

NCR CORP
Form 10-Q
August 08, 2007
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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 June 30, 2007

Commission File Number 001-00395

NCR CORPORATION

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

1700 South Patterson Blvd.

Dayton, Ohio 45479

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (937) 445-5000

31-0387920
(I.R.S. Employer
Identification No.)

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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 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.

Large accelerated filer Accelerated filer Non-accelerated filer

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

Number of shares of common stock, \$0.01 par value per share, outstanding as of July 31, 2007, was approximately 180.5 million.

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Table of Contents**Part I. Financial Information****Item 1. Financial Statements****Condensed Consolidated Statements of Operations (Unaudited)**

	Three Months Ended		Six Months Ended	
	June 30		June 30	
In millions, except per share amounts	2007	2006	2007	2006
Product revenue	\$ 850	\$ 805	\$ 1,515	\$ 1,442
Service revenue	759	726	1,440	1,372
Total revenue	1,609	1,531	2,955	2,814
Cost of products	531	534	1,007	936
Cost of services	579	572	1,106	1,101
Selling, general and administrative expenses	283	264	528	509
Research and development expenses	60	58	116	118
Total operating expenses	1,453	1,428	2,757	2,664
Income from operations	156	103	198	150
Interest expense	6	6	12	12
Other income, net	(7)	(5)	(16)	(14)
Income before income taxes	157	102	202	152
Income tax expense	59	24	70	33
Net income	\$ 98	\$ 78	\$ 132	\$ 119
Net income per common share				
Basic	\$ 0.54	\$ 0.43	\$ 0.73	\$ 0.66
Diluted	\$ 0.54	\$ 0.42	\$ 0.72	\$ 0.64
Weighted average common shares outstanding				
Basic	180.1	181.1	179.7	181.4
Diluted	182.8	184.2	182.4	184.6

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**Condensed Consolidated Balance Sheets (Unaudited)**

In millions, except per share amounts	June 30,	December 31,
	2007	2006
Assets		
Current assets		
Cash and cash equivalents	\$ 1,139	\$ 947
Accounts receivable, net	1,385	1,408
Inventories, net	739	677
Other current assets	343	300
Total current assets	3,606	3,332
Property, plant and equipment, net	370	378
Goodwill	148	150
Prepaid pension cost	727	639
Deferred income taxes	336	374
Other assets	428	354
Total assets	\$ 5,615	\$ 5,227
Liabilities and stockholders equity		
Current liabilities		
Short-term borrowings	\$ 1	\$ 1
Accounts payable	516	534
Payroll and benefits liabilities	248	291
Deferred service revenue and customer deposits	556	492
Other current liabilities	515	452
Total current liabilities	1,836	1,770
Long-term debt	306	306
Pension and indemnity plan liabilities	477	481
Postretirement and postemployment benefits liabilities	448	463
Deferred income taxes	42	27
Income tax accruals	168	132
Other liabilities	174	147
Minority interests	17	20
Total liabilities	3,468	3,346
Commitments and contingencies (Note 8)		
Stockholders equity		
Preferred stock: par value \$0.01 per share, 100.0 shares authorized, no shares issued and outstanding at June 30, 2007 and December 31, 2006		
Common stock: par value \$0.01 per share, 500.0 shares authorized, 180.5 and 178.9 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively		
	2	2
Paid-in capital	720	655
Retained earnings	2,032	1,900
Accumulated other comprehensive loss	(607)	(676)
Total stockholders equity	2,147	1,881

Total liabilities and stockholders equity	\$ 5,615	\$ 5,227
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See Notes to Condensed Consolidated Financial Statements.

Table of Contents**Condensed Consolidated Statements of Cash Flows (Unaudited)**

In millions	Six Months Ended	
	June 30	
	2007	2006
Operating activities		
Net Income	\$ 132	\$ 119
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	87	78
Stock-based compensation expense	16	14
Excess tax benefit from stock-based compensation	(8)	(12)
Deferred income taxes	41	18
Other adjustments to income, net	(4)	(1)
Changes in assets and liabilities:		
Receivables	23	4
Inventories	(62)	(65)
Current payables and accrued expenses	(59)	(67)
Deferred service revenue and customer deposits	64	50
Employee severance and pension	(3)	34
Other assets and liabilities	6	(26)
Net cash provided by operating activities	233	146
Investing activities		
Expenditures for property, plant and equipment	(45)	(38)
Proceeds from sales of property, plant and equipment	11	12
Additions to capitalized software	(54)	(44)
Other investing activities, business acquisitions and divestitures, net	(4)	(31)
Net cash used in investing activities	(92)	(101)
Financing activities		
Repurchases of Company common stock		(186)
Excess tax benefit from stock-based compensation	8	12
Short-term borrowings, repayments	(1)	
Proceeds from employee stock plans	36	61
Other financing activities, net	1	
Net cash provided by (used in) financing activities	44	(113)
Effect of exchange rate changes on cash and cash equivalents	7	5
Increase (decrease) in cash and cash equivalents	192	(63)
Cash and cash equivalents at beginning of period	947	810
Cash and cash equivalents at end of period	\$ 1,139	\$ 747

See Notes to Condensed Consolidated Financial Statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements have been prepared by NCR Corporation (NCR, the Company, we or us) without audit pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC) and, in the opinion of management, include all adjustments necessary for a fair statement of the consolidated results of operations, financial position, and cash flows for each period presented. The consolidated results for the interim periods are not necessarily indicative of results to be expected for the full year. These financial statements should be read in conjunction with NCR's Form 10-K for the year ended December 31, 2006.

Strategic Separation On January 5, 2007, NCR announced its intention to separate into two independent publicly traded companies through the spin-off of 100% of the Company's Teradata Data Warehousing business to holders of shares of NCR stock. The transaction, expected to be tax-free to NCR and its shareholders, will enable the two public companies to better focus on their distinct customer bases, business strategies and operational needs.

The stock distribution ratio for the Teradata Data Warehousing spin-off is expected to be one-for-one, and the separation is expected to be completed at the end of the third quarter of 2007. Consummation of the proposed separation is subject to certain conditions, including final approval by NCR's Board of Directors, receipt of a ruling from the Internal Revenue Service (IRS) with respect to the tax-free status of the spin-off, the absence of any material changes or developments, and the acceptance of registration statements with the Securities and Exchange Commission. The separation will not require a vote by NCR shareholders.

In connection with the proposed separation, the Company incurred \$12 million of costs in the second quarter of 2007 and \$14 million of costs for the six months ended June 30, 2007. These costs were primarily for legal, accounting, and other professional and consulting fees, which have been recorded as selling, general and administrative expense in the condensed consolidated statements of operations. In total, the Company expects to incur \$55 to \$65 million of nonrecurring costs related to the spin-off. These nonrecurring costs are expected to consist of, among other things, legal, tax and accounting fees, professional advisory services, employee transition costs and other costs associated with executing the separation transaction.

Out of Period Adjustments In the second quarter of 2007, the Company recorded an adjustment to increase income tax expense by \$18 million relating to immaterial errors originating in prior years. The adjustment is composed of an increase to income tax expense of \$26 million due to an understatement of income tax expense in the years 2001 through 2006 and the first quarter of 2007 relating to the accounting for income taxes on intercompany profit. This adjustment is offset, in part, by an adjustment to reduce income tax expense by \$8 million as a result of an overstatement of income tax expense (and the related liability) in 2006 due to an error in preparing that year's income tax provision. Because these errors, either individually or in the aggregate, were not material to any of the prior years' financial statements, and the impact of correcting these errors in the current year is not expected to be material to the full year 2007 financial statements, we have recorded the correction of these errors in the second quarter of 2007 financial statements.

Additionally, we are correcting our disclosures as it relates to the impact of the adoption of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48). In the financial statements for the quarter ended March 31, 2007, we recorded and described the impact of adopting FIN 48 as an \$8 million reduction at January 1, 2007 in the liability for unrecognized tax benefits, with a corresponding increase in retained earnings. This previously recorded and disclosed amount relates to a reduction of tax liabilities to correct the \$8 million tax provision error recorded in 2006 and described above. The correction of that error should not have been described as an impact of adopting FIN 48 and should not have been recognized as an adjustment to retained earnings as of January 1, 2007. The out of period adjustment described above properly reflects the correction of that error as a decrease to income tax expense. See Note 9 - Income Taxes for further details.

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Use of Estimates The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the period reported. Actual results could differ from those estimates.

2. SUPPLEMENTAL FINANCIAL INFORMATION

In millions	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2007	2006	2007	2006
Comprehensive Income				
Net income	\$ 98	\$ 78	\$ 132	\$ 119
Other comprehensive income, net of tax:				
Unrealized loss on securities		(2)	(1)	(1)
Unrealized loss on derivatives accounted for as hedges	(1)	(2)	(2)	(4)
Amortization of costs associated with pension, postemployment and postretirement benefits	22		45	
Currency translation adjustments	21	50	27	61
Other adjustments				3
Total comprehensive income	\$ 140	\$ 124	\$ 201	\$ 178

In millions	June 30,	December 31,
	2007	2006
Inventories		
Work in process and raw materials	\$ 124	\$ 106
Finished goods	231	215
Service parts	384	356
Total inventories, net	\$ 739	\$ 677

3. NEW ACCOUNTING PRONOUNCEMENTS

FASB Interpretation No. 48 In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing thresholds and attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure. The Company adopted the provisions of FIN 48 on January 1, 2007. See Note 9 for further discussion of the adoption of FIN 48.

Statement of Financial Accounting Standards No. 157 In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (SFAS 157), *Fair Value Measurements*. This statement defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 157 on our financial condition and results of operations.

Statement of Financial Accounting Standards No. 159 In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115*. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The fair value option may be elected on

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an instrument-by-instrument basis, with few exceptions. SFAS 159 also establishes presentation and disclosure requirements to facilitate comparisons between companies that choose different measurement attributes for similar assets and liabilities. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 159 on our financial condition and results of operations.

4. MANUFACTURING REALIGNMENT

On January 11, 2007, NCR announced plans to realign its global manufacturing operations. These include:

Reducing manufacturing operations and shifting the focus of the Dundee, Scotland facility to new product introductions and the manufacturing of high-complexity/low-volume solutions;

Meeting volume demand in Europe, Middle East, Africa and Asia-Pacific through lower-cost manufacturing facilities in Hungary, China and India; and

Moving to a contract manufacturing model with Solectron in the Americas.

The realignment is expected to reduce overall operating costs and to free capital to invest in revenue-generating programs in sales, engineering and market development. The Company will continue to focus resources on engineering and advanced development, product management and marketing in affected locations where the manufacturing realignment is anticipated to result in reductions in manufacturing employment. As a result of these changes, in the first quarter of 2007, the Company recorded \$46 million for employee severance and other termination benefits in cost of products. Of the \$46 million total, \$37 million was recorded as a discrete cost in accordance with Statement of Financial Accounting Standards No. 112, *Employers' Accounting for Postemployment Benefits*, when the severance liability was determined to be probable and reasonably estimable. The remaining \$9 million was recorded in accordance with Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. For the six months ended June 30, 2007, a total of \$14 million has been paid related to these plans. As some employees were terminated prior to eligibility for severance and others are now expected to continue employment in other parts of the company, as well as due to the mix of employees differing from the original expected employee mix, the amount of severance payouts is expected to be lower than originally expected. Accordingly, the Company reduced the restructuring reserves by \$11 million in the second quarter of 2007 to reflect the change in estimate. This reduction was recorded in cost of products in the condensed consolidated statements of operations for the three and six months ended June 30, 2007.

The following table summarizes the costs recorded for these activities and the remaining liability as of June 30, 2007, which is included on the condensed consolidated balance sheet in other current liabilities. The cash expenditures necessary to satisfy the remaining obligations will be primarily paid over the balance of 2007.

In millions	Employee Severance and Other Benefits
Restructuring reserve liability	
Beginning balance as of January 1, 2007	\$
Costs initially recognized during the first six months of 2007	46
Payments during the first six months of 2007	(14)
Change in estimate	(11)
Ending balance as of June 30, 2007	\$ 21

Related to the manufacturing realignment described above, the Company expects to incur an additional \$10 to \$15 million in restructuring costs in 2007 for potential impairment costs associated with stranded assets, lease termination costs, employee retention payouts and other costs that are a direct result of the restructuring initiative.

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The costs for these activities primarily relate to the Company's Financial Self Service segment. The operating results by segment, reported under Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*, excludes the impact of these costs, which is consistent with the manner by which management assesses the performance and views the results of each segment.

5. IDENTIFIABLE INTANGIBLE ASSETS

NCR's identifiable intangible assets, reported under Other Assets in the unaudited condensed consolidated balance sheets, were specifically identified when acquired, and are determined to have finite lives. The gross carrying amount and accumulated amortization for NCR's identifiable intangible assets were as follows:

In millions	Original	June 30, 2007		December 31, 2006	
	Amortization Life (in Years)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Identifiable intangible assets					
Non-compete arrangements	4 - 5	\$ 5	\$ (2)	\$ 5	\$ (1)
Intellectual property	4 - 10	67	(26)	61	(21)
Total identifiable intangible assets		\$ 72	\$ (28)	\$ 66	\$ (22)

During the quarter, the increase in intellectual property was primarily due to the purchase of software, related to new industry solutions in our Teradata Data Warehousing business.

The aggregate amortization expense (actual and estimated) for identifiable intangible assets for the following periods is as follows:

In millions	Six months ended June 30,		For the year ended (estimated)				
	2007	2007	2007	2008	2009	2010	2011
Amortization expense	\$ 6	\$ 13	\$ 13	\$ 11	\$ 8	\$ 3	\$ 3

6. STOCK COMPENSATION PLANS

As of June 30, 2007, the Company's primary types of share-based compensation were stock options and restricted stock. The Company recorded stock-based compensation expense, under the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, for the periods ended June 30, 2007 and June 30, 2006 as follows:

In millions	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Stock options	\$ 4	\$ 4	\$ 9	\$ 8
Restricted stock	4	3	7	6
Total stock-based compensation (pre-tax)	8	7	16	14
Tax benefit	(2)	(2)	(4)	(4)
Total stock-based compensation, net of tax	\$ 6	\$ 5	\$ 12	\$ 10

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Stock-based compensation expense for the first six months of 2007 was computed using the fair value of options as calculated using the Black-Scholes option-pricing model. The weighted average fair value of grants was estimated based on the below weighted average assumptions and was \$18.39 for three months ended June 30, 2007 and \$17.03 for the six months ended June 30, 2007.

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Dividend yield				
Risk-free interest rate	4.63%	4.96%	4.51%	4.61%
Expected volatility	31.6%	35.3%	32.5%	35.7%
Expected holding period (years)	5.0	5.3	5.0	5.3

Expected volatility incorporates a blend of both historical volatility of the Company's stock over a period equal to the expected term of the options and implied volatility from traded options on the Company's stock, as management believes this is more representative of prospective trends. The Company uses historical data to estimate option exercise and employee termination within the valuation model. The expected holding period represents the period of time that options are expected to be outstanding. The risk-free interest rate for periods within the contractual life of the option is based on the five-year U.S. Treasury yield curve in effect at the time of grant.

7. EMPLOYEE BENEFIT PLANS

Components of net periodic benefit expense for the three months ended June 30 are as follows:

In millions	U.S. Pension Benefits		International Pension Benefits		Total Pension Benefits	
	2007	2006	2007	2006	2007	2006
Net service cost	\$	\$ 11	\$ 11	\$ 12	\$ 11	\$ 23
Interest cost	46	45	23	21	69	66
Expected return on plan assets	(62)	(60)	(32)	(31)	(94)	(91)
Settlement charge				(1)		(1)
Amortization of:						
Prior service cost			3	2	3	2
Actuarial loss	1	13	21	23	22	36
Net benefit (income) cost	\$ (15)	\$ 9	\$ 26	\$ 26	\$ 11	\$ 35

Components of net periodic benefit expense for the six months ended June 30 are as follows:

In millions	U.S. Pension Benefits		International Pension Benefits		Total Pension Benefits	
	2007	2006	2007	2006	2007	2006
Net service cost	\$	\$ 23	\$ 21	\$ 22	\$ 21	\$ 45
Interest cost	92	90	45	41	137	131
Expected return on plan assets	(123)	(120)	(63)	(60)	(186)	(180)
Special Termination Benefit		9				9
Amortization of:						
Prior service cost			6	3	6	3
Actuarial loss	2	26	42	45	44	71
Net benefit (income) cost	\$ (29)	\$ 28	\$ 51	\$ 51	\$ 22	\$ 79

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The net periodic benefit cost of the postretirement plan for the three months and six months ended June 30 were:

In millions	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2007	2006	2007	2006
Interest cost	\$ 2	\$ 2	\$ 4	\$ 4
Amortization of:				
Prior service benefit	(4)	(4)	(7)	(7)
Actuarial loss	2	2	3	4
Net benefit cost	\$	\$	\$	\$ 1

The net periodic benefit cost of the postemployment plan for the three months and six months ended June 30 were:

In millions	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2007	2006	2007	2006
Net service cost	\$ 8	\$ 8	\$ 16	\$ 17
Interest cost	1	5	6	9
Amortization of:				
Prior service cost				