21.2	$26.0	$44.8	$47.4
Denominator:	—	—		
Denominator for basic net income per share-weighted average shares outstanding and vested/unissued restricted stock awards	38,972,930	38,694,583	38,913,836	