DELPHI AUTOMOTIVE SYSTEMS CORP
Form 10-Q
October 16, 2001

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549-1004

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 September 30, 2001

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ___________ to ___________ .

Commission file No. 1-14787

DELPHI AUTOMOTIVE SYSTEMS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
38-3430473 (State or other jurisdiction of incorporation or organization) (IRS employer identification number)
5725 Delphi Drive, Troy, Michigan
48098 (Address of principal executive offices) (Zip code)

(248) 813-2000

(Registrant s telephone number, including area code)

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

As of September 30, 2001, there were 560,234,058 outstanding shares of the registrant s $0.01 par value common stock.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DELPHI AUTOMOTIVE SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	**2000**	**2001**	**2000**
	(in millions, except per share amounts)			

Net sales:

General Motors and affiliates
$4,238 $4,682 $13,328 $15,844
Other customers
1,991 1,966 6,380 6,386

Total net sales
6,229 6,648 19,708 22,230

Less operating expenses:

Cost of sales, excluding items listed below
5,540 5,773 17,465 18,825
Selling, general and administrative
348 420 1,089 1,289
Depreciation and amortization
260 225 831 686
Restructuring (Note 2)
536
Acquisition-related in-process research and development (Note 3)
51

Total operating expenses	6,148	6,418	19,921	20,851
Operating income (loss)	81	230	(213)	1,379
Less interest expense	57	42	169	127
Other income, net	17	48	23	116
Income (loss) before income taxes	41	236	(359)	1,368
Income tax expense (benefit)	15	88	(120)	506
Net income (loss)	$26	$148	$(239)	$862
Earnings (loss) per share (Note 1)				
Basic	$0.05	$0.26	$(0.43)	$1.54

Diluted	$0.05	$0.26	$(0.43)	$1.53

See notes to consolidated financial statements.

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DELPHI AUTOMOTIVE SYSTEMS CORPORATION

CONSOLIDATED BALANCE SHEETS

	September 30, 2001 (Unaudited)	December 31, 2000
	(in millions)	
ASSETS		
Current assets:		
Cash and cash equivalents	$758	$760
Accounts receivable, net:		
General Motors and affiliates	3,525	3,308
Other customers	1,851	2,050
Inventories, net (Note 4)	1,803	1,707
Deferred income taxes	635	569
Prepaid expenses and other	166	209
Total current assets	8,738	8,603
Long-term assets:		
Property, net	5,712	5,718
Deferred income taxes	2,212	2,043
Other	2,271	2,157
Total assets	$18,933	$18,521
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		

Notes payable and current portion of long-term debt	$1,423	$1,559
Accounts payable	3,122	2,871
Restructuring obligations (Note 2)	217	
Accrued liabilities	1,702	1,813
Total current liabilities	6,464	6,243
Long-term liabilities:		
Long-term debt	2,092	1,623
Postretirement benefits other than pensions	4,864	4,573
Other	2,226	2,316
Total liabilities	15,646	14,755
Stockholders equity (Note 7):		
Common stock, $0.01 par value, 1,350 million shares authorized, 565 million shares issued in 2001 and 2000	6	6
Additional paid-in capital	2,450	2,450
Retained earnings	1,513	1,869
Other comprehensive income	(592)	(463)
Treasury stock, at cost (4.8 million and 5.2 million shares in 2001 and 2000, respectively)	(90)	(96)
Total stockholders equity	3,287	3,766

Total liabilities and stockholders equity	$18,933	$18,521

See notes to consolidated financial statements.

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DELPHI AUTOMOTIVE SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Nine Months Ended September 30,	
	2001	**2000**
	(in millions)	
Cash flows from operating activities:		
Net income (loss)	$(239)	$862
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	831	686
Restructuring	536	
Acquisition-related in-process research and development		51
Changes in operating assets and liabilities:		
Accounts receivable, net	38	(140)
Inventories, net	(66)	(130)
Prepaid expenses and other	67	144
Deferred income taxes	(244)	259
Accounts payable	231	(12)
Restructuring obligations	(250)	
Accrued liabilities	(142)	(1,293)
Other long-term liabilities	202	(139)
Other	(80)	(62)
Net cash provided by operating activities	884	226

Cash flows from investing activities:		
Capital expenditures	(734)	(927)
Cost of acquisitions, net of cash acquired	(313)	(897)
Other	(5)	105
Net cash used in investing activities	(1,052)	(1,719)
Cash flows from financing activities:		
Net proceeds from (repayments of) borrowings under credit facilities and other debt	(174)	1,066
Net proceeds from issuance of debt securities	498	
Dividend payments	(117)	(118)
Issuance (purchase) of treasury stock, net	6	(64)
Other		(95)
Net cash provided by financing activities	213	789
Effect of exchange rate fluctuations on cash and cash equivalents	(47)	(115)

Decrease in cash and cash equivalents	(2)	(819)
Cash and cash equivalents at beginning of period	760	1,546
Cash and cash equivalents at end of period	$758	$727

See notes to consolidated financial statements.

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DELPHI AUTOMOTIVE SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. BASIS OF PRESENTATION

General Delphi Automotive Systems Corporation (Delphi) is a world-leading supplier of vehicle electronics, transportation components, integrated systems and modules. The consolidated financial statements and notes thereto included in this report should be read in conjunction with our consolidated financial statements and notes thereto included in our 2000 Annual Report on Form 10-K filed with the Securities and Exchange Commission. The consolidated financial statements include the accounts of Delphi and its wholly-owned and majority-owned subsidiaries.

All significant intercompany transactions and balances between consolidated Delphi businesses have been eliminated. In the opinion of management, all adjustments, consisting of only normal recurring items, which are necessary for a fair presentation have been included. The results for interim periods are not necessarily indicative of results which may be expected from any other interim period or for the full year and may not necessarily reflect the consolidated results of operations, financial position and cash flows of Delphi in the future.

Certain prior period amounts have been reclassified to conform with the current period presentation.

Earnings Per Share Basic earnings per share amounts were computed using weighted average shares outstanding for each respective period. Diluted earnings per share also reflect the weighted average impact from the date of issuance of all potentially dilutive securities, unless inclusion would have had an antidilutive effect. Actual weighted average shares outstanding used in calculating basic and diluted earnings per share were:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
	(in thousands)			
Weighted average shares outstanding	560,180	559,952	559,975	561,368
Effect of dilutive securities	5,581	2,483		2,976
Diluted shares outstanding	565,761	562,435	559,975	564,344

The Board of Directors declared a dividend on Delphi common stock of $0.07 per share on September 5, 2001, which was paid on October 16, 2001, to holders of record on September 17, 2001. The dividend declared on June 27, 2001 was paid on August 6, 2001.

Recently Issued Accounting Pronouncements On July 20, 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations. The statement requires that all future business combinations be accounted for using the purchase method of accounting and that certain acquired intangible assets in a business combination are recognized as assets apart from goodwill. Effective July 1, 2001, we adopted SFAS No. 141, which did not impact our financial position or results of operations.

Also on July 20, 2001, the FASB issued SFAS No. 142, Goodwill and Other Intangible Assets. Among other provisions, goodwill will no longer be amortized but will be subject to impairment tests at least annually. We will adopt SFAS No. 142 effective January 1, 2002. As required by SFAS No. 142, we will cease amortization of purchased goodwill effective January 1, 2002. At September 30, 2001, our unamortized purchased goodwill was approximately $630 million. Application of the non-amortization provisions of SFAS No. 142 would have increased our diluted earnings per share by $0.01 and decreased our loss per share by $0.04, respectively, for the three months and nine months ended September 30, 2001 if such provisions had been adopted at the beginning of the period. As required by SFAS No. 142, during 2002 we will perform the required impairment tests of goodwill and indefinite-lived intangible assets. Until those tests are performed and other transitional issues are finalized, we are unable to estimate the effect that the initial adoption of this statement will have on our financial position or results of operations.

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2. RESTRUCTURING AND IMPAIRMENT CHARGES

In the first quarter of 2001, Delphi approved plans to sell, close or consolidate nine plants, downsize the workforce at more than 40 other facilities and exit selected products by the first quarter of 2002. We also recorded an impairment loss related to certain long-lived assets at impacted sites and certain investments in joint ventures. As a result of these actions, we recorded a total charge of $617 million ($404 million after-tax) in the first quarter of 2001.

The restructuring charge of $536 million included $492 million of employee costs (including postemployment benefits and special termination pension and postretirement benefits) and $44 million in other exit costs (principally lease termination and contract cancellation payments). The plans entail the elimination of approximately 11,500 positions worldwide, comprised of 5,600 U.S. hourly employees, 2,000 U.S. salaried employees, and 3,900 employees in non-U.S. locations. During the first quarter, employees at impacted locations were informed of the restructuring initiatives. We have communicated benefits available to them under applicable benefit plans or related contractual provisions. Affected employees have left or will leave Delphi using a mixture of voluntary and involuntary separation programs, early retirements, social plan programs and layoffs. As of September 30, 2001, approximately 8,500 employees had been separated under the plans including 3,300 U.S hourly employees, 1,900 U.S. salaried employees and 3,300 non-U.S. employees. We expect an additional 1,000 to 1,500 employees to separate during the fourth quarter of 2001, with the remainder during the first quarter of 2002. The employee cost component for the U.S. hourly plans recorded in the first quarter of 2001 included accruals required by SFAS No. 112, Employer s Accounting for Postemployment Benefits. These accruals were based upon certain assumptions regarding the status and seniority of affected individuals, as well as the time frame and the duration of the layoffs prior to final separation. Although our actual experience on a plant-by-plant basis has varied from our original assumptions, our overall estimates regarding the total number of employees impacted and related costs remain appropriate. We continue to work with our unions on specifics regarding our assumptions for the remaining impacted employees. In the event our plant-by-plant results vary in a manner that changes the overall totals or our negotiations with our unions change our assumptions, we will, as required by SFAS No. 112, revise our estimates of impacted employees and related postemployment benefit costs.

Of the $536 million restructuring charge, we expect to pay approximately $450 million in cash; the balance consists primarily of special termination pension and postretirement benefits. During the third quarter of 2001, our restructuring obligations decreased by $109 million. Third quarter payments were $98 million related to employee costs and $10 million related to other exit costs. In the third quarter, non-cash charges were $1 million for special termination pension and postretirement benefits. For the first nine months of 2001, we paid $234 million related to employee costs and $16 million in other exit costs. Non-cash charges were $69 million, with $62 million for special termination pension and postretirement benefits, and the balance for currency translation for the first nine months of 2001.

The carrying value of a long-lived asset is considered impaired when the anticipated separately identifiable undiscounted cash flows from that asset are less than the carrying value of the asset. In the first quarter of 2001, we evaluated the carrying value of the long-lived assets at each site impacted by the restructuring plans for impairment, and recorded impairment losses of $63 million. The impairment losses, primarily related to machinery and equipment held for use in the Safety, Thermal and Electrical Architecture sector, were recorded in depreciation and amortization. The impairment losses were determined based on the amount by which the carrying value exceeded the fair market value of the asset. Fair market value was determined primarily using the anticipated discounted cash flows.

In addition, in the first quarter of 2001, we recorded impairment charges of $18 million related to permanent declines in the value of our investments in certain joint ventures. These charges, included in other income, net, primarily related to certain Korean joint ventures as more fully explained in Note 9.

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3. ACQUISITIONS

Delphi Connection Systems-Specialty Electronics

On June 4, 2001, we purchased Specialty Electronics, Inc., now Delphi Connection Systems-Specialty Electronics, for approximately $22 million. The acquisition was accounted for under the purchase method of accounting. Delphi Connection Systems-Specialty Electronics is a provider of electronic connector products and customized interconnect solutions to the telecommunications, computer, industrial electronics, medical and automotive markets, which complements Delphi s strategic expansion into new markets.

Delphi Mechatronic Systems

On March 30, 2001, Delphi acquired substantially all of the assets and assumed certain liabilities of Eaton Corporation s Vehicle Switch/ Electronics Division, now Delphi Mechatronic Systems, for approximately $0.3 billion. The purchase price is subject to adjustment for certain post-closing events. Delphi Mechatronic Systems is a global producer of electromechanical switches, mechatronic modules and body electronics for the light vehicle industry with 2000 sales of $320 million, primarily in North America. Delphi Mechatronic Systems technology, complemented by our extensive electrical and electronic integration capabilities, will enable us to offer customers new solutions in modular cockpits, doors and overhead systems. The Delphi Mechatronic Systems acquisition supports our goals of enhancing our technology, diversifying our customer base and geographic footprint, and leveraging our system integration capabilities. The acquisition has been accounted for using the purchase method of accounting and therefore the purchase price has been allocated preliminarily to assets acquired and liabilities assumed based on estimated fair values. The results of operations of Delphi Mechatronic Systems are included in our consolidated financial statements from the acquisition date. The $131 million of excess consideration given over the estimated fair value of net assets acquired has been recorded as goodwill and is being amortized over 20 years. We will discontinue the amortization of goodwill on January 1, 2002 when we adopt the provisions of SFAS No. 142, as discussed in Note 1.

The purchase price and related allocations are preliminary and may be revised up to one year from the date of acquisition. Delphi can provide no assurances as to whether any revisions to the preliminary purchase price and related allocations will be material. Adjustments to the purchase price and related preliminary allocations may occur as a result of obtaining more information regarding asset valuations, liabilities assumed, purchase price adjustments pursuant to the purchase agreement, and revisions of preliminary estimates of fair values made at the date of purchase. We are evaluating how the acquired operations will be integrated into our overall business strategy and are in the process of developing a plan for restructuring those operations. It is possible that our integration plan, when finalized, will impact the preliminary purchase price allocations.

Delphi Lockheed Automotive

In February 2000, Delphi purchased Automotive Products Distribution Services, now Delphi Lockheed Automotive, for $63 million. Delphi Lockheed Automotive is a leading European distributor of automotive aftermarket products for passenger cars and commercial vehicles.

Delphi Diesel Systems

In January 2000, Delphi purchased Lucas Diesel Systems, now Delphi Diesel Systems, for $0.8 billion, net of cash acquired. Delphi Diesel Systems is one of the world s largest producers of diesel fuel-injection systems for light, medium and heavy-duty vehicles. In conjunction with the acquisition of Delphi Diesel Systems during the first quarter of 2000, we recognized a one-time, non-cash charge to earnings of $51 million ($32 million after-tax) resulting from acquisition-related in-process research and development that had not reached technological feasibility and had no

alternative use.

The pro forma effects of these acquisitions would not be significantly different from reported results.

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4. INVENTORIES, NET

Inventories, net consisted of:

	September 30, 2001	December 31, 2000
	(in millions)	
Productive material, work-in-process and supplies	$1,786	$1,689
Finished goods	313	314
Total inventories at FIFO	2,099	2,003
Less allowance to adjust the carrying value of certain inventories to LIFO	(296)	(296)
Total inventories, net	$1,803	$1,707

At September 30, 2001, inventories, net include inventories related to Delphi Mechatronic Systems and Delphi Connection Systems-Specialty Electronics of $34 million.

5. DERIVATIVES AND HEDGING ACTIVITIES

Effective January 1, 2001, Delphi adopted SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, which requires that all derivative instruments be reported on the balance sheet at fair value and establishes criteria for designation and effectiveness of transactions entered into for hedging purposes. The cumulative effect of adopting SFAS No. 133 was to increase other comprehensive income (OCI) by $14 million, after-tax. The effect on net income was not significant, primarily because the hedges in place as of January 1, 2001 qualified for hedge accounting treatment and were highly effective.

Delphi is exposed to market risk, such as fluctuations in currency exchange rates, commodity prices and changes in interest rates. To manage the volatility relating to these exposures, we aggregate the exposures on a consolidated basis to take advantage of natural offsets. For exposures that are not offset within our operations, we enter into various derivative transactions pursuant to our risk management policies. Designation is performed on a transaction basis to

support hedge accounting. The changes in fair value of these hedging instruments are offset in part or in whole by corresponding changes in the fair value or cash flows of the underlying exposures being hedged. We assess the initial and ongoing effectiveness of our hedging relationships in accordance with our documented policy. We do not hold or issue derivative financial instruments for trading purposes.

Delphi has currency exchange exposure from buying and selling in currencies other than the local currencies of our operating units. The primary purpose of our currency hedging activities is to manage the volatility associated with forecasted currency purchases and sales. Principal currencies hedged include the Mexican peso, Canadian dollar, euro, Japanese yen, Singapore dollar, and Brazilian real. We primarily utilize forward exchange contracts with maturities of less than 18 months, which qualify as cash flow hedges.

Delphi has exposure to the prices of commodities in the procurement of certain raw materials. The primary purpose of our commodity price hedging activities is to manage the volatility associated with these forecasted inventory purchases. We primarily utilize swaps and options with maturities of less than 24 months, which qualify as cash flow hedges. These instruments are intended to offset the effect of changes in commodity prices on forecasted inventory purchases.

In order to manage the interest rate risk associated with our debt portfolio, we periodically enter into derivative transactions to manage our exposure to changes in interest rates.

Gains and losses on derivatives qualifying as cash flow hedges are recorded in OCI to the extent that hedges are effective until the underlying transactions are recognized in earnings. Net losses included in OCI as of September 30, 2001, including the transition adjustment, were $23 million after-tax ($36 million pre-tax). Of this pre-tax total, a gain of approximately $7 million is expected to be included in cost of sales within the next 12 months and a loss of approximately $37 million is expected to be included in subsequent periods. A loss of approximately $6 million is expected to be included in depreciation and amortization expense over the lives of the related fixed assets. The unrealized amounts in OCI will fluctuate based on changes in the fair value of open contracts at each reporting period. Cash flow hedges are discontinued when it is probable that the original forecasted transactions will not occur. Due to unusually pronounced production volume reductions, we discontinued several cash flow hedges during the first quarter of 2001, which resulted in the immediate recognition of $6 million of income included in cost of sales. The amount included in cost of sales related to hedge ineffectiveness and the time value of options was not material.

In 2000, we entered into certain commodity derivative instruments to protect against commodity price changes related to forecasted inventory purchases. Although these derivatives are effective as economic hedges of our commodity price exposures, due to differences in pricing terms between the derivative instruments and the forecasted purchases, the SFAS No. 133 effectiveness threshold was not met. The change in fair value of these instruments was included in cost of sales as of September&nb