

CIRCOR INTERNATIONAL INC  
Form 10-Q  
August 01, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 29, 2014.

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_ .  
Commission File Number 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  
(781) 270-1200  
(Zip Code)  
(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  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  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 Exchange Act.

Large accelerated filer  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 Exchange Act). Yes  No

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As of July 24, 2014, there were 17,674,618 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 share data)

	June 29, 2014 (Unaudited)	December 31, 2013
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$116,326	\$102,180
Short-term investments	95	95
Trade accounts receivable, less allowance for doubtful accounts of \$2,832 and \$2,449, respectively	168,541	144,742
Inventories, net	196,389	199,404
Prepaid expenses and other current assets	19,817	19,815
Deferred income tax asset	19,476	17,686
Total Current Assets	520,644	483,922
PROPERTY, PLANT AND EQUIPMENT, NET	105,461	107,724
<b>OTHER ASSETS:</b>		
Goodwill	76,860	75,876
Intangibles, net	34,476	35,656
Deferred income tax asset	16,779	18,579
Other assets	4,866	4,893
<b>TOTAL ASSETS</b>	<b>\$759,086</b>	<b>\$726,650</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$81,886	\$70,589
Accrued expenses and other current liabilities	63,023	57,507
Accrued compensation and benefits	24,369	31,289
Income taxes payable	6,396	3,965
Notes payable and current portion of long-term debt	3,642	7,203
Total Current Liabilities	179,316	170,553
LONG-TERM DEBT, NET OF CURRENT PORTION	39,797	42,435
DEFERRED INCOME TAXES	9,236	9,666
OTHER NON-CURRENT LIABILITIES	23,375	27,109
<b>SHAREHOLDERS' EQUITY:</b>		
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; 17,674,618 and 17,610,526 shares issued and outstanding at June 29, 2014 and December 31, 2013, respectively	170	176
Additional paid-in capital	274,580	269,884
Retained earnings	227,868	202,930
Accumulated other comprehensive gain, net of taxes	4,744	3,897
Total Shareholders' Equity	507,362	476,887
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$759,086</b>	<b>\$726,650</b>

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



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

	Three Months Ended		Six Months Ended	
	June 29, 2014	June 30, 2013	June 29, 2014	June 30, 2013
Net revenues	\$207,884	\$223,644	\$419,070	\$429,042
Cost of revenues	148,184	153,538	294,731	299,086
<b>GROSS PROFIT</b>	<b>59,700</b>	<b>70,106</b>	<b>124,339</b>	<b>129,956</b>
Selling, general and administrative expenses	42,609	47,596	87,498	93,168
Special charges, net	1,257	2,254	100	3,632
<b>OPERATING INCOME</b>	<b>15,834</b>	<b>20,256</b>	<b>36,741</b>	<b>33,156</b>
Other (income) expense:				
Interest expense, net	891	838	1,809	1,625
Other (income) expense, net	(384	) 626	(853	) 1,239
<b>TOTAL OTHER EXPENSE, NET</b>	<b>507</b>	<b>1,464</b>	<b>956</b>	<b>2,864</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>15,328</b>	<b>18,792</b>	<b>35,785</b>	<b>30,292</b>
Provision for income taxes	3,402	6,124	9,227	9,715
<b>NET INCOME</b>	<b>\$11,926</b>	<b>\$12,668</b>	<b>\$26,558</b>	<b>\$20,577</b>
Earnings per common share:				
Basic	\$0.68	\$0.72	\$1.51	\$1.17
Diluted	\$0.67	\$0.72	\$1.50	\$1.17
Weighted average number of common shares outstanding:				
Basic	17,665	17,565	17,643	17,539
Diluted	17,767	17,607	17,754	17,569
Dividends paid per common share	\$0.0375	\$0.0375	\$0.0750	\$0.0750

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		Six Months Ended	
	June 29, 2014	June 30, 2013	June 29, 2014	June 30, 2013
Net income	\$11,926	\$12,668	\$26,558	\$20,577
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	1,566	112	851	(8,531 )
Other comprehensive income (loss)	1,566	112	851	(8,531 )
COMPREHENSIVE INCOME	\$13,492	\$12,780	\$27,409	\$12,046

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

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

	Six Months Ended	
	June 29, 2014	June 30, 2013
<b>OPERATING ACTIVITIES</b>		
Net income	\$26,558	\$20,577
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	8,185	8,035
Amortization	1,591	1,509
Compensation expense of share-based plans	4,020	2,156
Tax effect of share-based plan compensation	(971)	(422)
(Gain) on disposal of property, plant and equipment	(54)	(129)
Change in operating assets and liabilities:		
Trade accounts receivable, net	(23,705)	(9,406)
Inventories, net	3,600	(4,059)
Prepaid expenses and other assets	143	(2,412)
Accounts payable, accrued expenses and other liabilities	7,988	3,583
Net cash provided by operating activities	27,355	19,432
<b>INVESTING ACTIVITIES</b>		
Additions to property, plant and equipment	(5,603)	(8,808)
Proceeds from the sale of property, plant and equipment	32	314
Net cash used in investing activities	(5,571)	(8,494)
<b>FINANCING ACTIVITIES</b>		
Proceeds from long-term debt	81,910	74,255
Payments of long-term debt	(88,776)	(84,679)
Dividends paid	(1,341)	(1,340)
Proceeds from the exercise of stock options	237	1,498
Tax effect of share-based compensation	971	422
Net cash used in financing activities	(6,999)	(9,844)
Effect of exchange rate changes on cash and cash equivalents	(639)	(2,002)
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>14,146</b>	<b>(907)</b>
Cash and cash equivalents at beginning of period	102,180	61,738
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$116,326</b>	<b>\$60,831</b>
Supplemental Cash Flow Information:		
Cash paid during the period presented for:		
Income taxes	\$6,375	\$3,464
Interest	\$1,358	\$1,054

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 financial 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, 2013 is as reported in our audited financial statements as of that date. Our accounting policies are described in the notes to our December 31, 2013 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, 2013.

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 six months ended June 29, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

(2) Summary of Significant Accounting Policies

The significant accounting policies used in preparation of these condensed consolidated financial statements for the three and six months ended June 29, 2014 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, 2013.

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-08, Reporting Discontinued Operations and Disclosure of Disposals of Components of an Entity, to modify the requirements for reporting a discontinued operation. The new guidance is applicable for all disposals (or classification as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. No discontinued operations were disclosed during the three and six months ended June 29, 2014 or June 30, 2013.

In May 2014, FASB issued ASU 2014-09, Revenue from Contracts with Customers. The new standard substantially converges revenue recognition under U.S. GAAP and International Financial Reporting Standards. The new standard is effective for public companies for fiscal years beginning after December 15, 2017, and interim and annual periods thereafter. Early adoption is not permitted. This new accounting guidance had no impact on our disclosures for the three and six months ended June 29, 2014 or June 30, 2013.

There were no additional new accounting pronouncements adopted during the six months ended June 29, 2014 that had a material impact on our financial statements.

### (3) Share-Based Compensation

As of June 29, 2014, we have two share-based compensation plans. The 2014 Stock Option and Incentive Plan (the "2014 Plan") was adopted by our Board of Directors on February 12, 2014 and approved by our shareholders at the Company's annual meeting held on April 30, 2014. As of April 30, 2014, no new awards will be granted under the existing Amended and Restated 1999 Stock Option and Incentive Plan (the "1999 Plan"). Any shares subject to outstanding awards under the 1999 Plan that expire, are canceled or otherwise terminate, or are withheld to satisfy tax withholding obligations are not available for award grant purposes under the 2014 Plan. Both plans permit the grant 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 ("SARs") and dividend equivalent rights. The 2014 Plan provides for the issuance of up to 1,700,000 shares of common stock (subject to adjustment for stock splits and similar events). Under the 2014 Plan, shares issued for awards other than stock options or SARs count against the aggregate share limit as 1.9 shares for every share actually issued. New options granted under the 2014 Plan could have varying vesting provisions and exercise periods. Options granted under the 1999 Plan vest in periods ranging from one year to five years and expire either seven years or ten years after the grant date. Restricted stock units granted under the 1999 Plan generally vest from two years to six years. Vested restricted stock units will be settled in shares of our common stock. As of June 29, 2014, there were 490,330 stock options (including the CEO and CFO stock option awards noted below) and 205,000 restricted stock units outstanding. In addition, there were 1,697,002 shares available for grant under the 2014 Plan as of June 29, 2014. As of June 29, 2014, there were 250 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.

The Black-Scholes option pricing model was used to estimate the fair value of each stock option grant at the date of grant excluding the 2013 and 2014 CEO and CFO stock option awards noted below. 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 at an exercise price of \$41.17 per share ("2013 CEO Option Award"). On December 2, 2013, the Company granted stock options to purchase 100,000 shares of common stock to its newly appointed Executive Vice President and Chief Financial Officer at an exercise price of \$79.33 per share ("2013 CFO Option Award"). On March 5, 2014, the Company granted stock options to purchase 100,000 shares of common stock to its President and Chief Executive Officer at an exercise price of \$70.42 per share ("2014 CEO Option Award"). Both the 2013 CEO Option Award and the 2013 CFO Option Award were considered inducement awards and were granted outside of the Company's 1999 Plan. All three of these option awards include a service period and a market performance 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:

#### 2013 CEO Option Award

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

2013 CFO and 2014 CEO Option Award

Stock Price Target	Cumulative Vested Portion of Stock Options (in Shares)
\$87.50	25,000
\$100.00	50,000
\$112.50	75,000
\$125.00	100,000

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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 Stock Price Target for the 2013 CEO Option Award was met. On January 6, 2014 and January 28, 2014, the \$60.00 and \$70.00 Price targets for the 2013 CEO Option Award were met, respectively. Therefore, 150,000 options have vested of which 37,500 are currently exercisable under the 2013 CEO Option Award. These stock option awards are being expensed utilizing a graded method and are subject to forfeiture in the event of employment termination (whether voluntary or involuntary) prior to vesting. All three of these option awards have a 10 year term but to the extent that the market conditions above (Stock Price Targets) are not met, these options will not vest and will forfeit 5 years from grant date. The Company used a Monte Carlo simulation option pricing model to value these option awards.

During the six months ended June 29, 2014, the Company granted 164,503 stock options (including the 2014 CEO Option Award noted above). This compares with 200,000 stock options granted during the first six months of 2013. The average fair value of stock options granted during the first six months of 2014 was \$26.32 and was estimated using the following weighted-average assumptions:

Risk-free interest rate	1.8	%
Expected life (years)	3.7	
Expected stock volatility	41.4	%
Expected dividend yield	0.2	%

We account for Restricted Stock Unit Awards (“RSU Awards”) by expensing the weighted average fair value to selling, general and administrative expenses ratably over vesting periods generally ranging from two to six years. During the six months ended June 29, 2014 and June 30, 2013, we granted 33,532 and 130,845 RSU Awards with approximate fair values of \$72.11 and \$42.12 per RSU Award, respectively. During the first six months of 2014 and 2013, the Company granted performance-based RSUs as part of the overall mix of RSU Awards. These performance-based RSUs include metrics for achieving Return on Invested Capital and Adjusted Operating Margin with target payouts ranging from 0% to 200%. Of the 33,532 RSUs granted during the six months ended June 29, 2014, 11,881 are performance-based RSU awards. This compares to 35,329 performance-based RSU awards granted during the six months ended June 30, 2013.

The CIRCOR Management Stock Purchase Plan, which is a component of both the 2014 Plan and the 1999 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 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. RSU MSPs totaling 32,752 and 28,463 with per unit discount amounts representing fair values of \$23.61 and \$13.90 were granted under the CIRCOR Management Stock Purchase Plan during the six months ended June 29, 2014 and June 30, 2013, respectively.

Compensation expense related to our share-based plans for the six month periods ended June 29, 2014 and June 30, 2013 was \$4.0 million and \$2.3 million, respectively, and was recorded as selling, general and administrative expense. As of June 29, 2014, there was \$14.3 million of total unrecognized compensation costs related to our outstanding share-based compensation arrangements. 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 June 29, 2014 was 8.7 years and 7.8 years, respectively. The aggregate intrinsic value of stock options exercised during the six months ended June 29, 2014 was \$0.6 million and the aggregate intrinsic value of stock options outstanding and options exercisable as of June 29, 2014 was \$9.4 million and \$2.5 million, respectively.

The aggregate intrinsic value of RSU Awards settled during the six months ended June 29, 2014 was \$3.4 million and the aggregate intrinsic value of RSU Awards outstanding and RSU Awards vested and deferred as of June 29, 2014 was \$7.3 million and less than \$0.1 million, respectively.

The aggregate intrinsic value of RSU MSPs settled during the six months ended June 29, 2014 was \$1.1 million and the aggregate intrinsic value of RSU MSPs outstanding and RSU MSPs vested and deferred as of June 29, 2014 was \$2.9 million and none, respectively.

The Company also grants Cash Settled Stock Unit Awards to its international participants. These Cash Settled Stock Unit Awards typically cliff-vest in three years and are settled in cash based on the company's closing stock price at the time of vesting. As of June 29, 2014, there were 38,418 Cash Settled Stock Unit Awards outstanding compared to 40,568 Cash Settled Stock Unit Awards as of June 30, 2013. During the six months ended June 29, 2014, the aggregate cash used to settle Cash Settled Stock Unit Awards was \$0.6 million. As of June 29, 2014, the company had \$1.2 million of accrued expenses in current liabilities associated with these Cash Settled Stock Unit Awards compared with \$0.8 million as of June 30, 2013. Cash Settled Stock Unit Awards related compensation costs for the six month periods ended June 29, 2014 and June 30, 2013 was \$0.3 million and \$0.5 million, respectively, and was recorded as selling, general, and administrative expense.

## (4) Inventories

Inventories consist of the following (in thousands):

	June 29, 2014	December 31, 2013
Raw materials	\$67,322	\$59,255
Work in process	94,001	95,236
Finished goods	35,066	44,913
	\$196,389	\$199,404

## (5) Goodwill and Intangible Assets

The following table shows goodwill by segment as of June 29, 2014 (in thousands):

	Energy	Aerospace & Defense	Consolidated Total
Goodwill as of December 31, 2013	\$52,930	\$22,946	\$ 75,876
Currency translation adjustments	999	(15 )	984
Goodwill as of June 29, 2014	\$53,929	\$22,931	\$ 76,860

The table below presents gross intangible assets and the related accumulated amortization as of June 29, 2014 (in thousands):

	Gross Carrying Amount	Accumulated Amortization
Patents	\$6,066	\$(5,703 )
Non-amortized intangibles (primarily trademarks and trade names)	17,165	—
Customer relationships	34,992	(20,426 )
Backlog	1,174	(1,174 )
Other	7,666	(5,284 )
Total	\$67,063	\$(32,587 )
Net carrying value of intangible assets	\$34,476	

The table below presents estimated remaining amortization expense for intangible assets recorded as of June 29, 2014 (in thousands):

	2014	2015	2016	2017	2018	After 2019
Estimated amortization expense	\$1,572	\$3,139	\$2,852	\$2,717	\$2,455	\$4,579





## (6) Segment Information

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

	Energy	Aerospace & Defense	Corporate / Eliminations	Consolidated Total
<b>Three Months Ended June 29, 2014</b>				
Net revenues	\$160,581	\$47,303	\$—	\$207,884
Inter-segment revenues	339	52	(391)	) —
Operating income (loss)	22,992	(2,235)	) (4,923)	) 15,834
Interest expense, net				891
Other (income) expense, net				(384)
Income before income taxes				\$15,328
Identifiable assets	628,626	213,114	(82,654)	) 759,086
Capital expenditures	1,707	1,039	187	2,933
Depreciation and amortization	2,910	1,717	294	4,921
<b>Three Months Ended June 30, 2013</b>				
Net revenues	\$173,558	\$50,086	\$—	\$223,644
Inter-segment revenues	261	19	(280)	) —
Operating income (loss)	22,299	4,527	(6,570)	) 20,256
Interest expense, net				838
Other (income) expense, net				626
Income before income taxes				\$18,792
Identifiable assets	572,579	228,382	(91,535)	) 709,426
Capital expenditures	3,278	745	79	4,102
Depreciation and amortization	2,836	1,599	343	4,778
<b>Six Months Ended June 29, 2014</b>				
Net revenues	\$323,167	\$95,903	\$—	\$419,070
Inter-segment revenues	545	131	(676)	) —
Operating income (loss)	44,767	4,335	(12,361)	) 36,741
Interest expense, net				1,809
Other (income) expense, net				(853)
Income before income taxes				