

CTS CORP
Form 10-Q
July 26, 2011

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

(Mark One)

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

For the Quarterly Period Ended July 3, 2011

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: 1-4639

CTS CORPORATION

(Exact name of registrant as specified in its charter)

Indiana

35-0225010

(State or other jurisdiction of
incorporation or organization)

(IRS Employer
Identification Number)

905 West Boulevard North, Elkhart, IN

46514

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: 574-523-3800

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if smaller
reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of July 22, 2011:
34,420,834.

CTS CORPORATION AND SUBSIDIARIES
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PART I FINANCIAL INFORMATION**Item 1. Financial Statements**

CTS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS **UNAUDITED**
(In thousands, except per share amounts)

| | Three Months Ended | | Six Months Ended | |
|--|---------------------------|-------------------------|-------------------------|-------------------------|
| | July 3, 2011 | July 4, 2010 | July 3, 2011 | July 4, 2010 |
| Net sales | \$ 146,919 | \$ 138,851 | \$ 298,437 | \$ 268,254 |
| Costs and expenses: | | | | |
| Cost of goods sold | 119,051 | 108,511 | 241,409 | 207,435 |
| Selling, general and administrative expenses | 18,057 | 18,283 | 36,429 | 37,832 |
| Research and development expenses | 4,590 | 4,316 | 9,619 | 8,899 |
| Restructuring charge Note M | 694 | | 694 | |
| Operating earnings | 4,527 | 7,741 | 10,286 | 14,088 |
| Other (expense)/income: | | | | |
| Interest expense | (511) | (228) | (1,003) | (463) |
| Interest income | 276 | 81 | 472 | 134 |
| Other | 743 | (337) | 1,873 | (821) |
| Total other income/(expense) | 508 | (484) | 1,342 | (1,150) |
| Earnings before income taxes | 5,035 | 7,257 | 11,628 | 12,938 |
| Income tax expense | 903 | 1,365 | 2,380 | 2,615 |
| Net earnings | \$ 4,132 | \$ 5,892 | \$ 9,248 | \$ 10,323 |
| Net earnings per share Note J | | | | |
| Basic | \$ 0.12 | \$ 0.17 | \$ 0.27 | \$ 0.30 |
| Diluted | \$ 0.12 | \$ 0.17 | \$ 0.26 | \$ 0.30 |
| Cash dividends declared per share | \$ 0.03 | \$ 0.03 | \$ 0.06 | \$ 0.06 |
| Average common shares outstanding: | | | | |
| Basic | 34,375 | 34,048 | 34,334 | 34,001 |
| Diluted | 35,025 | 34,874 | 35,050 | 34,811 |

See notes to unaudited condensed consolidated financial statements.

CTS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS **UNAUDITED**
(In thousands of dollars)

| | July 3, 2011 | December 31, 2010 |
|--|-------------------------|----------------------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 75,056 | \$ 73,315 |
| Accounts receivable, less allowances (2011 - \$1,253; 2010- \$1,269) | 87,792 | 95,930 |
| Inventories, net Note D | 88,602 | 76,885 |
| Other current assets | 23,903 | 20,525 |
| Total current assets | 275,353 | 266,655 |
| Property, plant and equipment, less accumulated depreciation (2011 - \$242,471; 2010 - \$244,662) | 79,211 | 78,213 |
| Other Assets | | |
| Prepaid pension asset | 48,377 | 44,075 |
| Goodwill Note L | 500 | 500 |
| Other intangible assets, net Note L | 31,227 | 31,432 |
| Deferred income taxes | 59,050 | 59,956 |
| Other | 1,705 | 1,753 |
| Total other assets | 140,859 | 137,716 |
| Total Assets | \$ 495,423 | \$ 482,584 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Notes payable | \$ 246 | \$ 75,384 |
| Accounts payable | 77,087 | 44,716 |
| Accrued liabilities | 40,718 | 120,100 |
| Total current liabilities | 118,051 | 70,000 |
| Long-term debt Note E | 74,500 | 18,234 |
| Other long-term obligations | 17,129 | |
| Shareholders' Equity | | |
| Preferred stock authorized 25,000,000 shares without par value; none issued | | |
| Common stock authorized 75,000,000 shares without par value; 54,788,197 shares issued at July 3, 2011 and 54,517,560 shares issued at December 31, 2010 | 287,635 | 285,515 |
| Additional contributed capital | 37,808 | 37,775 |
| Retained earnings | 342,709 | 335,524 |
| Accumulated other comprehensive loss | (85,074) | (87,555) |
| | 583,078 | 571,259 |
| | (297,335) | (297,009) |

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Cost of common stock held in treasury Note K (2011 20,356,259 and 2010
20,320,759 shares)

| | | |
|--|-------------------|-------------------|
| Total shareholders equity | 285,743 | 274,250 |
| Total Liabilities and Shareholders Equity | \$ 495,423 | \$ 482,584 |

See notes to unaudited condensed consolidated financial statements.

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CTS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS **UNAUDITED**
(In thousands of dollars)

| | Six Months Ended | |
|---|-------------------------|-------------------------|
| | July 3, 2011 | July 4, 2010 |
| Cash flows from operating activities: | | |
| Net earnings | \$ 9,248 | 10,323 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 8,766 | 8,832 |
| Prepaid pension asset | (4,302) | (3,905) |
| Equity-based compensation Note B | 2,361 | 2,167 |
| Restructuring charge Note M | 694 | |
| Amortization of retirement benefit adjustments Note F | 2,542 | 2,500 |
| Other | (1,481) | (538) |
| Changes in assets and liabilities, net of acquisitions | | |
| Accounts receivable | 10,188 | (13,770) |
| Inventories | (10,633) | (14,675) |
| Other current assets | (1,369) | (1,683) |
| Accounts payable and accrued liabilities | (7,174) | 17,095 |
| Total adjustments | (408) | (3,977) |
| Net cash provided by operating activities | 8,840 | 6,346 |
| Cash flows from investing activities: | | |
| Payment for acquisition, net of cash acquired | (2,930) | |
| Earnout payment related to a 2008 acquisition | | (500) |
| Capital expenditures | (6,526) | (6,207) |
| Proceeds from sales of assets | | 960 |
| Net cash used in investing activities | (9,456) | (5,747) |
| Cash flows from financing activities: | | |
| Payments of long-term debt Note E | (1,989,500) | (1,565,150) |
| Proceeds from borrowings of long-term debt Note E | 1,994,000 | 1,580,650 |
| Payments of short-term notes payable | (2,203) | (1,631) |
| Proceeds from borrowings of short-term notes payable | 2,449 | 1,631 |
| Purchase of treasury stock | (326) | |
| Dividends paid | (2,056) | (2,038) |
| Exercise of stock options | 472 | 92 |
| Other | 204 | (24) |
| Net cash provided by financing activities | 3,040 | 13,530 |
| Effect of exchange rate on cash and cash equivalents | (683) | (62) |

| | | |
|--|------------------|------------------|
| Net increase in cash and cash equivalents | 1,741 | 14,067 |
| Cash and cash equivalents at beginning of year | 73,315 | 51,167 |
| Cash and cash equivalents at end of period | \$ 75,056 | \$ 65,234 |

Supplemental cash flow information

Cash paid during the period for:

| | | |
|------------------|-----------------|-----------------|
| Interest | \$ 885 | \$ 398 |
| Income taxes net | \$ 2,060 | \$ 2,303 |

See notes to unaudited condensed consolidated financial statements.

CTS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS UNAUDITED
(In thousands of dollars)

| | Three Months Ended | | Six Months Ended | |
|---|---------------------------|-------------------------|-------------------------|-------------------------|
| | July 3, 2011 | July 4, 2010 | July 3, 2011 | July 4, 2010 |
| Net earnings | \$ 4,132 | \$ 5,892 | \$ 9,248 | \$ 10,323 |
| Other comprehensive earnings/(loss): | | | | |
| Cumulative translation adjustment | 7 | (203) | 995 | (1,636) |
| Amortization of retirement benefit adjustments (net of tax) | 750 | 687 | 1,486 | 1,416 |
| Comprehensive earnings | \$ 4,889 | \$ 6,376 | \$ 11,729 | \$ 10,103 |

See notes to unaudited condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED
July 3, 2011

NOTE A Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared by CTS Corporation (CTS or the Company) without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The unaudited condensed consolidated financial statements should be read in conjunction with the financial statements, notes thereto, and other information included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

The accompanying unaudited condensed consolidated financial statements reflect, in the opinion of management, all adjustments (consisting of normal recurring items) necessary for a fair statement, in all material respects, of the financial position and results of operations for the periods presented. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ materially from those estimates. The results of operations for the interim periods are not necessarily indicative of the results for the entire year.

NOTE B Equity-Based Compensation

At July 3, 2011, CTS had five equity-based compensation plans: the 1996 Stock Option Plan (1996 Plan), the 2001 Stock Option Plan (2001 Plan), the Nonemployee Directors Stock Retirement Plan (Directors Plan), the 2004 Omnibus Long-Term Incentive Plan (2004 Plan), and the 2009 Omnibus Equity and Performance Incentive Plan (2009 Plan). All of these plans, except the Directors Plan, were approved by shareholders. As of December 31, 2009, additional grants can only be made under the 2004 and 2009 Plans. CTS believes that equity-based awards align the interest of employees with those of its shareholders.

The 2009 Plan, and previously the 1996 Plan, 2001 Plan and 2004 Plan, provides for grants of incentive stock options or nonqualified stock options to officers, key employees, and nonemployee members of CTS board of directors. In addition, the 2009 Plan and the 2004 Plan allows for grants of stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units, and other stock awards.

The following table summarizes the compensation expense included in the Unaudited Condensed Consolidated Statements of Earnings for the three and six months ended July 3, 2011 and July 4, 2010 relating to these plans:

| | Three Months Ended | | Six Months Ended | |
|--------------------------|---------------------------|-------------------------|-------------------------|-------------------------|
| | July 3, 2011 | July 4, 2010 | July 3, 2011 | July 4, 2010 |
| <i>(\$ in thousands)</i> | | | | |
| Stock options | \$ | \$ 1 | \$ | \$ 3 |
| Restricted stock units | 1,181 | 905 | 2,361 | 2,164 |
| Total | \$ 1,181 | \$ 906 | \$ 2,361 | \$ 2,167 |

The following table summarizes the status of these plans as of July 3, 2011:

| | 2009 Plan | 2004 Plan | 2001 Plan | 1996 Plan |
|------------------------------------|------------------|------------------|------------------|------------------|
| Awards originally available | 3,400,000 | 6,500,000 | 2,000,000 | 1,200,000 |
| Stock options outstanding | | 257,200 | 505,500 | 75,350 |
| Restricted stock units outstanding | 543,459 | 146,195 | | |
| Options exercisable | | 257,200 | 505,500 | 75,350 |
| Awards available for grant | 2,512,140 | 268,500 | | |

Stock Options

Stock options are exercisable in cumulative annual installments over a maximum 10-year period, commencing at least one year from the date of grant. Stock options are generally granted with an exercise price equal to the market price of the Company's stock on the date of grant. The stock options generally vest over four years and have a 10-year contractual life. The awards generally contain provisions to either accelerate vesting or allow vesting to continue on schedule upon retirement if certain service and age requirements are met. The awards also provide for accelerated vesting if there is a change in control event.

The Company estimated the fair value of the stock option on the grant date using the Black-Scholes option-pricing model and assumptions for expected price volatility, option term, risk-free interest rate, and dividend yield. Expected price volatilities were based on historical volatilities of the Company's stock. The expected option term is derived from historical data on exercise behavior. The dividend yield was based on historical dividend payments. The risk-free rate for periods within the contractual life of the option was based on the U.S. Treasury yield curve in effect at the time of grant.

A summary of the status of stock options as of July 3, 2011 and July 4, 2010, and changes during the six-month periods then ended, is presented below:

| | July 3, 2011 | | July 4, 2010 | |
|----------------------------------|--------------|---------------------------------|--------------|---------------------------------|
| | Options | Weighted-Average Exercise Price | Options | Weighted-Average Exercise Price |
| Outstanding at beginning of year | 1,093,063 | \$ 12.61 | 1,179,088 | \$ 13.72 |
| Exercised | (59,263) | \$ 7.91 | (17,000) | \$ 7.70 |
| Expired | (195,750) | \$ 21.99 | (43,375) | \$ 44.79 |
| Outstanding at end of period | 838,050 | \$ 10.75 | 1,118,713 | \$ 12.61 |
| Exercisable at end of period | 838,050 | \$ 10.75 | 1,118,713 | \$ 12.61 |

The total intrinsic value of share options exercised during the six-month periods ended July 3, 2011 and July 4, 2010 were \$209,000 and \$30,000, respectively. The weighted average remaining contractual life of options outstanding and options exercisable at July 3, 2011 and July 4, 2010 were 2.2 years and 2.8 years, respectively. The aggregate intrinsic value of options outstanding and options exercisable at July 3, 2011 and July 4, 2010 were approximately \$378,000 and \$341,000, respectively. There were no unvested stock options at July 3, 2011.

The following table summarizes information about stock options outstanding at July 3, 2011:

| Range of Exercise Prices | Number Outstanding at 7/3/11 | Options Outstanding | | Options Exercisable | |
|--------------------------|------------------------------|------------------------------------|---------------------------------|------------------------------|---------------------------------|
| | | Remaining Contractual Life (Years) | Weighted Average Exercise Price | Number Exercisable at 7/3/11 | Weighted Average Exercise Price |
| \$7.70 - 11.11 | 616,250 | 2.22 | \$ 9.53 | 616,250 | \$ 9.53 |
| \$13.68 - 16.24 | 221,800 | 2.16 | \$ 14.13 | 221,800 | \$ 14.13 |

Service-Based Restricted Stock Units

Service-based restricted stock units (RSUs) entitle the holder to receive one share of common stock for each unit when the unit vests. RSUs are issued to officers and key employees as compensation. Generally, the RSUs vest over a three to five-year period. A summary of the status of RSUs as of July 3, 2011 and July 4, 2010, and changes during the six-month periods then ended is presented below:

July 3, 2011

July 4, 2010

| | RSUs | Weighted-average Grant-Date Fair Value | RSUs | Weighted-average Grant-Date Fair Value |
|---|------------------|---|-------------|---|
| Outstanding at beginning of year | 807,601 | \$ 8.39 | 854,745 | \$ 8.47 |
| Granted | 219,100 | \$ 11.89 | 271,500 | \$ 7.52 |
| Converted | (297,104) | \$ 8.52 | (280,495) | \$ 8.97 |
| Forfeited | (39,943) | \$ 8.89 | (13,920) | \$ 6.62 |
| Outstanding at end of period | 689,654 | \$ 9.42 | 831,830 | \$ 8.34 |
| Weighted-average remaining contractual life | 6.7 years | | 5.32 years | |

CTS recorded compensation expense of approximately \$691,000 and \$1,412,000 related to service-based restricted stock units during the three and six month periods ended July 3, 2011, respectively. CTS recorded compensation expense of approximately \$657,000 and \$1,544,000 related to service-based restricted stock units during the three and six month periods ended July 4, 2010, respectively.

As of July 3, 2011, there was \$2.6 million of unrecognized compensation cost related to nonvested RSUs. That cost is expected to be recognized over a weighted-average period of 1.2 years. CTS recognizes expense on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards.

Performance-Based Restricted Stock Units

On February 6, 2007, CTS granted performance-based restricted stock unit awards for certain executives. Executives received a total of 17,100 units based on achievement of year-over-year sales growth and free cash flow performance goals for fiscal year 2007. These units cliff vested and converted one-for-one to CTS common stock on December 31, 2010.

On February 2, 2010, CTS granted performance-based restricted stock unit awards for certain executives. Vesting may occur in the range from zero percent to 200% of the target amount of 78,000 units in 2012 subject to certification of the 2011 fiscal year results by CTS independent auditors. Vesting is dependent upon CTS achievement of sales growth targets.

On February 3, 2011, CTS granted performance-based restricted stock unit awards for certain executives. Vesting may occur in the range from zero percent to 200% of the target amount of 53,200 units in 2013 subject to certification of the 2012 fiscal year results by CTS independent auditors. Vesting is dependent upon CTS achievement of sales growth targets.

CTS recorded compensation expense of approximately \$177,000 and \$343,000 related to performance-based restricted stock units during the three and six month periods ended July 3, 2011, respectively. CTS recorded compensation expense of approximately \$74,000 and \$177,000 related to performance-based restricted stock units during the three and six month periods ended July 4, 2010, respectively. As of July 3, 2011 there was approximately \$748,000 of unrecognized compensation cost related to performance-based RSUs. That cost is expected to be recognized over a weighted-average period of 1.0 year.

Market-Based Restricted Stock Units

On July 2, 2007, CTS granted a market-based restricted stock unit award for an executive officer. An aggregate of 25,000 units may be earned in performance years ending in the following three consecutive years on the anniversary of the award date. Vesting may occur in the range from zero percent to 150% of the target award on the end date of each performance period and is tied exclusively to CTS total stockholder return relative to 32 enumerated peer group companies total stockholder return rates. The vesting rate will be determined using a matrix based on a percentile ranking of CTS total stockholder return with peer group total shareholder return over a three-year period. During the year ended December 31, 2010, 12,500 units were earned and awarded to the executive officer.

On February 4, 2009, CTS granted market-based restricted stock unit awards for certain executives and key employees. Vesting may occur in the range from zero percent to 200% of the target amount of 128,000 units in 2011. Vesting is dependent upon CTS total stockholder return relative to 28 enumerated peer group companies stockholder return rates. No awards were vested as the vesting criterion was not met.

On February 2, 2010, CTS granted market-based restricted stock unit awards for certain executives and key employees. Vesting may occur in the range from zero percent to 200% of the target amount of 117,000 units in 2012. Vesting is dependent upon CTS total stockholder return relative to 28 enumerated peer group companies stockholder return rates.

On February 3, 2011, CTS granted market-based restricted stock unit awards for certain executives and key employees. Vesting may occur in the range from zero percent to 200% of the target amount of 79,800 units in 2013. Vesting is dependent upon CTS total stockholder return relative to 28 enumerated peer group companies stockholder return rates.

CTS recorded compensation expense of approximately \$313,000 and \$606,000 related to market-based restricted stock units during the three and six month periods ended July 3, 2011, respectively. CTS recorded compensation

expense of approximately \$173,000 and \$441,000 related to market-based restricted stock units during the three and six month periods ended July 4, 2010, respectively. As of July 3, 2011, there was approximately \$1.3 million of unrecognized compensation cost related to market-based RSUs. That cost is expected to be recognized over a weighted-average period of 1.0 year.

Stock Retirement Plan

The Directors Plan provides for a portion of the total compensation payable to nonemployee directors to be deferred and paid in CTS stock. The Directors Plan was frozen effective December 1, 2004. All future grants will be from the 2009 Plan.

NOTE C Acquisition

In January 2011, CTS acquired certain assets and assumed certain liabilities of Fordahl SA, a privately held company located in Brugg, Switzerland. This business was acquired for approximately \$2.9 million, net of cash acquired. The assets acquired include inventory, accounts receivables, leasehold improvements, machinery and equipment, and certain intangible assets.

The Fordahl SA product line includes high-performance temperature compensated crystal oscillators and voltage controlled crystal oscillators. This product line is expected to expand CTS frequency product portfolio from clock and crystals to highly-engineered precision ovenized oscillators. This acquisition is expected to add new customers and to open up new market opportunities for CTS.

The following table summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition:

| | Estimated Fair Values At January 24, 2011 |
|--------------------------|--|
| <i>(\$ in thousands)</i> | |
| Current assets | \$ 2,293 |