STONERIDGE INC
Form 10-Q
November 09, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarter ended September 30, 2007

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: 001-13337

STONERIDGE, INC.

(Exact name of registrant as specified in its charter)

Ohio	**34-1598949**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
9400 East Market Street, Warren, Ohio	**44484**
(Address of principal executive offices)	*(Zip Code)*

(330) 856-2443

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 þ Yes o No

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). o Yes þ No

The number of Common Shares, without par value, outstanding as of October 26, 2007 was 24,226,564.

STONERIDGE, INC. AND SUBSIDIARIES
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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

STONERIDGE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 67,649	$ 65,882
Accounts receivable, less allowances for doubtful accounts and other reserves of $5,521 and $5,243, respectively	123,916	106,985
Inventories, net	57,591	58,521
Prepaid expenses and other	19,925	13,448
Deferred income taxes	9,305	9,196
Total current assets	278,386	254,032
Long-Term Assets:		
Property, plant and equipment, net	102,378	114,586
Other Assets:		
Goodwill	65,176	65,176
Investments and other, net	40,317	30,875
Deferred income taxes	36,896	37,138
Total long-term assets	244,767	247,775
Total Assets	$ 523,153	$ 501,807
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 65,753	$ 72,493
Accrued expenses and other	53,949	45,624
Total current liabilities	119,702	118,117
Long-Term Liabilities:		
Long-term debt	200,000	200,000
Deferred income taxes	2,030	1,923
Other liabilities	3,800	3,145

Total long-term liabilities	205,830	205,068
Shareholders Equity:		
Preferred Shares, without par value, authorized 5,000 shares, none issued		
Common Shares, without par value, authorized 60,000 shares, issued 24,599 and 23,990 shares and outstanding 24,227 and 23,804 shares, respectively, with no stated value		
Additional paid-in capital	153,585	150,078
Common Shares held in treasury, 373 and 186 shares, respectively, at cost	(383)	(151)
Retained earnings	31,891	21,701
Accumulated other comprehensive income	12,528	6,994
Total shareholders equity	197,621	178,622
Total Liabilities and Shareholders Equity	$ 523,153	$ 501,807

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

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STONERIDGE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Net Sales	$ 172,814	$ 172,351	$ 541,644	$ 537,484
Costs and Expenses:				
Cost of goods sold	134,944	134,173	422,045	414,619
Selling, general and administrative	32,407	29,074	99,209	92,044
(Gain) loss on sale of property, plant and equipment, net	223	15	(1,465)	(1,454)
Operating Income	5,240	9,089	21,855	32,275
Interest expense, net	5,467	5,710	16,570	17,462
Equity in earnings of investees	(3,506)	(1,838)	(7,924)	(4,804)
Other (income) loss, net	273	(55)	785	1,697
Income Before Income Taxes	3,006	5,272	12,424	17,920
Provision for income taxes	381	866	2,234	4,857
Net Income	$ 2,625	$ 4,406	$ 10,190	$ 13,063
Basic net income per share	$ 0.11	$ 0.19	$ 0.44	$ 0.57
Basic weighted average shares outstanding	23,213	22,880	23,106	22,833
Diluted net income per share	$ 0.11	$ 0.19	$ 0.43	$ 0.56
Diluted weighted average shares outstanding	23,694	23,396	23,656	23,250

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

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STONERIDGE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

	Nine Months Ended September 30, 2007	2006
OPERATING ACTIVITIES:		
Net income	$ 10,190	$ 13,063
Adjustments to reconcile net income to net cash provided by (used for) operating activities -		
Depreciation	21,775	19,124
Amortization	1,196	1,238
Deferred income taxes	(1,272)	2,726
Equity in earnings of investees	(7,924)	(4,804)
Gain on sale of property, plant and equipment	(1,465)	(1,454)
Share-based compensation expense	1,858	1,380
Postretirement benefit settlement gain		(1,242)
Changes in operating assets and liabilities -		
Accounts receivable, net	(15,197)	(19,499)
Inventories, net	756	(3,094)
Prepaid expenses and other	(1,676)	189
Other assets	(101)	1,149
Accounts payable	(8,446)	12,020
Accrued expenses and other	8,215	1,814
Net cash provided by operating activities	7,909	22,610
INVESTING ACTIVITIES:		
Capital expenditures	(14,259)	(19,794)
Proceeds from sale of property, plant and equipment	5,042	2,266
Business acquisitions and other		(668)
Net cash used for investing activities	(9,217)	(18,196)
FINANCING ACTIVITIES:		
Repayments of long-term debt		(44)
Share-based compensation activity, net	1,956	47
Other financing costs		(150)
Net cash provided by (used for) financing activities	1,956	(147)
Effect of exchange rate changes on cash and cash equivalents	1,119	1,679

Net change in cash and cash equivalents	1,767	5,946
Cash and cash equivalents at beginning of period	65,882	40,784
Cash and cash equivalents at end of period	$ 67,649	$ 46,730

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

STONERIDGE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(in thousands, except share and per share data, unless otherwise indicated)

(1) Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared by Stoneridge, Inc. (the Company) without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the Commission). The information furnished in the condensed consolidated financial statements includes normal recurring adjustments and reflects all adjustments, which are, in the opinion of management, necessary for a fair presentation of such financial statements. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to the Commission s rules and regulations. Although the Company believes that the disclosures are adequate to make the information presented not misleading, it is suggested that these condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company s Form 10-K for the fiscal year ended December 31, 2006.

The results of operations for the nine months ended September 30, 2007 are not necessarily indicative of the results to be expected for the full year.

Beginning in 2005, the Company changed from a calendar year-end to a 52-53 week fiscal year-end. Until October 30, 2006, the Company s fiscal quarters were comprised of 13-week periods. On October 30, 2006, the Company changed back to a calendar (December 31) fiscal year-end; therefore, the 2006 fiscal year ended on December 31, 2006. Our fiscal quarters are now comprised of 3-month periods. Throughout this document, three months and nine months will be used to reference the 3- and 9-month periods of 2007 and the comparable 13- and 39-week periods of 2006.

The Company has reclassified the presentation of certain prior-period information to conform to the current presentation.

(2) Inventories

Inventories are valued at the lower of cost or market. Cost is determined by the last-in, first-out (LIFO) method for approximately 69% and 67% of the Company s inventories at September 30, 2007 and December 31, 2006, respectively, and by the first-in, first-out (FIFO) method for all other inventories. Inventory cost includes material, labor and overhead. Inventories consist of the following:

	September 30, 2007	December 31, 2006
Raw materials	$ 38,239	$ 39,832
Work-in-progress	9,263	8,196
Finished goods	11,919	12,614
Total inventories	59,421	60,642
Less: LIFO reserve	(1,830)	(2,121)
Inventories, net	$ 57,591	$ 58,521

(3) Fair Value of Financial Instruments

Financial Instruments

A financial instrument is cash or a contract that imposes an obligation to deliver, or conveys a right to receive cash or another financial instrument. The carrying values of cash and cash equivalents, accounts receivable and accounts payable are considered to be representative of fair value because of the short maturity of these instruments. The estimated fair value of the Company s senior notes (fixed rate debt) at September 30, 2007 and 2006, per quoted market sources, was $207.0 million and $192.0 million, respectively. On both dates, the carrying value was $200.0 million.

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STONERIDGE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(in thousands, except share and per share data, unless otherwise indicated)

Derivative Instruments and Hedging Activities

The Company makes use of derivative instruments in foreign exchange and commodity price hedging programs. Derivatives currently in use are foreign currency forward and commodity swap contracts. These contracts are used for hedging and not for speculative purposes. Management believes that its use of these instruments to reduce risk is in the Company s best interest.

As a result of the Company s international business presence it is exposed to foreign currency exchange risk. The Company uses derivative financial instruments, including foreign currency forward contracts, to mitigate its exposure to fluctuations in foreign currency exchange rates by reducing the effect of such fluctuations on foreign currency denominated intercompany transactions and other known foreign currency exposures. The principal currencies hedged by the Company include the Swedish krona, British pound and Mexican peso. In certain instances, the foreign currency forward contracts are marked to market, with gains and losses recognized in the Company s condensed consolidated statement of operations as a component of other income. The Company s foreign currency forward and option contracts substantially offset gains and losses on the underlying foreign currency denominated transactions. In addition, the Company s contracts intended to reduce exposure to the Mexican peso were executed to hedge forecasted transactions, and therefore the contracts are accounted for as cash flow hedges. The effective portion of the unrealized gain or loss is deferred and reported as a component of accumulated other comprehensive income. The Company s expectation is that the cash flow hedges will be highly effective in the future. The effectiveness of the transactions will be measured on an ongoing basis using the hypothetical operative method.

The Company s foreign currency forward contracts had a notional value of $18,743 and $15,044 at September 30, 2007 and 2006, respectively. The purpose of these investments is to reduce the risk of exposure related to the Company s Mexican peso-, Swedish krona- and British pound-denominated exposures. The contracts related to the Company s Swedish krona denominated exposures expired on July 2, 2007. The estimated fair value of the existing contracts at September 30, 2007 and 2006, per quoted market sources, was approximately $198 and $(311), respectively. In 2006, the Company used foreign currency option contracts to reduce the risk of exposures to the Mexican peso. As of September 30, 2006, the Company s foreign currency option contracts had a notional value of $56 and an estimated fair value of $12. The Company s foreign currency option contracts expired as of December 31, 2006.

To mitigate the risk of future price volatility and, consequently, fluctuations in gross margins, the Company has entered into fixed price commodity swaps with a bank to fix the cost of copper purchases. In December 2006, we entered into a fixed price swap for 480 metric tonnes of copper. In January 2007, we entered into an additional fixed price swap for 420 metric tonnes of copper. Because these contracts were executed to hedge forecasted transactions, the contracts are accounted for as cash flow hedges. The unrealized gain or loss for the effective portion of the hedge is deferred and reported as a component of accumulated other comprehensive income. The Company s expectation is that the cash flow hedges will be highly effective in the future; however, as of December 31, 2006 they were not deemed effective and had no impact on other comprehensive income. The effectiveness of the transactions has been and will be measured on an ongoing basis using the hypothetical operative method. As of September 30, 2007, the fair value of the fixed price commodity swap contracts was approximately $536.

(4) Share-Based Compensation

Total compensation expense recognized in the condensed consolidated statements of operations for share-based compensation arrangements was $606 and $454 for the three months ended September 30, 2007 and 2006, respectively. For the nine months ended September 30, 2007 and 2006, total compensation expense recognized in the condensed consolidated statements of operations for share-based compensation arrangements was $1,858 and $1,380, respectively.

The total income tax benefit recognized in the condensed consolidated statements of operations for share-based compensation arrangements was $212 and $159 for the three months ended September 30, 2007 and 2006, respectively. For the nine months ended September 30, 2007 and 2006, total income tax benefit recognized in the condensed consolidated statements of operations for share-based compensation arrangements was $650 and $483, respectively. There was no share-based compensation cost capitalized as inventory or fixed assets for either period.

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STONERIDGE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(in thousands, except share and per share data, unless otherwise indicated)

(5) Comprehensive Income (Loss)

Statement of Financial Accounting Standards (SFAS) No. 130, *Reporting Comprehensive Income*, establishes standards for the reporting and disclosure of comprehensive income.

The components of comprehensive income, net of tax are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net income	$ 2,625	$ 4,406	$ 10,190	$ 13,063
Other comprehensive income:				
Currency translation adjustments	3,019	249	5,001	3,608
Pension liability adjustments	(24)	(41)	(60)	(275)
Unrealized gain (loss) on marketable securities	(22)	10	39	32
Unrecognized gain (loss) on derivatives	(547)		554	
Total other comprehensive income	2,426	218	5,534	3,365
Comprehensive income	$ 5,051	$ 4,624	$ 15,724	$ 16,428

Accumulated other comprehensive income, net of tax is comprised of the following:

	September 30, 2007	December 31, 2006
Foreign currency translation adjustments	$ 13,526	$ 8,525
Pension liability adjustments	(1,527)	(1,467)
Unrealized loss on marketable securities	(25)	(64)
Unrecognized gain on derivatives	554	
Accumulated other comprehensive income	$ 12,528	$ 6,994

6) Long-Term Debt

Senior Notes

On May 1, 2002, the Company issued $200.0 million aggregate principal amount of senior notes. The $200.0 million senior notes bear interest at an annual rate of 11.50% and mature on May 1, 2012. The senior notes (the Notes) are redeemable at 105.75 until April 2008. The Notes will remain redeemable at various levels until the maturity date. Interest is payable on May 1 and November 1 of each year. On July 1, 2002, the Company completed an exchange offer of the senior notes for substantially identical notes registered under the Securities Act of 1933.

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Credit Agreement

On March 7, 2006, the Company amended the existing credit agreement, which provided the Company with substantially all of its borrowing capacity on the $100.0 million credit facility. The credit agreement contains various covenants that require, among other things, the maintenance of certain specified ratios of consolidated total debt to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA) and interest coverage. Restrictions also include limits on capital expenditures, operating leases and dividends. The amendment utilizes a borrowing base composed of accounts receivable and inventory. The borrowing base limitation expired June 30, 2007. In addition, the Company is prohibited from repurchasing, repaying or redeeming subordinated notes until certain covenant levels are met. As of September 30, 2007, $96.3 million of the $100.0 million credit facility was available to the Company. The revolving facility expires on April 30, 2008 and requires a commitment fee of 0.375% to 0.500% on the unused balance. The revolving facility permits the Company to borrow up to half its borrowings in specified foreign currencies. Interest is payable quarterly at either (i) the prime rate plus a margin of 0.25% to 1.25% or (ii) LIBOR plus a margin of 1.75% to 2.75%, depending upon the Company s ratio of consolidated total debt to consolidated EBITDA, as defined. Interest on the swing line facility is payable monthly at the quoted overnight borrowing rate plus a margin of 1.75% to 2.75%, depending upon the Company s ratio of consolidated total debt to consolidated EBITDA, as defined.

On November 2, 2007, the Company entered into an asset-based credit facility, which permits borrowing up to a maximum level of $100.0 million. The available borrowing capacity on this credit facility is based on eligible current assets, as defined. The asset-based credit facility does not contain maintenance covenants; however, restrictions include limits on capital expenditures, operating leases and dividends. The asset-based credit facility expires on November 1, 2011, and requires a commitment fee of 0.25% on the unused balance. Interest is payable quarterly at either (i) the higher of the prime rate or the Federal Funds rate plus 0.50%, plus a margin of 0.00% to 0.25% or (ii) LIBOR plus a margin of 1.00% to 1.75%, depending upon the Company s undrawn availability, as defined.

(7) Net Income Per Share

Basic net income per share was computed by dividing net income by the weighted-average number of Common Shares outstanding for each respective period. Diluted net income per share was calculated by dividing net income by the weighted-average of all potentially dilutive Common Shares that were outstanding during the periods presented.

Actual weighted-average shares outstanding used in calculating basic and diluted net income per share are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Basic weighted-average shares outstanding	23,213,240	22,880,325	23,105,561	22,833,392
Effect of dilutive securities	481,190	515,368	550,038	416,626
Diluted weighted-average shares outstanding	23,694,430	23,395,693	23,655,599	23,250,018

For the three months ended September 30, 2007 and 2006, options to purchase 139,500 and 470,250 Common Shares at an average price of $15.56 and $13.46, respectively, were not included in the computation of diluted net income per share because their respective exercise prices were greater than the average market price of Common Shares and, therefore, their effect would have been anti-dilutive. Options not included in the computation of diluted net income per share to purchase 139,500 and 610,850 Common Shares at an average price of $15.56 and $12.18, respectively, were outstanding during the nine months ended September 30, 2007 and 2006, respectively.

As of September 30, 2007, 499,950 performance-based restricted shares were outstanding. These shares were not included in the computation of diluted net income per share because not all vesting conditions were met. Approximately one tenth of these shares was associated with a plan that used highly optimistic earnings per share targets. At this time, we believe that meeting

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(Unaudited)
(in thousands, except share and per share data, unless otherwise indicated)

such thresholds is highly unlikely. The remainder may or may not become dilutive based on the Company s ability to exceed future earnings thresholds or attain certain targets of total return to its shareholders measured against a peer group s performance.

(8) Restructuring

In January 2005, the Company announced restructuring initiatives related to the rationalization of certain manufacturing facilities in Europe and North America. This rationalization is part of the Company s cost reduction initiatives. In connection with these initiatives, the Company recorded restructuring charges of $2 and $80 for the three months ended September 30, 2007 and 2006, respectively. Restructuring charges for the nine months ended September 30, 2007 and 2006 was $74 and $154, respectively. Restructuring expenses are included in the Company s condensed consolidated statement of operations as a part of selling, general and administrative expense.

The restructuring charges related to the Electronics reportable segment included the following:

	Severance Costs	Asset-Related Charges	Total
Total expected restructuring charges	$ 966	$ 127	$ 1,093
Balance at December 31, 2004	$	$	$
First quarter charge to expense	88	127	215
Second quarter charge to expense	9		9
Third quarter charge to expense	356		356
Fourth quarter charge to expense	70		70
Cash payments	(111)		(111)
Non-cash utilization		(127)	(127)
Balance at December 31, 2005	$ 412	$	$ 412
First quarter charge to expense	176		176
Second quarter charge to expense	(370)		(370)
Third quarter charge to expense	127		127
Fourth quarter charge to expense	436		436
Cash payments	(343)		(343)
Balance at December 31, 2006	$ 438	$	$ 438
First quarter charge to expense	41		41
Second quarter charge to expense	31		31
Third quarter charge to expense	2		2
Cash payments	(512)		(512)

Balance at September 30, 2007	$	$	$