

Spectrum Brands, Inc.
Form 10-Q
August 12, 2005
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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 July 3, 2005

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 001-13615

Spectrum Brands, Inc.

(Exact name of registrant as specified in its charter)

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Wisconsin (State or other jurisdiction of incorporation or organization)	22-2423556 (I.R.S. Employer Identification Number)
Six Concourse Parkway, Suite 3300, Atlanta, Georgia (Address of principal executive offices)	30328 (Zip Code)

(770) 829-6200

(Registrant's telephone number, including area code)

(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 ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The number of shares outstanding of the Registrant's common stock, \$.01 par value, as of August 5, 2005, was 50,805,469.

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SPECTRUM BRANDS, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR QUARTER ENDED JULY 3, 2005

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****SPECTRUM BRANDS, INC.****Condensed Consolidated Balance Sheets****July 3, 2005 and September 30, 2004****(Unaudited)****(Amounts in thousands, except per share figures)**

	July 3, 2005	September 30, 2004
	<u> </u>	<u> </u>
-ASSETS-		
Current assets:		
Cash and cash equivalents	\$ 27,007	\$ 15,789
Receivables, less allowances of \$44,210 and \$23,071, respectively	462,565	289,632
Inventories	470,315	264,726
Prepaid expenses and other	99,555	80,365
	<u> </u>	<u> </u>
Total current assets	1,059,442	650,512
Property, plant and equipment, net	310,701	182,396
Goodwill	1,432,636	320,577
Intangible assets, net	1,169,683	422,106
Deferred charges and other	43,525	35,079
Debt issuance costs, net	40,149	25,299
	<u> </u>	<u> </u>
Total assets	<u>\$ 4,056,136</u>	<u>\$ 1,635,969</u>
-LIABILITIES AND SHAREHOLDERS' EQUITY-		
Current liabilities:		
Current maturities of long-term debt	\$ 38,830	\$ 23,895
Accounts payable	280,170	228,052
Accrued liabilities	261,242	146,711
	<u> </u>	<u> </u>
Total current liabilities	580,242	398,658
Long-term debt, net of current maturities	2,297,915	806,002
Employee benefit obligations, net of current portion	73,796	69,246
Other	259,163	44,640
	<u> </u>	<u> </u>
Total liabilities	<u>3,211,116</u>	<u>1,318,546</u>
Minority interest in equity of consolidated affiliates		1,379

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Shareholders' equity:		
Common stock, \$.01 par value, authorized 150,000 shares; issued 66,579 and 64,219 shares, respectively; outstanding 50,751 and 34,683 shares, respectively	666	642
Additional paid-in capital	670,523	224,962
Retained earnings	270,192	220,483
Accumulated other comprehensive income, net	13,341	10,621
Notes receivable from officers/shareholders	(955)	(3,605)
	<hr/>	<hr/>
	953,767	453,103
Less treasury stock, at cost, 15,828 and 29,536 shares, respectively	(70,813)	(130,070)
Less unearned restricted stock compensation	(37,934)	(6,989)
	<hr/>	<hr/>
Total shareholders' equity	845,020	316,044
	<hr/>	<hr/>
Total liabilities and shareholders' equity	\$ 4,056,136	\$ 1,635,969
	<hr/>	<hr/>

See accompanying notes which are an integral part of these condensed consolidated financial statements (unaudited).

Table of Contents**SPECTRUM BRANDS, INC.****Condensed Consolidated Statements of Operations****For the three and nine month periods ended July 3, 2005 and June 27, 2004****(Unaudited)****(Amounts in thousands, except per share figures)**

	THREE MONTHS		NINE MONTHS	
	2005	2004	2005	2004
Net sales	\$ 730,445	\$ 308,264	\$ 1,755,725	\$ 1,040,297
Cost of goods sold	446,003	173,555	1,083,424	590,855
Restructuring and related charges	7,807		7,807	(1,137)
Gross profit	276,635	134,709	664,494	450,579
Selling	143,662	60,996	349,608	219,837
General and administrative	44,217	28,281	115,810	97,923
Research and development	7,993	6,207	21,214	15,347
Restructuring and related charges	7,365	1,685	7,521	7,717
Total operating expenses	203,237	97,169	494,153	340,824
Operating income	73,398	37,540	170,341	109,755
Interest expense	38,623	15,617	94,544	49,041
Other (income) expense, net	(1,107)	1,340	(1,274)	(392)
Income from continuing operations before income taxes	35,882	20,583	77,071	61,106
Income tax expense	12,171	7,826	27,362	23,225
Income from continuing operations	23,711	12,757	49,709	37,881
(Income) loss from discontinued operations, net of tax benefits of \$14 and \$539, respectively		(57)		267
Net income	\$ 23,711	\$ 12,814	\$ 49,709	\$ 37,614
Basic earnings per share:				
Weighted average shares of common stock outstanding	48,916	33,648	42,024	32,977
Income from continuing operations	\$ 0.48	\$ 0.38	\$ 1.18	\$ 1.15
Loss from discontinued operations				(0.01)
Net income	\$ 0.48	\$ 0.38	\$ 1.18	\$ 1.14
Diluted earnings per share:				

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Weighted average shares and equivalents outstanding	51,086	35,388	43,919	34,413
Income from continuing operations	\$ 0.46	\$ 0.36	\$ 1.13	\$ 1.10
Loss from discontinued operations				(0.01)
Net income	\$ 0.46	\$ 0.36	\$ 1.13	\$ 1.09

See accompanying notes which are an integral part of these condensed consolidated financial statements (unaudited).

Table of Contents**SPECTRUM BRANDS, INC.****Condensed Consolidated Statements of Cash Flows****For the nine month periods ended July 3, 2005 and June 27, 2004****(Unaudited)****(Amounts in thousands)**

	NINE MONTHS	
	2005	2004
Cash flows from operating activities:		
Net income	\$ 49,709	\$ 37,614
Non-cash adjustments to net income:		
Discontinued operations		267
Depreciation	34,168	24,259
Amortization	8,206	742
Amortization of debt issuance costs	4,188	3,133
Loss on debt extinguishment	12,033	
Inventory valuation purchase accounting charges	34,961	
Stock option income tax benefit	10,234	8,150
Non-cash restructuring and related charges	11,132	(1,137)
Other non-cash adjustments	535	(8,313)
Net changes in operating assets and liabilities, net of acquisitions and discontinued operations	(25,536)	16,300
Net cash provided by continuing operating activities	139,630	81,015
Cash flows from investing activities:		
Purchases of property, plant and equipment, net	(41,108)	(16,444)
Payment for acquisitions, net of cash acquired of \$27,452 and \$5,653, respectively	(1,598,703)	(41,980)
Net cash used by investing activities	(1,639,811)	(58,424)
Cash flows from financing activities:		
Reduction of debt	(911,208)	(324,937)
Proceeds from debt financing	2,432,266	195,100
Debt issuance costs	(31,109)	(1,351)
Proceeds from exercise of stock options	18,028	18,846
Cash repayment of notes receivable from officers/shareholders	2,650	
Net cash provided (used) by financing activities	1,510,627	(112,342)
Net cash used by discontinued operations		(336)
Effect of exchange rate changes on cash and cash equivalents	772	145
Net increase (decrease) in cash and cash equivalents	11,218	(89,942)
Cash and cash equivalents, beginning of period	15,789	107,774
Cash and cash equivalents, end of period	\$ 27,007	\$ 17,832

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Supplemental Non-Cash Investing Activities

Issuance of Treasury shares for the United acquisition	\$ 439,175	\$
Sale of Mexican manufacturing facility:		
Reduction in deferred proceeds	\$ 9,440	\$
Reduction in assets held for sale	\$ 7,874	\$
Amount payable for Ningbo minority interest	\$ 2,876	\$

See accompanying notes which are an integral part of these condensed consolidated financial statements (unaudited).

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SPECTRUM BRANDS, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

(Amounts in thousands, except per share figures)

1 DESCRIPTION OF BUSINESS

Spectrum Brands, Inc. and its subsidiaries (the "Company") is a global branded consumer products company with leading market positions in seven major product categories: consumer batteries; lawn and garden; pet supplies; electric shaving and grooming; household insect control; electronic personal care products; and portable lighting. The Company is a leading worldwide manufacturer and marketer of alkaline, zinc carbon and hearing aid batteries, a leading worldwide designer and marketer of rechargeable batteries and battery-powered lighting products and a leading worldwide designer and marketer of electric shavers and accessories, grooming products, hair care appliances and aquariums and aquatic health supplies. The Company is also a leading North American manufacturer and marketer of lawn fertilizers, herbicides, pet supplies and food products, and insecticides and repellents.

The Company sells its products in approximately 120 countries through a variety of trade channels, including retailers, wholesalers and distributors, hearing aid professionals, industrial distributors and original equipment manufacturers ("OEMs") and enjoys strong name recognition in its markets under the Rayovac, VARTA and Remington brands, each of which has been in existence for more than 80 years, and under the Spectracide, Cutter, Tetra, 8-in-1 and various other brands. The Company has 53 manufacturing and product development facilities located in the United States, Europe, China and Latin America. The Company manufactures alkaline and zinc carbon batteries, zinc air hearing aid batteries, lawn fertilizers, herbicides, pet supplies and insecticides and repellents in its company operated manufacturing facilities.

On April 29, 2005, the Company acquired all of the outstanding equity interests of Tetra Holding GmbH ("Tetra") for a purchase price of approximately \$550,000, net of cash acquired of approximately \$13,100 and inclusive of a final working capital payment of \$2,400, made in July 2005. The aggregate purchase price also includes acquisition related expenditures of approximately \$16,100. The acquisition was financed with additional borrowings under an Incremental Term Loan Facility and existing Revolving Credit Facility. Headquartered in Melle, Germany, Tetra manufactures, distributes and markets a comprehensive line of foods, equipment and care products for fish and reptiles, along with accessories for home aquariums and ponds. This acquisition extends the Company's position in the rapidly growing North American specialty pet supplies category to a global presence. Tetra currently has approximately 700 employees, operates in over 90 countries worldwide and holds leading market positions in Germany, the United States, Japan and the United Kingdom. Subsequent to the acquisition, the financial results of Tetra are reported as a separate segment within the Company's condensed consolidated results. (See also footnote 11, "Acquisitions," for additional information on the Tetra acquisition).

On February 7, 2005, the Company completed the acquisition of all of the outstanding equity interests of United Industries Corporation ("United"), a leading manufacturer and marketer of products for the consumer lawn and garden and household insect control markets in North America and a leading supplier of quality pet supplies in the United States. The aggregate purchase price was approximately \$1,504,000, which includes cash consideration of approximately \$1,043,000, common stock of the Company totaling approximately \$439,000, acquisition related expenditures of approximately \$22,000, plus assumed debt of approximately \$14,000. United has approximately 2,800 employees throughout North America and is organized under three operating divisions: U.S. Home & Garden, Nu-Gro Corporation and United Pet Group. The acquisition of United gives the Company a significant presence in several new consumer products markets, including categories that will significantly diversify the Company's revenue base. Subsequent to the acquisition, the financial results of United are reported as a separate segment within the Company's condensed consolidated results. (See also footnote 11, "Acquisitions," for additional information on the United acquisition).

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On May 28, 2004, the Company completed the acquisition of 90.1% of the outstanding capital stock, including all voting stock, of Microlite S.A. (Microlite), a Brazilian battery company, from VARTA AG of

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SPECTRUM BRANDS, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

(Amounts in thousands, except per share figures)

Germany and Tabriza Brasil Empreendimentos Ltda. (Tabriza) of Brazil. The total cash paid was approximately \$30,000, including approximately \$21,100 in purchase price, approximately \$7,000 of contingent consideration, and approximately \$1,900 of acquisition related expenditures, plus approximately \$8,000 of assumed debt. Tabriza earned the contingent consideration based upon Microlite's attainment of certain earnings targets through June 30, 2005. Upon the calculation and payment of the total contingent consideration due to Tabriza, which may exceed the \$7,000 of contingent consideration paid at closing, Tabriza will transfer Microlite's remaining outstanding capital stock to the Company. Microlite operates two battery-manufacturing facilities in Recife, Brazil and has several sales and distribution centers located throughout Brazil. Microlite manufactures and sells both alkaline and zinc carbon batteries as well as battery-operated lighting products. Microlite has operated as an independent company since 1982. The acquisition of Microlite consolidates the Company's rights to the Rayovac brand in Latin America. (See also footnote 11, Acquisitions, for additional information on the Microlite acquisition).

On March 31, 2004, the Company completed the acquisition of an 85% equity interest in Ningbo Baowang Battery Company, Ltd. (Ningbo) of Ninghai, China for approximately \$17,000 in cash, including approximately \$600 of direct acquisition related expenditures, plus approximately \$14,000 of assumed debt. In March 2005, the Company signed an agreement to purchase the remaining 15% equity interest for approximately \$2,900. Ningbo, founded in 1995, produces alkaline and zinc carbon batteries for retail, OEM and private label customers within China. Ningbo also exports its batteries to customers in North and South America, Europe and Asia. (See also footnote 11, Acquisitions, for additional information on the Ningbo acquisition).

2 SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation: These condensed consolidated financial statements have been prepared by the Company, without audit, pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC) and, in the opinion of the Company, include all adjustments (which are normal and recurring in nature) necessary to present fairly the financial position of the Company at July 3, 2005, and the results of operations and cash flows for the three and nine month periods ended July 3, 2005 and June 27, 2004. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted pursuant to such SEC rules and regulations. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2004. Certain prior period amounts have been reclassified to conform to the current period presentation.

Significant Accounting Policies and Practices: The condensed consolidated financial statements include the condensed consolidated financial statements of the Company and are prepared in accordance with generally accepted accounting principles in the United States of America. All significant intercompany balances and transactions have been eliminated. The Company's fiscal year ends September 30. References herein to 2005 and 2004 refer to the fiscal years ended September 30, 2005 and 2004, respectively.

The preparation of condensed consolidated financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of

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contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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SPECTRUM BRANDS, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

(Amounts in thousands, except per share figures)

The Company's Condensed Consolidated Financial Statements presented herein include the results of operations for Tetra subsequent to the April 29, 2005 date of acquisition, the results of operations for United subsequent to the February 7, 2005 date of acquisition, the results of operations for Microlite subsequent to the May 28, 2004 date of acquisition, and the results of operations for Ningbo subsequent to the March 31, 2004 date of acquisition. See footnote 11, Acquisitions, for additional information on the Tetra, United, Microlite and Ningbo acquisitions.

Discontinued Operations: The Company has reflected Remington's United States and United Kingdom service centers as discontinued operations. The Company discontinued operations at these service centers during 2004 as part of the Remington integration initiatives. See footnote 12, Restructuring and Related Charges, for additional discussion of Remington integration initiatives. The following amounts have been segregated from continuing operations and are reflected as discontinued operations for the three and nine months ended June 27, 2004:

	Three Months	Nine Months
Net sales	\$ 906	\$ 21,470
Loss from discontinued operations before income taxes	(43)	806
Provision for income tax benefits	(14)	(539)
(Income) loss from discontinued operations, net of tax	\$ (57)	\$ 267
Depreciation expense associated with discontinued operations	\$ 9	\$ 263

Revenue Recognition: The Company recognizes revenue from product sales at the point at which title and all risks and rewards of ownership of the product are passed, provided that: there are no uncertainties regarding customer acceptance; persuasive evidence that an arrangement exists; the price to the buyer is fixed or determinable; and collectibility is deemed reasonably assured. The Company is not obligated to allow for, and the Company's general policy is not to accept, product returns associated with battery sales. The Company does accept returns in specific instances related to its shaving, grooming, personal care, lawn and garden, household and pet products. The provision for customer returns is based on historical sales and returns, analyses of credit worthiness and other relevant information. The Company estimates and accrues the cost of returns, which are treated as a reduction of Net sales.

The Company enters into various promotional arrangements, primarily with retail customers, including arrangements entitling such retailers to cash rebates from the Company based on the level of their purchases, which require the Company to estimate and accrue the estimated costs of the promotional programs. These costs are treated as a reduction of Net sales.

The Company also enters into promotional arrangements targeted to the ultimate consumer. Such arrangements are treated as either a reduction of Net sales or an increase of Cost of goods sold, based on the type of promotional program. The income statement characterization of the Company's promotional arrangements complies with the Emerging Issues Task Force (EITF) No. 01-09, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)*.

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For all types of promotional arrangements and programs, the Company monitors its commitments and uses various measures including past experience to determine amounts to be recorded for the estimate of the earned, but unpaid, promotional costs. The terms of the Company's customer-related promotional arrangements and programs are individualized to each customer and are documented through written contracts, correspondence or other communications with the individual customers.

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SPECTRUM BRANDS, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

(Amounts in thousands, except per share figures)

The Company also enters into various contractual arrangements, primarily with retail customers, which require the Company to make upfront cash, or slotting payments, to secure the right to distribute through such customers. The Company capitalizes slotting payments, provided the payments are supported by a time or volume based contractual arrangement with the retailer, and amortizes the associated payment over the appropriate time or volume based term of the contractual arrangement. The amortization of the slotting payment is treated as a reduction in Net sales and the corresponding asset is included in Deferred charges and other in the accompanying Condensed Consolidated Balance Sheets (unaudited).

Shipping and Handling Costs: The Company incurred shipping and handling costs of \$55,530 and \$114,494 for the three and nine months ended July 3, 2005, respectively, and \$14,545 and \$47,763 for the three and nine months ended June 27, 2004, respectively. These costs are included in Selling expense. Shipping and handling costs include costs incurred with third-party carriers to transport products to customers as well as salaries and overhead costs related to activities to prepare the Company's products for shipment from its distribution facilities.

Concentrations of Credit Risk: Trade receivables subject the Company to credit risk. The Company extends credit to its customers based upon an evaluation of the customer's financial condition and credit history, but generally does not require collateral. The Company monitors its customers' credit and financial condition based on changing economic conditions and will make adjustments to credit policies as required. Provision for losses on uncollectible trade receivables are determined principally on the basis of past collection experience applied to ongoing evaluations of the Company's receivables and evaluations of the risks of nonpayment for a given customer.

The Company has a broad range of customers including many large retail outlet chains, one of which accounts for a significant percentage of its sales volume. This customer represented approximately 20% and 19% of the Company's Net sales during the three and nine month periods ended July 3, 2005, respectively, and 13% and 18% of its Net sales during the three and nine month periods ended June 27, 2004, respectively. This major customer also represented approximately 20% and 16% of its trade accounts receivable, net as of July 3, 2005 and September 30, 2004, respectively.

Approximately 39% of the Company's sales occur outside of North America. These sales and related receivables are subject to varying degrees of credit, currency, and political and economic risk. The Company monitors these risks and makes appropriate provisions for collectibility based on an assessment of the risks present.

Stock-Based Compensation: The Company has stock option and other stock-based compensation plans, which are fully described in the Company's consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2004. The Company accounts for its stock-based compensation plans using the intrinsic value method, under the principles prescribed by Accounting Principles Board (APB) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. For stock options granted, no employee compensation cost is reflected in the Company's results of operations as all options granted under the plans have an exercise price equal to the market value of the underlying common stock at the grant date.

Table of Contents**SPECTRUM BRANDS, INC.****Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**

(Amounts in thousands, except per share figures)

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS Statement No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*. Had compensation cost for stock options granted been determined based on the fair value at the grant date for such awards consistent with an alternative method prescribed by SFAS No. 123, the Company's net income and earnings per share would have reflected the pro forma amounts indicated below:

	Three Months		Nine Months	
	2005	2004	2005	2004
Net income, As reported	\$ 23,711	\$ 12,814	\$ 49,709	\$ 37,614
Add: Stock-based compensation expense included in reported net income, net of tax	1,930	763	4,676	2,471
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of tax	(2,358)	(1,290)	(6,033)	(5,096)
Net income, Pro forma	\$ 23,283	\$ 12,287	\$ 48,352	\$ 34,989
Basic earnings per share:				
Net income, As reported	\$ 0.48	\$ 0.38	\$ 1.18	\$ 1.14
Net income, Pro forma	\$ 0.48	\$ 0.37	\$ 1.15	\$ 1.06
Diluted earnings per share:				
Net income, As reported	\$ 0.46	\$ 0.36	\$ 1.13	\$ 1.09
Net income, Pro forma	\$ 0.46	\$ 0.35	\$ 1.10	\$ 1.02

In December 2004, SFAS No. 123 (Revised 2004), *Share-Based Payment* was issued. SFAS No. 123(R) provides investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. SFAS No. 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS No. 123(R) replaces SFAS No. 123, and supersedes APB 25. SFAS No. 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that statement permitted entities the option of continuing to apply the guidance in APB No. 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. The Company is required to apply SFAS No. 123(R) in fiscal year end 2006, which is the first fiscal year that begins after June 15, 2005.

Beginning in the fourth quarter of fiscal 2004, the Company ceased issuing stock options to employees. Restricted stock, the cost of which is required to be recognized as expense, is now issued to employees. As a result, the adoption of SFAS No. 123(R) is not expected to have a significant impact on the Company's overall results of operations or financial position.

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Derivative Financial Instruments: Derivative financial instruments are used by the Company principally in the management of its interest rate, foreign currency and raw material price exposures. The Company does not hold or issue derivative financial instruments for trading purposes.

The Company uses interest rate swaps to manage its interest rate risk. The swaps are designated as cash flow hedges with the changes in fair value recorded in Accumulated other comprehensive income, net (AOCI) and

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as a hedge asset or liability, as applicable. The swaps settle periodically in arrears with the related amounts for the current settlement period payable to, or receivable from, the counter-parties included in accrued liabilities or receivables and recognized in earnings as an adjustment to interest expense from the underlying debt to which the swap is designated. Pretax derivative losses from such hedges recorded as an adjustment to Interest expense were \$369 and \$1,793 during the three and nine months ended July 3, 2005, respectively, and \$1,143 and \$3,675 during the three and nine months ended June 27, 2004, respectively. The pretax adjustment to Interest expense for ineffectiveness from such hedges included in the amounts above, was a loss of \$20 and \$128 during the three and nine months ended July 3, 2005, respectively, and a gain of \$98 and \$34 during the three and nine months ended June 27, 2004, respectively. At July 3, 2005 and September 30, 2004, the Company had a portfolio of interest rate swaps outstanding which effectively fixes the interest rates on floating rate debt at rates as follows: 3.974% for a notional principal amount of \$70,000 through October 2005 and 3.799% for a notional principal amount of \$100,000 through November 2005. The derivative net gain on these contracts recorded in AOCI at July 3, 2005 was \$167, net of tax expense of \$94. The derivative net loss on these contracts recorded in AOCI at September 30, 2004 was \$1,375, net of tax benefit of \$843.

The Company periodically enters into forward foreign exchange contracts to hedge the risk from foreign denominated third party payments. These obligations generally require the Company to exchange foreign currencies for U.S. Dollars, Euros, Pounds Sterling or Canadian Dollars. These foreign exchange contracts are cash flow hedges of forecasted product or raw material purchases. Until the purchase is recognized, the fair value of the related hedges is recorded in AOCI and as a hedge asset or liability, as applicable. At the time the purchase is recognized, the fair value of the related hedges is reclassified as an adjustment to purchase price variance in Cost of goods sold. Pretax derivative gains (losses) from such hedges recorded as an adjustment to Cost of goods sold were \$157 and \$87 during the three and nine months ended July 3, 2005, respectively. No pretax derivative losses from such hedges were recorded as an adjustment to Cost of goods sold during the three and nine months ended June 27, 2004. Following the purchase, subsequent changes in the fair value of the derivative hedge contracts are recorded as a gain or loss in earnings as an offset to the change in value of the related liability recorded in the Condensed Consolidated Balance Sheet (unaudited). Pretax derivative gains (losses) from such hedges recorded as an adjustment to earnings in Other income, net were \$443 and \$354 during the three and nine months ended July 3, 2005, respectively and \$282 for both the three and nine months ended June 27, 2004. At July 3, 2005 and September 30, 2004, the Company had \$12,780 and \$0, respectively, of such foreign exchange derivative contracts outstanding. The pretax derivative adjustment to earnings for ineffectiveness from these contracts at July 3, 2005 and September 30, 2004 was immaterial.

The Company periodically enters into forward and swap foreign exchange contracts to hedge the risk from third party and intercompany payments. These obligations generally require the Company to exchange foreign currencies for U.S. Dollars, Euros, Pounds Sterling or Canadian Dollars. These foreign exchange contracts are fair value hedges of a related liability or asset recorded in the Condensed Consolidated Balance Sheet (unaudited). The gain or loss on the derivative hedge contracts is recorded in earnings as an offset to the change in value of the related liability or asset. Pretax derivative (losses) gains from such hedges recorded as an adjustment to earnings in Other income, net were \$(406) and \$(933) during the three and nine months ended July 3, 2005, respectively, and \$0 and \$118 during the three and nine months ended June 27, 2004, respectively. At July 3, 2005 and September 30, 2004, the Company had \$1,900 and \$480, respectively, of such foreign exchange derivative contracts outstanding. The pretax derivative adjustment to earnings for ineffectiveness from these contracts at July 3, 2005 and September 30, 2004 was immaterial.

The Company is exposed to risk from fluctuating prices for raw materials, including zinc, urea and diammonium phosphates used in its manufacturing processes. The Company hedges a portion of the risk associated with these materials through the use of commodity swaps. The swaps are designated as cash flow hedges with the

Table of Contents**SPECTRUM BRANDS, INC.****Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)****(Amounts in thousands, except per share figures)**

fair value changes recorded in AOCI and as a hedge asset or liability, as applicable. The unrecognized changes in fair value of the swaps are reclassified from AOCI into earnings when the hedged purchase of raw materials also affects earnings. The swaps effectively fix the floating price on a specified quantity of raw materials through a specified date. Pretax derivative gains of \$1,703 and \$3,082 were recorded as an adjustment to Cost of goods sold for swap contracts settled at maturity during the three and nine month periods ended July 3, 2005 and \$718 and \$1,586 for the three and nine month periods ended June 27, 2004, respectively. The hedges are generally highly effective, however, pretax derivative gains of \$181 and \$106 were recorded as an adjustment to Cost of goods sold during the three and nine month periods ended July 3, 2005, respectively. No such amounts were recorded for hedging ineffectiveness during the three and nine month periods ended June 27, 2004. At July 3, 2005 and September 30, 2004, the Company had a series of such swap contracts outstanding through December 2005 with a contract value of \$8,641 and \$15,234, respectively. The derivative net gain on these contracts recorded in AOCI at July 3, 2005 was \$587, net of tax expense of \$336. The derivative net gain on these contracts recorded in AOCI at September 30, 2004 was \$1,109, net of tax expense of \$655.

3 OTHER COMPREHENSIVE INCOME

Comprehensive income and the components of other comprehensive income, net of tax, for the three and nine months ended July 3, 2005 and June 27, 2004 are as follows:

	Three Months		Nine Months	
	2005	2004	2005	2004
Net income	\$ 23,711	\$ 12,814	\$ 49,709	\$ 37,614
Other comprehensive income:				
Foreign currency translation	(12,819)	(357)	390	6,845
Adjustment of additional minimum pension liability	63		1,251	133
Net unrealized gain on derivative instruments	20	1,286	1,079	2,988
Net change to derive comprehensive income for the period	(12,736)	929	2,720	9,966
Comprehensive income	\$ 10,975	\$ 13,743	\$ 52,429	\$ 47,580

Net exchange gains or losses resulting from the translation of assets and liabilities of foreign subsidiaries are accumulated in the AOCI section of Shareholders' equity. Also included are the effects of exchange rate changes on intercompany balances of a long-term nature and transactions designated as hedges of net foreign investments. The changes in accumulated foreign currency translation for the three and nine months ended July 3, 2005 and June 27, 2004 were primarily attributable to the impact of translation of the net assets of the Company's European operations, primarily denominated in Euros and Pounds Sterling.

4 NET INCOME PER COMMON SHARE

Net income per common share for the three and nine months ended July 3, 2005 and June 27, 2004 is calculated based upon the following number of shares:

	Three Months		Nine Months	
	2005	2004	2005	2004
Basic	48,916	33,648	42,024	32,977
Effect of restricted stock and assumed conversion of options	2,170	1,740	1,895	1,436
Diluted	51,086	35,388	43,919	34,413

Table of Contents**SPECTRUM BRANDS, INC.****Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)****(Amounts in thousands, except per share figures)****5 INVENTORIES**

Inventories, which are stated at lower of cost or market, consist of the following:

	July 3, 2005	September 30, 2004
Raw materials	\$ 121,472	\$ 47,882
Work-in-process	39,969	31,382
Finished goods	308,874	185,462
	<u>\$ 470,315</u>	<u>\$ 264,726</u>

6 GOODWILL AND ACQUIRED INTANGIBLE ASSETS

Goodwill and intangible assets consist of the following:

	North America	Europe/ROW	Latin America	United	Tetra	Total
Goodwill:						
Balance as of September 30, 2004	\$ 130,173	\$ 105,414	\$ 84,990	\$	\$	\$ 320,577
Goodwill recognized during period		6,283	30,610	798,289	321,120	1,156,302
Purchase price allocation during period			(21,685)			(21,685)
Effect of translation	6	(2,548)	6,952	(649)	(26,319)	(22,558)
Balance as of July 3, 2005	<u>\$ 130,179</u>	<u>\$ 109,149</u>	<u>\$ 100,867</u>	<u>\$ 797,640</u>	<u>\$ 294,801</u>	<u>\$ 1,432,636</u>
Intangible Assets:						
Trade Names Not Subject to Amortization						
Balance as of September 30, 2004, net	\$ 159,000	\$ 161,753	\$ 85,125	\$	\$	\$ 405,878
Additions				316,996	175,500	492,496
Purchase price allocation during period			21,685			21,685
Effect of translation		(4,385)	4,844			459

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Balance as of July 3, 2005, net	\$ 159,000	\$ 157,368	\$ 111,654	\$ 316,996	\$ 175,500	\$ 920,518
Technology Assets, Customer Relationships and Trade Names Subject to Amortization						
Balance as of September 30, 2004, gross	\$ 1,385	\$ 14,061	\$	\$	\$	\$ 15,446
Less: Accumulated amortization	(434)	(1,071)				(1,505)
Balance as of September 30, 2004, net	951	12,990				13,941
Additions				183,100	58,500	241,600
Amortization during period	(67)	(766)		(6,539)	(834)	(8,206)
Effect of translation		(204)			6	(198)
Balance as of July 3, 2005, net	\$ 884	\$ 12,020	\$	\$ 176,561	\$ 57,672	\$ 247,137
Pension Intangible Assets						
Balance as of July 3, 2005	\$ 2,028	\$	\$	\$	\$	\$ 2,028
Total Intangible Assets, net	\$ 161,912	\$ 169,388	\$ 111,654	\$ 493,557	\$ 233,172	\$ 1,169,683

The carrying value of technology assets was \$41,031, net of accumulated amortization of \$2,740 at July 3, 2005 and \$12,149, net of accumulated amortization of \$1,076, at September 30, 2004. The trade names subject to

Table of Contents**SPECTRUM BRANDS, INC.****Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)****(Amounts in thousands, except per share figures)**

amortization relate to United. The carrying value of these trade names was \$7,672 net of accumulated amortization of \$1,128 at July 3, 2005. Remaining intangible assets subject to amortization include customer relationship intangibles. Of the intangible assets acquired in the United acquisition, customer relationships and technology assets have been assigned a life of approximately 12 years and other intangibles have been assigned lives of 1 year to 4 years. Of the intangible assets acquired in the Tetra acquisition, customer relationships have been assigned a 12 ¹/₂ year life and technology assets have been assigned a 6 year life. The pension intangible asset totaled \$2,288 at September 30, 2004.

The Company completed the acquisitions of Ningbo and Microlite during 2004 and the acquisitions of United and Tetra during 2005. During 2005, the Company allocated a portion of the Microlite, United and Tetra purchase price to unamortizable intangible assets. The allocation consisted of \$21,685 (using exchange rates in effect as of September 30, 2004) to the trade name in Brazil, \$290,800 to United trade names, \$175,500 to Tetra trade names and \$26,100 to United license agreements.

The purchase price allocation for the Tetra acquisition is based on preliminary estimates and is pending finalization of the valuation of property, plant and equipment, inventory and intangibles. The purchase price allocation for the United acquisition will be finalized upon the final valuation of certain assets and liabilities. The purchase price allocation for Microlite has been finalized. Future allocations of the Tetra and United purchase prices may impact the amount and segment allocation of goodwill. See also footnote 11, Acquisitions, for additional information on the Tetra, United, Ningbo and Microlite acquisitions.

Amortization expense for the three and nine months ended July 3, 2005 and June 27, 2004 is as follows:

	Three Months		Nine Months	
	2005	2004	2005	2004
Proprietary technology amortization	\$ 760	\$ 209	\$ 1,664	\$ 565
Customer relationships amortization	3,704	59	5,414	177
Trade names amortization	754		1,128	
	\$ 5,218	\$ 268	\$ 8,206	\$ 742

The Company estimates annual amortization expense for the next five fiscal years will approximate \$23,000 per year.

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(Amounts in thousands, except per share figures)

7 DEBT

Debt consists of the following:

	July 3, 2005		September 30, 2004	
	Amount	Rate ^(A)	Amount	Rate ^(A)
Senior Subordinated Notes, due February 1, 2015	\$ 700,000	7.4%	\$	
Senior Subordinated Notes, due October 1, 2013	350,000	8.5%	350,000	8.5%
Term Loan, US Dollar, expiring February 6, 2012	653,362	5.3%		
Term Loan, Canadian Dollar, expiring February 6, 2012	71,024	4.7%		
Term Loan, Euro, expiring February 6, 2012	137,998	4.7%		
Term Loan, Euro Tranche B, expiring February 6, 2012	340,398	4.4%		
Term C Loan, expiring September 30, 2009			257,000	4.2%
Euro Term C Loan, expiring September 30, 2009			141,845	5.1%
Revolving Credit Facility, expiring February 6, 2011	28,250	7.3%		
Revolving Credit Facility, expiring September 30, 2008			37,000	5.7%
Euro Revolving Credit Facility, expiring February 6, 2011	3,632	4.4%		
Other notes and obligations	26,733		20,530	
Capitalized lease obligations	25,348		23,522	
	<u>2,336,745</u>		<u>829,897</u>	
Less current maturities	38,830		23,895	
Long-term debt	<u>\$ 2,297,915</u>		<u>\$ 806,002</u>	

^(A) Interest rates on Senior Credit Facilities represent the weighted average rates on balances outstanding.

On February 7, 2005, the Company completed its acquisition of United. In connection with that acquisition, the Company completed its offering of \$700,000 aggregate principal amount of its 7³/₈% Senior Subordinated Notes due 2015 and its tender offer for United's 9⁷/₈% Senior Subordinated Notes due 2009, retired United's senior credit facilities and replaced the Company's Senior Credit Facilities with new Senior Credit Facilities. At the time of the refinancing, the outstanding amount of the Revolving Credit Facility was \$34,000, the outstanding amount of the Euro denominated Term C Loan was \$132,738, and the outstanding amount of the U.S. Term C Loan was \$241,344. Additionally, in connection with the refinancing the Company assumed \$10,205 of United's senior subordinated notes which were subsequently repurchased on April 1, 2005. The Company also assumed \$3,441 of United capital leases in connection with the acquisition. In connection with the refinancing and the issuance of the new Senior Subordinated Notes, the Company incurred approximately \$28,000 in new debt issuance costs, which are being amortized over the life of the debt using the effective interest method. In addition, the Company expensed approximately \$12,000 in remaining

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debt issuance costs associated with the old Senior Credit Facilities. This amount is included in Interest expense in the Condensed Consolidated Statement of Operations (unaudited).

On April 29, 2005, the Company acquired all of the outstanding equity interests of Tetra Holding GmbH (Tetra) for a purchase price of approximately \$550,000, net of cash acquired and inclusive of a final working capital payment of \$2,400, made in July 2005. The acquisition utilized \$500,000 of an incremental Term Loan Facility and approximately \$53,000 of the Revolving Credit Facility (see footnote 11, Acquisitions, where the Tetra acquisition is further described). The incremental Term Loan Facility was denominated in a \$115,000

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SPECTRUM BRANDS, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

(Amounts in thousands, except per share figures)

addition to the existing U.S. Dollar Term Loan, a CAD \$24,830 addition (USD \$20,000 at April 29, 2005) to the existing CAD Term Loan and a Tranche B 281,202 Term Loan (USD \$365,000 at April 29, 2005). The Fourth Amended and Restated Credit Agreement was amended (the First Amendment) to reflect utilization of the incremental Term Facility. The payment provisions of the respective increments to the Term Loan Facility are the same as the existing term loans in the respective currency denominations. In connection with the acquisition of Tetra and the issuance of the incremental Term Loan Facility, the Company incurred approximately \$3,100 in new debt issuance costs, which are being amortized over the life of the debt using the effective interest method.

The Company's Senior Credit Facility includes aggregate facilities of \$1,502,782 consisting of a \$653,362 U.S. Dollar Term Loan which replaced the pre-existing outstanding amount \$257,000 Term C Loan (USD), a \$114,000 Term Loan (\$137,998 at July 3, 2005) which replaced the pre-existing outstanding amount \$102,500 Term Loan, a new Tranche B 281,202 Term Loan (USD \$340,398 at July 3, 2005), a CAD \$87,012 Term Loan (USD \$71,024 at July 3, 2005), and a new Revolving Credit Facility of \$300,000 which replaced the pre-existing \$120,000 Revolving Credit Facility and the \$40,000 Revolving Credit Facility of which \$28,250 and \$3,000, respectively, were outstanding. The new Revolving Credit Facility includes foreign currency sublimits equal to the U.S. Dollar equivalent of \$25,000 for borrowings in Euros and the U.S. Dollar equivalent of £10,000 for borrowings in Pounds Sterling, and the equivalent of borrowings in Chinese Yuan of \$35,000.

Approximately \$239,607 remains available under the Revolving Credit Facility as of July 3, 2005, net of approximately \$28,511 of outstanding letters of credit.

Including the refinancing mentioned above, during the nine months ended July 3, 2005, the Company made gross payments of \$610,774 on the prior Term Loans, Revolving Credit Facilities and Senior Subordinated Notes, \$299,240 on the new Term Loans, Revolving Credit Facilities and assumed Senior Subordinated Notes, and \$994 on capital leases and other notes and obligations. Additionally, during the same period the Company's borrowings included \$169,000 under the prior Revolving Credit Facility and \$2,263,266 under the new Term Loans, new Revolving Credit Facilities and new Senior Subordinated Notes.

The interest and fees per annum are calculated on a 365-day basis for Base Rate loans and loans denominated in Pounds Sterling. For all other denominations, interest and fees per annum are calculated on the basis of a 360-day year. The interest rates per annum applicable to the Senior Credit Facility are the Eurocurrency Rate plus the Applicable Margin, or at the Company's option in the case of advances made in U.S. Dollars, the Base Rate plus the Applicable Margin. The fees associated with these facilities were capitalized and are being amortized over the term of the facilities.

In addition to principal payments, the Company is required to pay a quarterly commitment fee of 0.50% on the unused portion of the Revolving Credit Facility.

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The new Senior Credit Facility contains financial covenants with respect to borrowings, which include maintaining minimum interest coverage and maximum leverage ratios. In accordance with the Fourth Agreement (and consistent with the Third Agreement), the limits imposed by such ratios become more restrictive over time. In addition, the Fourth Agreement restricts the Company's ability to incur additional indebtedness, create liens, make investments or specified payments, give guarantees, pay dividends, make capital expenditures, and enter into a merger or acquisition or sell assets. Indebtedness under these facilities (i) is secured by substantially all of the assets of the Company, and (ii) is guaranteed by certain of the Company's subsidiaries.

The terms of both the \$350,000 and \$700,000 Senior Subordinated Notes permit the holders to require the Company to repurchase all or a portion of the notes in the event of a customary event of default, including a change of control. In addition, the terms of the notes restrict or limit the ability of the Company and its subsidiaries to,

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SPECTRUM BRANDS, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

(Amounts in thousands, except per share figures)

among other things: (i) pay dividends or make other restricted payments, (ii) incur additional indebtedness and issue preferred stock, (iii) create liens, (iv) enter into mergers, consolidations, or sales of all or substantially all of the assets of the Company, (v) make asset sales, (vi) enter into transactions with affiliates, and (vii) issue or sell capital stock of wholly owned subsidiaries of the Company. Payment obligations of the notes are fully and unconditionally guaranteed on a joint and several basis by all of the Company's domestic subsidiaries.

The Company was in compliance with all covenants associated with the Senior Credit Facilities and Senior Subordinated Notes that were in effect as of and during the period ended July 3, 2005.

8 EMPLOYEE BENEFIT PLANS

The Company has various defined benefit pension plans covering some of its employees in the United States and certain employees in other countries. Plans generally provide benefits of stated amounts for each year of service. The Company's practice is to fund pension costs at amounts within the acceptable ranges established by the Employee Retirement Income Security Act of 1974, as amended.

The Company also sponsors or participates in a number of other non-U.S. pension arrangements, including various retirement and termination benefit plans, some of which are covered by local law or coordinated with government-sponsored plans, which are not significant in the aggregate.

The Company also has various nonqualified deferred compensation agreements with certain of its employees. Under certain of these agreements, the Company has agreed to pay certain amounts annually for the first 15 years subsequent to retirement or to a designated beneficiary upon death. It is management's intent that life insurance contracts owned by the Company will fund these agreements. Under the remaining agreements, the Company has agreed to pay such deferral amounts in up to 15 annual installments beginning on a date specified by the employee, subsequent to retirement or disability, or to a designated beneficiary upon death. The Company established a rabbi trust to fund these agreements.

The Company also provides certain health care and life insurance benefits to eligible retired employees. Participants earn retiree health care benefits after reaching age 45 over the next 10 succeeding years of service and remain eligible until reaching age 65. The plan is contributory; retiree contributions have been established as a flat dollar amount with contribution rates expected to increase at the active medical trend rate. The plan is unfunded. The Company is amortizing the transition obligation over a 20-year period.

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The Company's results of operations for the three and nine months ended July 3, 2005 and June 27, 2004, respectively, reflect the following pension and deferred compensation benefit costs.

	Three Months		Nine Months	
	2005	2004	2005	2004
Components of net periodic pension benefit and deferred compensation cost				
Service cost	\$ 367	\$ 471	\$ 1,125	\$ 1,400
Interest cost	1,038	999	3,179	2,983
Expected return on assets	(539)	(555)	(1,632)	(1,648)
Amortization of prior service cost	68	138	205	282
Amortization of transition obligation	12	11	34	33
Recognized net actuarial loss	142	128	430	514
Net periodic benefit cost	\$ 1,088	\$ 1,192	\$ 3,341	\$ 3,564

	Three Months		Nine Months	
	2005	2004	2005	2004
Pension and deferred compensation contributions				
Contributions made during period	\$ 134	\$ 563	\$ 613	\$ 1,756

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(Amounts in thousands, except per share figures)

9 SHAREHOLDERS' EQUITY

The following table details activity in shareholders' equity for the nine months ended July 3, 2005:

	Common Stock		Notes						Total
			Additional	Retained	Accumulated	Receivable		Unearned	
	Number	Share	Paid-In	Earnings	Other	Officers/	Treasury	Compensation	Shareholders
	Shares	Amount	Capital	Earnings	Income, Net	Shareholders	Stock		Equity
Balances at September 30, 2004	34,683	\$ 642	\$ 224,962	\$ 220,483	\$ 10,621	\$ (3,605)	\$ (130,070)	\$ (6,989)	\$ 316,044
Net income				49,709					49,709
Adjustment of additional minimum pension liability					1,251				1,251
Cumulative translation adjustment					390				390
Other unrealized gains and losses					1,079				1,079
Issuance of restricted stock, net of forfeitures	1,133	12	38,605					(38,617)	
Exercise of stock options	1,227	12	28,137						