WATER PIK TECHNOLOGIES INC
Form 10-Q
August 10, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2004

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

For the transition period from to

Commission file number 1-15297

WATER PIK TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**25-1843384** (IRS Employer Identification No.)

23 Corporate Plaza, Suite 246

Newport Beach, CA 92660
(Address of principal executive offices, including zip code)

Registrant s telephone number, including area code: **(949) 719-3700**

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 ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2): Yes ý No o

The number of shares of Common Stock outstanding on August 4, 2004 was 12,281,977 shares.

WATER PIK TECHNOLOGIES, INC.

INDEX

PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

Water Pik Technologies, Inc.

Consolidated Balance Sheets

(In thousands, except for share and per share amounts)

	June 30, 2004 (Unaudited)	December 31, 2003
Assets		
Current assets:		
Cash	$ 3,272	$ 970
Accounts receivable, less allowances of $2,496 at June 30, 2004 and $1,952 at December 31, 2003	61,256	85,527
Inventories	40,132	41,772
Deferred income taxes	7,453	7,321
Prepaid expenses and other current assets	2,759	4,320
Total current assets	114,872	139,910
Property, plant and equipment, net	45,939	48,637
Goodwill, net	34,928	26,020
Deferred income taxes	909	657
Other assets	3,794	3,352
Total assets	$ 200,442	$ 218,576
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 23,632	$ 25,169
Accrued income taxes	766	1,559
Accrued liabilities	25,741	28,797
Current portion of long-term debt	3,874	3,879
Total current liabilities	54,013	59,404
Long-term debt, less current portion	24,827	42,589
Other accrued liabilities	5,139	5,242
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.01 par value: 5,000,000 shares authorized; none issued		
Common stock, $0.01 par value: 50,000,000 shares authorized; 12,274,210 and 12,365,036 shares issued and outstanding at June 30, 2004 and December 31, 2003, respectively	128	125
Additional paid-in capital	82,481	79,481
Equity adjustments due to stock plans	(1,202)	(6,369)
Retained earnings	40,917	37,980
Accumulated comprehensive income	1,269	2,123
Treasury stock at cost, 541,343 and 178,482 shares at June 30, 2004 and December 31, 2003, respectively	(7,130)	(1,999)
Total stockholders equity	116,463	111,341
Total liabilities and stockholders equity	$ 200,442	$ 218,576

See accompanying notes

Water Pik Technologies, Inc.

Consolidated Statements of Operations

(In thousands, except for share and per share amounts)

(Unaudited)

	Three Months Ended June 30, 2004	Three Months Ended June 30, 2003	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
Sales	$ 90,272	$ 76,496	$ 157,933	$ 131,885
Cost and expenses:				
Cost of sales	65,162	52,345	115,487	92,440
Selling expenses	11,592	10,998	22,768	21,924
General and administrative expenses	5,618	4,920	10,917	9,518
Research and development expenses	1,694	1,689	3,396	3,876
	84,066	69,952	152,568	127,758
Operating income	6,206	6,544	5,365	4,127
Interest expense	348	560	894	1,099
Other income	(90)	(84)	(160)	(208)
Income from continuing operations before income taxes	5,948	6,068	4,631	3,236
Income tax provision	2,167	2,214	1,699	1,179
Income from continuing operations	3,781	3,854	2,932	2,057
Discontinued operations:				
Income (loss) from operations of discontinued product line	7	(9)	7	(72)
Income tax provision (benefit)	2	(2)	2	(25)
Income (loss) on discontinued operations	5	(7)	5	(47)
Net income	$ 3,786	$ 3,847	$ 2,937	$ 2,010
Basic net income per common share				
Continuing operations	$ 0.32	$ 0.32	$ 0.25	$ 0.17
Discontinued operations				
Net income	$ 0.32	$ 0.32	$ 0.25	$ 0.17
Diluted net income per common share				
Continuing operations	$ 0.30	$ 0.31	$ 0.23	$ 0.16
Discontinued operations				
Net income	$ 0.30	$ 0.31	$ 0.23	$ 0.16
Shares used in per share calculation basic	11,851,000	12,082,000	11,896,000	12,078,000
Shares used in per share calculation diluted	12,592,000	12,282,000	12,590,000	12,274,000

See accompanying notes

Water Pik Technologies, Inc.

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
Operating activities:		
Net income	$ 2,937	$ 2,010
Loss (income) from discontinued product line	(5)	47
Income from continuing operations	2,932	2,057
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,924	4,818
Deferred income taxes	(366)	662
Tax benefit from exercise of stock option	547	
Compensation expense arising from stock awards	417	362
Interest income from stockholders note	(64)	(223)
Change in operating assets and liabilities, net of effects of business acquisitions:		
Accounts receivable	23,992	27,379
Inventories	2,686	(4,199)
Accounts payable	(1,689)	(3,326)
Accrued liabilities	(3,257)	(10,633)
Accrued income taxes	(793)	(51)
Other assets and liabilities	989	(940)
Cash provided by operating activities	30,318	15,906
Investing activities:		
Purchase of business	(10,128)	(7,703)
Purchase of property, plant and equipment	(2,234)	(2,569)
Disposals of property, plant and equipment	27	32
Cash used in investing activities	(12,335)	(10,240)
Financing activities:		
Net borrowings under revolving credit facilities	(15,862)	(3,884)
Payments on promissory notes	(1,905)	(1,912)
Proceeds from exercise of options	2,120	56
Cash used in financing activities	(15,647)	(5,740)
Effect of exchange rate changes on cash	(39)	(58)
Cash provided by (used in) discontinued operations	5	(47)
Increase (decrease) in cash	2,302	(179)
Cash at beginning of period	970	1,038
Cash at end of period	$ 3,272	$ 859

See accompanying notes

Water Pik Technologies, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

DESCRIPTION OF BUSINESS

Water Pik Technologies, Inc. (Water Pik Technologies or the Company) is a leader in designing, manufacturing and marketing a broad range of well-recognized personal health care products and pool products and water-heating systems. The Company s products include: showerheads; consumer and professional oral health products; water filtration products; personal stress relief products; swimming pool and spa heaters, heat pumps, electronic controls, valves, pumps, filters, automatic salt chlorine generators and water features; and residential and commercial water-heating systems. Water Pik Technologies operates in two business segments the Personal Health Care segment and the Pool Products and Heating Systems segment.

In July 2004, the Company announced a decision to pursue an orderly exit of its Personal Stress Relief products line, a category of the Personal Health Care segment. The Personal Stress Relief product line, introduced in 2002, includes foot spas and personal massagers. The decision is intended to focus the Company s product development, marketing and selling resources on its core personal health care product lines toward the goal of improving its operating margin and return on capital.

In December 2002, the Company formalized a plan to dispose of its Ozone product line, a component of the Personal Health Care segment. The Ozone product line includes the Aquia® home sanitizing product introduced in September 2001. The operating results of the discontinued product line have been reported separately as discontinued operations in the consolidated statements of operations and the assets and liabilities have been reclassified to other assets and other liabilities in the consolidated balance sheets for all periods presented.

FISCAL YEAR

The Company operates on a 52- or 53- week fiscal year ending on the Sunday nearest to its fiscal year-end with fiscal quarters ending on the Sunday nearest to the end of the applicable thirteen-week period. In January 2004, the Company changed its fiscal year-end from December to September. To accommodate the transition, the Company will report its results for the nine-month period ending on the Sunday nearest to September 30, 2004 on Form 10-K, with full twelve-month fiscal year reporting beginning with fiscal year 2005 and thereafter. The fiscal quarter and year-to-date periods identified in the Company s consolidated financial statements are identified as of the last day of the calendar quarter for convenience.

UNAUDITED INTERIM FINANCIAL INFORMATION

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Certain amounts reported in previous years have been reclassified to conform to the 2004 presentation. These reclassifications had no effect on reported results of operations or stockholders equity. These financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2003. Operating results for the interim periods presented are not necessarily indicative of the results to be expected for the nine-month transition period ending September 30, 2004.

2. Inventories

Inventories are stated at the lower of cost (last-in, first-out (LIFO) and first-in, first-out (FIFO) cost methods) or market. Inventories consist of the following:

		June 30, 2004		December 31, 2003
		(In thousands)		
Raw materials and supplies	$	18,697	$	19,860
Work-in-process		3,641		4,418
Finished goods		21,910		21,446
Total inventories at current cost		44,248		45,724
Less: Allowances to reduce current cost values to LIFO basis		(4,116)		(3,952)
Total inventories	$	40,132	$	41,772

Inventories determined using the LIFO cost method were $33,678,000 at June 30, 2004 and $34,922,000 at December 31, 2003, net of the respective LIFO reserves. The remainder of inventory was determined using the FIFO cost method.

3. Acquisitions

On January 20, 2004, as part of its strategic objective to accelerate sales and profit growth in its pool business through development of a more comprehensive package of pool equipment and accessories, the Company acquired substantially all of the assets of Huron Tech Systems, a Jacksonville, Florida manufacturer of salt chlorine generators, used for swimming pool and spa water sanitation, and titanium heat exchangers, a component used in premium heat pumps. The estimated purchase price at June 30, 2004 totaled $10,128,000 (consisting of $10,000,000 in cash and $128,000 in direct acquisition costs). The preliminary allocation of the purchase price resulted in $8,884,000 in goodwill, $100,000 in identifiable intangible assets with estimated three-to five-year lives, $1,494,000 of current assets (primarily accounts receivable and inventory), $120,000 in property, plant and equipment and $470,000 in assumed liabilities. The goodwill was assigned to the Pool Product and Heating Systems segment and is expected to be deductible for tax purposes. In connection with the acquisition, the Company entered into two component supply agreements with the durations of one and five years, respectively, with Finnchem USA, Inc. The results of operations of Huron Tech Systems are included in the Company s consolidated results of operations beginning January 20, 2004.

On June 2, 2003, as part of its strategic objective to accelerate sales and profit growth in its pool business through development of a more comprehensive package of pool equipment and accessories, the Company acquired substantially all of the assets of Air Energy Heat Pumps, Inc. and affiliates (Air Energy), a Ft. Lauderdale, Florida manufacturer of premium branded heat pumps for swimming pools and spas. On January 22, 2004, the Company executed an amendment to the asset purchase agreement that revised the additional contingent future payments resulting in a $278,000 reduction of the purchase price and goodwill. The final purchase price totaled $8,438,000 (including direct acquisition costs) with payment consisting of $7,703,000 in cash. The final purchase price as of June 30, 2004 has been adjusted to reflect additional information regarding assets acquired, liabilities assumed and estimated contingent payments. The allocation of the purchase price to acquired net assets resulted in $7,188,000 in goodwill, $110,000 in identifiable intangible assets with estimated three-year lives, $2,797,000 of current assets (primarily accounts receivable and inventory), $819,000 in property, plant and equipment and $2,476,000 in assumed liabilities. The goodwill was assigned to the Pool Product and Heating Systems segment and is expected to be deductible for tax purposes. The results of operations of Air Energy are included in the Company s consolidated results of operations beginning June 2, 2003.

4. Long-Term Debt

Long-term debt is comprised of the following:

	June 30, 2004	December 31, 2003
	(In thousands)	
Revolving credit facility	$ 1,435	$ 17,297
Mortgage notes payable	18,394	18,806
Promissory notes payable equipment financing facility	8,809	10,288
Other	63	77
	28,701	46,468
Less: Current portion	(3,874)	(3,879)
Long-term debt	$ 24,827	$ 42,589

The Company utilizes interest rate swap agreements as cash flow hedges to lock in the interest rate on borrowings and therefore achieve a desired proportion of variable versus fixed-rate debt. At June 30, 2004 and December 31, 2003, the Company had outstanding two interest rate swap agreements related to borrowings under the equipment financing facility with aggregate notional amounts of $5,660,000 and $6,689,000, respectively, expiring on January 1, 2007. The changes in their fair values resulted in gains of $119,000 and $133,000 for the three months and six months ended June 30, 2004, respectively, and a loss of $5,000 and a gain of $15,000 for the three months and six months ended in June 30, 2003, respectively, which have been recognized in accumulated comprehensive loss within stockholders equity. The counterparty to these interest rate swap agreements is a major financial institution. The Company continually monitors the credit quality of the financial institution and anticipates full performance by the counterparty.

The revolving credit facility and the Company s real estate loan agreement and related mortgage notes require the Company to be in compliance with specific financial and non-financial covenants and restrictions relating to indebtedness, liens, investments, dividends, fixed charge coverage, capital expenditures and the relationship of our total consolidated indebtedness to EBITDA. The Company was in compliance with these covenants at June 30, 2004.

5. Stock Compensation Plans

In the quarter ended June 2004, pursuant to the Stock Acquisition and Retention Program (SARP) under the Company s Employee Stock Purchase Plan, certain officers of the Company tendered back to the Company a total of 182,410 shares of the Company s Common Stock, which they had originally purchased pursuant to the SARP, as repayment of principal and accrued interest on notes owed by the officers to the Company totaling $2,829,000.

During the quarter ended March 2004, certain officers of the Company tendered back to the Company a total of 180,451 shares of the Company s Common Stock, which they had originally purchased pursuant to the SARP, as repayment of principal and accrued interest on notes owed by the officers to the Company totaling $2,302,000.

Pursuant to the terms of the SARP, the tendered shares were valued at the average of the high and low market price on the day preceding the date the shares were tendered to the Company. The terms of the SARP permit repayment of the loans and interest using shares of Common Stock originally purchased under the SARP**.**

As a result of the transactions in March and April 2004, the number of outstanding shares of the Company s Common Stock was reduced by 362,861. As of June 30, 2004, there were no outstanding loans by the Company to any officers or directors of the Company.

6. Stock Option Fair Value Disclosure

The Company has adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, but applies Accounting Principles Board (APB) No. 25 and related interpretations in accounting for its plans. If the Company had elected to recognize compensation cost for its stock option plans based on the fair value at the grant dates, consistent with the method prescribed by SFAS No. 123, net income and net income per common share would have been as follows:

	Three Months Ended June 30, 2004	Three Months Ended June 30, 2003	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
	(In thousands, except per share amounts)			
Net income, as reported	$ 3,786	$ 3,847	$ 2,937	$ 2,010
Stock based compensation expense included in reported net income, net of tax	132	113	264	230
Total stock-based compensation expense determined under the fair value based method for all awards, net of tax	(374)	(341)	(635)	(693)
Pro forma net income	$ 3,544	$ 3,619	$ 2,566	$ 1,547
Basic net income per common share as reported	$ 0.32	$ 0.32	$ 0.25	$ 0.17
Basic net income per common share pro forma	$ 0.30	$ 0.30	$ 0.22	$ 0.13
Diluted net income per common share as reported	$ 0.30	$ 0.31	$ 0.23	$ 0.16
Diluted net income per common share pro forma	$ 0.28	$ 0.29	$ 0.20	$ 0.13

For purposes of pro forma disclosure, the estimated fair value of the options is amortized ratably over the options vesting period. The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model. During the quarter ended June 30, 2004, the Company granted 241,000 stock options. The following weighted average assumptions were used for grants in 2004: an expected dividend yield of zero percent, an average expected life of the options of 6 years, an expected volatility of 40.2 percent and a risk-free interest rate of 3.8 percent. The weighted-average fair value of options granted during 2004 was $6.62. There were no options granted during the three months and six months ended June 30, 2003.

7. Comprehensive Income

The components of comprehensive income were as follows:

	Three Months Ended June 30, 2004	Three Months Ended June 30, 2003	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
	(In thousands)			
Net income	$ 3,786	$ 3,847	$ 2,937	$ 2,010

Foreign currency translation gains (losses)		(486)		1,462		(987)		2,211
Change in fair value of cash flow hedge		119		(5)		133		15
Comprehensive income	$	3,419	$	5,304	$	2,083	$	4,236

8. Income Taxes

The provision for income taxes for the 2004 and 2003 interim periods was computed in accordance with FASB Interpretation No. 18, Accounting for Income Taxes in Interim Periods, and was based on projections of total year pretax income in accordance with SFAS No. 109, Accounting for Income Taxes. The effective income tax rate attributable to continuing operations was 36.4 percent and 36.7 percent for the three months and six months ended June 30, 2004, respectively, compared to 36.5 percent and 36.4 percent for the three months and six months ended June 30, 2003, respectively.

9. Commitments and Contingencies

WARRANTIES

The Company provides for the estimated cost of product warranties at the time revenue is recognized. The Company generally warrants its products for a period ranging from one to five years. Factors considered in determining appropriate accruals for product warranty obligations include size of the installed base of products subject to warranty protection, historical warranty claim rates, historical cost-per claim, and knowledge of specific product failures that are outside the Company s typical experience. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future expectations.

Information on changes in the Company s accrued warranties and related costs are as follows:

	Six Months Ended June 30, 2004		Six Months Ended June 30, 2003	
	(In thousands)			
Beginning warranty reserves	$	5,909	$	4,820
Cost of warranty claims		(5,523)		(3,815)
Product warranties acquired		922		134
Accruals for product warranties		5,514		3,952
Ending warranty reserves	$	6,822	$	5,091

INSURANCE RESERVES AND LEGAL CONTINGENCIES

A number of lawsuits, claims and proceedings have been or may be asserted against the Company relating to the conduct of its business, including those pertaining to product liability, personal injury, patent infringement, commercial, employment and employee benefits. While the outcome of litigation cannot be predicted with certainty and some of these lawsuits, claims or proceedings may be determined adversely to the Company, management does not believe that the disposition of any such pending matters is likely to have a material adverse effect on the Company s financial condition or liquidity, although the resolution in any reporting period of one or more of these matters could have a material adverse effect on the Company s results of operations for that period and ultimately could affect the Company s insurance premiums or its ability to obtain insurance coverage.

As a consumer goods manufacturer and distributor, the Company is subject to continuing risk of product liability and related lawsuits involving claims for substantial monetary damages. The Company is party to various personal injury and property damage lawsuits and claims relating to its products and other litigation incidental to its business. The Company has general liability, product liability and workers compensation insurance coverage. The Company s insurance coverage provides that the Company is responsible for policy deductibles and legal costs and expenses. Loss accruals have been recorded in accordance with SFAS No. 5, Accounting for Contingencies to cover the portion of general liability, product liability and workers compensation claims, both asserted claims and incurred but not reported claims, that are not covered by insurance policies. Such accruals are based on estimates which include information provided by the Company s insurance company, claims adjusters and insurance broker, taking into account prior experience, numbers of claims, discussions with legal counsel and other relevant factors. The methods of making such estimates and establishing the resulting accrual are reviewed on a regular basis and any adjustments are reflected in current operating results.

Effective January 1, 2004, the Company changed its employee medical coverage from a fully insured plan to a self-insured plan. The plan is partially funded by payroll deductions from participating employees. The Company has a maximum liability per participant per year in addition to an aggregate maximum liability for all claims. Amounts in excess of the stated maximums are covered under a separate policy provided by an insurance company. The Company provides for both reported and incurred but not reported medical costs and pays claims and administrative expenses as they become due.

The Company has recorded loss accruals covering the portion of lawsuits and claims not covered by insurance policies of $4,406,000 and $3,702,000 as of June 30, 2004 and December 31, 2003, respectively. The amount related to product and general liability lawsuits, asserted claims and incurred but not reported claims was $2,004,000 and $2,382,000 as of June 30, 2004 and December 31, 2003, respectively. The amount related to workers compensation asserted claims and incurred but not reported claims was $1,323,000 and $1,320,000 as of June 30, 2004 and December 31, 2003, respectively. The amount related to medical and dental self-insured reserves including the asserted claims and incurred but not reported claims was $1,079,000 as of June 30, 2004.

10. Net Income Per Common Share

Basic net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share is calculated by dividing net income by the sum of the weighted average number of common shares outstanding plus the dilutive effect of unvested restricted shares and outstanding stock options using the treasury stock method.

Three Months Ended
June 30,